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Decision No. 84616

ORIGINAL

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 CALIFORNIA SOURCES. (Gas)	Application No. 55468 (Filed January 30, 1975)
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 EL PASO NATURAL GAS COMPANY. (Gas)	Application No. 55469 (Filed January 30, 1975)
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. (Gas)	Application No. 55470 (Filed January 30, 1975)

SECOND INTERIM OPINION

On June 17, 1975 we issued Decision No. 84571 which, on an interim basis, authorized Pacific Gas and Electric Company (PG&E) to increase its rates, on an overall cents-per-therm basis, by $17,578,000 to offset the increased cost of gas it will purchase from El Paso Natural Gas Co. effective June 17, 1975.

Beginning July 1, 1975, PG&E claims that it must pay $40,336,000 more on an annual basis for California produced natural gas because of an increase in cost of gas from 45¢ to 75¢ per Mcf for 1,000 Btu heating value gas delivered at 33-1/3 percent load factor.

PG&E's vice president - gas supply testified as follows:

Since the early 1930's, PG&E has purchased gas from producers in northern and central California. In 1974, the purchases amounted to approximately 147 billion cubic feet, or approximately 17 percent of PG&E's total gas purchases. PG&E purchases gas from 68 fields in California. It has 234 contracts with 81 producers. PG&E normally enters into a 20-year contract with a producer which contract gives PG&E the right to purchase all of the producer's gas underlying the lands set forth in the contract. PG&E estimates that a 20-year term will more than cover the normal life of the average gas field in California.

PG&E purchases the gas at the wellhead, and is responsible for the collection, dehydration, odorization, transmission, and distribution of the gas to its points of use.

PG&E has an obligation to purchase a certain amount of gas under each contract on an annual basis. The annual obligation is usually the lesser of:

1. 5 percent of the estimate proved recoverable reserves of gas attributable to the contract, or
2. 33-1/3 percent of the daily deliverability attributable to the wells under the contract times 365. This 33-1/3 percent is the load factor.

A 33-1/3 percent load factor means that the producer must be willing and able to deliver at PG&E's request an amount of gas equal to at least three times PG&E's average annual daily purchase obligation. According to PG&E, the 33-1/3 percent load factor gives it part of the flexibility necessary to adjust to its customers' seasonal and daily demands for gas.

From 1960 to July 1, 1971, the basic price paid by PG&E for California-produced natural gas was 30¢ per Mcf for gas having a heat content of 1,000 Btu per cubic foot delivered at 33-1/3 percent load factor.

For gas with a higher or lower heating value, the price generally varied in direct proportion to the variance in the heating value.

During the period of July 1, 1971 to June 30, 1973, the basic price paid by PG&E for California-produced natural gas was 35¢ per Mcf for gas having a heat content of 1,000 Btu per cubic foot delivered at 33-1/3 percent load factor.

On July 1, 1973, the basic price paid by PG&E for California-produced natural gas was increased to 43¢ per Mcf for 1,000 Btu gas delivered at 33-1/3 percent load factor, and on July 1, 1974, that price was increased to 45¢ per Mcf.

PG&E's contracts with California producers provide for price redetermination effective July 1, 1975. Approximately 185 of PG&E's gas purchase contracts representing about 95 percent of its total California gas purchases have the right of price redetermination on July 1, 1975.

On July 1, 1975, a new price schedule for California-produced natural gas will become effective for the period July 1, 1975 through June 30, 1976, inclusive.

PG&E's witness testified that the new price schedule was developed in the following manner:

PG&E considered the price it was currently paying for California gas and related that price to factors which have influenced that price since it was established. PG&E personnel met separately with each of the California gas producers with whom PG&E has gas purchase contracts. At these meetings PG&E and producer representatives comprehensively reviewed the current gas supply situation and its relationship to the price to be paid for California gas on July 1, 1975.

Generally, the producers felt substantial increases in the price of gas were warranted considering the change in market conditions since the last price increase went into effect on July 1, 1974.

The range of producer suggestions for a higher price was between $1.11 per Mcf and $3 per Mcf, and the suggested effective date and the suggested effective period for a redetermined price was one year.

After negotiations between PG&E and the producers, a new price schedule based upon a price of 75¢ per Mcf for gas having a heating value of 1,000 Btu per cubic foot and delivered at 33-1/3 percent load factor was formulated.

Contract amendments reflecting the new price were then mailed to each of the California producers with whom PG&E has gas purchase contracts.

As of February 19, 1975, producers representing approximately 69 percent of the volume of PG&E California gas purchases and representing approximately 93 percent of the California producers with whom PG&E has gas purchase contracts had agreed to the new price schedule.

According to PG&E, the principal factors which were considered in negotiating for the new price were both PG&E's and producer's arguments as to the reasonable market value of California gas, the costs of alternate fuels such as low sulfur fuel oil ranging from $2 to $3 per million Btu, the price PG&E pays for Canadian gas, the price PG&E pays for El Paso gas, and the prices paid elsewhere in California and the United States for natural gas.

Consideration was also given to the results of an arbitration case between McCulloch Oil Corporation and Pacific Lighting Service Company concluded in October 1974 in which a price of 70¢ per million Btu was awarded, applicable to gas sold during the 18 months ending December 31, 1975, for 100 percent load factor associated gas produced from the Oxnard field north of Los Angeles and sold by McCulloch to Pacific Lighting.

PG&E's gas supply estimate was taken from the 1974 California Gas Report (Exhibit 16). PG&E's estimate of annual contract quantities of California gas for 1975 is 137,041 M-Dth.

PG&E estimated the cost of California gas in the following manner:

Volumes were estimated by well field. The average price for each field is based on the average heat content of the gas delivered from such field. From the Kirkwood, Winters, Main Prairie Old, and Millar fields gas is delivered from more than one producer under varying conditions of delivery. The price used in each of these fields has been weighted for delivery conditions based on the volumes of gas delivered from such fields in 1973. Included with prices used in the estimate which are to be effective July 1, 1975 are 2,906 MMcf of Lathrop prepaid gas which has been included in the estimate at a price of 26.3¢ per Mcf.

Prices for 1,000 Btu gas are:

Load Factor %	Through June 30, 1975 - ¢/Mcf	Effective July 1, 1975 - ¢Mcf
100	37	63
90	39	Not Applicable
66-2/3	40	68
50	42	71
33-1/3	45	75

The cost of gas was calculated for each field by applying the present price to estimated 1975 production volumes to obtain the cost at present prices of $60,713,503 or an average of 43.993¢ per Mcf. The prices effective July 1, 1975 were then applied to the same volumes to obtain the cost of gas at the recently negotiated prices of $100,710,258 or an average of 72.975¢ per Mcf. The difference is the requested offset for California gas of $39,996,755.

The staff estimated the cost of California gas by using 127,353 MMcf as adopted by Decision No. 83915 dated December 30, 1974 in Application No. 55228 and applied the same average prices per Mcf as used by PG&E.

The staff used the volume estimate from Decision No. 83915 because "Those were the volumes most recently approved by the Commission and represent the latest substantiated estimate."

The executive secretary of the California Gas Producers Association presented an exhibit (No. 11) entitled "Alternative Arrangements for Purchase and Disposition of Additional Supplies of California Source Gas". The exhibit sets forth four alternative arrangements for the purchase and disposition by PG&E of additional supplies of California source gas including:

1. Cut back in PG&E purchases of El Paso gas.
2. Cut back in PG&E purchases of Canadian gas.
3. Additional sales of gas to PG&E customers.
4. Sales of additional gas volumes to SoCal Gas.

These four alternatives are listed in inverse relationship to their recommendation. That is, the cut back in PG&E purchases of El Paso gas is the least beneficial alternative and sales of additional volumes of gas to Southern California Gas Company is the most beneficial alternative--and this most beneficial alternative is the one recommended by the witness for adoption by the Commission.

According to the witness, in each case not only will there be substantial benefits in lowering the cost of gas deliveries to PG&E's northern California gas consumers, but there will be substantial additional benefits in reducing the cost of alternative fuels to natural gas customers in California (including PG&E's own steam-electric generating plants). Finally, the production of additional northern California dry gas supplies will provide additional revenues to the California gas producers, their employees, royalty holders (landowners from whose land the gas is produced), and the various taxing entities (principally the individual counties) throughout the northern part of the State.

According to the witness, Exhibit 6 shows that during the 10 years, 1964-73, PG&E purchased an average of 233 billion cubic feet (an average of about 639,000 Mcf per day) in northern California. In 1974 this purchase volume was reduced by about 37 percent from this average to 147 billion cubic feet (an average of about 403,000 Mcf per day). In the test year 1975, PG&E proposes to further reduce its volume of California gas purchases to 138 billion cubic feet (an average of 378,000 Mcf per day), a reduction of over 40 percent. The Commission staff suggests an even greater reduction, to 127 billion cubic feet (to an average of 349,000 Mcf per day), a reduction of over 45 percent. Based upon an approximate value of 73¢ per Mcf, this represents a major reduction in the sales revenues for the year starting July 1, 1975, otherwise applicable to PG&E's California gas purchases.

Period	Volume (Bcf)	Value (at 73¢/Mcf)
1964-73 (10-Year Average)	233.328	$170,000,000*
1974 Actual	147.000	$107,000,000**
1975 Forecast		
PG&E	138.007	$101,000,000
CPUC Staff	127.353	$ 93,000,000

*While the value of PG&E's purchases of California-produced gas ranged between 30¢-43¢ per Mcf during this period, the 73¢ per Mcf figure is used as a basis for showing the loss that will occur during 1975 as a result of the forecast reduction in PG&E California gas purchase volumes.

**During 1974, the value of PG&E's gas purchases (at 33 percent load factor) were 43¢-45¢ per Mcf rather than the 73¢ per Mcf figure used in this computation.

In spite of this forecast reduction during the past four years, the reserves of northern California dry gas (DOG District 6) have been maintained at approximately their present level: December 31, 1970 - 2.498 trillion cubic feet vs. January 1, 1974 - 2.426 trillion cubic feet, a reduction of less than 3 percent. Thus, the reserves of northern California dry gas as of December 31, 1973 (January 1, 1974) of 2.426 trillion cubic feet were 6 percent above the reserves 11 years before: 2.288 trillion cubic feet, as of January 1, 1962. Even the reduction in reserves from the all time high of 3.136 trillion cubic feet (as of December 31, 1962) to the latest 2.426 trillion cubic feet as of December 31, 1973 (January 1, 1974) was less than 23 percent--compared to a cut back of 40-45 percent proposed by PG&E and the Commission staff during the 1975 test year alone.

In order to partially restore this situation, according to the witness for the California Producers, there should be an increase of 44 billion cubic feet[1/] in PG&E's purchases of California-produced gas during the 1975 test year, bringing the PG&E purchase volumes about half-way up from the present depressed 1975 forecast levels of 138 billion cubic feet (PG&E forecast) and 127 billion cubic feet (Commission staff forecast) back to the 233 billion cubic feet purchase levels in effect for the 1964-73 10-year period.

Discussion

In Decision No. 78973 dated July 27, 1971 in Application No. 52565, we placed PG&E on notice that it must carry its burden of proof as to the reasonableness of the cost of California-produced gas when requesting authorization to raise its rates to cover increased costs from its suppliers of such gas. We said in Decision No. 78973 "This record is devoid of any meaningful evidence regarding the cost

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1/ According to this witness, it is interesting that this recommendation to produce and deliver an additional 44 billion cubic feet of natural gas in northern California, increasing PG&E's 1975 purchases from 138.007 billion cubic feet to 182 billion cubic feet, falls far short of the 222.352 benchmark reference volume for the test year 1973 used in the Commission's December 1972 Decision (Decision No. 80878 dated December 19, 1972) (Exhibit 10, col. (A), line 35).

of producing an Mcf of gas at the wellhead." Almost four years later we can say that <u>this</u> record is devoid of any meaningful evidence regarding the cost of producing an Mcf of gas at the wellhead.

It is the position of the staff in this proceeding (as it was in earlier proceedings) that the Commission should address the issue of the profit margins enjoyed by producers of California gas. The staff, having obtained nothing from PG&E regarding the cost of producing California gas, attempted to obtain such information from the producers directly. The results of such effort can be summarized thusly: The large producers of California gas believe that an individual company cost-of-service method is not a feasible or suitable one for regulating sales of independent producers. Based on Exhibit 7, the California Gas Producers Association believes that the true market value applicable to deliveries of northern California dry gas at 33 percent load factor for the 12-month period July 1, 1975-June 30, 1976 is $2.96 per million Btu instead of the new contract price of 75¢ per million Btu.

The tabulation below shows that when PG&E pays the new contract price for California gas of 75¢ per Mcf it will be paying more on a Btu basis for wellhead gas than it is paying for pipeline quality gas delivered at the Arizona border.

Present Cost of Gas - Various Sources

Source	¢/Mcf	¢/M^{2}Btu
El Paso	79.4	72.8
Transwestern	73.2	71.1
California Gas	73.5	73.0

This record shows that many large oil companies produce California gas for sale under contract to PG&E. Among these oil companies are: Mobil Oil Corporation, Gulf Oil Company-U.S., Amerada Hess Corporation, Burmah Oil and Gas Company, Texaco, Oxy Petroleum, Inc., Standard Oil Company of California, Western Operations, Inc., and The Superior Oil Company. These companies take the position that cost-of-service studies are not the proper vehicle to determine cost of gas.

What is clear from this record is that very large price increases with respect to California natural gas have taken place and even more substantial price increases are contemplated for next year. It would appear to this Commission that the California gas producers are simply attemtping to ride the coattails of the oil exporting nations cartel. That is to say, they clearly want to tie the price of natural gas to the constantly rising oil prices, without regard to any operating costs incurred to produce this gas.

Therefore, we are moved to an immediate consideration as to whether the price of natural gas presently under contract should be directly regulated by this Commission. We are, of course, mindful of the danger of price regulation with respect to gas yet to be discovered. In a time of severe natural gas shortage, we will not embark upon a course of action that would hinder development of new gas supplies. However, simply raising the price of gas already under contract surely cannot result in additional new supplies of natural gas. Hence, we will today direct our staff to set into motion a proceeding before this Commission to determine which California gas producers should be declared public utilities subject to the jurisdiction, control, and regulation of this Commission.

In addition, in the event that it should be determined that legislation is required to provide or supplement jurisdiction for the public utility regulation of wellhead sales of natural gas produced in California, the Commission will seek legislative cooperation to accomplish that end.

Pending a resolution of this jurisdictional issue, we are of the opinion that it would not be prudent for PG&E to renegotiate any further price increases to be paid to California gas producers.

Adopted Results

We will issue an interim decision in order that PG&E may promptly recover in rates the amount it will reasonably pay to its suppliers of California-produced gas (plus amounts for franchise taxes and uncollectibles).

The subject of the amount to be allowed for increased payments to Pacific Gas Transmission Company will be covered in a subsequent decision.

We have compared the estimates of offset relief required as prepared by PG&E and by the staff. We will adopt the same heating value estimates as were used in the last general rate case (Decision No. 80878). We are of the opinion that by using the fiscal year 1975-76 test period and the purchased volumes associated therewith, PG&E's obligation to its California suppliers will be $36,366,000 as estimated by the staff or an increase of 0.437¢ per therm.

Findings

1. On July 1, 1975 the cost of gas supplied by California producers to PG&E is estimated by PG&E to increase by $40,366,000.

2. According to the staff, based on a fiscal 1975-76 test year, the increase in gas costs from California sources to PG&E would be $36,366,000.

3. The staff's estimate of cost of gas is reasonable.

4. The increase in rates and charges authorized herein are justified; the rates and charges authorized herein are reasonable, and the present rates and charges insofar as they differ from those prescribed herein are for the future unjust and unreasonable.

5. PG&E and the California producers enter into a long-term contract which gives PG&E the right to all of the gas (except for minor amounts used by the producers) produced from the field under contract. The contracts allow for price redetermination at stated intervals.

6. There is a need for the issuance of an Order To Show Cause which will direct the producers of California gas to show cause why they should not be regulated by this Commission as public utilities.

Conclusions

1. PG&E should be authorized to increase rates to its customers by $36,366,000.

2. The $36,366,000 increase should be apportioned to PG&E's customers on the following basis:

(a) A uniform cents-per-therm increase to all rate schedules effective as of July 1, 1975.

(b) When PG&E files tariff sheets which establish schedules for the residential customers pursuant to Decision No. 84571, it shall file rate schedules for residential customers which exclude any increase due to this interim decision.

(c) Within 30 days after the receipt of the PG&E rate schedules this Commission will adopt tariff sheets which will apportion the amount of the increase granted herein to the non-residential schedules.

3. We should direct our staff to prepare an Order To Show Cause to be served on PG&E's California producers requiring the producers to show cause, if any, why they should not be regulated as public utilities by this Commission.

4. It would be imprudent for PG&E to renegotiate any contract with any of its suppliers of California gas pending a decision on the above-mentioned Order To Show Cause.

SECOND INTERIM ORDER

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) is authorized on or after the effective date of this order to file increased gas rates to offset the increased cost of gas from its California sources as follows:

Rate Schedule

Effective Date	Offset Increase
July 1, 1975	0.437¢/Therm

2. Tariff filings to reflect these increases shall be in accordance with General Order No. 96-A. The revised schedules shall be effective on the date of filing and shall apply only to service rendered on and after July 1, 1975.

3. Such increases shall be subject to refund as specified in PG&E's Preliminary Statement.

4.a. When PG&E files tariff sheets establishing schedules for the class of residential customers as ordered by Decision No. 84571, it shall concurrently file rate schedules for residential customers which exclude any increase due to this interim decision.

b. Rates for resale customers will be set to allow similar exclusion of this increase from their residential schedules, without burdening their nonresidential customers in any greater degree than those of PG&E.

5. Within thirty days after the receipt of the PG&E rate schedules this Commission will adopt tariff sheets which will apportion the amount of the increase granted herein to the nonresidential schedules.

6. The Legal Division of our staff shall prepare an Order To Show Cause, to be served on all producers of California gas who are under contract to supply such gas to PG&E, why they should not be regulated by this Commission as public utilities.

7. PG&E should not renegotiate any contract with any of its suppliers of California gas pending a decision in the Order To Show Cause ordered by paragraph 6 above.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 1st day of JULY, 1975.

President

William Symons Jr.

Vernon L. Sturgeon

Robert Batinovich

Commissioners

Commissioner Leonard Ross, being necessarily absent, did not participate in the disposition of this proceeding.