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Decision No. 86213

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 EL PASO NATURAL GAS COMPANY. (Gas)	Application No. 56392 (Filed April 8, 1976)
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. 56393 (Filed April 8, 1976)

Peter W. Hanschen and Malcolm H. Furbush, Attorneys at Law, for Pacific Gas and Electric Company, applicant.

Gordon E. Davis and William H. Booth, Attorneys at Law, for California Manufacturers Corporation; Henry F. Lippitt, 2nd, Attorney at Law, for California Gas Producers Association; Edward Mrizek, for City of Palo Alto; and Charles R. Farrar, Jr., and James P. Bennett, Attorneys at Law, for Kerr-McGee Chemical Corporation; interested parties

Walter H. Kessenick, Attorney at Law, and Vlado Bevc, for the Commission staff.

INTERIM OPINION

Statement of Facts

At the present time Pacific Gas and Electric Company (PG&E) obtains approximately 45 percent of its natural gas from El Paso Natural Gas Company (El Paso) and approximately 15 percent from California gas producers. El Paso obtains its gas from out-of-state sources, and the price El Paso charges PG&E for gas delivered is regulated by the Federal Power Commission (FPC). On the other hand, prices charged PG&E by the California gas producers for gas delivered are not presently regulated.[1/] For its gas delivered from California sources PG&E must contract with each of approximately 80 California gas producers.[2/] The terms of these contracts require PG&E to pay "reasonable market value", a figure determined by negotiation or by binding arbitration.

In 1975 one of PG&E's major California source producers, Occidental Petroleum Corporation (Occidental), refused to accept the July 1, 1975 base price of 75 cents per Mcf that had been agreed to by all of PG&E's other California producers and demanded arbitration to determine the "reasonable market value" of the gas it was delivering. Accordingly, PG&E and Occidental entered arbitration proceedings and these proceedings had not been completed when the public hearing on these applications began. Pending results of the arbitration, Occidental continued to supply natural gas to PG&E under contract provisions that any increased price above 75 cents per Mcf would be retroactive to July 2, 1975.

1/ In proceedings under Application No. 55468, an offset application by PG&E, the Commission raised the question of what is the cost of producing the California natural gas sold to PG&E by California producers and whether the price of that gas sold under contract to PG&E should be directly regulated by this Commission. By Decision No. 85827 dated May 18, 1976 in that application, the Commission issued to those producers an Order to Show Cause as to why they should not be regulated by this Commission as public entities.

2/ PG&E presently has approximately 200 gas purchase contracts with about 80 California gas producers.

In 1976 PG&E offered its California source producers a July 1, 1976 base price of 90 cents per Mcf for gas to be furnished under its contracts commencing July 1, 1976. Many of PG&E's California producers are unwilling to conclude negotiations on the July 1, 1976 base price until the results of the Occidental arbitration are known.3/

As a consequence of various filings it was expected that El Paso would make with FPC, it was anticipated that effective August 1, 1976 the cost of natural gas purchased by PG&E from El Paso would increase $46,907,000 on an annualized basis.4/

3/ Of the approximately 200 contracts subject to renegotiations, only 20 producers with 29 contracts, representing 2.1 percent of the volume of California gas under PG&E contract, have accepted the PG&E 90 cents per Mcf offer.

4/ On January 30, 1976 El Paso filed a general rate increase with the FPC. By Docket No. RP 76-59 the FPC suspended the effective date of the proposed increase, amounting to 5.382 cents per Mcf, until August 1, 1976.

In Opinions Nos. 749 and 749-A dated December 31, 1975 and February 27, 1976, respectively, the FPC authorized jurisdictional pipelines having purchased gas adjustment clauses to file special rate adjustments to offset increases resulting from the FPC's establishment of certain nationwide rates for natural gas flowing in interstate commerce prior to January 1, 1973. Under these authorizations El Paso was to make special filings for rate increases to be effective May 1, 1976 and July 1, 1976. These increases were to be in addition to El Paso's scheduled April and October purchased gas adjustments. To mitigate administrative burden, El Paso indicated it would ask FPC to permit it to make the May 1 and July 1 special rate increases effective on August 1, 1976 - the same date El Paso's general rate increase will become effective. El Paso estimated that the May 1 and July 1 increases to be made effective August 1, 1976 would amount to 9.50 cents per Mcf, of which 5.61 cents per Mcf represented a special 2-month surcharge to be applicable to August and September 1976 only. This special 2-month surcharge would be eliminated in El Paso's October purchased gas adjustment and in PG&E's corresponding tracking adjustment. The combination of the 5.382 cents per Mcf general increase, and the 9.50 cents per Mcf special rate increases,

(Continued)

Additionally, as noted earlier, based upon the 90 cents per Mcf offered by PG&E to its California source producers, effective July 1, 1976 PG&E will incur an additional cost, on an annualized basis, of at least $16,567,000 for California source natural gas.5/

4/ (Continued)
all effective August 1, 1976, would amount to a 14.882 cents per Mcf increase PG&E could expect to pay El Paso for natural gas effective August 1, 1976. Annualized, these increases would amount to $29,840,000 and $16,909,000, respectively, and when included with an anticipated allowance for uncollectibles, franchise taxes, and net storage credit, would amount to a total increase to PG&E on an annualized basis of $46,907,000 for gas purchased from El Paso.

However, subsequent to the May 25-26, 1976 hearing in this case, it was learned that as a result of actual weighted average gas costs under its producer-supplier contracts, El Paso had filed for slightly smaller increases than those anticipated (and used by PG&E in this application). [The Commission takes official notice of El Paso Natural Gas Company's Special PGAC Notice of Rate Change Based on Changes in Purchased Gas Costs Resulting from Opinions Nos. 749 and 749-A. Dated June 30, 1976.] Under its actual filing with the FPC dated June 30, 1976, El Paso's May 1 and July 1 increases to be effective August 1, 1976 amount to 8.85 cents per Mcf, of which 5.43 cents per Mcf represents the special 2-month surcharge which will be eliminated October 1, 1976. Combined with the 5.382 cents per Mcf general increase, the 8.85 cents per Mcf special rate increases amount to an overall 14.232 cents per Mcf which PG&E must pay El Paso effective August 1, 1976 for gas. The combined May 1 and July 1 increases, and the general rate increase, on an annualized basis, amount to $27,806,000 and $16,909,000, respectively, and together with an allowance for uncollectibles, franchise taxes, and net storage credit results in a total increase to PG&E according to PG&E of $44,858,000 on an annualized basis effective August 1, 1976 for natural gas purchased from El Paso. It should be noted, however, that the El Paso general rate increase will be subject to reduction and refund under provisions of the Natural Gas Act should FPC ultimately determine that El Paso's rates exceed just and reasonable levels. PG&E has agreed to make corresponding reductions and refunds in such eventuality.

5/ As PG&E approached California gas producers for the July 1, 1976 base year contracts, producer demands ranged between $1.15 and $2.35 per Mcf. As noted above, PG&E increased its 1976 base year offer to 90 cents per Mcf from the 75 cents per Mcf contracted for the 1975 base year (with all producers except Occidental). This 15 cents per Mcf base price increase for 1,000 Btu heating value California natural gas delivered at 33-1/3 percent load factor will increase PG&E's annualized expense by $16,567,000.

By Decision No. 84902 dated September 16, 1975 in Application No. 54230, this Commission found on a 1975 test year basis that a rate of return of 8.65 percent would be reasonable for PG&E's gas department and authorized increases in rates to enable PG&E to earn that 8.65 percent rate of return. PG&E's present gas rates to its consumers do not reflect either the $44,858,000 El Paso increase, based upon the June 30, 1976 filing, or the minimal $16,567,000 California source increase, and without commensurate increases in PG&E's annual revenues, its gas department rate of return will drop by 2.47 percentage points, bringing the rate of return below the level of 8.65 percent last found to be fair and reasonable by the Commission.

It was against this backdrop of anticipated cost increases in its supply of delivered natural gas that PG&E, unable economically to delay further as the July and August deadlines approached, filed these offset applications.6/ A duly noticed public hearing was held in San Francisco on May 25, 26, 1976 before Examiner John B. Weiss. The hearing was sparsely attended by the general public.7/ During the first day of hearing, the arbitration award in the Occidental and PG&E matter was introduced into evidence.

6/ PG&E asserts that unless it is permitted to make the proposed offset rates effective on the dates requested, it will suffer an irreparable daily loss of approximately the following amounts:

To Offset the Cost of Gas From:	Daily Amount
California Producers	$ 45,000
El Paso	$122,900 *

*Based upon the $44,858,000 El Paso increase.

7/ Although approximately a dozen individuals from the general public were in attendance during the two-day hearing, none availed himself of a proffered opportunity to speak on the applications. There were 66 communications from the public and various entities - all but two were opposed to the increases.

The two-to-one split decision of the arbitration panel found that for the July 1, 1975-June 30, 1976 period, the "reasonable market value"8/ for gas under the seven individual Occidental contracts ranged from 92 cents per MMBtu to $1.12 per MMBtu and determined a proper rate of escalation of the one-year prices for subsequent years as 20 percent. Based on the two to four-year terms of the individual contracts, the panel's order set the prices payable by PG&E to Occidental retroactive to July 2, 1975 (with two minor exceptions) under the individual contracts in a range from $1.01 per MMBtu to $1.36 per MMBtu. PG&E now must decide whether to accept the arbitration award setting prices in excess of the 75 cents per Mcf it had allocated for the July 1, 1975 base year as regards the seven Occidental contracts, or litigate the arbitration award.

Further, PG&E must also now determine the effect the Occidental arbitration award may have on prices to be negotiated with each of approximately 80 California source gas producers for contracts to cover the July 1, 1976 base year. PG&E's vice president for gas supply testified that "it is highly unlikely that the renegotiated price will be less than 90 cents per MBtu," and that "it is quite possible that the final price arrived at by PG&E and the producers will be in excess of that amount." In view of the shortness of time before the effective date of the new base price, he also stated that it was "...in fact quite likely that the necessary contract amendments will not be signed until after July 1, 1976, but they will be effective as of that date."9/

8/ The definition of "reasonable market value" used in the arbitration proceeding was: "The price that a willing purchaser would be willing to pay a willing seller for gas delivered in comparable quantities under like conditions."

9/ Page 23, lines 4-7, of Transcript Vol. 1, May 25, 1976.

By these applications PG&E asks the Commission to issue appropriate orders:

1. Authorizing PG&E to file and place into effect as of August 1, 1976 and July 1, 1976, respectively, certain rate increases set forth in its applications designed to offset the El Paso and California sources increases which will be effective on those dates.
2. Finding that PG&E's present rates for natural gas service on and after August 1, 1976 and July 1, 1976, respectively, in light of the El Paso and California sources increases, will be insufficient, injurious, unreasonable, and inadequate, and that the proposed offset rates contained in its applications are fair and reasonable.
3. Authorizing PG&E to establish and record in an appropriate gas adjustment account, and amortize by temporary changes in rates, the effect of the differences, if any, in costs of California source gas between the 90 cents per Mcf offered by PG&E and the base price finally established for base year July 1, 1976.
4. Authorizing PG&E to include in the proposed gas adjustment account the additional cost above 75 cents per Mcf which PG&E will be obligated to pay Occidental resulting out of the Occidental-PG&E arbitration award of May 24, 1976 for gas already delivered to PG&E during the July 1, 1975 base year.

The staff did not object to an interim decision offsetting anticipated additional costs to PG&E resulting from gas delivered from El Paso, or from California source gas based on PG&E's current 90 cents per Mcf offer to California producers. However, the staff did take exception in both applications to recognition of changes resulting from injections into storage, contending that this is against their policy as not being likely to occur during normal test year conditions, and recognizing how much of a problem over-collections have recently been. The staff also submitted slightly higher Pacific Gas Transmission (PGT) estimates than those proposed in the PG&E applications, basing their figures on those used in the PG&E current general rate case, Application No. 55510. In both applications the staff contentions resulted in rates slightly less than those proposed by PG&E because the amount necessary to offset these increases can be spread over a larger volume of sales.

The staff agreed with PG&E's proposal to establish a gas adjustment account, stating it would be an appropriate way of handling the overall unknown amount of PG&E's liability under its California source contracts.[10/] However, pending subsequent auxiliary filings which PG&E offered to make, the staff reserved expression on how the account would be handled. The staff also wanted further hearings to test the reasonableness of new prices applicable to the California source gas. Finally, the staff agreed with PG&E's proposal on rate design, noting that the design used is consistent with the latest Commission philosophy applicable to PG&E offset increases as expressed in Decision No. 85082 dated October 31, 1975 and Decision No. 85626 dated March 30, 1976, in Applications Nos. 55468, 55469, 55470, and 55687.

10/ PG&E contracts with its California gas producers to assure a continuing supply of natural gas over varying number of years. These contracts include renegotiation provisions. When negotiations have not been concluded by the beginning of a new base year, the gas continues to flow to PG&E, but PG&E is liable from the beginning of that new base year for the new base price subsequently arrived at.

Discussion

An offset case differs from the traditional rate setting case substantially. In the traditional rate setting case each element of the cost of service is usually thoroughly examined, a lengthy and time consuming process, but one essential to insure that the projected revenue does not exceed the cost of service. The adjustment of rates to reflect the effect of a change in but one or two specific definable elements, independent of the other major elements making up the total cost, is known as an "offset", and is designed to provide prompt relief on limited issues. A rate setting procedure involving such a change is known as an "offset proceeding". In the matters at hand, changes in two major cost elements are involved - the costs of natural gas purchased by PG&E from (1) El Paso and (2) from California sources. PG&E's applications here meet the criteria for an offset proceeding.

The Commission has received a number of letters from people asking us to simply deny the rate increase and make PG&E absorb the additional costs. This we cannot do. In Decision No. 84902 dated September 16, 1975 in Application No. 54280, a traditional rate setting case, this Commission found that a rate of return of 8.65% based on test year 1975 would be reasonable for PG&E's gas department. There is no suggestion or evidence here that the rates allowed by the instant order will permit PG&E to exceed its last authorized rate of return stated above. On the contrary, the anticipated El Paso and California source increases, unless offset, would serve to drop that rate by 2.47 percentage points, thus bringing PG&E's rate of return below that previously found reasonable. A rate which is too low to bring in a reasonable return is said to be "confiscatory" and a taking of the utility's property without due process; something we cannot do constitutionally (Smyth v Ames (1898) 169 U.S. 466, 526). There just is no basis in the evidence before us to burden PG&E with any part of the increases. They simply serve to keep PG&E in the same financial posture it would be in were these source costs not to increase. We have no alternative but to allow PG&E to increase rates to recover increased costs. However, we do want to avoid any proliferation of rate increases to the consumer such as would arise out of piecemeal authorizations pending determined actual costs Accordingly, we will approach the El Paso and California source offsets as follows.

El Paso

In considering PG&E's application to offset the anticipated El Paso increases, we note that the staff, with minor exceptions, generally concluded that the revenue increase sought was designed to offset only the increased cost of El Paso natural gas, provide for an increase in franchise taxes resulting from the requested revenue increase, and cover an anticipated increase in uncollectibles. We agree with the staff in this conclusion, and have proceeded, substituting herein figures derived from the actual increase filed June 30, 1976 by El Paso with FPC for the slightly larger figures (derived from the anticipated El Paso filing) used by both PG&E and the staff in the application and at the hearing. We approve the adoption by PG&E of the staff's estimate of heating value used in the current PG&E general rate case, Application No. 55510. In accord with staff policy not to allow changes for injection into underground storage during normal test years, in preparing its gas supply estimate the staff disallowed the 4,522 MMcf PG&E included in its estimate. A PG&E witness asserted that on some summer days PG&E was unable to take all the PGT gas offered to it because it lacked storage capacity at that point and the surplus could not effectively be placed in the PG&E system. The staff witness agreed this might happen. However, when the examiner suggested PG&E introduce hard evidence such as day-to-day recap records to support the assertions, none was forthcoming. The burden of proof always must rest with the applicant and we do not find they have met it here. Accordingly, we will adopt the staff's approach in this instance and disallow any injection into storage. The staff also used an updated estimate of the PGT supply volume (taken from the current PG&E general rate case, Application No. 55510 - a figure accepted by the utility in that proceeding).[11] We too will adopt the staff estimate for PGT source gas.

TABLE I

Gas Supply Estimates (MMcf) El Paso
(For 12 months beginning August 1, 1976, at rates effective April 1, 1976)

Source	PG&E*	Staff
El Paso	314,185	314,185
California	120,754	120,754
PGT	365,431	367,400
Total gas purchased	800,370	802,339
Injected into storage (credit)	4,522	(disallowed)
Total gas charged to operations	795,848	802,339

*Figures taken from test year 1975, Decision No. 84902, adjusted.

The estimated sales for the 12 month period beginning August 1, 1976, at rates effective April 1, 1976, reflect the additional PGT gas volume estimate taken from the current PG&E general rate case, Application No. 55510 and the disallowed net storage credit.

11/ While the PG&E attorney in one brief question inferred that the PG&E "acceptance" was not concurrence, but was "expediency" in Application No. 55510, the matter was not pursued further.

TABLE II

Estimated Sales (MDth) El Paso
(For 12 months beginning August 1, 1976,
at rates effective April 1, 1976)

	PG&E*	Staff
Firm		
General Service	382,309	382,309
Resale	9,514	9,514
Interruptibles		
Regular	345,782	348,589
Resale	355	355
Steam Electric	75,171	79,381
Total Sales	813,131	820,148
Gas Department Use	8,273	8,273
Unaccounted for	20,411	20,411
Total Gas to Operations	841,815	848,832

*Figures taken from test year 1975,
Decision No. 84902, adjusted.

Comparison of the PG&E and staff Results of Operations, adjusted to reflect the slightly lower actual El Paso June 30, 1976 FPC filing, follows in Table III. We adopt the adjusted staff results.

TABLE III

Results of Operations - El Paso
(000's omitted)

PG&E

	Test Year*	Cost of Gas Incr.	With El Paso Increase of 8/1/76 Without Rate Proposal	Rate Proposal	With Ratec Proposal
Gross Operating Revenue	$1,293,290	$ -	$1,293,290	$44,858	$1,338,148
Operating Expenses					
Cost of Gas	1,000,234	$44,462	1,044,696	-	1,044,696
Other Expenses, Excl. Taxes Based on Income	206,776	-	206,776	396	207,172
Taxes Based on Income	4,781	(23,423)	(18,642)	23,423	4,781
Total Oper. Exp.	1,211,791	21,039	1,232,830	23,819	1,256,649
Net for Return	81,499	(21,039)	60,460	21,039	81,499
Rate Base	1,120,182	-	1,120,182	-	1,120,182
Rate of Return	7.28%	(1.88)%	5.40%	1.88%	7.28%

*Figures from test year 1975, Decision No. 84902 adjusted for gas cost increase, increased revenue from offset rates through 4/1/76 and gas supply for the 12-month period beginning 8/1/76.

Staff

	Test Year*	Cost of Gas Incr.	With El Paso Increase of 8/1/76 Without Rate Proposal	Rate Proposal	With Rate Proposal
Gross Operating Revenue	$1,304,408	$ -	$1,304,408	$45,112	$1,349,520
Operating Expenses					
Cost of Gas	1,009,264	44,715	1,053,979	-	1,053,979
Other Expenses, Excl. Taxes Based on Income	231,212	-	231,212	397	231,609
Taxes Based on Income	(3,275)	(23,556)	(26,831)	23,556	(3,275)
Total Oper. Exp.	1,237,201	21,159	1,258,360	23,953	1,282,313
Net for Return	67,207	(21,159)	46,048	21,159	67,207
Rate Base	1,198,096	-	1,198,096	-	1,198,096
Rate of Return	5.61%	(1.77)%	3.84%	1.77%	5.61%

*Staff test year based on updated data from PG&E current general rate case, Application No. 55510 (see Staff Exhibit 61).

Under the regulatory background involved, and bearing in mind the right of the utility to the 8.65 percent return we previously determined to be reasonable, we find that the rates proposed, as adjusted herein, merely keep PG&E whole, and therefore are fair and reasonable.

The rate design proposed by PG&E is based upon Commission policy as enunciated in Decision No. 85082 dated October 31, 1975 in Applications Nos. 55468, 55469, 55470, and 55687, and Decision No. 85626 dated March 30, 1976 involving limited rehearing on rate design in Applications Nos. 55468, 55469, 55470, and 55687. By its design proposal PG&E would equate the rate for sales over 75 therms in Schedule G-7 with Schedules G-1 through G-13. Each resale schedule would exempt a percentage of the firm sales from the full per therm increase in recognition of the lifeline usage of customers of purchasers under resale schedules. This is a step in the direction we wish to take and is directed towards ultimately achieving equal non-lifeline rates for Schedules G-1 through G-13. Adjustment of PG&E's schedule of increases to the slightly smaller increase per therm proposed by the staff results in a 4/100 of 1 cent per MMBtu reduction from the 7.25 cents per MMBtu requested by PG&E to offset the anticipated El Paso increase. Accordingly, effective August 1, 1976 we will approve the PG&E proposal as adopted to accommodate the more conservative staff approach on net storage injections and the more recent data on PGT volumes. The maximum schedules we will adopt and authorize for the El Paso increase are in Table IV.

TABLE IV

Offset Increases by Schedules - El Paso

General Service	
Schedule G-1 through G-5	
First 75 therms	no increase
Over 75 therms	$0.00721 per therm
Schedule G-7	$0.00124 per therm
Schedule G-11 through G-13	no increase
Schedule G-30	$0.00721 per therm
Resale - Firm	
Schedule G-60	no increase
First 32.2% of sales	no increase
Over 32.2% of sales	$0.00721 per therm
Schedule G-61	
First 59.0% of sales	no increase
Over 59.0% of sales	$0.00721 per therm
Schedule G-62	
First 44.0% of sales	no increase
Over 44.0% of sales	$0.00721 per therm
Schedule G-63	
First 35.9% of sales	no increase
Over 35.9% of sales	$0.00721 per therm
Interruptible - All Sales	$0.00721 per therm

This offset is approved with the requirement that PG&E, beginning August 1, 1976, establish and maintain a balancing account showing over and undercollection of gas costs incurred as a result of the El Paso June 30, 1976 FPC filing, using an interest requirement of seven per cent per annum (the legal rate of interest in California) for both excess accruals and deficits, and to include in its next offset application a rate revision to adjust for any over- or undercollection for the 2-month period ending October 1, 1976.

This offset is approved with the understanding that PG&E will be required to make appropriate rate reductions and refunds to correspond with any reductions and refunds which might ultimately be ordered if the FPC should determine that El Paso's rates filed in Docket No. RP76-59 exceed just and reasonable levels under provisions of the Natural Gas Act.

California Sources

As stated before, we wish to avoid piecemeal authorizations pending determination of actual costs, and therefore at this time we will not approve PG&E's application for an increase in its rates to consumers based upon the as yet undetermined costs above 75 cents per Mcf for California source natural gas obtained under (1) the July 1, 1975 base year Occidental contracts, or (2) the July 1, 1976 base year California source contracts.

We recognize that the contract pricing mechanism characterized by the California source gas contracts of PG&E, including final resort provisions for arbitration, is one which today is being adopted by many industries, particularly where it is essential to the public welfare - or the industrial process - that the service continue without interruption. Unhappily in this inflationary era it is not always possible to reach agreement before contract deadline. In preference to a cessation of delivery pending final resolution of the price - a resolution which can literally take months, especially where, as here, there are 80 producers and 200 contracts involved - and in order to assure the hapless consumer customer of a constant availability of fuel when he needs it, PG&E has elected to contract in this manner. When agreement on price cannot be reached by the contract date, the contracts provide that the supply goes on and the existing PG&E price prevails until agreement on a new price is reached, or in event agreement cannot be reached, an arbitration proceeding sets the new price. But PG&E is obligated under that contract to pay any later agreed-on price or price set by arbitration award retroactive to the beginning of that base year.

However, until PG&E has negotiated, arbitrated, or litigated final prices on their base year July 1, 1975 Occidental contracts,[12/] and their base year July 1, 1976 California source contracts (including Occidental), and we have had opportunity after further filings and hearings to test the reasonableness of any rates proposed, we must reserve judgment on the reasonableness of any price paid by PG&E. In the interim, and recognizing that PG&E's gas costs, to the extent that they result in just and reasonable rates, must ultimately be flowed through to the consumer, we authorize PG&E to establish and maintain a California source balancing account to accrue the cost of natural gas above 75 cents per Mcf derived (1) from the July 1, 1975 base year Occidental contracts, and (2) from the July 1, 1976 base year California sources contracts (including Occidental), so that when the prices are finally established, PG&E may submit proposed tariffs for our approval. The balancing account will include interest at the rate of seven percent per annum (the legal rate of interest in California). When base prices are finally established it would be our intention to amortize all or such portion of the accrued balance as we subsequently find just and reasonable.

In our view, such balancing account practices, under these circumstances, leading to amortization to the extent found reasonable, are a practical method of offsetting undercollected costs incurred as a product of contract provisions providing for later negotiated, or arbitrated, or litigated prices, arrived at after delivery, and do not constitute retroactive ratemaking.

12/ PG&E agrees that it has no obligation whatsoever to go back and pay the 80 California source producers other than Occidental that higher Occidental award figure for PG&E's base year July 1, 1975.

Findings

1. PG&E has requested authority to offset the effect of certain increases forthcoming effective July 1, 1976 and August 1, 1976 in the prices of natural gas obtained form California sources and El Paso Natural Gas Company, respectively.

2. An offset proceeding, as differentiated from a general rate increase proceeding, is designed to provide prompt relief on limited issues.

3. The increases in natural gas costs represented here are extraordinary and the proper subject of an offset proceeding.

4. There was no competent evidence offered to significantly dispute or contradict the statements, computations, exhibits, and conclusions of PG&E or the staff.

5. On August 1, 1976, PG&E will become obligated, on an annualized basis, to a $45,112,000 additional cost for natural gas obtained from El Paso Natural Gas Company as the result of various filings El Paso has made with the Federal Power Commission, subject in part to possible reduction and refund under the Natural Gas Act.

6. In Decision No. 84902 this Commission found a rate of return of 8.65 percent would be reasonable for PG&E's gas department, and authorized rates to enable PG&E to earn that rate of return. Only offset increases have been added to those rates, all of which offset increases have been found to be reasonable and not to increase PG&E's rate of return above that authorized by Decision No. 84902.

7. The anticipated increased costs of gas purchased by PG&E from El Paso, if not offset, would reduce PG&E's gas department's rate of return by 1.77 percent and result in a rate of return which would be unjust and unreasonable.

8. The offset increase which should be authorized to PG&E to offset the El Paso increases in costs would result in an increased unit cost of not more than 0.721 cents per therm, which is spread to conform with the rate design policy enunciated by this Commission in Decisions Nos. 85082 and 85626, accommodating lifeline and in furtherance of our policy of ultimately achieving equal non-lifeline rates for Schedules G-1 through G-13 in the PG&E tariff.

9. The offsets which should be authorized are just and reasonable and will not increase PG&E's gas department's rate of return above the last authorized rate of 8.65 percent.

10. The rate design set forth herein, with its lifeline features, is just and reasonable.

11. In 1975 Occidental Petroleum Company rejected PG&E's base year July 1, 1975 offer of 75 cents per Mcf, and when agreement could not be reached went to arbitration to determine the price.

12. On July 1, 1975, PG&E became obligated to an as yet undetermined additional cost for natural gas obtained from Occidental Petroleum Company for base year July 1, 1975.

13. The arbitration award in the Occidental-PG&E dispute over Occidental's seven PG&E contracts for base year July 1, 1975 was issued May 24, 1976, too late to determine its effect on the California source contracts before commencement of base year July 1, 1976.

14. PG&E, as of the last day of hearing in this proceeding, had not determined whether to accept or litigate the Occidental-PG&E arbitration award, thus leaving the difference between the 75 cents per Mcf paid Occidental, and the final price PG&E must eventually pay Occidental for gas delivered in base year July 1, 1975, still unknown.

15. PG&E offered 90 cents per Mcf to the California producers for base year July 1, 1976; however, most of these producers have not accepted the 90 cents per Mcf offer pending outcome of the Occidental-PG&E arbitration proceedings as to base year July 1, 1975.

16. On July 1, 1976, PG&E became obligated to an as yet unknown additional cost for natural gas obtained from California producers, including Occidental Petroleum Company, for base year July 1, 1976.

17. PG&E should be authorized to establish and maintain two balancing accounts as follows:

(1) The El Paso Balancing Account, showing over- and undercollections of gas costs accrued as a result of the El Paso June 30, 1976 FPC filing, using an interest requirement of seven percent per annum for both excess accruals and deficits.

(2) The California Sources Balancing Account, to accrue the costs of natural gas above 75 cents per Mcf, derived from (a) the base year July 1, 1975 Occidental contracts, and (b) the base year July 1, 1976 California source producers (including Occidental), so that when final prices applicable to these contracts are determined, PG&E can submit proposed tariffs

> to this Commission, designed to amortize all or such portions of these accruals as we subsequently find just and reasonable. These accruals will accrue interest at the rate of seven percent per annum.

18. The setting of future rates to reflect past undercollections in this context and under these circumstances is not retroactive ratemaking.

19. To minimize undercollections and to prevent PG&E from incurring a substantial reduction in its authorized rate of return by costs increasing effective July 1, 1976, this order should be effective the date it is signed.

20. To prevent PG&E from incurring a substantial reduction in its authorized rate of return by increased costs effective August 1, 1976, this order should be effective the date it is signed.

Conclusions

1. Two (2) balancing accounts called (1) the El Paso Balancing Account, and (2) the California Sources Balancing Account should be authorized and appropriate recordings to it authorized.

2. The offset relief requested shall be granted by subsequent order to the extent set forth in this decision.

INTERIM ORDER

IT IS ORDERED that:

1. PG&E is authorized and directed to establish and maintain an El Paso Balancing Account to record over- and undercollections of gas costs accrued as a result of the El Paso June 30, 1976 FPC filing, using an interest requirement of seven percent per annum for both excess accruals and deficits.

2. PG&E is authorized and directed to establish and maintain a California Sources Balancing Account to separately accrue the undercollection of purchased natural gas costs above 75 cents per Mcf derived from (a) the base year July 1, 1975 Occidental contracts and (b) the base year July 1, 1976 California source producer contracts (including Occidental), and, when final contract prices between PG&E and the sources are determined, PG&E is authorized to submit proposed tariff schedules to this Commission designed to amortize these accruals to the extent the Commission determines them just and reasonable. The accruals will, to the extent found just and reasonable, accrue interest at the rate of seven percent per annum.

3. PG&E and the Commission staff are directed to work out details of the respective balancing accounts.

The effective date of this interim order is the date hereof.

Dated at San Francisco, California, this 3rd day of AUGUST, 1976.

President

Commissioners

Commissioner Robert Batinovich, being necessarily absent, did not participate in the disposition of this proceeding.