PRELIMINARY STATEMENT

VI. ELECTRIC DISTRIBUTION & GAS PERFORMANCE BASED RATEMAKING (PBR) MECHANISM

A. OVERVIEW

Pursuant to Decision D.08-07-046, the Electric Distribution and Gas Performance-Based Ratemaking (PBR) Mechanism consists of 1) a revenue adjustment mechanism; 2) Z-Factor; 3) performance indicators; and 4) ratemaking procedures.

1. Revenue Requirement and Adjustment Mechanism – All authorized base rate revenues shall be recoverable by SDG&E through the operation of a regulatory balancing account mechanism, so that the recovery of the approved revenue requirement is not affected by variances in sales forecasts.

2. Z-Factor – Z Factors are exogenous events, unforeseen at the implementation or PBR, largely uncontrollable by management, having a material and disproportionate impact on SDG&E.

3. Performance Indicators – Performance rewards or penalties are accrued based on the utility's performance in employee safety. The total electric distribution and gas performance T
indicator reward or penalty that may be accrued in any year of the PBR mechanism, beginning with 2008, shall not exceed $2,500,000. T

4. Ratemaking Procedures – The ratemaking procedures establish the requirements for filing annual rate adjustments, the filing of the annual PBR performance report, the submittal of an annual internal audit report and the accounting for approved rewards and penalties for both electric and gas.

B. EFFECTIVE DATE / DURATION

The PBR mechanism shall be effective through 2011. Pursuant to D.08-07-046, the performance T
incentives shall be effective from 2008 onwards until modified or terminated by further action of the T
Commission.

C. AUTHORIZED REVENUE REQUIREMENT AND ADJUSTMENT MECHANISM

The 2008 authorized base margin for SDG&E is $1,097,897,000 for electric and $235,125,000 for gas for a total of $1,333,022,000. The annual revenue requirement changes for the attrition years 2009-2011, excluding FF&U, will be fixed dollar amounts as follows:

AY2009-	$41 million
AY2010-	$44 million
AY2011-	$44 million

These adjustments will be included as part of SDG&E's annual consolidated advice letter. Revenue T
requirement and rate base changes outside the scope of D.08-07-046 (e.g. cost of capital, Catastrophic Event Memorandum Account, etc.) are incremental to the fixed attrition amounts.

On a monthly basis, actual base margin revenues shall be recorded to the Electric Distribution Fixed Cost Account (EDFCA) and the Non-fuel Generation Balancing Account (NGBA) for electric and the Gas Core and Noncore Fixed Cost Accounts (CFCA, NFCA) for gas to be balanced against the monthly portion of the authorized base margin revenue requirement.

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PRELIMINARY STATEMENT

VI. ELECTRIC DISTRIBUTION & GAS PERFORMANCE BASED RATEMAKING (PBR) MECHANISM

D. Z FACTOR

1. Definition

Z Factors are exogenous events, unforeseen at the implementation of PBR, largely uncontrollable by management, having a material and disproportionate impact on SDG&E as described below. Additionally, Z Factors include costs which are not a normal part of doing business, the costs and event are not reflected in the rate update mechanism, the cost impact must be measurable and incurred reasonably. Potential Z Factors shall include, but are not limited to the items set forth below: T

a. Accounting rule changes promulgated by the Financial Accounting Standards Board (FASB), the Securities and Exchange Commission (SEC) or the California Public Utilities Commission (CPUC);

b. Tax law changes by the federal government, the State Franchise Tax Board, Board of Equalization, or any local jurisdiction having taxing authority;

c. Costs resulting from other mandated state, federal, or local governmental programs or from regional environmental programs;

d. In the event that the Catastrophic Event Memorandum Account (CEMA) is subsequently eliminated, material cost impacts resulting from natural disasters; and

e. Other events meeting the criteria set forth herein.

SDG&E must promptly notify the Commission of all potential Z Factors in compliance with D.99-05-030. Notice to the Commission shall be by a letter addressed to the Executive Director. Copies of the letter shall be sent to the following at the Commission: the Director of the Energy Division, the Investigations, Monitoring and Compliance Branch Chief, Energy Division, and the Director of the ORA. The letter shall clearly identify the proposed Z Factor to be recorded in the Z Factor Memorandum Account, shall include a detailed description of the event and a forecast of the annual cost impact of such Z Factor. SDG&E shall then be authorized to record, on a monthly basis, the associated cost in the Z Factor Memo Account.

2. Operation of the Z Factor Memorandum Account

SDG&E shall maintain a separate Z Factor Memorandum Sub-Account for each identified Z Factor. Recorded costs are charged to each sub-account at the end of each month. Revenues authorized by the Commission to amortize the balance are credited to each sub-account at the end of each month. Interest shall accrue on a monthly basis by applying 1/12 of the most recent month's interest rate on Commercial Paper (prime, 3 months), published in the Federal Reserve Statistical Release, H.15, to the average of the beginning and ending balance (either positive or negative) less a $5,000,000 deductible amount which is applicable to each qualifying Z Factor event.

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PRELIMINARY STATEMENT

VI. ELECTRIC DISTRIBUTION & GAS PERFORMANCE BASED RATEMAKING (PBR) MECHANISM

D. Z FACTOR (Continued) T L

3. Measure of Adjustment

a. Z Factor Calculation

The impact of the Z Factor event is less the $5,000,000 deductible. The impact of the Z Factor event above the $5,000,000 deductible will be the Z Factor used in the Base Rate Indexing Mechanism. The precise calculation is shown in the following formula:

$Zs = [ZCs - \$5{,}000{,}000)]$

Where:

Zs = A particular Z Factor for subject year s
ZCs = Z Factor cost level in subject year s

b. Capital Related Z Factor Costs

The formula is identical for capital costs except that the result is multiplied by the Capital Service Price, where the Capital Service Price is defined as the margin requirement for capital related costs determined under traditional cost of service methodology divided by the associated capital costs. Such costs are: return on weighted average rate base (using the current CPUC authorized rate of return), taxes on that return, depreciation expense at the CPUC adopted system average rate, plus authorized franchise fees and uncollectible expense. The precise calculation is shown in the following formula:

$Zs = (ZCs * SPs) - \$5{,}000{,}000$

Where:
Zs = A particular Z Factor for subject year s
ZCs = Z Factor cost level in subject year s
SPs = Capital Service Price in subject year s

c. Subsequent Year Adjustment

In subsequent years the Z Factor will be modified as described in D.4 below.

4. Operation of the $5,000,000 Deductible Feature

To limit recoverable Z Factors to material events, the deductible feature of $5,000,000 was authorized by the Commission in D.99-05-030 to operate as follows:

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PRELIMINARY STATEMENT

VI. ELECTRIC DISTRIBUTION & GAS PERFORMANCE BASED RATEMAKING (PBR) MECHANISM

D. Z FACTOR (Continued) T, L

4. Operation of the $5,000,000 Deductible Feature (Continued)

a. The deductible is a one-time feature applicable to the first $5,000,000 in costs for each Z Factor event. For example, if a qualified Z Factor increased costs by $20,000,000 in each year 1, 2 and 3 above the base level, the deductible will apply in year 1. Thus, the compensable amounts will be $15,000,000, $20,000,000 and $20,000,000 in years 1, 2 and 3, respectively.

b. The deductible is cumulative for each Z Factor event and completes its application in the first year that the cumulative Z Factor costs exceed the deductible amount. For example, if a qualified Z Factor increased costs by $4,000,000, $4,000,000 and $4,000,000 in years 1, 2 and 3 above the base level, the deductible will be fully applied during year 2. Thus, the compensable amounts will be $0, $3,000,000 ($4,000,000 plus $4,000,000 minus $5,000,000) and $4,000,000 in years 1, 2 and 3, respectively. As demonstrated above, once a Z Factor is created and the full deductible is applied, the Z Factor remains compensable in subsequent years even if the amount is less than the one-time deductible.

c. The deductible is applicable to each separate Z Factor event. Thus, in the event of multiple Z Factors, the following table depicts the Z Factor amounts, application of the deductible, and the compensable amounts:

	Year		
($ Millions)	1	2	3
Z Factor (a)	$8	$3	$3
Z Factor (b)	6	6	4
Sub-Total	14	9	7
Deductible (a)	(5)	-	-
Deductible (b)	(5)	-	-
Compensable Amount	$4	$9	$7

As demonstrated above, the deductible is a one-time amount applicable to each individual Z Factor. Again, once the deductible level is exceeded in any year for an individual Z Factor, that Z Factor is fully compensable in subsequent years. L

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PRELIMINARY STATEMENT

VI. ELECTRIC DISTRIBUTION & GAS PERFORMANCE BASED RATEMAKING (PBR) MECHANISM

E. PERFORMANCE INDICATORS

The total amount of electric distribution and gas performance indicator reward or penalty in any year of the PBR Mechanism, beginning with 2008, shall not exceed $2,500,000. The performance reward or penalty will be based on the utility's performance related to Employee Safety. T T D

1. Employee Safety:

The Employee Safety performance indicator measures SDG&E performance based on it's OSHA rate, a metric established by the Federal Occupational Safety and Health Act (OSHA). The OSHA rate is the number of incidents per 200,000 hours worked.

Reward/penalty mechanism – The employee safety indicator establishes a deadband for which no reward or penalty will apply. Beyond the deadband, SDG&E is authorized an incentive rate or $12,500 per 0.01 change in the rate for a maximum reward or penalty of $2.500,000. Refer to the table below for details for each year 2008, 2009, 2010, and 2011. Rewards or penalties received for employee safety performance are allocated 79% to the electric department and 21% to the gas department revenue requirements based on the percent of authorized operating revenue as provided for in D08-07-046. T T

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SDG&E Employee Safety Performance Indicators

	2008	2009	2010	2011
OSHA Rate	5.11	4.92	4.74	4.55
Deadband	4.45-5.61	4.34-5.50	4.21-5.37	3.87-5.03
Reward Band	2.44-4.44	2.33-4.33	2.20-4.20	1.86-3.86
Penalty Band	5.62-7.62	5.51-7.51	5.38-7.38	5.04-7.04
Increment	0.01	0.01	0.01	0.01
Reward/Penalty Per Increment	$12,500	$12,500	$12,500	$12,500
Maximum Reward/Penalty	$2,500,000	$2,500,000	$2,500,000	$2,500,000

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2. Service Guarantee T L

SDG&E shall continue its current Service Guarantee. If the utility is unable to meet an appointment commitment with a customer for services at the customer's premises when access is required, SDG&E will credit $50 to the customer's account. Appointments can be all day or they may be made within appointment windows (a.m./p.m.). The credit does not apply if the customer is notified at least four hours before the end of the appointment period. For establishment of service (turn-on orders), the customer will be credited with the applicable service establishment charge ($15 or $30) rather than the $50. The guarantee does not apply for gas pilot light service or if the utility documents that the reason for the missed appointment was due to natural disaster, labor strike or the service person was called off to work on an Emergency Order. Emergency Orders are excluded as a result of the utility's public safety obligations and include the following events: 1) Fire or explosion; 2) Broken or blowing gas line; 3) High gas pressure; 4) Emergency carbon monoxide; and, 5) Hazardous leaks. L

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E. PERFORMANCE INDICATORS

2. Service Guarantee (Continued) T

When an individual customer requests a date for a permanent new service establishment, the utility will turn on new service on the day promised (prior to midnight) or credit the customer's electric) instead of the $50 stated above. The credit does not apply if at least 24 hours notice of a date change is given to the customer. Notice given on an answering machine or to another number designated by the customer is sufficient. For the guarantee to be valid, there must be: 1) Open access to the facility and the meter panel or gas service; 2) All required inspections must be completed and approved; and, 3) No threats or harm to utility employees

F. RATEMAKING PROCEDURES L

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1. Annual PBR Report T

SDG&E will file an annual advice letter providing the results of the performance indicators for the previous calendar year. If there are any rewards/penalties under the PBR mechanism, the rewards/penalties shall be included in rates on January 1 of the subsequent year upon Commission approval. SDG&E will submit this advice letter on May 1 of the following year, including workpapers detailing operating results for SDG&E's base rates.

2. Annual Internal Audit Report T

SDG&E will undertake an annual internal audit to ensure incentive mechanisms as described in Section E above are implemented, operated and calculated correctly and fairly. The internal audit will examine internal controls and management oversight of the calculations. The internal audit report will be submitted to the Director of the Energy Division, Director of the Consumer Protection and Safety Division, and the Director of Ratepayer Advocates. The internal audit report will be held confidential pursuant to the Commission's General Order 66-C and Public Utilities Code Section 583. SDG&E will submit the internal audit report on May 1 of each year for the prior calendar year. SDG&E executive management will report all remedial actions taken in response to the internal audit as part of the report. T T

3. Rewards and Penalties Balancing Account (RPBA) T

Pursuant to Resolution E-3588, the utility shall record rewards and penalties under the PBR mechanism to its gas and electric Rewards and Penalties Balancing Account (RPBA). The utility shall file in October of each year an advice letter requesting to amortize the projected RPBA year-end balance in the electric distribution and gas transportation rates effective January 1 of the following year.

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