Southern California Gas Company's and San Diego Gas & Electric Company's

Comments on Utility Core Gas Procurement Activities by:

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To what extent are gas utilities and ratepayers exposed to natural gas price fluctuations?

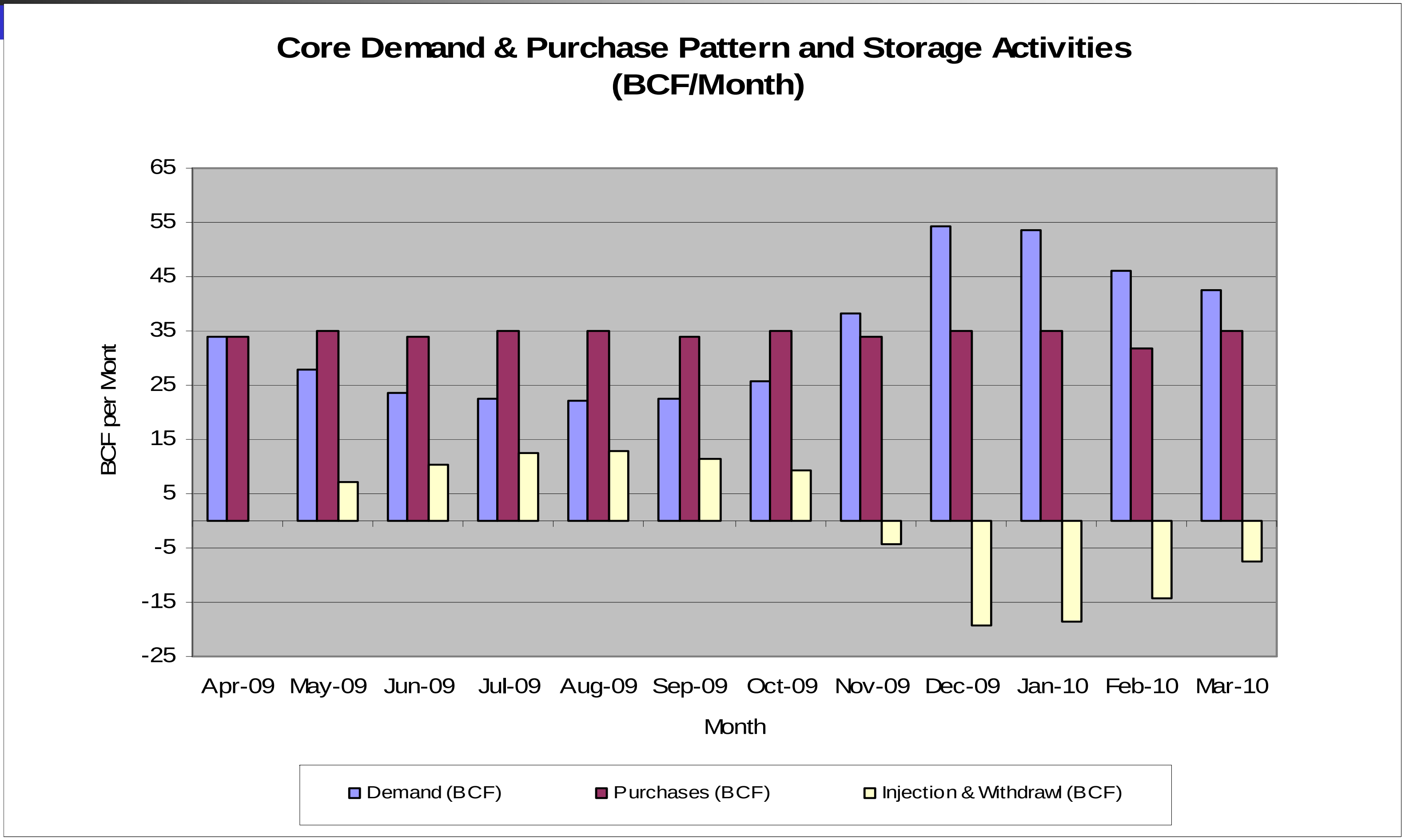
- Core ratepayers are partially exposed to monthly price fluctuations due to the monthly pricing of the commodity cost of gas in rates.
  - **Residential and Core Commercial and Industrial customers using 3,000 therms per year or less can choose a Level Pay Plan with an annual true-up that reduces their exposure to price fluctuations significantly.**

- In addition, Core ratepayers are protected from the most price severe price shocks due to the significant core storage capacity and annual winter hedging programs approved by the CPUC.
  - SoCalGas/SDG&E core storage capacities are as follows:
    - **Inventory 79 BCF**
    - **Injection 369 MMcfd**
    - **Withdrawal 2,225 MMcfd**

  - Hedging authorized at $2/customer per winter

- Currently SoCalGas/SDG&E's shareholders are not exposed to natural gas price fluctuations as long as core customer purchased gas costs are no more than 2% above the Gas Cost Incentive Mechanism (GCIM) monthly benchmark.
  - **This aligns utility shareholder interests with California's support for energy efficiency and demand reductions (e.g., shareholders do not lose money when consumption declines)**

Core storage and winter hedging reduces core ratepayers' exposure to price fluctuations.



Non-core customers also have the ability to use SoCalGas' storage and other options to reduce their exposure to price fluctuations.

- Balancing Service capacities
  - Inventory 4.2 BCF
  - Injection 200 MMcfd
  - Withdrawal 340 MMcfd
  - Monthly Balancing +/- 10%
- Unbundled Storage Program capacities
  - Inventory 47.9 BCF
  - Injection 281 MMcfd
  - Withdrawal 634 MMcfd
- Hedging on the NYMEX Gas Futures Market
- Buying fixed-price volumes of gas

Diversified sources of supply and firm interstate pipeline contracts to the producing basins reduces the core ratepayers' price fluctuation risk.

- SoCalGas/SDG&E Interstate Pipeline contracts (Feb. 2009):

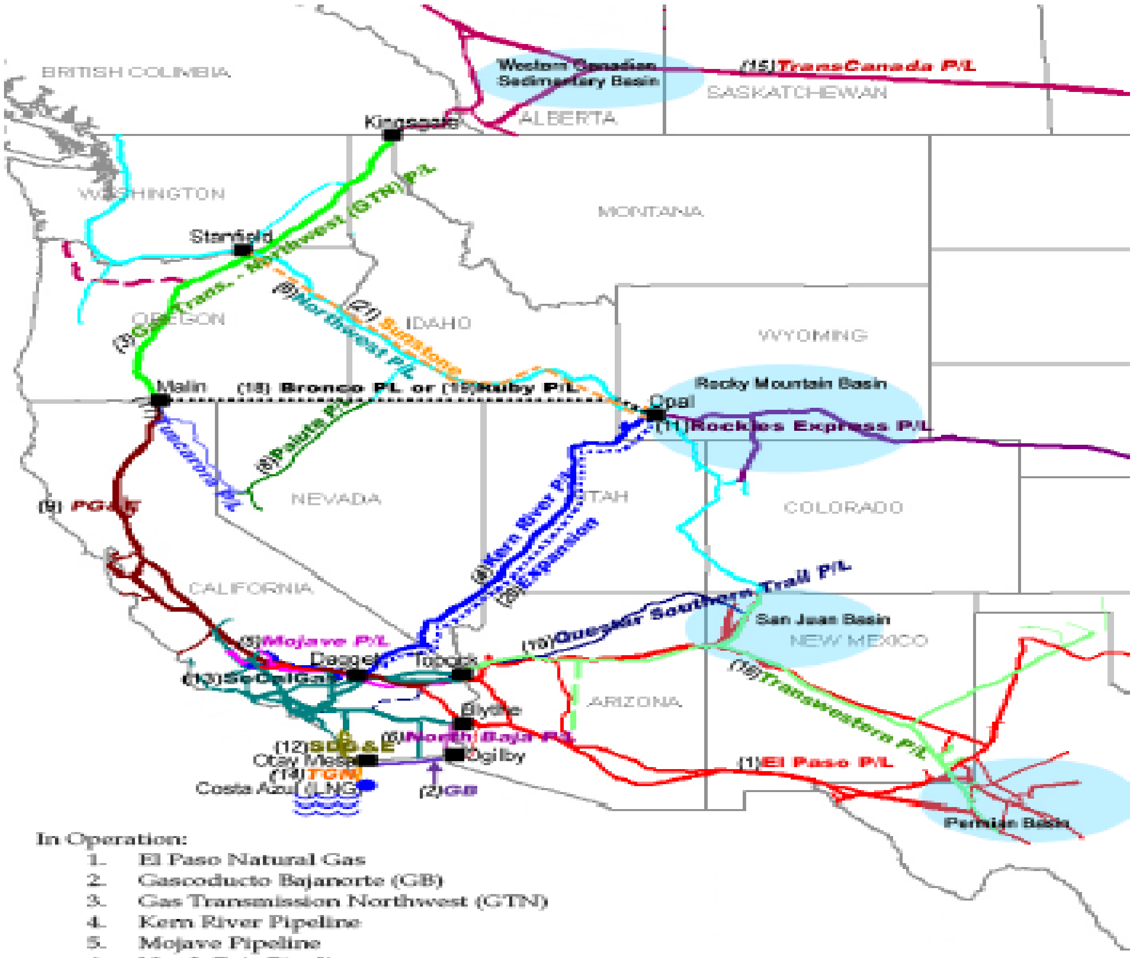
El Paso San Juan	800 MMcfd
Transwestern San Juan	164 MMcfd
Kern River Rockies	107 MMcfd
Canadian Path	51 MMcfd
Total	1,122 MMcfd

What options do utilities have for natural gas procurement and cost recovery?

- GCIM Benchmark
  - Benchmark commodity costs are set at point of purchase:
    - Monthly volumes purchased at each pipeline and basin receipt point times the Industry Publication Monthly Index Price at that pipeline and basin.
    - Interstate pipeline reservation costs are a pass-through cost.
    - Actual costs are the total cost of purchases and or sales of core gas and core market transactions using core storage and pipeline capacities.
    - Hedging costs or fixed price contracts are allowed.
  - All monthly core procurement activity is coordinated with Commission staff (DRA and Energy Division) and TURN.
  - GCIM costs are audited annually by DRA in their Monitoring and Evaluation Report issued for each GCIM Year (April through March).

- SoCalGas/SDG&E are allowed to recover all of their gas purchase costs in rates as long as the cost of purchases are no more than 2% above the GCIM benchmark.

Western North American Natural Gas Pipelines



In Operation:

1. El Paso Natural Gas
2. Gascoducto Bajanorte (GB)
3. Gas Transmission Northwest (GTN)
4. Kern River Pipeline
5. Mojave Pipeline
6. North Baja Pipeline
7. Northwest Pipeline
8. Paiute Pipeline
9. Pacific Gas Electric Company
10. Questar Southern Trail Pipeline
11. Rockies Express (REX)
12. San Diego Gas &Electric Company
13. Southern California Gas Company
14. Transportadora de Gas Natural (TGN)
15. TransCanada Pipeline
16. Transwestern Pipeline
17. Tuscarora Pipeline

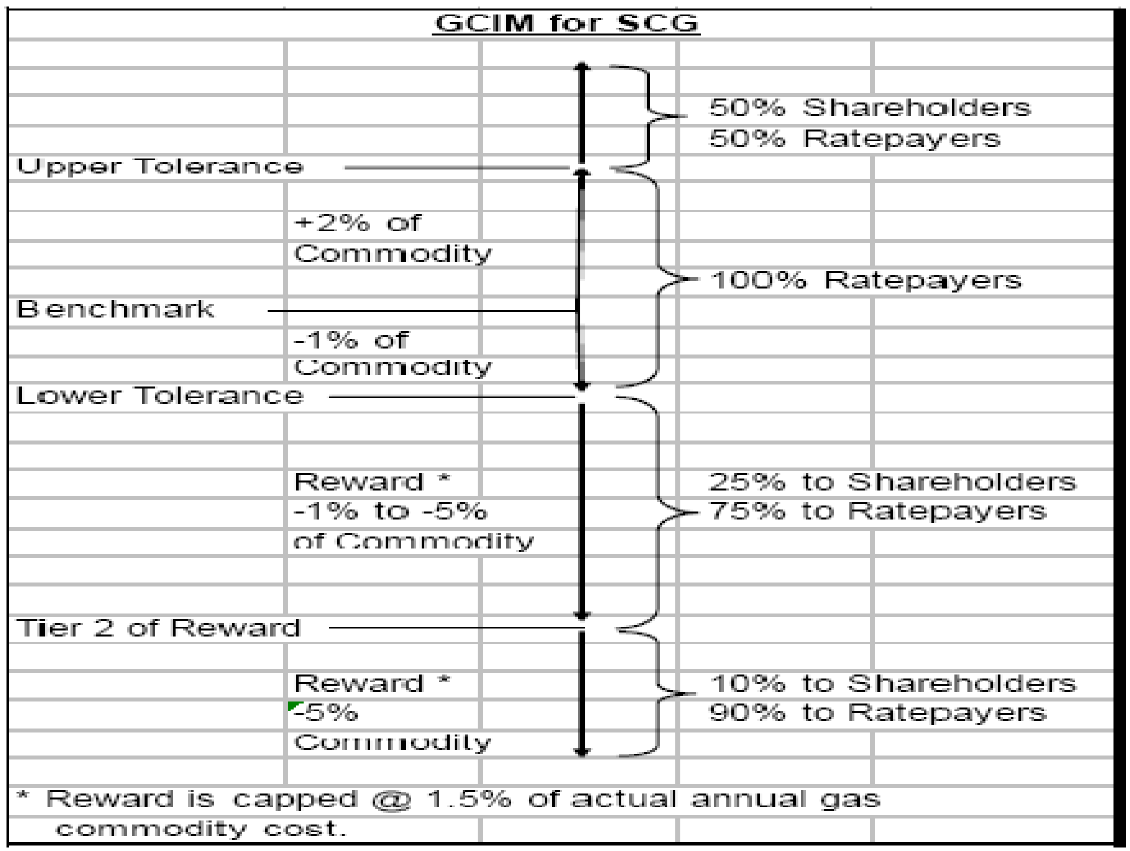
Proposed:

18. Bronco Pipeline
19. Ruby Pipeline
20. Kern River Expansion
21. Sunstone Pipeline

What risk mitigation strategies are available to utilities (example. Hedging)

- The SoCalGas/SDG&E Utility Gas Procurement Department uses storage as their main tool to mitigate price and volume risk.
- Purchasing gas in the summer months, when gas prices are usually low, and withdrawing gas from storage in the winter, when prices are usually higher, allows the utility to mitigate volume and price risk for core ratepayers.
- Holding interstate pipeline capacity on several different pipelines with access to several supply basins further mitigates price and volume risk.
- Winter hedging programs approved by the CPUC outside of the GCIM program allows the utilities to take Futures and Options positions designed to reduce extreme price shocks to ratepayers.
- Additional hedging done within the GCIM also provides some additional price mitigation for core ratepayers.

SoCalGas/SDG&E are allowed to recover all of their gas purchase costs in rates as long as the cost of purchases are no more than 2% above the GCIM benchmark. If purchases are 1% or more below the benchmark, shareholders and ratepayers share the benefit.



How are the risks of hedging balanced against the benefits of hedging?

- Hedging allows the utility to lock in certain volumes of gas at a set price using Storage, Futures or Options.
  - If the price locked in turns out to be lower than the fluctuating daily or monthly price the utility and ratepayers both gain benefits.
  - If the price locked in with the hedge turns out to be higher than the fluctuating daily or monthly price the utility and ratepayers both lose.
  - Hedging cannot guarantee a gain or a loss for the utility or ratepayers but can only reduce price fluctuation which is defined as risk.
  - The value of reduced price fluctuation or risk is based on consumers' risk preference such as choosing a fixed rate mortgage compared to a variable rate mortgage.
  - If the mortgage or monthly gas bill is a large part of a consumer's budget, one would think that a fixed price option is desirable because the consumer could probably not absorb the higher price risk. This is the case for the preference for fixed-rate mortgages compared to variable-rate mortgages for home loans.
  - If the monthly bill is a small part of a consumers budget, such as the average monthly winter gas bill of $67, one would think that customers will be willing to absorb the price risk and avoid the cost of hedging.
  - Fixed-price contracts are more expensive than monthly contracts because the seller has to recover the cost of hedging when offering the fixed-price option.

How do regulatory incentive mechanisms function in the overall procurement process?

- The SoCalGas/SDG&E GCIM has been very effective in aligning ratepayer and shareholder interests by providing a known market-based benchmark that gives the utility the incentive to buy reliable, low-cost gas supplies for core customers.
- The GCIM has eliminated the contentious Reasonableness Reviews process that wasted the time and money of the utility and the regulatory agency.
- The GCIM has resulted in over $763 million gas cost savings over the past 14 years.
- The active coordination with DRA, Energy Division and TURN has further aligned utility, ratepayer and regulatory interests to assure reliable, low-cost supplies to core customers.
- The GCIM has motivated the utility to efficiently and effectively use core customer assets to reduce core ratepayer gas costs and shareholder earnings.