IB/lmm

Decision No. 85731 ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into electric utility Fuel Cost Adjustment tariff provisions and procedures; and the changes, if any, that should be made to said tariff provisions and procedures.

Case No. 9886
(Filed March 18, 1975)

(Appearances listed in Appendix A)

OPINION

On March 18, 1975 this Commission issued an Order Instituting Investigation (OII) in C.9886 for the purpose of investigating the electric fuel cost adjustment tariff provisions granted to the major electric generating corporations under our jurisdiction (all respondents herein), namely, Pacific Gas and Electric Company (PG&E); Sierra Pacific Power Company (Sierra); Southern California Edison Company (Edison); and San Diego Gas & Electric Company (SDG&E). The fuel cost adjustment (fca) provisions commenced with that granted Edison on March 21, 1972 and since that date to the present time these clauses have been operating as designed, with but minor modifications.1/

1/ For a complete listing of the case numbers and dates of authorization, see OII, C.9886 dated March 18, 1975, p. 1.

The fca allows the electric utilities to arithmetically add an adjustment (billing factor) to their rates in order to provide for increases and decreases in the cost of fossil fuel. It was designed to operate quarterly by advice letter filings (although lately none have been granted without hearings by the Commission).

Generally, these clauses allow the computation of the billing factor on a future average-year forecast in the same manner as rates in a general rate proceeding are set and have been set for many years in California.[2/] (All respondents except SDG&E have Federal Power Commission (FPC) fca provisions, though on a prior period basis.)

In our OII we concluded that the public interest required a thorough review of the operation of these fca tariffs to determine what, if any, changes should be made in them. On page 3 of the OII we set forth the purposes of this proceeding, as follows:

1. Whether there are reasonable alternatives to the use of average-year conditions as a basis for determining fuel cost adjustment revisions and, if so, whether any such reasonable alternatives should be adopted in this proceeding;

2. Whether the present fuel cost adjustment procedures should be revised;

3. Whether any revision should be made in the nature or amount of the evidence required to support the granting of fuel cost adjustment rate increases; and

4. Whether the Commission, in the lawful exercise of its jurisdiction, should in any other way modify the fuel cost adjustment tariff provisions of the respondents.

2/ Sierra has a recorded fuel clause although no reason for the distinction was made in granting this type of fuel clause to Sierra.

During the proceedings the issue of whether the prices paid for fuel oil should be publicly disclosed was added.

One of the major issues to be addressed in the OII (and which was one of its instigating factors) was whether or not the revenues collected by the respondent utilities under their respective fuel clauses were greater than the fuel expenses actually incurred and intended to be offset by these revenues. If there has been such an over- or undercollection, what adjustments are necessary, appropriate, and lawful to eliminate the cumulative excess or deficiency?

These issues, of course, have created a multitude of corollary sub-issues including, but not limited to, the validity of meteorological forecasting as it affects electric generation, the incentives provided by the current fuel clause and any alternatives, and factors affecting the precision and stability (or minimal variances) of the fca tariffs. Before proceeding with the discussion and analysis of the evidence, the various positions on the multiple issues, and our conclusions, we set forth the following assumptions:

1. That the fca was originally adopted because in an inflationary period, with rapid changes in the cost of fuel, an expedited method is required to permit a utility to recover these costs so its ability to function is not impaired; because such an expedited proceeding will lessen the frequency of general rate cases; and because it enhances a utility's position in the financial community (Southern California Edison Company, D.79838 dated March 21, 1972).

2. That all moneys collected by the respondent utilities in the rates authorized as a result of the fca tariffs were lawfully collected after a finding by this Commission that the rates were just and reasonable.

3. That the clauses presently in effect pertain only to fossil fuels.[3/]

4. That the existing clauses, except Sierra's, compute the fca on an average-year forecast method.

5. That in all previous filings made by the utilities under their respective fuel clauses they represented that no change would result in the then existing rate of return as a result of the revenues generated under the fca, since what was being generated was a dollar-for-dollar reimbursement for the increased cost of fossil fuel to be expected in the forecast period.

6. That all filings made under their respective fuel clauses by the respondent utilities have complied with the terms of their fca.

During the course of the proceedings PG&E moved to terminate the proceedings relating to the determination of an over- or undercollection of revenues compared to expenses under its fuel clause; and Toward Utility Rate Normalization (TURN) moved to immediately suspend the operation of the fuel clause and the rates and revenues generated thereby pending the decision in this matter. These motions have not been previously acted upon by the Commission. By reason of the decision herein, the issues raised are moot and, therefore, need not be decided and will not be further discussed.

Hearings were held before Examiner Phillip E. Blecher between May 5, 1975 and October 17, 1975, with the matter being submitted, subject to the filing of briefs, on the latter date.

3/ Sierra had a purchased power clause added to its tariffs after authorization of its original fca.

The Evidence

The electric fuel clause originally arose because of the steep increases in fuel oil prices that commenced in the early 1970's. The decisions authorizing the fuel clause for various utilities beginning with D.79838 for Edison clearly indicated the purposes of the fuel clause as discussed on page 3. The fca is basically determined by deducting from the total fuel requirements (based on forecast sales, in KWH) in the forecast period (under average conditions of temperature and precipitation) the fuel requirements in the forecast period expected to be supplied by nonfossil fuels; the balance is estimated to be supplied by fossil fuels (primarily gas and oil). The fca then provides for estimating costs at the latest known prices for the oil and gas, determining total estimated fuel expenses, and deducting the base cost fuel component included in base rates. The result is those revenues to be generated under the fuel clause as a result of the increase in fossil fuel costs over the fossil fuel costs used in determining the base rates.

Since the enactment of the subject fuel clauses there have been experienced above-average wet years. Theoretically, over an extended period of time these nonaverage wet years would be averaged out by nonaverage dry years. It is conceded that under the average-year forecast method, in a nonaverage wet year more hydroelectric power is generated and the requirements for fuel oil are diminished, and thus, because of the large difference in cost between fuel oil and hydroelectric power the fuel clause will generate much more revenue than the expense actually incurred or even anticipated to be incurred under average-year conditions. The reverse is true in non-average dry years. The meteorological evidence adduced clearly indicates that forecasting weather conditions 12 months in advance is inaccurate and unreliable. It is only possible to predict the amount of hydro a few months before the hydroelectric power would actually be available, and then not always with any degree of accuracy. No other meteorological forecast in excess of 30 days has any more than marginal utility at best,[4] and therefore, the use of current-outlook forecasting of meteorological conditions is impractical under the existing state of the art. Although there is now experimentation in moderate and long-range forecasting taking place, a great deal of additional time and study is necessary before its feasibility can be verified.

The various utility witnesses, as well as the staff witness, concluded that the evaluation of the present fuel clauses should be on an average-year basis since this is how they were designed, although the utilities and the staff differed somewhat in their determination of what the average-year measurement should be. The staff witness also indicated that the measurement of the performance of the clause on a recorded basis, that is, comparing the revenues generated by the clause with the expenses actually incurred for additional fuel is inappropriate, though actual revenues received have been substantially in excess of actual expenses incurred when compared this way, but only as a result of various accidents of weather. It was pointed out that the opposite could result by opposite accidents of weather; this is obviously true. Thus, we have an important issue to be resolved here: What is the proper test of the performance of the existing fuel clauses?

4/ PG&E's meteorologist indicates any weather forecasting past seven days is marginal.

The three respondent utilities having an average-year forecast fuel clause have on a recorded basis collected revenues which exceeded the expenses actually incurred for increased fuel expenses. As of August 31, 1975 these amounts were respectively as follows: PG&E - $156,265,000; Edison - $177.1 million; SDG&E - $1,789,100. For Sierra, which has a recorded fuel clause, there was an excess of actual expenses incurred over revenues collected of $324,246 as of June 30, 1975. The bulk of these amounts was accumulated during the record wet year 1974, as a result of the increased natural gas availability for electric generation during that year (compared to the forecasts) and the huge amount of hydroelectric power availability (and thus reduced need for much more expensive fuel oil). We do not agree with Edison's position that there is a distinction between determining the amount of overcollection as opposed to the test for proper measurement of the performance of the fuel clause. The annual reports published by the companies do not make such a distinction. The real world does not make such a distinction. The financial community makes no such distinction. We see no reason to make a distinction of that nature. The only measurement for the performance of the clause is how it performs in reality. The real world does not use average-year bases. The basic reason for this procedure was that it was thought it might allow a more accurate long-term correlation between revenues and expenses, though all the parties concede that there is really no such thing as an average year. Over some indeterminable period performance on an average-year basis might balance out, but we can see no reason why the utility should have the benefit of receiving large amounts of additional funds for its use at the expense of the ratepayers simply because we are using a fictitious basis for determining its rates, particularly where the intention should be to match actual major increased expenses on a dollar-for-dollar basis. All performance is measured in reality. In our view it's the only proper test of the performance of the fuel clause which, in turn, determines whether or not there was an under- or overcollection.

Edison's 1974 annual report (exhibit 21) indicates that its earnings per share in 1974 were $4.10 compared to $2.70 in 1973, a 51.9 percent increase, while its pre-tax earnings from 1973 to 1974 went from approximately $193 million to $351 million, an increase of $158 million, an 81 percent increase. The other utilities also reflected as actual earnings the increase in revenues over expenses actually incurred as a result of the fca. Therefore, we think it reasonable that to determine whether or not the fuel clause performed as anticipated, it must be measured on an actual or recorded basis. This is notwithstanding Edison's protestations that the revenues generated by an increase in rates through the application on the fca should be distributed between fuel clause revenues and revenues generated by base rates (or the deficiency thereof due to base costs). This is specious reasoning since the fuel clause was designed to provide the difference between revenues generated by base rates (of which base costs of fuel are one component) and eligible fuel expenses, though on an average-year basis. Thus, all the moneys generated over base rates are attributable directly to the fuel clause adjustment.

PG&E's position is that while it has had fuel expenses much less than revenue generated by the fca on an actual basis, it has incurred, because of delays in the regulatory process, other expenses for which it has not been compensated by reasonable rates. We believe this to be an untenable position also as the fuel clause adjustment is an extraordinary proceeding designed for a specific, extraordinary purpose. It has no connection with applications for general rate increases and other matters but must be treated separately.

PG&E and Edison have adopted the position that regardless of how much money was collected under the fuel clause over actual expenses incurred, or any other basis, those revenues collected are inviolable so long as the utility did not exceed its authorized rate of return even though it may have increased its actual rate of return experienced on the date of the application for or granting of the fca. These arguments do not reach the issue. The issue is simply this; when we are changing to a new procedure based on actual energy costs from one based on average year experience in the middle of a weather cycle when the utilities have had the benefit of a series of wet years (with lower than average fuel costs), should we adopt a conversion adjustment of some type to prevent the utilities from experiencing windfalls by avoiding the adverse results of the dry side of the cycle. We conclude that such a conversion adjustment should be adopted. Accordingly, each of the utilities (including Sierra, which has a revenue deficit under its recorded fuel clause) will be directed to compute on an actual recorded basis (in a similar manner as the amounts set forth on page 7, supra, were computed), from its inception through the latest date available the amount of over- or undercollection experienced under its fca.

Having thus determined one of the basic issues in this matter, the question becomes: What, if anything, can and should be done about this?

All the moneys generated by the fca were lawfully collected. In our view, it is fair and reasonable that under- and overcollections be eliminated so that the fca effect shall be as originally intended--to reimburse the utilities for increased fossil fuel expenses. The only objection raised to any implementation of this view is the argument that it would constitute retroactive ratemaking, which is barred by Public Utilities Code Section 728 and various California Supreme Court cases interpreting it, primarily PT&T v PUC (1965) 62 Cal 2d 634. The Court there said "...we have concluded that the Legislature has not undertaken to bestow on the Commission the power to rollback general rates already approved by it under an order which has become final, or to order refunds of amounts collected by a public utility pursuant to such approved rates and prior to the effective date of a Commission decision ordering a general rate reduction." (P.651.) The Court also stated on page 652: "This Court has also declared the principle that 'The fixing of a rate in the first instance is prospective in its application and legislative in its character. Likewise the reducing of that rate would be prospective in its application and legislative in its character.'" (Citations omitted.) This language clearly bars the reducing or refunding of revenues under rates which were lawfully and finally effective.

We intend to do neither. However, we see no proscription in the cases discussing retroactive ratemaking (and contrariwise we see authority) for reducing rates prospectively even though that reduction may be appropriate in part because of past performance. When we find overcollections we have the option of reducing rates or reducing the rate of return. (Cf. City of Los Angeles v Public Utilities 15 Cal 3d 680, filed on December 12, 1975.) City and County of San Francisco v PUC (1971) 6 Cal 3d 119 is analogous to the facts in this matter. In that case the Court said that this Commission has the power to prevent a utility from resorting to accounting practices that result in unreasonably inflated tax expense and may prevent a utility from passing unreasonable costs for materials and services on to the ratepayers by disallowing expenditures that we find unreasonable. It also said that by permitting a utility to include in its costs a charge for federal taxes greatly in excess of its actual federal tax expense, this Commission deviated from the basic principle of utility rate setting calling for the establishment of a rate that would permit the utility to recover its costs and expenses plus a reasonable return on the value of property devoted to public use. If we substitute the words "fuel costs" for the words "federal taxes" and "federal tax expense", this language would be completely apropos to this proceeding and we so find it to be. We see no distinction between unreasonably inflated federal tax expense and unreasonably inflated fuel cost expense though the latter may have been completely unintentional and caused by unanticipated weather accidents.

Original
H-2
4/27/76

Several parties in this matter advanced the theory that the fca, because it is generated by an extraordinary proceeding which might be characterized as a special proceeding and not as part of a general rate proceeding, should be treated in a manner different from general rates. This concept could be implied from the language used by the Supreme Court, supra[5/] in its discussion about general rates. We think this is a valid distinction. All the parties agree that the purpose and intent of the fuel clause is to match increased fuel costs with increased revenues on a dollar-for-dollar basis. There is no intent to provide either the utilities or the ratepayers with a windfall. Had the amount of overcollection occurring to date been an equal amount of undercollection, we believe the utilities would have been before this Commission forthwith with applications for rate relief to assist them in keeping their operations viable. Now it is of academic interest since the shoe is on the other foot; we think the shoes on both feet should match. We believe the public interest requires this Commission to balance these interests. Therefore, we hold that the distinction between general rate revenues and fca revenues is so clear that there is a correspondingly clear distinction between fca increases and general rate increases.

Thus, we shall compute the specific amount of over- and undercollection for each of the respondents under their respective existing fuel clauses as of the latest date available and amortize that amount, adjusted as appropriate, initially over a period not to exceed 36 months[6/] and order a commensurate reduction in rates, subject to revision. Interest will be included on this balance at the rate of 7 percent per annum (the legal rate of interest in California) starting with the Fuel Collection Balance as determined as of April 1, 1976.

5/ PT&T v PUC (1965) 62 Cal 2d 634.

6/ Recommended periods of possible amortization of such revenues ranged between 2 and 60 months.

The next matter to be determined in this proceeding is whether the existing fuel clause should be revised, and if so, how? TURN suggested the abolition of the fuel clause.

The reasons given for authorizing the existing fuel clauses - inflation, rapid changes in the cost of fuel, need to prevent impairment of the utility, lessen frequency of general rate cases, enhance the utility's financial position - are still valid, perhaps even more so because of the large increase in the ratio of fuel costs to total costs.[7/] But it must be borne in mind that the original purpose was to provide for rapid increases in the cost of fuel, not merely any increases, as increases have occurred in all the other expenses borne by a utility.

We believe that it is appropriate to adopt a regulatory procedure for reflecting in rates substantial changes in fuel costs. We do not believe, however, that any such procedure should be "automatic", nor that it should dispense with the safeguards of public hearing and independent staff review.

Edison desires and has recommended the continuation of its existing average-year forecast fuel clause with certain modifications, which in its opinion more clearly reflects today's realities. SDG&E has recommended a current-outlook fuel clause, which is basically a forecast fuel clause estimated on approximately a three-month basis (in lieu of the 12-month basis, as at present). PG&E and Sierra have recommended generally the use of a recorded fuel clause with a balancing account.

One of the areas of controversy revolves around the procedure of forecasting estimates of future data (sales, revenues, etc.). This can be avoided simply by using recorded data, since all parties concede that controversy over the method of determining the fuel

---

7/ At the time of the authorization of the existing clauses fuel costs ranged from 17 to 20 percent of total costs. The record here indicates that fuel costs are now approximately 50 percent of total costs.

clause revenues should be avoided, as should potential overcollections by the utilities. But determining that we are going to use recorded data still leaves many matters to be resolved for the specific formulation of the fuel clause.

A. What type of recorded basis?

We think the best fuel clause is that which uses recorded data over a full cycle of experience, seasons, temperature, and weather conditions. This means a 12-month moving recorded basis for sales and quantities of energy, since it will absorb all the peaks and valleys of a full cycle of variables. To most accurately reflect energy costs, we shall compute the costs of energy on an end-of-period basis. During the last month prior to the time for energy clause application, the cost of fuel oil shall be computed on a weighted average cost basis of the inventory then existing; all other energy sources shall use the latest tariff, contract, or delivered price figure for the cost, for purposes of the energy clause.

B. Filing Interval

We believe that a six-month filing period will tend to stabilize rates, reduce the frequency of rate changes, and simplify the administration of the fca to obtain the best possible review of the data. After evaluating the performance of the new clause we are authorizing here, we may amend this interval to more adequately accomplish the objectives of the new clause. The utilities will be required to submit their initial filing as soon as possible, after which we will establish a staggered filing schedule, assigning specific dates to each utility.

C. How are we going to match revenues and expenses more closely?

This can be accomplished by the introduction of what has been called a balancing account (or deferred energy accounting system), on the books of the utility. Each month the utility will record the required data pertaining to energy revenue and expense to determine what its increased cost was for the month on a recorded 12-month rolling average basis. If the amount of cost exceeds the amount of revenue generated in that month by the clause (or, prior to the first adjustment factor, adopted base rates), a debit should be entered in the balancing account, indicating the utility has funds coming to it at the time of the implementation of the next adjustment factor. If the revenue has exceeded the cost of energy, on the same basis, for that month, then an entry on the credit side of the account should be entered to indicate the utility has collected excess revenue over energy cost, which will be accounted for at the time of the implementation of the next change. At the last day of the third month preceding the date for implementation the account should be balanced out to implement the next filing.

D. <u>What shall we do with the previous over- or undercollections arising from the existing fuel clause</u>?

A Fuel Collection Balance for each utility shall be computed by the Commission at the time the new clause goes into effect. It would commence with a debit balance if the utility undercollected or a credit balance if the revenue exceeded actual fuel cost during the period in which the previous fuel clause was in effect. At the time the beginning balance is finally determined, as discussed earlier, a monthly collection factor would be determined on a recorded latest 12-month sales basis and added to or subtracted from the FCA or ECAC rates then in effect. The overcollection credit would be developed on a uniform cents-per-kwhr basis applicable to all appropriate sales and the credit would be specified separately. Any collection debits would be developed as part of the energy cost adjustment factor and applied on a cents-per-kwhr basis only to sales above lifeline quantities. All energy cost adjustment factors and collection balances would be reviewed on a periodic recorded basis to determine their operation.

The collection balance, in order to be added to or subtracted from the rates, would be amortized initially over a period of 36 months so that 1/36th of that amount would be effective for each month and, therefore, for an adjustment to be carried over a period of six months, one-sixth of the total collection balance would be added to or subtracted from the then existing rates, as indicated above.

Consistent with the treatment of the ongoing revenue-expense imbalance indicated in Section C, above, as historical behavior of the Fuel Collection Balance amortization develops we reserve final resolution of the amortization mechanism to a future time. Our intent, however, is to maintain future clause recorded revenue-expense differentials at a minimum and to bring to zero the existing Fuel Collection Balance, within a reasonable time, but not to exceed 36 months. Interest will be included at the rate of 7 percent per annum starting with the Fuel Collection Balance as determined as of April 1, 1976.

E. How are we to determine whether the fuel costs paid by the utilities are reasonable and proper?

We contemplate that only reasonably incurred reasonable costs for fuel are to be recovered. To determine this in the annual review, we would require the utilities to file with us all fuel oil contracts, written solicitations, bids, and offers whether for long-term or spot purchase, for the sale of fuel, with adequate documentation as to dates, terms and other pertinent data, and explanation of the reasons for rejecting each such bid, offer, or solicitation.

F. Should public disclosure of fuel oil prices be required by the Commission?

The utilities maintain the position that such public disclosure will be detrimental to them in negotiating both long-term and spot purchases of fuel oil, since their suppliers may know prices and terms they are paying to competitors, thus disadvantaging the utility in negotiating better terms than presently exist in their oil contracts. In the event that the question of reasonableness is legitimately and properly raised by any of the parties to a proceeding, including the staff, then the documentation submitted as far as necessary to determine the question of reasonableness would be subject to public disclosure at hearings or otherwise. This may be determined by the presiding examiner.

G. <u>What fuels are to be included in the fuel clause</u>?

To be fair and consistent, we are including <u>all</u> energy sources in the new clause except utility-owned hydroelectric power. This will enable the utility and its ratepayers to reflect the true cost of energy sources on a system-wide basis. The total cost of all sources is to be computed on the past 12-month quantities of energy by applying the end-of-period prices of each in determining the adjustment factor.

H. <u>How will this clause affect incentives to minimize fuel costs</u>?

The effect on management of any form of fuel clause, apart from the inherent incentive of management to operate as efficiently as possible to improve earnings and avoid regulatory review, is to reduce the incentive for minimization of fuel prices, since the utility obtains in rates that which it spends for fuel. An incentive in the proposed clause lies in the fact that the use of recorded data on a 12-month basis will always result in a gap between last experienced prices and the amounts recovered on a system-average basis, either up or down.

I. <u>Base Cost</u>

One of the problems in the implementation of the new clause is where to peg the base cost of fuels. Several possibilities have been suggested: the existing base cost component of base rates; rolling in previous fuel cost adjustment components into existing base rates and using the resultant figures; reducing base cost to zero (so all fuel costs would be computed under the fuel clause), depending on the type of fuel clause adopted; recomputing base costs on either an average-year forecast, current outlook, or recorded basis. For the time being we will utilize the existing base fuel cost component of base rates adjusted to reflect all energy sources. This will allow the new clause to initially reflect the difference in total energy cost and base cost. We intend to modify the base cost to zero in the pending SDG&E general rate proceeding. The base cost for PG&E, Edison, and Sierra will be modified in new general rate proceedings filed subsequent to our determination on SDG&E.

J. State Water Project and Other Special Contracts

PG&E, Edison, and SDG&E have contracts with the State Department of Water Resources (DWR) and others dating from the mid-1960's, some of which cannot be renegotiated until the mid-1980's. The prices for sale and purchase are thus fixed. In computing previous fca's, these sales were included in the utilities' sales forecasts, having the effect of computing the fca rate as though it applied to these sales, while the savings due to the purchases from DWR and others are not accounted for. The three affected utilities maintain this is unfair, and is becoming an increasingly more serious problem as the cost of generating power keeps increasing. We agree with the utilities and will allow them to deduct these sales from total KWH sales in computing the new adjustment factor, to the extent that such sales do not exceed purchases from the state water projects and others. To the extent that prices for purchases from DWR and others are less than prices for sales to DWR and others, there will still remain a net saving to the ratepayers if such sales and purchases are equal, while allowing the energy cost adjustment revenues to match actual energy expenses more accurately.

K. Btu v KWH

Our present fuel clauses reflect the heat rate, which is the amount of heat (Btu's) necessary to generate a KWH. The purpose is to provide the utility with an incentive to improve its heat rate (and thus its efficiency) to create additional revenue to be generated bythe fuel clause. Because base rates are formulated on a KWH basis, we believe it is appropriate to have the clause reflect the KWH basis also, as it will then more correctly reflect the cost of fuel and energy necessary to generate or purchase the power available for sale. The fuel cost recovered through sales of fuel to others is to be deducted from any fuel cost to be recovered under the clause, as is presently done.

L. What costs are to be recovered in the procedure?

The delineation of specific items of cost to be included involves some hairline decisions. Generally, we think it reasonable to include the direct reasonable cost of fuel and energy and other variable charges directly associated therewith. This is generally in line with the recommendations of both the Utilities and Finance and Accounts Divisions of our staff. Thus, we shall exclude fixed charges, costs not directly attributable to energy sources, and costs primarily accounted for in general rate proceedings. This excludes all costs relating to company, affiliate or subsidiary owned transportation (including pipeline) and storage facilities, unloading charges from transportation facilities, tankers under hire or contract which are not actually used, all handling by company, affiliate, or subsidiary employees, transportation beyond the unloading point, operation and maintenance charges related to purchased power, and all costs included in base rates. It includes all other previously included charges relating to fossil fuels and the following charges, where not covered above, relating to the newly included energy sources:

Nuclear - fuel and fuel assemblies, fabrication cost, leased or rented storage, and transportation less salvage value.

Geothermal - unit price (by contract, where applicable) of steam plus effluent disposal cost.

Purchased Power - energy and capacity charges.

In addition, no interest charge will accrue to the amount in the balancing account, but a fixed one percent charge for local franchise fees and uncollectible expense will be allowed in each adjustment factor on the amount then found to be collectible or refundable. The cost of fuel oil to be reflected in the factor shall be determined by taking the recorded quantity of oil (in Btu's) used during the 12-month period, and costing it at the price of the inventory at the end of the period. All adjustment factors, in either direction, shall not be final without an express finding and order.

Miscellany

1. The Mono Power Company service charges shall be included in the eligible expenses for Edison, in accordance with the intent of the decision authorizing this charge.

2. The burden of proving reasonableness of fuel cost is on the utility.

3. Since the new clause includes all energy sources, including purchased hydroelectric power, it shall be renamed the Energy Cost Adjustment Clause (ECAC).

4. Each respondent utility, individually or collectively, shall submit a sample ECAC, conforming with this decision, within 20 days after the effective date. After such filing, and the filing of the recorded data discussed earlier, the staff shall recommend an ECAC which shall contain the base cost for each utility, together with the first six-month amortization of the fuel collection balance of each utility, expressed in both total dollars, and cents per KWH. Notice requirements shall remain as at present.

Findings

1. The rates fixed as a result of the fca are not general rates, but specialized, extraordinary rates not created by or in a general rate proceeding.

2. The amount of over- or undercollection of fuel clause revenues compared to increased fuel costs should realistically be determined on an actual recorded basis from the birth of the fuel clauses through the latest available date. Consistent with our opinion on the sales to DWR and others, any recorded overcollection should include adjustment for past revenue loss related to those sales. SDG&E's Fuel Collection Balance should also be adjusted consistent with prior decisions regarding gains from the sale of fuel.8/

3. Any difference in revenues and expenses, as computed under Finding 2, should be amortized in rates over a period not to exceed 36 prospective months, on an interim basis. Thirty-six months is a fair and reasonable initial time period over which to amortize such difference, without unduly burdening either the utility or the ratepayer, and the Fuel Collection Balance as of April 1, 1976 shall bear interest at the rate of 7 percent per annum.

4. In ordering a future reduction or increase of rates due to an over- or undercollection of revenues compared to increased fuel costs, on a recorded basis, under the fca, we are setting future rates because of existing financial inequities due to past performance.

5. The average-year forecast type of fuel clause does not accurately match fuel clause revenue with associated increased fuel cost. This is particularly true in the comparatively short term. This clause should be abandoned because of this inherent defect and because it generates controversy and litigation over the use of estimates and forecasts.

6. The fuel clause adjustment procedure is a reasonable device for protecting the utility against actual extraordinary increases in the cost of its single largest expense, on a dollar-for-dollar basis, and should be implemented in a reasonable manner to allow the utility to keep its operations viable, while not penalizing the ratepayer.

8/ All respondents shall in the future promptly advise the Commission of such transactions and appropriately adjust energy costs.

This holds true even though the utility's incentive to keep fuel cost down is essentially vitiated by a fuel clause. The type of recorded fuel clause, now to be called the Energy Cost Adjustment Clause we have designed, as defined in Sections A, B, C, E, G, H, I, J, K, and L, supra, most fairly and adequately meets the objections to the existing fuel clause, the abolition of fuel clauses generally, and the balancing of the interests of the utility and the ratepayer, for the reasons set forth in the body of this decision. The matters covered under Miscellany should be included for specific respondents, where applicable.

7. The disclosure of fuel oil prices should be handled as set forth in Section F, supra.

8. The new ECAC is a reasonable alternative to the existing fca and should be adopted in this proceeding.

9. The burden of proving the reasonableness of all fuel prices and purchases is upon the utility. All ECAC filings must be made by application. Any application seeking a rate increase will be set for hearing. Other applications may be determined without hearing if no special circumstances exist.

10. PG&E, Edison, and SDG&E have overcollected under their respective existing fuel clauses, while Sierra has undercollected, as set forth herein, but the actual amounts involved shall be determined after the filing of the data required under Finding 2.

11. Meteorological forecasting as it affects electric generation is not a useful tool for anything other than extremely short range periods, and is not necessary for the adopted ECAC, since it is a recorded basis clause not requiring forecasting.

12. The overcollection credit should be applied on a uniform cents-per-kwhr basis to all appropriate sales and the credit should be specified separately. The energy cost adjustment factor should be applied on a cents-per-kwhr basis only to sales above lifeline quantities.

Conclusions

1. Each respondent utility should file, within 20 days after the effective date of this order, (1) computations on an actual recorded basis indicating the amount of revenue collected and increased fuel cost experienced under its respective fuel clause, from its inception through the latest available date, all on the same basis documented in Exh. No. 13 as modified in Finding 2, and (2) a sample ECAC conforming with the requirements herein stated.

2. The staff should recommend: (1) an ECAC, and (2) the first Fuel Collection Balance amount for each utility and the first six-month amortization thereof.

3. All notice requirements should remain unchanged.

4. The setting of future rates to reflect past over- or undercollections is not retroactive ratemaking.

5. The future reduction of fuel clause adjustment rates is not retroactive ratemaking.

6. Because it is in the public interest to require at the earliest practical date the filings and disclosure herein we will make this decision effective on the date of signing.

ORDER

IT IS ORDERED that:

1. Each respondent utility, within twenty days after the effective date of this order, shall file:

a. Data indicating the amount of over- or undercollection of fuel clause revenue compared to increased fuel cost expense on an actual recorded basis from the inception of its respective fuel clause through the latest available date.

b. A sample Energy Cost Adjustment Clause (ECAC) conforming to the requirements and containing the elements set forth in this decision.

2. The staff shall:

   a. Recommend a proposed ECAC conforming to the requirements and containing the elements set forth in this decision.

   b. Recommend the amounts of over- or under-collection determined under respondents' respective fuel clauses through the latest available date.

   c. Recommend a rate adjustment for each utility based on the determination in (b) above, and the date of the first scheduled ECA, in conformance with the determinations made herein, including interest.

3. We shall adopt by further order or resolution a new ECAC and shall determine the amount of over- or undercollection and proportionate rate adjustments for each utility.

4. All ECAs in the future shall be on an interim basis, unless otherwise ordered by this Commission.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 27th day of APRIL, 1976.

[illegible signature]
President

Leonard Ross
Robert Batinovich
Commissioners

I will file a written dissenting ~~and~~ concurring opinion
William Symons Jr.

I will file a written dissenting and concurring opinion
Vernon L. Sturgeon

APPENDIX A

LIST OF APPEARANCES

Respondent: John C. Morrissey, Malcolm H. Furbush, Robert Ohlbach, and Kermit R. Kubitz, Attorneys at Law, for Pacific Gas and Electric Company; Sherman Chickering, C. Hayden Ames, and David A. Lawson, Attorneys at Law for Chickering & Gregory; Gordon Pearce, Attorney at Law, John H. Woy, Stanley Jewell, Vice President and General Counsel, for San Diego Gas & Electric Company; Rollin E. Woodbury, Robert J. Cahall, William E. Marx, Dennis G. Monge, and Richard K. Durant, Attorneys at Law, for Southern California Edison Company; and John Madariaga, Attorney at Law, Ralph Cromer, Vice President Commercial Services, and Richard G. Campbell, Vice President and General Counsel, for Sierra Pacific Power Company.

Interested Parties: Frank J. Dorsey, for Office of the Staff Judge Advocate, Headquarters Sixth U. S. Army Presidio of San Francisco; George R. Gilmour, Attorney at Law, Eugene P. Coyle, and Sylvia M. Siegel, for TURN; Robert P. Will, and R. D. Twomey, Jr., Attorneys at Law, for The Metropolitan Water District of Southern California; William S. Shaffran, Deputy City Attorney, John W. Witt, and Manley Edwards, for the City of San Diego; Robert W. Erickson, for the City of Anaheim; Gordon E. Davis, and William Booth, Attorneys at Law, for Brobeck, Phleger, and Harrison; William H. Edwards, Attorney at Law, for California Farm Bureau Federation; Steven R. Cohen, Attorney at Law, Lloyd Harvego, and Dean L. Hunt, for California Department of Water Resources; Thomas J. Graff, for Environmental Defense Fund; Henry F. Lippitt, II, for California Gas Producers Association; Richard C. Morse, for Atlantic Richfield Company; Joseph Byrne, for Union Oil Company of California; Peter H. Kruse, for Perta Oil Marketing Corporation; Richard T. Mulcahy, for Pacific Resources, Inc.; Thomas M. O'Connor, City Attorney, for City of San Francisco; Alexander Googooian, for City of Bellflower; Leonard Snaider, Deputy City Attorney, Robert Russell, and Manuel Kroman, for City of Los Angeles; Joe Westmoreland, for City of Riverside, Scott B. Johnson; Dave Johnson, and Larry Moss, for Sierra Club; Norman Elliott, Attorney at Law, for Enright, Elliott & Betz; Page Miller, for Electricity and Gas for the People; Gary H. Twisselmann, for Ford Motor Company; John R. Phillips, Attorney at Law, for Center for Law in the Public Interest; and William M. Pfeiffer, for Southern California Gas Company.

Commission Staff: Peter Arth, Attorney at Law, John Johnson and Kenneth Chew.

C. 9886 - D. 85731

COMMISSIONER WILLIAM SYMONS, JR., Dissenting in Part and
Concurring in Part

COMMISSIONER VERNON L. STURGEON, Dissenting in Part and
Concurring in Part

While we can concur in the revision of the fuel cost adjustment clause from a forecast basis to a recorded basis, we dissent when the majority decides to exceed the law to order refunds.

The majority's illegal action can be characterized not only as short-sighted, but one-eyed:

- In ordering immense refunds by PG&E and Southern California Edison, immediate payouts will result, always popular in the short-term, but the utilities' financial ability for the long-haul work of providing electricity is unfairly impaired.
- In concocting its refund order, the majority indulges in unlawful retroactive ratemaking.
- In gazing back, moreover, it looks not at the total picture of overall company earnings -- which the record shows were below authorized earning levels during the period in questions -- but to the single expense area of fuels, known before hand to show a surplus when viewed in isolation.

Revision of the Method of Fuel Cost Adjustment

Existing arrangements under the fuel cost adjustment clause have been thoroughly examined in the case before us -- experience with its operation to date has been accumulated, its benefits and defects argued, and alternative, reasonable methods have been proposed for the future.

Our basic method of regulating utilities over the decades in this state and across the country has been the average year forecast method, and the logic of that regulatory method was followed in properly adopting the present fuel cost adjustment procedure. However, we have long known that forecasting is not without its inherent problems, one of which is variation between the average year construct and the particular year which does occur. The virtue of the average year forecast method, is that the shareholder, not the ratepayer, is at risk if the year varies from the average normal year. Under the regularly adopted and valid fuel adjustment clause, these variations have occured as the theoretical model would predict. That the actual weather variations for the first two years proved favorable to the utilities has led to a clamor to erase these results by hook or by crook.

Selection of the term "overcollections" to characterize the variation between average forecast year and actual experienced year which has by chance of weather turned out positive, introduces an emotional short-circuit into the analysis. "Overcollections" suggests that more than proper and authorized rates have been taken from the ratepayer, which is not the case. But misperceptions can have strong impact, and this misnomer has provided the drumbeat for the push to retroactively mandate refunds from the companies.

But putting aside the question of retroactivity for the moment, our experience with the fuel clause and changing circumstances since its inception do sufficiently support a revision of the fuel cost adjustment clause (FCA). Since the initial adoption of the FCA in 1972, we have experienced a dramatic decline in supply of natural gas, with a resulting swing to dependence on oil. This, combined with the Arab oil cartel effect on oil prices, has driven the component cost of fuel for the utilities from 20% to nearly 50% of the total costs of doing business. Given such a weighty impact, there is substantial merit in revising the fuel clause adjustment to operate in the future on the basis of recorded data so that wide variations in revenue and expense can be reduced and the actual cost of fuel be more nearly tracked.

Retroactive Ratemaking

Major revision of the tariffs providing for a fuel cost adjustment clause is not, however, a license to engage in retroactive ratemaking, as the final ECAC constructed by the majority attempts.

In seeking to recapture all funds collected "from the birth of the fuel clauses" (Opinion p. 21), the majority attempts to turn the clock back as far as March 21, 1972, and nullify the finality of all rate change decisions rendered since that day to this.

It has often been observed that "hard cases make bad law." The majority seeks equalization by means of hindsight. But to permit adjustment by means of retroactive ratemaking wreaks havoc to the whole scheme of supervision of public utilities in California. No decision would ever be final, either for purposes of establishing definitely the current income of a utility or allowing prospective investors to reliably evaluate the underlying value of securities to be purchased. Nor could any firm opinions based on generally accepted accounting principles be given as to the utilities assets and income, when retroactive ratemaking is permitted. What judicial review of the Commission final orders could be had, when such orders would be subject to reconsideration, manipulation or adjustment at some undetermined future date? The reasons for the prohibition of retroactive ratemaking are clear. With the uncertainty retroactive ratemaking invariably introduces, the cure is infinitely worse than the problem sought to be solved.

Nor is the Commission possessed of authority to invoke retroactive ratemaking. The controlling statutory authority is Public Utilities Code § 728 which reads in pertiment part:

> "Whenever the commission, after a hearing, finds that the rates or classifications, demanded, observed, charged, or collected by any public utility for or in connection with any service, product, or commodity, or the rules, practices, or contracts affecting such rates or classifications are insufficient, unlawful, unjust, unreasonable, discriminatory, or preferential, the commission shall determine and fix, by order, the just, reasonable, or sufficient rates, classifications, rules, practices, or contracts to be thereafter observed and in force." (Emphasis added)

The clear reading of this section states that rates are to be set prospectively. As this Commission stated succinctly in Decision 43145, Pacific Telephone and Telegraph Company, 48 Cal PUC 823, 836 (1949):

> "There are definite rules of law governing rate-fixing and this Commission is bound thereby. Broad and plenary as its authority may be to fix rates, it is not free to disregard cardinal principles of rate-fixing. There is no better established rule with regard to the prescription of rates for a public utility than the one that holds that rate-fixing may not be accomplished retroactively, unless some specific statutory or constitutional authority permits. Past deficits may not be made up by excessive charges in the future nor may past profits be reduced by disallowance to future operating expense."

For more extensive discussion, see also the instructive dissent of Commissioner William Bennett in Decision 67369, Pacific Telephone and Telegraph Company, dated July 26, 1962.

In Pacific Telephone and Telegraph Company v. Public Utilities Commission 62 C. 2d 634, 650 (1965) the Supreme Court of California provided clear instruction as to the import of Section 728 of the Public Utilities Code, stating that "this language is plain and unambiguous." The Court concluded

"... that the Legislature has not undertaken to bestow on the commission the power to roll back general rates already approved by it under an order which has become final, or to order refunds of amounts collected by a public utility pursuant to such approved rates and prior to the effective date of a commission decision ordering a general rate reduction. ..."

The Court reiterated its earlier declaration of principle, at page 652, that

" 'The fixing of a rate in the first instance is prospective in its application and legislative in its character. Likewise the reducing of that rate would be prospective in its application and legislative in its character.' (Southern Pac. Co. v. Railroad Com., 194 Cal. 734, 739 /231 P. 28/, see also People v. Western Air Lines, Inc., supra, 42 Cal.2d 621, 630.)"

Nor can the majority elude the prohibition against retroactive ratemaking by re-characterizing rate increases under the tariff provisions of the fuel cost adjustment clause as "specialized, extraordinary rates" (Opinion, p. 20, Finding 1). This would be contrary to the indication given by the Supreme Court of California in City of Los Angeles v. Public Utilities Commission, 15 C.3d 680, at pages 695-703, that clearly includes rate increases due to fuel cost adjustment clauses within the ambit of § 728.

Further, the majority can find no support for its retroactive ratemaking in its vague citation to City of Los Angeles v. Public Utilities Commission on page 11 of the majority decision. While commenting permissibly upon annual adjustments regarding tax depreciation reserves, the Court did not act to overrule its explicit direction that the Public Utilities Commission was bound to set rates prospectively.

Nor will such a result be contrary to equity in the case at hand. Evidence was introduced into the record showing that over the term of the current fuel cost adjustment clause, the utilities to be hurt by this order have not exceeded their lawful authorized rate of return. Indeed, the revenue short-falls due to "regulatory lag" or commission-induced "regulatory stall" have been enormous. If the majority were free to set rates retroactively, it should at least consider this bigger picture. It would be ironic that the fuel cost adjustment clause, legitimately introduced to enhance the position of the utilities in the financial community and to guard that their ability to function be not impaired, be turned around like a boomerang to cause these very deteriorations it was supposed to prevent.

San Francisco, California
April 27, 1976

William Symons Jr.
WILLIAM SYMONS, JR.
Commissioner

Vernon L. Sturgeon
VERNON L. STURGEON
Commissioner