

ORIGINALDecision No. 80794

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND
ELECTRIC COMPANY for authority to
revise its gas service tariff to
offset the effect of increases in
the price of gas from Pacific Gas
Transmission Company and El Paso
Natural Gas Company.

Application No. 53552
(Filed August 28, 1972)

(Gas)

Robert Ohlbach, John C. Morrissey, Malcolm H. Furbush
and Robert Ohlbach, Attorneys at Law, for Pacific
Gas and Electric Company, applicant.

Mrs. Sylvia M. Siegel, for herself, S. F. Consumer
Action, Diablo Valley Consumer Action, and Alameda
Consumer Action, protestants.

Thomas M. O'Connor, City Attorney, Milton Mares, Deputy
City Attorney, and Robert Laughhead, for the City and
County of San Francisco; Brobeck, Phleger & Harrison,
by Gordon E. Davis and Larry Hultquist, Attorneys
at Law, for California Manufacturers Association;
Robert K. Booth, Jr., Senior Assistant City Attorney,
for the City of Palo Alto; Edwin J. Moore, Attorney
at Law, for the City of Santa Clara; William L.
Knecht, Attorney at Law, for the California Farm
Bureau Federation, interested parties.

Timothy E. Treacy, Attorney at Law, and Robert C.
Moeck, for the Commission staff.

O P I N I O N

After due notice, hearing was held on this application
before Examiner Coffey in San Francisco on October 27, 1972 on
which date matter was submitted.

Pacific Gas and Electric Company (PG&E) requests authority
to increase its rates and charges for natural gas service by
\$12,680,000 annually in two steps to offset increases in expense
caused by increases in the price of gas delivered to PG&E from
Pacific Gas Transmission Company (PGT) and El Paso Natural Gas
Company (El Paso). Alberta and Southern Gas Co., Ltd. (Alberta)

is a Canadian corporation engaged in purchasing gas which it transmits to the U. S. border where it is sold to PGT. PGT transmits the gas to the California border where it is sold to PG&E. PG&E owns 52.7 percent of PGT and 100 percent of Alberta.

PG&E asserts that authorization of its proposal will maintain it in the same position it would have been in if there were no such increases in the cost of gas from PGT or El Paso and that PG&E's Gas Department will be able to earn the same rate of return which it would earn if there were no gas cost increases above those upon which present rates are based. That rate of return is below the level last found fair and reasonable by the Commission and even farther below the level that is fair and reasonable at the present time and for the future.

Testimony on behalf of PG&E was presented by its Vice-president, Rates and Valuation, and by its Vice-president, Gas Supply. Testimony was not presented by any of the other parties to the proceedings; however, cross-examination of PG&E's witnesses was conducted by the parties and by staff counsel.

PG&E's Vice-president, Rates and Valuation, testified that the cost of gas purchased from PGT had increased \$10,830,000 a year, effective on October 1, 1972, because the price which PGT must pay for Canadian gas had increased correspondingly at the U. S. - Canadian border on that date; that the higher border price resulted from compliance with the pricing requirements of the National Energy Board of Canada (NEB), which regulates the volumes, prices, and other conditions of gas exported from Canada. The NEB has established three criteria to govern the price of such exported gas:

- (1) The export price must recover its appropriate share of the costs incurred;
- (2) The export price should, under normal circumstances, not be less than the price to Canadian purchasers for similar deliveries in the same area; and
- (3) The export price of gas should not result in prices in the United States market area materially less than the least cost alternative for energy from indigenous sources.

The third criterion is the one which causes the present increase since the Canadian export price is based on the equivalent border price of PG&E's alternative gas, namely that supplied by El Paso. The increase in price of this El Paso gas causes the upward adjustment of the Canadian gas price. This witness further testified that in the Federal Power Commission's proceeding in RP 72-150 the cost of gas to PG&E from El Paso will increase on January 1, 1973, by \$1,850,000 per year. According to this witness, the proposed first step offset rate increase would result in an increase of 0.107¢ per therm to PG&E's gas customers and the second step increase would amount to 0.018¢ per therm. He proposed that the increases to classes and schedules be added to the existing rates on a uniform cents-per-therm basis.

PG&E's Vice-president, Gas Supply, testified that the NEB's criteria for pricing gas to be exported from Canada were set forth in its August 1970 report which led to the licensing of the last volumes of gas obtained by PGT from Canada and that in implementation of the third criterion the NEB added Section 11A to its regulations, subjecting the price of Canadian gas being exported to review by the NEB and to increase in the event of significant increase in prices for competing gas supplies or alternative energy sources; that to meet the tests established in the August 1970 report and to comply with regulation 11A, Alberta proposed to the NEB by letter that the price for Canadian gas at the U. S. - Canadian border be based on a comparison of the price for that gas at the California - Oregon border and the El Paso price to PG&E at the California - Arizona border and that any differential between Alberta's cost of service at the U. S. - Canadian border and the border price itself be used by Alberta for gas acquisition activities; and that the NEB, in a following letter, indicated that the proposal was responsive to the Board's pricing policies.

The witness further testified that in response to inquiry from the NEB, Alberta wrote a letter indicating that if the proposed border price of 28¢ per Mcf, to be effective October 1, 1971, did not achieve "opportunity cost" because of increases in the price of El Paso gas at the Arizona - California border, that Alberta would renegotiate with PGT to achieve the new "opportunity cost" necessary to maintain parity. This witness further testified that the price paid for Canadian gas at the Canadian border did not meet the equivalent El Paso border price during the latter part of 1971 and in 1972; that to comply with the pricing requirements of the NEB and the commitments made to it the price was renegotiated and set at 31¢ per Mcf, to be effective October 1, 1972, which corresponds to the equivalent El Paso border price. The witness further testified that as of July 1972, the average price of gas exported from Canada to all pipeline purchasers was 31.10¢, according to the Federal Power Commission's monthly release dated September 29, 1972.

Following cross-examination of PG&E's witnesses, the Commission staff stated that it could not support the application with respect to the increase related to Canadian gas for the following reasons:

1. The Commission has heretofore held, and most recently in Decision No. 78973 dated July 27, 1971 in PG&E's Application No. 52565 to offset gas price increases from PGT and from California sources, that border prices are not a good criteria of reasonable prices.^{1/}

^{1/} Decision No. 78973 at page 11 states:

"We place applicant on notice that if the anticipated events enumerated above do come to pass applicant must carry its burden of proof as to the reasonableness of the cost to it of California produced gas when requesting authorization to raise its rates. We specifically disclaim, in accepting for purposes of this proceeding the reasonableness of 35¢ per Mcf of California gas, that the border price is the criterion for pricing northern California produced gas."

2. The fact that PG&E affiliates have renegotiated a price based on a border price does not make this renegotiated price a just and reasonable price.

3. The Canadian government has not issued an order fixing this price for Canadian gas.

4. The Canadian government, or any of its agencies, have not issued any order or directive that the price charged by Alberta to PGT be renegotiated at this time, the timing appearing to be an arbitrary determination by affiliates of PG&E and PG&E, itself.

5. The new price is based in part on estimated cost.

The staff argues that PG&E has not carried its burden of proof that the increase is just and reasonable since letters to the NEB were generated by PG&E affiliates and the response of the NEB is not an official statement of the NEB, being a letter from its Secretary. Also, PG&E has not been able to indicate that other parties to applications in the proceeding before the NEB in 1969 and 1970 are renegotiating the prices at this time.

The staff recommended, to the extent the Commission issues an order authorizing an increase based on the increased price of Canadian gas, that it require the following: (1) That PG&E be directed to file with the Commission a letter committing PG&E and Alberta to the proposition that the use of the amounts authorized in excess of Alberta's cost of service will be directed to gas acquisition activities and that the letter also state PG&E's and its affiliates' intention that any gas found as a result of the exploration activity funded by these moneys will be committed to the California market

insofar as it is within the power of PG&E and its affiliates to do so, and (2) that PG&E be directed to file a quarterly report for Alberta showing the total dollar amount of the difference between the border price and Alberta's cost of service, and the elements upon which the cost of service figure is developed, and that the quarterly report also include a statement of commitments and dispositions of the gas acquisition funds by projects for the quarterly period and the accumulated amounts to the date of the report.

The California Farm Bureau Federation indicated that it finds it difficult to understand how the Commission could reject PG&E's application, recognizing that the Canadian government has imposed conditions on the export of gas, but that the Commission should further pursue the gas acquisition activities of Alberta. California Manufacturers Association indicated that it did not know whether the relationships with the Canadian government would permit a complete denial of the application but felt that the Commission should exercise very close supervision over the affairs of Alberta, particularly scrutinizing dividends paid to PG&E by Alberta, disposition of Alberta's retained earnings, and Alberta's disposition of the gas acquisition fund. The City of Santa Clara supported the staff's position, and stated that in its opinion there should be open hearings in Canada concerning the pricing of Canadian gas. The City of Palo Alto objected to the imposition of any rate of return from Palo Alto under Schedule G-60 that exceeds the statewide rate of return. Sylvia Siegel, appearing for herself and several consumer action groups, moved for dismissal of the application on the ground that the proposed increase is unsupported by evidence.

Discussion

The record in these proceedings shows that PG&E's cost of gas from Pacific Gas Transmission Company increased on October 1, 1972, by 3¢ per Mcf, or \$10,830,000 per year, as the result of an increase in the price of Canadian gas at the U. S. - Canadian border in the same amount.

On October 1, 1971, the border price for Canadian gas was set at 28¢ per Mcf on the basis of the NEB's August 1970 report which set forth certain criteria for the pricing of Canadian gas for export. The relevant criterion insofar as this proceeding is concerned is that which states that the "export price of gas should not result in prices in the United States market area materially less than the least cost alternative for energy from indigenous sources." In response to this criterion and the subsequently promulgated Section 11A of the NEB's regulations^{2/} which enables the Canadian government to fix a minimum price for gas to be exported in the event of significant increase in price for competing gas supplies or alternative energy sources, Alberta proposed to the NEB by letter, dated January 5, 1971, that the price for gas exported from Canada be based on an equivalent border price of El Paso gas. At that time this method resulted in a 28¢ price for Canadian gas at the U. S. - Canadian border. The NEB indicated, also by letter, dated May 17, 1971, that the proposal was in accordance with its pricing policy. Alberta further committed itself to review the price of Canadian gas relative to the price of El Paso gas and to maintain parity between them. Following hearings, this Commission issued Decision No. 78973, dated July 27, 1971, authorizing PG&E to increase its rates to offset the 28¢ per Mcf border price, to be effective October 1, 1971.

2/ Approved by Order in Council P.C. 1970-1706 dated September 29, 1970.

Subsequent to October 1, 1971, Alberta reviewed the comparable border price with PGT and PG&E again. Alberta and PGT entered into an amending agreement whereby the Canadian border price was increased to 31¢ per Mcf, effective October 1, 1972. This amending agreement was filed with the Federal Power Commission by letter dated September 26, 1972.

On the basis of the record it appears that the 31¢ price will maintain parity with El Paso's equivalent border price on an average basis through October 1, 1973. This method in effect annually reviews the comparable border prices and would decrease the frequency of gas rate offset applications of PG&E to track each specific El Paso increase as it occurs.

In this general regard, we note that in Decision No. 78973 we specifically disclaimed the reasonableness of using border price as a criterion for pricing Northern California produced gas. The situation here is different. It appears that the Canadian government can regulate both the volumes of gas which it will allow to be exported from Canada as well as the price to be paid for that gas. It appears to have chosen to regulate the pricing of Canadian gas not by direct order authorizing a given price but rather through the establishment of general pricing criteria. The price increase in question results from Alberta's commitment to the NEB to maintain parity between the price of gas which it exports into the United States for ultimate sale to PG&E and the equivalent border price of gas which PG&E buys from El Paso. It appears that Alberta has thus far satisfied the NEB that pricing Canadian gas, which is a major source of supply for PG&E and its customers, on a basis comparable with PG&E's other major alternative source of gas. El Paso, is an acceptable method. At this time, it appears politic that the requirements of the NEB be met if that source is to be maintained.

The problem of primary concern, however, both to the parties who appeared in the proceeding and to the Commission in

this method of pricing Canadian gas is the possibility of windfalls to PG&E and its subsidiaries and of evasion of regulation. Alberta is a wholly owned Canadian subsidiary of PG&E. It is the Canadian company which obtains gas from Canadian sources and sells that gas at the U. S. - Canadian border to PGT, which is also a subsidiary of PG&E. PGT in turn sells the gas from Alberta to PG&E. PGT is a natural gas transmission company regulated by the Federal Power Commission under the natural gas act. PGT's rates for its sale of gas to PG&E are established by its tariff on file with the FPC. That tariff is a cost-of-service tariff; that is, the rates are based upon the costs incurred by PGT in providing its service to PG&E. A major item in its cost is the price it pays to Alberta for gas purchased in Alberta, Canada, and delivered to it at the U. S. - Canadian border. The price which Alberta charges PGT for this sale is subject to the jurisdiction of the National Energy Board of Canada. That price which is a cost to PGT is reported to the FPC and becomes included in the computation of rates to be charged by PGT to PG&E under its cost-of-service tariff.

Although Canada represents a significant source of gas supply for the California consumer and the requirements of the NEB are to be met to maintain that source of supply, the fact that the method evolved of satisfying the NEB's pricing policy involves agreements between PG&E and its subsidiaries raises certain questions primarily concerning the disposition of the money collected by Alberta as a result of the border price being in excess of Alberta's own cost of service. In this regard PG&E's Vice-president, Gas Supply, testified that all money which results from an excess of the border price over Alberta's cost of service is used and will continue to be used by Alberta for gas acquisition for the benefit of California consumers. In view of the existing gas supply situation, such disposition of the money in question may well be highly desirable from the standpoint of the California consumer. Although the evidence

in this record shows that the increase in the price of Canadian gas will not profit at this time PG&E or either of its subsidiaries, to insure that the pricing of Canadian gas will not result in windfalls for PG&E or its subsidiaries, or permit evasion of regulation, PG&E is placed on notice that the books and records of Alberta shall be made available for examination by the staff upon request and that in its next gas rate case involving Canadian gas prices it will be required to make a complete showing of Alberta's results of operation and the disposition of all money resulting from revenues in excess of Alberta's cost of service.

Representatives of PG&E stated in this proceeding that PG&E had no objection to making such a showing. In addition thereto, PG&E will be expected to propose appropriate safeguards which will insure that accumulated retained earnings in excess of reasonable costs of service will not result in future windfalls to PG&E stockholders. While it is true that such retained earnings help to insure adequate supplies of gas for California consumers, such earnings in excess of reasonable costs of service, including a reasonable return on stockholder contributed capital, are in essence a contribution of capital by consumers which must be protected and preserved for California consumer benefit.

There is no dispute that PG&E's Gas Department rate of return under present rates for estimated year 1973 either on PG&E's basis or on the staff's basis is well below the level last found fair and reasonable by the Commission and farther below the 7.85 percent rate of return recommended as fair and reasonable by the staff in PG&E's general gas rate proceedings submitted on August 10, 1972 in Application No. 53118. PG&E's proposed offset increases will not increase the rate of return above the existing level.

PG&E's proposal to spread the offset increases on a uniform cent-per-therm basis conforms to the rate spread ordered by the Commission in PG&E's most recent gas offset proceedings, Decision No. 78468, dated March 23, 1971, and Decision No. 78973, dated

July 27, 1971, and is not in dispute in this proceeding other than the heretofore stated position of the City of Palo Alto.

Findings of Fact

Based upon a consideration of the record herein, the Commission finds as follows:

1. PG&E's current gas rates were authorized by Decision No. 78973, dated July 27, 1971, plus adjustments to reflect El Paso tracking through August 12, 1972, as authorized by Decision No. 79383, dated November 23, 1971.
2. PG&E estimates that at present rates it will earn a rate of return of 5.62 percent on its Gas Department's rate base in 1973. The Commission staff in Application No. 53118 estimated that PG&E will earn a rate of return of 5.73 percent at present rates.
3. Both of these rates of return are below the rate of return of 7.3 percent last found fair and reasonable by the Commission and even farther below the 7.85 percent rate of return recommended by the staff as a fair and reasonable rate of return for PG&E's Gas Department in PG&E's general gas rate proceeding, Application No. 53118, submitted on August 10, 1972, and the 8.5 percent level recommended by PG&E as being fair and reasonable in the same proceeding.
4. On October 1, 1972, PG&E's cost of gas from PGT increased by 3¢ per Mcf as the result of a 3¢ per Mcf increase in the price of Canadian gas at the U. S. - Canadian border.
5. The 3¢ per Mcf increase in the border price of Canadian gas from 28¢ per Mcf to 31¢ per Mcf, effective October 1, 1972, is reasonable and complies with the requirements of the National Energy Board of Canada.
6. Moneys resulting from this increase in the border price of Canadian gas over Alberta's cost of service will be used by Alberta for gas acquisition activities to the benefit of the California consumer and will not increase at this time the profits of PG&E or its subsidiaries.

7. The FPC's order in FPC Docket No. RP 72-150 will result in a 0.45¢ per Mcf increase in the cost of gas which PG&E purchases from El Paso, effective on January 1, 1973.

8. The El Paso increase effective January 1, 1973, in FPC Docket No. RP 72-150 is subject to possible refund and rate reduction and it is reasonable to authorize PG&E to file an offsetting gas rate increase subject to refund and rate reduction to offset the effect of any refunds and rate reduction ordered by the FPC.

9. PG&E's estimates of the additional gross revenue requirements of \$10,830,000 to offset the increase in the cost of gas to its Gas Department effective October 1, 1972, and \$1,850,000 to offset the increase effective January 1, 1973, are reasonable.

10. The \$12,680,000 of increased revenues under PG&E's proposed offset increases will not increase PG&E's rate of return above the levels estimated by PG&E and the Commission staff of 5.62 and 5.73 percent, respectively, at present rates.

11. PG&E's proposed rates to offset the increase effective October 1, 1972 will increase rates to its gas customers by a uniform 0.107¢ per therm, and its proposed increase to offset the January 1, 1973 increase will increase rates to its gas customers by 0.018¢ per therm. These proposed increases are reasonable and should be authorized in this proceeding.

12. The increases proposed by PG&E are solely to pass through the effect of increases in its purchased gas expense not in excess of those allowable by applicable policies of the Federal Price Commission.

Conclusions of Law

Based on the foregoing findings, the Commission concludes that:

1. The authority sought by PG&E should be granted to the extent, and under the conditions, set forth in the order which follows.

2. All motions consistent with these findings and conclusions should be granted and those inconsistent therewith should be denied.

3. Rule 23.1(E)(1)(c) of this Commission applies to this rate increase application.

O R D E R

IT IS ORDERED that:

1. Applicant, Pacific Gas and Electric Company, is authorized to file with this Commission on or after the effective date of this order revised tariff schedules with changes in rates, charges, and conditions as set forth in Section C of Exhibits Nos. 2 and 3 in this proceeding. Such filings shall comply with General Order No. 96-A. The effective date of the revised schedules set forth in Part I of Section C shall be one day after the date of filing. The effective date of the revised schedules set forth in Part II of Section C shall be January 1, 1973. The revised schedules shall apply only to service rendered on and after the effective date thereof.

2. Applicant, Pacific Gas and Electric Company, shall pass on to its customers any reduced rates, and refund to its customers any refund from El Paso Natural Gas Company pursuant to order of the Federal Power Commission in Docket No. RP 72-150.

3. Applicant, Pacific Gas and Electric Company, on or before the effective date of revised tariffs authorized herein, shall file in this matter a letter signed by a responsible officer of PG&E which commits PG&E and Alberta and Southern Gas Co., Ltd. that the use of amounts previously authorized and authorized herein in excess of Alberta's cost of service will be directed to gas acquisition activities and which commits PG&E and its affiliates that any gas found as a result of the exploration activity funded by such excess amounts will be supplied to the California market unless prevented by government order.

4. PG&E shall file quarterly and annually reports showing the difference between the revenues received from Pacific Gas Transmission Company and the Alberta and Southern Gas Co., Ltd. cost of service, setting forth the basis on which Alberta's cost of service was determined including rate of return and for the quarterly and annual periods, a statement of commitments, disposition, and accumulated amounts of the gas acquisition funds by projects.

5. All motions consistent with the findings and conclusions set forth above in this decision are granted, and those inconsistent therewith are denied.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 5th
day of DECEMBER, 1972.

Vernon L. Sturgeon
President
William J. Sykes
J. M. Moran
Thomas Moran
Commissioners

Commissioner Thomas Moran, being necessarily absent, did not participate in the disposition of this proceeding.