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Decision 82 12 109 DEC 22 1982 ORIG

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY for authority to decrease its electric rates and charges effective August 1, 1982, and to establish an annual energy rate and to make certain other rate changes in accordance with the energy cost adjustment clause as modified by Decision No. 92496 and its electric tariffs.	Application 82-06-08 (Filed June 3, 1982)
Application of PACIFIC GAS AND ELECTRIC COMPANY for authorization to carry out the terms and conditions of an amendment dated February 8, 1982 to an agreement dated May 26, 1965 with CHEVRON, U.S.A., INC. (Gas)	Application 82-06-20 (Filed June 3, 1982)

(See Appendix A for appearances.)

FINAL OPINION

Introduction

By Application (A.) 82-06-08 Pacific Gas and Electric Company (PG&E) requests authority to decrease its electric rates by approximately $158 million for the 12-month period beginning August 1, 1982. The requested decrease is the net amount resulting from a $211 million Energy Cost Adjustment Clause (ECAC) decrease and requested increases in the Annual Energy Rate (AER) of $34 million and in the Electric Revenue Adjustment Mechanism (ERAM) of $19 million.

By A.82-06-20 PG&E requests authority to amend a PG&E/Chevron U.S.A, Inc. (Chevron) Gas Purchase Agreement, the effect of which is that PG&E agrees to transport Chevron-produced gas to Chevron's Richmond refinery.

On August 18, 1982, we issued Decision (D.) 82-08-084 decreasing ECAC rates by $132.4 million on an interim basis.

A.82-06-08 and A.82-06-20 were consolidated for hearing. Hearings were held on these matters over 15 days in July and August 1982.

This decision does the following:

1. Declines to authorize the PG&E/Chevron Gas Transport Agreement.
2. Requires a decrease of $63,405,000 in the AER.

In reaching a decision on the above items, we have of necessity reviewed the PG&E/Chevron low sulfur fuel oil (LSFO) contract.

PG&E/Chevron LSFO Contracts

During the course of this proceeding the parties devoted a considerable amount of hearing time to whether the Commission should validate or invalidate the renegotiated 1981 PG&E/Chevron LSFO contract. The background of this contract was contained in the testimony of PG&E witness Kaprielian and Chevron witness Bowles. The testimony is summarized in PG&E's brief at pages 74 and 75 quoted below:

"By the early 1980's, energy conditions and customer demands were considerably different from what had been forecast in the early 1970's. Substantially increased supplies of natural gas and increased conservation by customers had reduced the need for LSFO drastically. These trends and other factors that reduced the need for oil resulted in a situation in which PGandE's contracted oil supplies exceeded its evolving forecasts of LSFO requirements. Under the original 1974 Chevron contract, PGandE was obligated to buy 15 million barrels of LSFO per year. The declining need for oil, however, left PGandE with a significantly larger contractual obligation than was required. Although this energy problem had been partially alleviated through limited underlift arrangements in the late 1970's and terminations of other purchase commitments, by early 1981, the problem of a continuing overabundance of LSFO had become a dominant concern in PGandE's energy management strategy. (Ex. No. 23.)

"Faced with a LSFO surplus that was forecast to last until the mid-1980's, PGandE undertook to renegotiate its oil contract with Chevron to reduce its purchase obligation. The negotiations to restructure the contract were already underway by early 1981. (Tr. 880.) By October, 1981, the basic framework of the renegotiated contractual arrangements had been agreed upon. (Tr. 952.) The renegotiated contract was executed in March 1982. (Tr. 871-872.)"

As part of the LSFO contract renegotiation PG&E and Chevron renegotiated a Gas Purchase Agreement and entered into a Gas Transport Agreement which are discussed below.

The relevance of these agreements to this proceeding relates to our jurisdictional role with respect to (1) a regulated utility and (2) a supplier of some good or service to that utility.

Toward Utility Rate Normalization (TURN), along with other parties, argues that the 1981 LSFO contract renegotiation is not reasonable. TURN also recommends disapproval of the amendment to PG&E/Chevron Gas Purchase Agreement which, in its view, will automatically invalidate the 1981 LSFO contract and resurrect the 1976 LSFO contract. TURN believes that our request to suspend deliveries in D.82-04-072 under the 1981 contract would remain in place and PG&E could continue to suspend oil deliveries and pay the substantially lower charges provided for in the 1976 contract.

TURN's theory is built upon certain revisions in the 1981 LSFO contract and a series of assumptions, each of which would have to occur for TURN's results to follow.

The first assumption is that invalidation of the Gas Purchase Agreement would automatically invalidate the 1981 renegotiated LSFO contract. The second assumption is that invalidation of the 1981 LSFO contract would resurrect the 1976 LSFO contract. The third assumption is that our request in D.82-04-072 for PG&E to suspend deliveries of LSFO would have the same effect under both the 1976 and 1981 LSFO contracts. We have substantial doubt about each of the three assumptions.

TURN's contention that the validity of the 1981 LSFO contracts is conditioned upon the approval of the Gas Purchase Agreement depends on Exhibit 24 which is a transmittal letter dated March 24, 1982 and signed by representatives of both Chevron and PG&E. The letter contains the following paragraphs:

> "This letter serves to confirm our understanding that the aforementioned agreements, and each of them, shall only become effective when and if the Public Utilities Commission of the State of California approves the Amendment to Gas Purchase Agreement-Richmond Refinery.

"This letter also serves to confirm our previous understanding that to the extent PGandE is relieved of its obligations under the Gas Transport Agreement pursuant to Paragraph 11B thereof, by virtue of the fact that PGandE would by performance of such obligations be constituted a common carrier, then in that event PGandE and Chevron shall attempt to implement a comparable alternative business arrangement."

This letter apparently was signed nearly two weeks after the 1981 LSFO contract was signed. The 1981 contract contains the following clause:

"16. CONSTRUCTION OF CONTRACT

"This instrument contains the entire agreement between the parties covering the subject matter and cancels and supersedes, as of the date of execution hereof, all prior agreements between the parties with respect to the subject matter of this contract. There are no other agreements which constitute any part of the consideration for, or any condition to, either party's compliance with its obligations under this contract. No modification shall be binding unless in writing and signed. The headings of sections are for convenience only and are not to be considered a part of this contract."

The two documents appear to conflict. Whereas TURN sees approval of the Gas Purchase Agreement as a condition precedent, we have no certainty that the LSFO contract and Gas Purchase Agreement are so tied. We note that both parties have behaved as if the 1981 LSFO contract were in full force and effect. We will therefore continue our analysis of both agreements assuming that each stands alone.

TURN's second assumption also is weak. TURN offers no argument or analysis to support the proposition that if the 1981 contract is rendered ineffective then the 1976 contract is resurrected. In fact, the intent of the parties expressed in the 1981 contract is that the 1981 contract cancels and supersedes all prior agreements. Since that cancellation would have occurred immediately upon the 1981 contract's execution it could be argued that such a cancellation would not have been reversed by the March 24 letter, whatever that letter's prospective effect on the 1984 contract may have been.

The last assumption that TURN advances is that our request that PG&E suspend deliveries of LSFO made under the 1981 contract would have the same effect under the 1976 contract. TURN's position is based upon the fact that both contracts contain contingency clauses regarding governmental action. The clause is quoted below:

> "4.3.2 compliance, voluntary or involuntary, with a direction or request of any government, instrumentality thereof or person purporting to act with authority of any government or instrumentality thereof: excluding, however, any such direction or request restricting or otherwise regulating combustion of LSFO to be purchased by Buyer hereunder, the effect of which restrictions or regulations upon the parties' performance shall be governed by Section 7 of this contract;"

TURN correctly points out that although the two contingency clauses are identical the consequences of invocation of the contingency is different under the two contracts. The clause under the 1976 agreement provides for payment of "fixed costs" when the contingency is invoked. The 1981 contract provides for two levels of charges. One level obtains if the contingency is a government request or direction not based mainly on economic grounds. A higher charge occurs if the contingency is invoked because of a governmental request based on the availability of more economic fuel.

TURN's theory is interesting but misstates our jurisdictional authority. TURN seems to more correctly perceive our role in the following sentence at page 46 of its opening brief:

> "While the Commission can theoretically disallow imprudent costs, that remedy is often considered too severe when a long-term contract is involved. In this situation, however, the Commission is faced with a unique opportunity to right the wrong that would otherwise occur."

It is not our role to directly invalidate utility-supplier contracts but rather to allow only reasonably incurred costs to be recovered in rates. Staff, among the major parties in this proceeding, is the only party that seems to correctly perceive our role. We are not equipped to perform management's role and will refrain from such intrusions to the greatest extent possible.

We are uncertain why PG&E and Chevron have attempted to bring us so close to the contracting relationship. It is clear that the parties contemplated that at times there could be more economical fuels than LSFO and that the parties have mutually agreed on a level of payment to compensate Chevron when no LSFO is required. We fail to see why it should be our judgment rather than the judgment of PG&E management that more economic fuels are available.

In the mid-1970s we did encourage the utility to enter into long-range fuel oil contracts. PG&E in this proceeding proposed the following theory:

1. PG&E entered into a contract in 1976 that was reasonable and prudent. (Evidenced by our D.81931.)
2. PG&E's fuel strategies since entering the contract have been reasonable and prudent.
3. Therefore, the present results are reasonable and all present expenses must be allowed in rates.

PG&E's theory that once it is determined that it entered into a reasonable and prudent contract, its shareholders are absolved from all risk is not correct in that it neglects the very important factor of changed circumstances.

Whether or not a contract should remain in effect, be abrogated, or be renegotiated should be decided by utility management. It seems obvious that normally utility management will consider a change in the status quo only when there is an incentive for it to do so. If we pass through all expenses without determining their reasonableness simply because they have been contracted for, there would never be an incentive for utility review of such expenses. Our review of the reasonableness of contract expenses with the possibility of disallowance provides management incentive to incur only reasonable costs.

Most of the expenses (except the commodity price) flowing from the LSFO contract are reflected in the consideration of the AER. It is in this area that certain expenses which come from the Chevron/PG&E contract will not automatically be passed through in rates. The difficult situation that we must face now is that in 1976 PG&E entered into a type of contract (long-term fuel) which the Commission at that time encouraged. Would it now be fair and equitable to ignore totally that contract and construct a reasonable

level of expenses as if that contract did not exist? We think not. Rather it is more fair to give PG&E time to make any changes it deems necessary in its relationship with Chevron. However, in this case we will begin to shift some expenses back to the shareholders with the present intention of shifting more expenses in future years. What becomes a most difficult matter of judgment is the level of expenses that will not be allowed in rates, particularly in the AER.

Gas Purchase Agreement - A.82-06-20

Chevron at its Richmond refinery can presently purchase gas up to a maximum flow of 130,000 Mcf per day from PG&E. Chevron pays the current tariff rates for this gas under Schedules G-2 and G-52. The current average price is $5.468 per decatherm.

Chevron is also a gas supplier to PG&E, selling gas at Natural Gas Policy Act prices, which in May of 1982, averaged about $3.112 per decatherm.

In A.82-06-20 PG&E requests authority to transport Chevron-owned gas from Chevron's fields in northern California to Chevron's Richmond refinery. The amount of gas agreed to be transported is 25 million cubic feet per day during 1982-84; up to 23 million cubic feet per day during 1985-87; and 20 million cubic feet per day during 1988-89. The revenue loss to PG&E is approximately $20 million during the first year.

PG&E testified that the benefits to PG&E from this agreement are primarily threefold. First, Chevron has agreed to continue to sell gas to PG&E and has agreed to sell to PG&E at least 75% of any newly discovered gas it controls. Second, Chevron will continue to be a customer of PG&E at tariff rates for the remaining amounts of its needs, approximately 68 million cubic feet per day. Third, the renegotiation of the 1981 Chevron LSFO contract depended upon accommodating Chevron's desire to renegotiate the arrangements governing gas service to the Richmond refinery.

The alternative scenario developed by PG&E is that Chevron could build its own pipeline, transport its full requirements, and not sell gas to PG&E. PG&E would lose both a high-volume industrial customer and a supplier. The cost of this alternative scenario is substantially more than the $20 million cost associated with the amended Gas Purchase Agreement.

With this reasoning, PG&E argues that because of the threat of Chevron building a pipeline, it had to renegotiate. Consequently, anything it could get in the LSFO negotiation because of the gas negotiation would be a bonus.

TURN, California Department of Consumer Affairs (DCA), and California Farm Bureau Federation (CFBF) argue persuasively, based on the testimony of PG&E witness Kaprielian during cross-examination, that Chevron's threat to build its own pipeline was illusory. Kaprielian testified that without the LSFO problem, PG&E would not have negotiated the Gas Purchase Agreement and would not have done so for perhaps five years.

The benefit of keeping Chevron as a supplier to PG&E is also of no great weight since the California Gas Producers continue to testify that they are ready, willing, and able to supply much more gas to PG&E than it is willing to take.

We believe that the benefits to PG&E of the Gas Purchase Agreement standing alone do not equal or outweigh the costs of the agreement, and we will not authorize it at this time. We arrive at this conclusion without reaching the issue of the common carrier aspects of the agreement or the agreement's precedential value which were argued by the California Gas Producers and DCA.

Preliminary Adjustment

Before we can develop the AER, we must settle a preliminary issue raised by the staff. The issue concerns the Martin Marietta Adjustment and affects the AER and ECAC calculations.

During the first quarter of 1981, PG&E entered into an Energy Call Agreement with Martin Marietta, whereby PG&E sold 467,000 barrels of fuel oil to Martin Marietta at a price of $27.257/barrel. The agreement allowed Martin Marietta to call on the energy, sell the fuel oil to a third party, or terminate the agreement and request that PG&E repurchase the fuel oil at the initial sales price, plus an interest component ($3,040,091). This last alternative occurred on March 1, 1982.

During the course of the agreement (January 1981-February 1982) PG&E maintained a fuel oil inventory well in excess of that previously authorized. Therefore, the net saving of this transaction ($2,270,153) accrued solely to shareholders. Staff recommends that the $3,040,091 interest expense not be recouped by PG&E through the ECAC balancing account. The staff recommendation results in a reduction from $38.48 to $38.24 per barrel of the weighted average inventory price of fuel oil. This adjustment will be reflected in various aspects of this case as explained by staff witness Thompson at Tr. 358:

> "Q. With respect to how the Martin Marietta adjustment impacts rates, do we take the 24 cents a barrel adjustment and essentially apply that to oil already burned as a balancing account issue, oil to be burned the next four months as an ECAC issue, oil to be burned in the next 12 months, an AER 2 percent issue, and the value of oil in inventory as an AER issue, the same number running through all those calculations?
>
> "A. Yes. We are recommending that the $3 million that PG&E paid in addition to what it sold the oil for be disallowed from PG&E's March, 1982

> ending inventory amount and, therefore, that adjustment will affect the ECAC revenue requirement and will also affect the AER revenue requirement, and for that matter it will also affect the value of the oil in the inventory."

PG&E's basic argument is that the transaction was reasonable and prudent and the entire $33/barrel ($27 commodity plus $6 interest) should be allowed to compute the inventory value. PG&E points out that the $33/barrel was less than the $37/barrel it was paying Chevron at the time. PG&E argues that to allow the staff adjustment would severely penalize PG&E for a prudent transaction.

We agree with the staff analysis and recommendation. The transaction was certainly reasonable from one standpoint; it saved shareholders approximately $2.3 million. Since the benefits went to shareholders, the shareholders should also bear the expense. The interest expense therefore should not be borne by the ratepayers who received no benefit from the transaction.

AER

The purpose of the AER is to recover in rates certain fuel-related costs which are not given balancing account treatment. The AER is determined by forecasting reasonable costs for the 12-month period beginning August 1, 1982. The AER cost elements are:

1. Carrying costs of fuel oil inventory allowed in rate base.
2. Estimated expense for facilities charges and underlift payments.
3. Gains and losses on the sale of fuel oil; and
4. 2% of the energy costs included in ECAC.

As can be readily seen from this outline of the AER elements, the first three elements are intimately tied to the fuel oil contracts PG&E has previously entered.

Fuel Oil Inventory

The different levels of expenses for fuel oil inventory requested by PG&E and recommended by the staff reflect diametrically opposed ratemaking philosophies. The company begins with its existing inventory as of August 1982 of 13,607,000 barrels and then uses a multiple year planning horizon to plan the most economic fuels strategy for the upcoming year. The result of the optimum fuels strategy is the costs associated with the AER. The key foundation of the plan is the current level of fuel oil inventory.

Under the staff theory, staff would only allow the amount of fuel oil in inventory to meet the operational needs of the company for the upcoming year. The actual beginning fuel oil inventory is irrelevant. What should be allowed is a reasonable fuel oil inventory to meet operational needs. The staff, however, has no recommendation for the minimum operational inventory requirement. Since the staff was unable to apply its theory completely, it recommends that the amount of fuel oil allowed during the last AER period (8.8 million barrels) be allowed once again. Staff noted that that amount was well over the minimum operational amounts.

DCA calculated an appropriate inventory allowance to be 8.4 million barrels, but generally agrees with the staff analysis. TURN favors a complex "two-tier" approach by which only that amount of fuel oil to meet operational needs would earn the rate of return with additional inventory amounts to be recovered at balancing account interest rates.

The company's minimum operational inventory for August 1982 is 5.0 million barrels. As of that date it had 13.6 million barrels in inventory. Even with no more takes of fuel oil, PG&E plans to reduce inventory by only 3.4 million barrels to 10.2 million barrels. It is apparent that PG&E has too much fuel oil. Two primary factors contribute to the excess fuel oil. One factor is the abundant levels of hydro during the 1981-1982 winter. The other factor is obviously the excessive amount of fuel oil previously contracted for.

PG&E argues in its reply brief (pg.36):

> "Furthermore, ignoring existing conditions for setting the AER oil inventory creates conflicting standards, as the utility's fuel management is judged in the reasonableness review based on the actual circumstances faced. Consistency in regulation is mandatory if the utility is to have the opportunity to conform its activities to the regulatory standard. Therefore, the standard for setting the AER elements must replicate the standard used in the reasonableness review, and must further accept existing conditions as its starting point."

PG&E argues that if we were to allow some amount less than it requests for inventory and it then took uneconomic steps (e.g., burn oil and reject cheaper gas) to reduce its inventory, it would be penalized in its next reasonableness review. Inherent in its argument is that this Commission must conclude that its fuel oil contract is reasonable. PG&E is incorrect; we do not pass judgment on the reasonableness of the fuel oil contract itself. We must simply decide to what extent the costs incurred under the fuel oil contract are reasonable for inclusion in rates.

We find that the annual average minimum operational inventory level is 5.4 million barrels, that last year we allowed 8.8 million barrels, and that PG&E currently requests 11.4 million barrels.

The record includes no showing of imprudence having caused PG&E to have held 13.6 million barrels in inventory as of August 1982. Rather, this excess is the result of a long-term oil contract which this Commission encouraged and of a very favorable hydro year. Nor do we have persuasive evidence that it would serve the economic interest of PG&E or its ratepayers for PG&E to reduce its inventory below 10.2 million barrels during the AER period. Yet we hesitate to recognize an economic inventory level of 11.4 million barrels for recovery through the AER when the minimum operational level is only 5.4 million.

For these reasons we favor, and will adopt, at least during the current period of excess fuel oil inventories, TURN's proposal of a "two-tier" approach. The 5.4 million barrels of fuel oil required

to meet operational needs will be recognized in the AER and thus will be treated as equivalent to a rate base item, investment therein earning the authorized rate of return. The additional inventory economic to hold but not needed for operational purposes, estimated for the forecast period at 6.0 million barrels, will be provided for in ECAC, with its carrying costs to be calculated at the interest rate applicable to the ECAC balancing account.

PG&E is put on notice that in ensuing years it is our intention to reduce the allowable inventory toward the operational requirement level and that it would be to PG&E's advantage for it to propose to implement a floating inventory mechanism that we have encouraged for over three years.

The following table illustrates the development of the allowed costs of fuel oil inventory to be recovered through the AER:

TABLE 1

Oil Inventory Revenue Requirement

Line 1	Annual Average (M = 1,000)	5,400 (Mbbl)
Line 2	Weighted Average Oil inventory price	$38.24 per barrel
		Dollars in Thousands
Line 3	Total Inventory (Line 1 x 2)	$206,496
Line 4	Allocation to CPUC jurisdiction (a)	198,174
Line 5	Return and Income Taxes (b)	41,972
Line 6	Franchise fees and Uncollectible Accounts (c)	333
Line 7	Adjusted Revenue Requirement	42,305

(a) Line 3 x .9597.
(b) Based on 12.57 rate of return and net-to-gross multiplier of 1.6849.
(c) Line 5 x .00793.

Losses on Sales of Fuel Oil

Although PG&E argues for consistent ratemaking treatment throughout our ECAC, AER, and reasonableness review, this element illustrates the competing interests that must be considered on individual merits, making consistency difficult and sometimes impossible. With its excess fuel oil problems, PG&E projects the need for the sale of 1.25 million barrels late in 1982 for a loss of $11.438 million.

The staff argues that sale of fuel oil at a loss is the most expensive of PG&E's options, with the least-cost option being to hold the oil in inventory. Staff recommends that no expenses be allowed recovery because, once again, if PG&E's inventory were at a reasonable level, a sale would not be necessary.

The staff's analysis is incorrect in at least two respects according to PG&E. In its analysis, staff used as the cost of gas, the rate that the electric department pays the gas department, rather than the cost of the gas to be rejected. Also, in computing the cost of holding the oil in inventory, the staff did not consider the length of time beyond the one year AER period that the oil would have to be held in inventory.

As summarized in its brief, PG&E considered the following in calculating the loss on the sale of fuel oil:

> "...the relative commodity costs of oil and gas, the costs of take-or-pay obligations incurred on gas from Pacific Gas Transmission Company (PGT), the loss on the resale of oil, the cost of future purchases of oil to replace oil burned earlier, the length of time PGT take-or-pay obligations would persist, the cost of carrying oil in inventory and the length of time various increments of oil are forecasted to remain in inventory. The analysis demonstrates that it is more economical to incur an expected $9.46 per barrel loss on the resale of 1.25 million barrels of inventory oil above the amount needed to meet December 1, 1983 inventory requirements, than to incur oil inventory carrying costs of $22-23 per barrel for holding that oil until December 1, 1984, or later." (Ex. No. 1, p. MJP-10)"[4]

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[4] PGandE estimates the per-year inventory carrying cost to be approximately $9 per barrel using a pre-tax average marginal cost of capital. (Ex. No. 1, p. MJP-8.)"

We find PG&E's analysis persuasive that the planned sale is an economic action. However, if we are to be entirely consistent in our ratemaking treatment of the excess oil in this case, we must ask what conditions require such a sale. If PG&E were operating with an annual average inventory anywhere near 5.4 million barrels rather than 11.4 million barrels, the economics of a sale might be different. Moreover, our reduction in the carrying charges applicable to economic oil inventory beyond operational needs changes the calculations appropriate to determine whether sale of fuel oil at a loss would benefit ratepayers, and therefore whether such losses should be recoverable in rates. The reasonableness of such transactions from this day forward will be judged in light of the oil inventory treatment adopted in this decision.

Thus, we find it impossible at this time and on the present record to forecast with adequate certainty the level of fuel oil sale losses which PG&E will reasonable incur during the forecast period. Therefore, we will include no allowance in the AER for such losses, but will permit recovery through ECAC of losses on sale of fuel oil reasonable incurred subsequent to the effective date of this decision. In order to moderate the rate adjustment which may subsequently be required and in view of the uncertainity whether PG&E will indeed incur oil sale losses during the ECAC forecast period, we will include in ECAC expense for the forecast period $3.0 million in oil sales losses. This estimate will be subject to adjustment based on actual experience and will be subject to reasonableness review.

Facility Charge

A contract for fuel oil can contain simply one price to be paid for a certain amount of fuel oil. If the utility does not need all of the fuel oil contracted for, it can either sell it or hold it in inventory. However, a third option is to contract with the supplier for two prices--one price for the commodity actually purchased and another price paid when less than the contracted for amounts are required. The money that is paid when less oil is taken is generally referred to as a facility charge or underlift fee. It

is basically a price paid for flexibility in the amount taken. If in analuzing the three options, the utility determines that the economic choice is to pay the "facility charge-underlift fee" for oil not needed, then we must determine to what extent the costs resulting from the charge/fee are reasonable for ratemaking purposes.

The 1976 PG&E/Chevron contract contained no provision for underlift fees or facility charges. The 1981 contract made certain changes in the 1976 contract as summarized in Chevron's brief as follows:

> "1. The Original LSFO Contract required PG&E to purchase 15 million barrels of LSFO per year. Under the

Renegotiated LSFO Contract, PG&E may still purchase as much as 15 million barrels per year, but it has the new right to purchase as little as six million barrels per year.

"2. The Renegotiated LSFO Contract separates the price for LSFO into two parts. One part is the Commodity Charge, which must be paid for each barrel of LSFO that is purchased. The second part is the Facility Charge, which must be paid regardless of the volume of oil purchased and which is intended to compensate Chevron both for the refinery investment it made to support the Original LSFO Contract and for the concession.

"3. The Renegotiated LSFO Contract permits PG&E to reduce or suspend deliveries of LSFO in favor of an alternative fuel in compliance with a governmental direction or request that is made mainly for the reason that the alternative fuel is believed to be more economical; but it requires PG&E to continue to pay the Facility Charge in the event of such a reduction or suspension of deliveries."

The facility charge in the 1981 contract will average $2.79 on the full 15 million barrels for a total California jurisdictional amount of $40,522,000.

In the 1981 contract the facility charge has four elements as follows:

1. Labor
2. Material
3. Capital Charge
4. Taxes.

The staff argues that the facility charge is reasonable except when no deliveries are scheduled. When PG&E suspends all deliveries, then the staff argues that that portion of the facility charge attributed to Labor and Materials is unreasonable. In this AER period the disallowance for these components would total $8,683,500.

DCA and TURN both adopt the same theory that the 1981 contract should be found unreasonable and recommend that the facility charge should be computed under the 1976 contract as if our request to suspend had the same effect as under the 1981 contract.

PG&E presented evidence that the facility charge is reasonable in its judgment through its own determination of the reasonable construction costs at the Richmond refinery attributable to the PG&E contract. Chevron presented testimony to show that the labor and materials components of the facility charge are incurred even when no deliveries of fuel oil were made to PG&E.

We approach consideration of underlift or facility charges with great concern that the reasonableness of passing the burden of such charges on to ratepayers be amply demonstrated. Because ratepayers derive no direct benefit from such charges, it is essential that the nexus between these payments and ratepayer benefits be clearly proven. In our decision earlier this month, D.82-12-056, authorizing amortized recovery of underlift charges by San Diego Gas & Electric Company (SDG&E) subject to further reasonableness review, we stressed the need for a comprehensive evidentiary showing to justify charging ratepayers for such payments.

In the present case the importance of full and critical evaluation of the reasonableness of permitting rate recovery of PG&E's facility charges is, perhaps, even more compelling than in the case of the SDG&E underlift charges. This is because PG&E's proposal to recover $40.5 million in facility charges through the current AER represents merely the first year's installments under a contract the term of which extends through 1989. Thus, a Commission finding of reasonableness as to these facility charges could have implications of great magnitude for years to come.

We are troubled by the failure of either PG&E or Chevron to provide a persuasive demonstration that the facility charge reflects an appropriate cost allocation of Chevron's investment in improvements to its Richmond refinery. PG&E offered only "informed speculation"; Chevron asserted that such an allocation of costs was impossible. It is, moreover, uncertain whether PG&E has improperly included variable labor and materials costs in its calculation of the facility charge. Such a record leaves us in doubt as to whether PG&E has negotiated a facility charge at a level low enough to warrant recovery in full from its ratepayers.

As staff noted in its opening brief, one aspect of the reasonableness issue is whether the facility charge represents a reasonable cost to avoid uncertainties of litigating the terms of the 1976 LSFO contract. Such litigation is now in progress between Chevron and Southern California Edison Company over a similar LSFO supply contract. We are concerned that hasty approval of rate recovery for PG&E contract costs not clearly proven reasonable might mislead the parties to that litigation into anticipating our acquiscence in unrealistic terms of settlement.

In view of the importance of the issue and the far-reaching consequences of a decision, we will not reach a decision today on the reasonableness of including PG&E's projection of facility charge costs in the calculation of an AER rate. We will, however, permit PG&E to record such costs incurred from the date of this decision in its ECAC balancing account. The reasonableness of such costs will be subject to further, thorough review in PG&E's next ECAC reasonableness review. The record developed in this proceeding as to the facility charge issue will be incorporated into the record of that future proceeding.

2% of Annual Fuel Costs

In calculating its annual fuel and purchased power costs for the upcoming year no party took ecxeption to PG&E's estimates except for the staff regarding purchased power.

PG&E projects purchases of 12,252 gWh. The staff proposes using a four-year historical average which produces 14,763 gWh. The difference of 2,511 gWh replaces gas generated electricity. The staff estimate is reasonable and will be adopted. The following table shows the development of the 2% AER factor.

TABLE 2

2% of Estimated Fuel Expenses for AER

Line No.		Estimated Prices(a)	PG&E Dollars in Thousands	Adopted Dollars in Thousands
	Steam Plants			
1	Gas	$5.4592	$1,770,577	$1,622,146
2	Oil-Residual(b)	$5.8346	101,574	101,574
3	Oil-Distillate	$6.0452	13,094	13,094
4	Geothermal	3.632¢	233,080	233,080
5	Purchased Power(c)	2.682¢	328,546	395,891
6	Total Fuel Expense		$2,446,871	$2,365,785
7	Allocation to CPUC Jurisdictional(d)		2,348,262	2,270,444
8	Two Percent of Fuel Expense(e)		46,965	45,409
9	Franchise Fees and Uncollectible Accounts Expense(f)		372	360
10	Revenue Requirement		$ 47,337	$ 45,769

(a) In dollars per million Btu or cents per kilowatt-hour
(b) Includes Conventional and Refinery Oil
(c) Excludes M&O for Irrigation Districts
(d) Line 6 x 0.9597
(e) Line 7 x 0.02
(f) Line 8 x 0.00793

Now that each of the elements has been resolved the following table shows the final calculation of the AER.

TABLE 3

SUMMARY OF ANNUAL ENERGY RATE REVENUE REQUIREMENT
TEST YEAR BEGINNING AUGUST 1, 1982

Line No.		PG&E $M	Adopted $M
1	Revenue Requirement Associated with the Proposed Volume and Price of Fuel Oil in Operational Inventory	$ 87,087	$ 42,305
2	Facilities Charges	40,522	0
3	Underlift Payments	0	0
4	Two Percent of Estimated Fuel Expense	47,337	45,769
5	Loss on Sales of Fuel Oil	11,438	0
6	Total Revenue Requirement	$186,384	$ 88,074
7	Less: Revenue at Present AER Rates	151,479	151,479
8	Increase in Revenue Requirement	$ 34,905	(63,405)

ECAC and ERAM

The current ECAC and ERAM revenue requirement is developed in our decision issued today in A.82-09-51. Because this decision on the August revision ECAC is being issued contemporaneously with the December revision ECAC (A.82-09-51) there is no need to develop two identical ECAC and ERAM revenue requirements.

Reasonableness of Past Actions

Under current ECAC procedure, the reasonableness of incurred energy expenses is reviewed once each year. This proceeding is the annual reasonableness review for PG&E. One of the most important actions that we can take in a reasonableness proceeding is a disallowance of an expense that we find has been incurred unreasonably. A quantification of a disallowance must logically be supported.

The burden of proof on the utility is correctly stated by PG&E in its brief pages 52-53 as follows:

> "...Decision No. 92496 requires the utility to make a 'substantial affirmative showing.' PG&E interprets this standard to be somewhat greater than the typical civil standard of a preponderance of the evidence, but less than the standard of 'clear and convincing' evidence necessary in such relatively unique situations as establishing fraud (34 Cal.Jur.3d, Fraud and Deceit, § 88, pp. 346-49); proving malice in a libel action (Belli v. Curtis Publishing Company (1972) 25 Cal.App.3d 384, 102 Cal.Rptr. 122); or proving by oral testimony the execution or

> contents of a lost instrument. (Nemo v. Farrington 7 Cal.App. 443, 94 P.874, hg. den. by Supreme Ct. as reported in 7 Cal.App. 451, 94 P.877 (1908))."

The major significance of the burden of proof is the guidance it offers in ruling upon competing evidence after the applicant has made its substantial affirmative showing. Imposing the burden on the utility does not relieve any other party which comes forward to challenge the utility's past actions of the obligation of fully supporting its recommendation.

In this proceeding the major contested disallowance other than those previously resolved involved a staff recommendation to disallow $25 million because PG&E turned down relatively inexpensive power from the Pacific Northwest, the Geysers, and Rancho Seco while failing to reduce fossil thermal operations to minimum levels during certain days. Rebuttal testimony by PG&E showed that the fossil thermal units were indeed reduced to the lowest level possible. whenever possible. The staff recommendation will not be adopted.

A corollary issue raised by TURN is that during this same period PG&E reduced the power output of Rancho Seco to avoid spilling its own hydro. TURN calculated the costs of such dispatching to be $4.5 million. The argument is summarized in its brief as follows:

> "During a day on which backdowns are anticipated that night, Rancho Seco is kept at full power. That generation, costing 8.05 mills per KWH (Tr. 1483), displaces thermal power costing 45 to 50 mills (Tr. 1484), a saving of at least 37 mills per KWH. At night, since Rancho

> Seco cannot be cycled, hydro would have to be spilled at a net loss of 8.05 mills per KWH, or any remaining Northwest surplus cut back for a net loss of 2.05 mills. Given that the minimum load hours are limited to about 11 pm. to 5 a.m., substantial overall savings could be realized on such a day."

PG&E's rebuttal showed that by reducing Rancho Seco output to avoid hydro spill, it also delayed refueling of Rancho Seco to a lower load month. PG&E estimates that the benefits of delaying refueling Rancho Seco could be as much as $15 million, which would more than compensate for the cost of earlier power reductions. Thus, while we agree that the hydro spill by PG&E might be a short-term least cost strategy, in the longer term PG&E's actions appear to be more cost-effective. We agree with PG&E that its actions in this regard were prudent.

SMUD Settlement

The last specific reasonableness item to be discussed is the Sacramento Municipal Utility District (SMUD) settlement. Since 1975, PG&E and SMUD have been involved in a controversy concerning a claim over the operations at Rancho Seco. In D.91335 we found that PG&E had not processed this claim, which totals $35 million, expeditiously. We therefore excluded the $35 million from the balancing account recovery until the claim had been settled.

In March 1982 PG&E, SMUD, and a variety of third parties settled the litigation. The claim was settled for $9.2 million plus certain future benefits. At that time, PG&E credited the balancing account by $9.2 million and debited the account by $35 million plus $13,075,000 interest on the $35 million, which was calculated based on the ECAC interest rate from the date on which the $35 million was removed from the ECAC balancing account to the settlement date.

The staff recommends that only interest ($9,857,000) earned on the difference between the claimed amount and the recovery be allowed. The shareholders would be responsible for the interest ($3,218,000) incurred on the recovery amount.

TURN recommends that no interest expense be recovered by PG&E and that the entire $13.1 million be absorbed by the shareholders. TURN makes the recommendation because prior to September 1979, PG&E had pursued the matter in a dilatory fashion and to allow any of the interest expense would be an improper award to PG&E.

In the discussion in D.91335, we stated that:

> "For approximately three years now the Commission has effectively allowed PG&E's ratepayers to absorb SMUD's capacity charges covering a period of 11-12 months in 1975-1976 during which Rancho Seco was, in fact, not commercially operative and for which PG&E now has a $35 million claim outstanding. The staff's position that PG&E's ratepayers have been called upon to bear the cost of this pending matter too long already and should not now be called upon to continue to bear such costs for a future one or one and one-half years is persuasive. It is the staff's view that PG&E's stockholders should now come forward and share in this burden pending final disposition of the utility's claim against SMUD. We agree. Therefore, in our determination of PG&E's ECAC billing factors for the immediate future we shall exclude any consideration of the pending $35 million claim against SMUD as proposed by the staff."

While PG&E was slow in pressing its claim prior to D.91335 we find that since the decision PG&E has acted in a reasonable manner in arriving at a fair settlement. However, a partial disallowance of interest related to the settlement is appropriate based on PG&E's earlier lack of vigor in pursuing its claim.

Allowance of interest on the difference between the claimed amount and the recovery will compensate PG&E shareholders for the removal from ECAC of costs which, based on the arbitration results, appear to have been reasonably incurred. No interest

should be allowed on the recovery amount beyond a reasonable settlement date. We adopt staff's recommended disallowance of interest on this amount past the time that we removed the entire claim from ECAC, consistent with our intent in D.91335. PG&E should adjust the balancing account to remove this amount, $3,218,000, which was debited in March 1982.

This interest disallowance should provide a signal to the utility to pursue future litigation in an expeditious manner. Our disallowance of interest on the recovery amount should not be considered precedential, since this could reduce the utility's incentive to obtain maximum settlements in any future comparable litigation. In this instance, however, this disallowance is a reasonable allocation of the costs incurred because PG&E did not pursue its claim expeditiously.

Miscellaneous Reasonableness Issues

Other reasonableness issues were raised in the briefs of DCA and TURN. The issues primarily concerned:

1. Outages at Pittsburg 7.
2. Reduced capacity factors at the Geysers Units.
3. Reliability criteria.

DCA cross-examined witnesses regarding these issues but did not make any affirmative showing of its own regarding them. DCA does not specifically recommend any monetary disallowances but rather recommends retention of a consultant to study PG&E's operations in these areas and the adoption of performance standards.

The testimony of PG&E shows that there were indeed substantial outages at Pittsburg 7 and decreasing capacity factors at the Geysers, and that PG&E reliability criteria sometimes prevent economic dispatch. The testimony of PG&E also shows that there were

reasonable causes for those events. These issues are in a gray area. Although PG&E has made a substantial showing, there still exists substantial doubt regarding the reasonableness of its operations in these areas. We expect that these issues will be primary issues in PG&E's next reasonableness proceeding.

Rate Design

In this proceeding PG&E made several minor rate design adjustments. The proposals concern (1) industrial time-of-use (TOU) rates and (2) agricultural TOU rates. PG&E's proposal regarding the industrial TOU rates involves adjusting the on/off-peak differentials to their original levels. The purpose of the proposal is to provide the proper incentive to shift usage from on-peak to off-peak hours. CMA contends that it is the absolute difference in rates that provides the incentive rather than the on-peak/off-peak ratios. We agree with PG&E and will authorize the proposed TOU adjustments to the A-21, A-22, and A-23 schedules.

The agriculture rate proposal is discussed in our decision in A.60153 (rate design phase) wherein PG&E's proposal is adopted. The reasoning for the agriculture TOU rate proposal is similar to the industrial TOU proposal discussed above.

Concerning other schedules, we will maintain our current policy of applying rate decreases on an equal cents-per-kWh basis.

Future Proceedings

This proceeding was PG&E's second reasonableness review under our current ECAC procedures. With this experience, several problems have come to light which principally involve PG&E's relationship with our staff in preparation for the reasonableness review.

PG&E is the sole party in possession of evidence regarding the reasonableness of its past actions. Our staff must have complete access to this information in order for the staff to formulate its recommendations. Also, the staff must not only have free access to the data, but also, PG&E must provide more complete data in its reasonableness report. The format of the reasonableness report should, therefore, be reformed. We will direct PG&E to begin to work with our staff within 30 days to develop a new format for the next reasonableness report. The types of information that we wish to see in future proceedings are:

1. Economic analysis of low cost (surplus power, geothermal, and nuclear) power turndowns or backdowns.
2. Cost/benefit analysis of reliability criteria.
3. Documentation and explanation of its relevant computer programs.

Rate Structure Effects

In D.91335 dated February 13, 1980 we ordered PG&E to study the effects of rate structures on customer usage patterns. Exhibit 20, introduced in this proceeding, is PG&E's most recent study on this subject. This study by PG&E witness Robert Howard measures the effect of a three-tier rate structure. The "rate structure" effect is isolated from "rate level" effects. The "rate structure" effect is the conservation that results solely from a three-tier structure while the "rate level" effects are the conservation caused by an overall increase in rates.

The study calculates that the "rate structure" effects of a three-tier rate design produce a savings in the range of 3.3% to 5.5%

for basic lifeline customers. This effect is about twice the effect of a two-tier rate design. Although there are additional conservation effects due to a three-tier rate design, PG&E correctly recognizes that other rate design considerations such as equity and customer billing impacts also will influence the choice of a rate design for residential customers.

Findings of Fact

1. By A.82-06-08 PG&E requests authority to decrease ECAC revenues by $211 million annually, increase AER revenues by $34 million, and increase ERAM revenues by $19 million.

2. The interest expense ($3,040,091) involved with the Martin Marietta transaction is associated with a benefit of $2,270,153 which flowed to shareholders.

3. The weighted average inventory price of oil is $38.24 per barrel.

4. 5.4 million barrels is the minimum fuel oil inventory required to meet operating needs and is a reasonable annual average inventory for AER recovery during the forecast period.

4a. 11.4 million barrels is a reasonable estimate of the average inventory which it is economic for PG&E to maintain during the forecast period, so PG&E should be permitted to recover through ECAC at current balancing account interest rates the carrying cost of 6.0 million barrels of fuel oil inventory in excess of minimum operating needs.

5. $ 3,000,000 is a reasonable level of expenses for the loss on the sale of fuel oil to be forecast for recovery through ECAC.

6. It is reasonable to permit PG&E to record facility charge payments in the ECAC balancing account but not, at this time, to provide for the recovery of such costs through AER rates or otherwise.

7. 14,763 gWh is a four-year recorded average and is a reasonable estimate of purchased power in the forecast year.

8. Decreased rates to produce a $63,405,000 AER decrease are reasonable.

8a. It is reasonable to require PG&E to remove its debit of $3,218,000 from the ECAC balancing account in March 1982 due to interest costs on the $9.2 million recovery from SMUD.

9. PG&E's operations of its gas and electric departments during the record period were sufficiently reasonable so that no disallowances other than that described in Finding of Fact 8a are warranted.

10. The development of the AER rates, as calculated in this decision, is reasonable.

11. Rate Schedules A-21, A-22, and A-23 should be adjusted so that the on-peak/off-peak ratios are as originally established.

12. With the exception of the adjustment of A-21, A-22, and A-23 schedules, the equal cents-per-kWh method is reasonable to implement rate changes.

13. Because the revision date for these rate changes is past, this order should be effective the date of signature.

14. The cost to ratepayers of the amended PG&E/Chevron Gas Purchase Agreement would be approximately $20 million in the forecast year.

15. The costs of the PG&E/Chevron amendment to the Gas Purchase Agreement outweigh the benefits.

16. The three-tier rate structure results in a 3.3% to 5.5% conservation effect.

Conclusions of Law

1. PG&E should be allowed to establish AER rates as set forth in the following order. These rates are just and reasonable.

2. The amendment to the PG&E/Chevron Gas Purchase Agreement is not reasonable.

3. Inclusion in ECAC of interest calculated from September 30, 1979 on the amount of PG&E's settlement with SMUD is not reasonable.

FINAL ORDER

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) is authorized to establish and file with this Commission, in conformity with the provisions of General Order 96-A, revised tariff schedules for the

AER in accordance with the decision issued in the rate design phase of A.60153 and to revise its streetlighting rates accordingly. Also, PG&E is authorized to adjust the TOU Schedules A-21, A-22, and A-23 as proposed.

2. PG&E's request for authority to carry out the terms and conditions of the amendment dated February 8, 1982 to the May 26, 1965 agreement with Chevron, U.S.A., Inc. is denied.

3. PG&E, in conjunction with our staff, shall develop a new format for its "Report on the Reasonableness of Operations." PG&E shall file a progress report on this project during its first ECAC proceeding in 1983.

4. PG&E shall remove from the ECAC balancing account its debit in March 1982 of $3,218,000 due to interest costs on the $9.2 million recovery from SMUD, and all interest which has accumulated in the balancing account due to that debit.

This order is effective today.

Dated DEC 22 1982, at San Francisco, California.

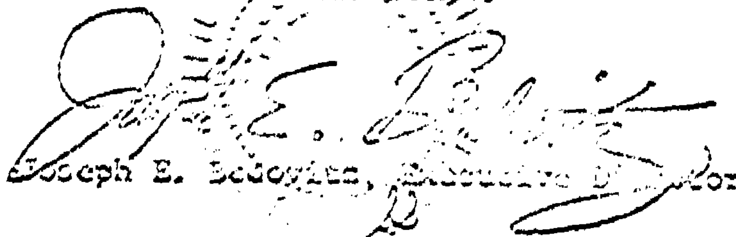
I dissent in part.

/s/ JOHN E. BRYSON
Commissioner

I dissent in part.

/s/ RICHARD D. GRAVELLE
Commissioner

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. GREW
Commissioners



APPENDIX A

Applicant: Daniel E. Gibson, Shirley A. Woo, and Steven F. Greenwald, Attorneys at Law, for Pacific Gas and Electric Company.

Interested Parties: J. R. Bury, H. R. Barnes, L. R. Cope, and C. W. Norris, Attorneys at Law, for Southern California Edison Company; Brobeck, Phleger & Harrison, by Gordon E. Davis, William H. Booth, and Richard C. Harper, Attorneys at Law, for California Manufacturers Association; Roger Dickinson and Thomas Greene, Attorneys at Law, and Robert Logan, for California Department of Consumer Affairs; Michel Peter Florio and Robert Spertus, Attorneys at Law, and Sylvia Siegel, for Toward Utility Rate Normalization (TURN); William L. Reed, Jeffrey L. Guttero, and Randall W. Childress, Attorneys at Law, for San Diego Gas & Electric Company; Glen J. Sullivan and Allen R. Crown, Attorneys at Law, for California Farm Bureau Federation; Downey, Brand, Seymour & Rohwer, by Philip A. Stohr, Attorney at Law, for General Motors Corporation; Nancy R. Teater, by William E. Swanson, for Stanford University; Gregg Wheatland, for California Energy Commission; Harry K. Winters, for University of California; Jane S. Kumin, Attorney at Law, for Natomas Co. and Thermal Power Co.; Richard L. Hamilton, Attorney at Law, for Western Mobilehome Association (WMA); Stephen P. Crouch, for Los Angeles Department of Water and Power; Robert M. Loch and Thomas D. Clarke, Esquire, by Robert W. Jacoby, Attorney at Law, for Southern California Gas Company; Henry F. Lippitt, 2nd, Attorney at Law, for California Gas Producers Association; and Russell L. Johnson and Sandy Creighton, Attorneys at Law, for Chevron U.S.A., Inc.

Commission Staff: Thomas P. Corr, Attorney at Law, and Raymond A. Charvez.

(END OF APPENDIX A)

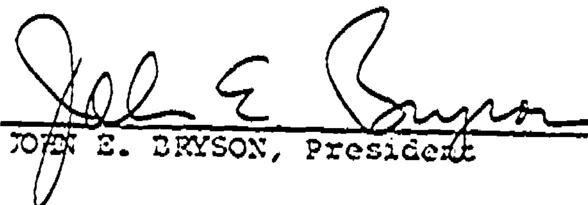
D.82-12-109
A.82-06-08
A.82-06-20

COMMISSION PRESIDENT, JOHN E. BRYSON, dissenting in part.

I dissent from the determination in this decision that $3,218,000, plus interest since March 1982, in carrying charges associated with the PG&E claim against the Sacramento Municipal Utility District (SMUD) should be disallowed. Any costs to ratepayers which were caused by lack of reasonable diligence in pursuing legal remedies should be disallowed. However, neither D.91335 nor this decision finds a specific lack of diligence. In addition, this decision does not find or seek to find that the $3.218 million in interest accruals is in fact the cost which was caused by whatever lack of diligence existed.

D.91335, on which today's decision is based, is ambiguous in its conclusion. The paragraph from that decision cited in the majority opinion raises the question of unreasonable delay, which should be investigated, but it does not reach a conclusion on imprudence. It also seems to defer judgment "pending final disposition of the utility's claim". In my view, the question of imprudence and of what specific costs any imprudence caused should be determined in PG&E's next reasonableness review.

If utilities conclude they risk being disallowed carrying costs whenever a claim takes a long period of time to recover, they will be encouraged to settle all claims early regardless of the optimal litigation and bargaining strategy. This result would be avoided were we to base our decision on a showing of either prudence or imprudence on the specifics of this claim.



JOHN E. BRYSON, President

December 22, 1982
San Francisco, California

A.82-06-08, A.82-06-20
D.82-12-109

RICHARD D. GRAVELLE, Commissioner, Dissenting in part:

While I applaud my fellow Commissioners for refusing to pass through to PG&E's customers the $40 million annual cost of the facility charge resulting from the 1981 Chevron - PG&E LSFO contract, I cannot agree with them that these charges should be reexamined a year from now or that PG&E should make such payments in the meantime.

We are here given a golden opportunity to benefit PG&E, its ratepayers and shareholders by boldly stating that we will not now or in the future allow those facility charges to be charged to ratepayers. We have disallowed the Chevron Gas Purchase agreement and if PG&E and Chevron are correct, the entire 1981 LSFO contract is in a position to be voided as well it should be.

We all have learned that the long term oil contracts hold no substantial assurance of supply for the utility buyer but do entail onerous price and purchase provisions that benefit only the seller. This is the world of 1982 and 1983 in which Chevron is selling .25 sulfur content oil to the Los Angeles Department of Water and Power for $30 per barrel while PG&E holds $40 per barrel oil in inventory and is liable, in addition, for underlift or facility charges. Such a situation is intolerable in my judgment. We should take whatever action we can through invocation of the force majeure provisions of the contracts or by way of disallowance to provide our regulated utilities, including PG&E, an incentive as well as a lawful means to void the contracts. Only by doing so will our regulated utilities be put in a position to bargain fairly with potential suppliers for their reasonable oil needs at reasonable prices and on reasonable terms reflective of the economic and energy atmosphere we find ourselves in as we move into 1983.

The facility charge in the 1981 Chevron - PG&E LSFO contract is now a zombie, half alive, half dead. I believe we should complete the ceremony with a decent burial so that all around can move to the future with a fresh, clean perspective.

Richard D. Gravelle, Commissioner

December 22, 1982
San Francisco, California

See Mary's copy

H-6

Insert JEB alt p 13, 14, 14a, 15, 17a - but change it to 17b, 19, 19a, 21.

VC alt p 17, 17a, 24, 24a, 25, 25a, 28, 29, 30

By A.82-06-20 PG&E requests authority to amend a PG&E/Chevron U.S.A, Inc. (Chevron) Gas Purchase Agreement, the effect of which is that PG&E agrees to transport Chevron-produced gas to Chevron's Richmond refinery.

On August 18, 1982, we issued Decision (D.) 82-08-084 decreasing ECAC rates by $132.4 million on an interim basis.

A.82-06-08 and A.82-06-20 were consolidated for hearing. Hearings were held on these matters over 15 days in July and August 1982.

This decision does the following:

1. Declines to authorize the PG&E/Chevron Gas Transport Agreement.
2. Requires a decrease of $63,405,000 in the AER.
3. Authorizes recovery of the ERAM balance of $20,490,000. ($58.7 million annualized increase.)

In reaching a decision on the above items, we have of necessity reviewed the PG&E/Chevron low sulfur fuel oil (LSFO) contract.

PG&E/Chevron LSFO Contracts

During the course of this proceeding the parties devoted a considerable amount of hearing time to whether the Commission should validate or invalidate the renegotiated 1981 PG&E/Chevron LSFO contract. The background of this contract was contained in the testimony of PG&E witness Kaprielian and Chevron witness Bowles. The testimony is summarized in PG&E's brief at pages 74 and 75 quoted below:

Toward Utility Rate Normalization (TURN), along with other parties, argues that the 1981 LSFO contract renegotiation is not reasonable. TURN also recommends disapproval of the amendment to PG&E/Chevron Gas Purchase Agreement which, in its view, will automatically invalidate the 1981 LSFO contract and resurrect the 1976 LSFO contract. TURN believes that our request to suspend deliveries in D.82-04-072 under the 1981 contract would remain in place and PG&E could continue to suspend oil deliveries and pay the substantially lower charges provided for in the 1976 contract.

TURN's theory is built upon certain revisions in the 1981 LSFO contract and a series of assumptions, each of which would have to occur for TURN's results to follow.

The first assumption is that invalidation of the Gas Purchase Agreement would automatically invalidate the 1981 renegotiated LSFO contract. The second assumption is that invalidation of the 1981 LSFO contract would resurrect the 1976 LSFO contract. The third assumption is that our request in D.82-04-072 for PG&E to suspend deliveries of LSFO would have the same effect under both the 1976 and 1981 LSFO contracts. We have substantial doubt about each of the three assumptions.

TURN's contention that the validity of the 1981 LSFO contracts is conditioned upon the approval of the Gas Purchase Agreement depends on Exhibit 24 which is a transmittal letter dated March 24, 1982 and signed by representatives of both Chevron and PG&E. The letter contains the following paragraphs:

> "This letter serves to confirm our understanding that the aforementioned agreements, and each of them, shall only become effective when and if the Public Utilities Commission of the State of California approves the Amendment to Gas Purchase Agreement-Richmond Refinery.

> "This letter also serves to confirm our previous understanding that to the extent PGandE is relieved of its obligations under the Gas Transport Agreement pursuant to Paragraph 11B thereof, by virtue of the fact that PGandE would by performance of such obligations be constituted a common carrier, then in that event PGandE and Chevron shall attempt to implement a comparable alternative business arrangement."

This letter apparently was signed nearly two weeks after the 1981 LSFO contract was signed. The 1981 contract contains the following clause:

> "16. <u>CONSTRUCTION OF CONTRACT</u>
>
> "This instrument contains the entire agreement between the parties covering the subject matter and cancels and supersedes, as of the date of execution hereof, all prior agreements between the parties with respect to the subject matter of this contract. There are no other agreements which constitute any part of the consideration for, or any condition to, either party's compliance with its obligations under this contract. No modification shall be binding unless in writing and signed. The headings of sections are for convenience only and are not to be considered a part of this contract."

The two documents conflict. Whereas TURN sees approval of the Gas Purchase Agreement as a condition precedent, we have ~~substantial doubt~~ that the LSFO contract and Gas Purchase Agreement are so tied. We note that both parties have behaved as if the 1981 LSFO contract were in full force and effect. We will therefore continue our analysis of both agreements assuming that each stands alone.

TURN's second assumption also is weak~~er still~~. TURN offers no argument or analysis to support the proposition that if the 1981 contract is rendered ineffective then the 1976 contract is resurrected. In fact, the intent of the parties expressed in the 1981 contract is that the 1981 contract cancels and supersedes all prior agreements. That cancellation must have occurred immediately upon the 1981 contract's execution and could not have been reversed by the March 24 letter, whatever that letter's prospective effect on the 1984 contract may have been.

The last assumption that TURN advances is that our request that PG&E suspend deliveries of LSFO made under the 1981 contract would have the same effect under the 1976 contract. TURN's position is based upon the fact that both contracts contain contingency clauses regarding governmental action. The clause is quoted below:

> "4.3.2 compliance, voluntary or involuntary, with a direction or request of any government, instrumentality thereof or person purporting to act with authority of any government or instrumentality thereof; excluding, however, any such direction or request restricting or otherwise regulating combustion of LSFO to be purchased by Buyer hereunder, the effect of which restrictions or regulations upon the parties' performance shall be governed by Section 7 of this contract;"

TURN correctly points out that although the two contingency clauses are identical the consequences of invocation of the contingency is different under the two contracts. The clause under the 1976 agreement provides for payment of "fixed costs" when the contingency is invoked. The 1981 contract provides for two levels of charges. One level obtains if the contingency is a government request or direction not based mainly on economic grounds. A higher charge occurs if the contingency is invoked because of a governmental request based on the availability of economic fuel.

We believe that the clause in the 1976 contract is a true force majeure clause contemplating a governmental action which directly disturbs the contract; the rest of the contract is consistent with this concept. However, under the 1981 contract it is our view that the consequences of the contingency are such that the nature of the clause has been changed from that of a force majeure clause to a plain contingency clause. It is also our view that a request by this Commission is not such a direct disturbance of a contract to trigger a true force majeure clause.

TURN's theory is interesting but misstates our jurisdictional authority. TURN seems to more correctly perceive our role in the following sentence at page 46 of its opening brief:

> "While the Commission can theoretically disallow imprudent costs, that remedy is often considered too severe when a long-term contract is involved. In this situation, however, the Commission is faced with a unique opportunity to right the wrong that would otherwise occur."

It is not our role to directly invalidate utility-supplier contracts but rather to allow only reasonably incurred costs to be recovered in rates. Staff, among the major parties in this proceeding, is the only party that seems to correctly perceive our role. We are not equipped to perform management's role and will refrain from such intrusions to the greatest extent possible.

We are uncertain why PG&E and Chevron have attempted to bring us so close to the contracting relationship. It is clear that the parties contemplated that at times there could be more economical fuels than LSFO and that the parties have mutually agreed on a level of payment to compensate Chevron when no LSFO is required. We fail to see why it should be our judgment rather than the judgment of PG&E management that more economic fuels are available.

Km

In the mid-1970s we did encourage the utility to enter into long-range fuel oil contracts. PG&E in this proceeding proposed the following theory:

1. PG&E entered into a contract in 1976 that was reasonable and prudent. (Evidenced by our D.81931.)
2. PG&E's fuel strategies since entering the contract have been reasonable and prudent.
3. Therefore, the present results are reasonable and all present expenses must be allowed in rates.

PG&E's theory that once it is determined that it entered into a reasonable and prudent contract, its shareholders are absolved from all risk is not correct in that it neglects the very important factor of changed circumstances.

Whether or not a contract should remain in effect, be abrogated, or be renegotiated should be decided by utility management. It seems obvious that normally utility management will consider a change in the status quo only when there is an incentive for it to do so. If we pass through all expenses without determining their reasonableness simply because they have been contracted for, there would never be an incentive for utility review of such expenses. Our review of the reasonableness of contract expenses with the possibility of disallowance provides management incentive to incur only reasonable costs.

Most of the expenses (except commodity price) flowing from the LSFO contract are reflected in the consideration of the AER. It is in this area that certain expenses which come from the Chevron/PG&E contract will not automatically be passed through in rates. The difficult situation that we must face now is that in 1976 PG&E entered into a type of contract (long-term fuel) which the Commission at that time encouraged. Would it now be fair and equitable to ignore totally that contract and construct a reasonable

level of expenses as if that contract did not exist? We think not. Rather it is more fair to give PG&E time to make any changes it deems necessary in its relationship with Chevron. However, in this case we will begin to shift some expenses back to the shareholders with the present intention of shifting more expenses in future years. What becomes a most difficult matter of judgment is the level of expenses that will not be allowed in rates, particularly the AER.

Gas Purchase Agreement - A.82-06-20

Chevron at its Richmond refinery can presently purchase gas up to a maximum flow of 130,000 Mcf per day from PG&E. Chevron pays the current tariff rates for this gas under Schedules G-2 and G-52. The current average price is $5.468 per decatherm.

Chevron is also a gas supplier to PG&E, selling gas at Natural Gas Policy Act prices, which in May of 1982, averaged about $3.112 per decatherm.

In A.82-06-20 PG&E requests authority to transport Chevron-owned gas from Chevron's fields in northern California to Chevron's Richmond refinery. The amount of gas agreed to be transported is 25 million cubic feet per day during 1982-84; up to 23 million cubic feet per day during 1985-87; and 20 million cubic feet per day during 1988-89. The revenue loss to PG&E is approximately $20 million during the first year.

PG&E testified that the benefits to PG&E from this agreement are primarily threefold. First, Chevron has agreed to continue to sell gas to PG&E and has agreed to sell to PG&E at least 75% of any newly discovered gas it controls. Second, Chevron will continue to be a customer of PG&E at tariff rates for the remaining amounts of its needs, approximately 68 million cubic feet per day. Third, the renegotiation of the 1981 Chevron LSFO contract depended upon accommodating Chevron's desire to renegotiate the arrangements governing gas service to the Richmond refinery.

Fuel Oil Inventory

The different level of expenses for fuel oil inventory requested by PG&E and that recommended by the staff reflect diametrically opposed ratemaking philosophies. The company begins with its existing inventory as of August 1982 of 13,607,000 barrels and then uses a multiple year planning horizon to plan the most economic fuels strategy for the upcoming year. The result of the optimum fuels strategy is the costs associated with the AER. The key foundation of the plan is the current level of fuel oil inventory.

Under the staff theory, staff would only allow the amount of fuel oil in inventory to meet the operational needs of the company for the upcoming year. The actual beginning fuel oil inventory is irrelevant. What should be allowed is a reasonable fuel oil inventory to meet operational needs. The staff, however, has no recommendation for the minimum operational inventory requirement. Since the staff was unable to apply its theory completely, it recommends that the amount of fuel oil allowed during the last AER period (8.8 million barrels) be allowed once again. Staff noted that that amount was well over the minimum operational amounts.

DCA calculated an appropriate inventory allowance to be 8.4 million barrels, but generally agrees with the staff analysis. TURN favors a complex "two-tier" approach by which only that amount of fuel oil to meet operational needs would earn the rate of return with additional inventory amounts to be recovered at balancing account interest rates.

The company's minimum operational inventory for August 1982 is 5.0 million barrels. As of that date it had 13.6 million barrels in inventory. Even with no more takes of fuel oil, PG&E plans to reduce inventory by only 3.4 million barrels to 10.2 million barrels. It is apparent that PG&E has too much fuel oil. Two primary factors contribute to the excess fuel oil. One factor is the abundant levels of hydro during the 1981-1982 winter. The other factor is obviously the excessive amount of fuel oil previously contracted for.

We find PG&E's analysis persuasive that the planned sale is an economic action. However, if we are to be entirely consistent in our ratemaking treatment of the excess oil in this case, we must ask what conditions require such a sale. If PG&E were operating with an annual average inventory anywhere near 5.4 million barrels rather than 11.4 million barrels, the economics of a sale might be different. Moreover, our reduction in the carrying charges applicable to economic oil inventory beyond operational needs changes the calculations appropriate to determine whether sale of fuel oil at a loss would benefit ratepayers, and therefore whether such losses should be recoverable in rates. The reasonableness of such transactions from this day forward will be judged in light of the oil inventory treatment adopted in this decision.

Thus, we find it impossible at this time and on the present record to forecast with adequate certainty the level of fuel oil sale losses which PG&E will reasonable incur during the forecast period. Therefore, we will include no allowance in the AER for such losses, but will permit recovery through ECAC of losses on sale of fuel oil reasonable incurred subsequent to the effective date of this decision. In order to moderate the rate adjustment which may subsequently be required and in view of the uncertainity whether PG&E will indeed incur oil sale losses during the ECAC forecast period, we will include in ECAC expense for the forecast period $3.0 million in oil sales losses. This estimate will be subject to adjustment based on actual experience and will be subject to reasonableness review.

Facility Charge

A contract for fuel oil can contain simply one price to be paid for a certain amount of fuel oil. If the utility does not need all of the fuel oil contracted for, it can either sell it or hold it in inventory. However, a third option is to contract with the supplier for two prices--one price for the commodity actually purchased and another price paid when less than the contracted for amounts are required. The money that is paid when less oil is taken is generally referred to as a facility charge or underlift fee. It

is basically a price paid for flexibility in the amount taken. If in analuzing the three options, the utility determines that the economic choice is to pay the "facility charge-underlift fee" for oil not needed, then we must determine to what extent the costs resulting from the charge/fee are reasonable for ratemaking purposes.

TABLE 2

2% of Estimated Fuel Expenses for AER

Line No.		PG&E Estimated Prices(a)	PG&E Dollars in Thousands	Adopted Dollars in Thousands
	Steam Plants			
1	Gas	$5.4592	$1,770,577	$1,622,146
2	Oil-Residual(b)	$5.8346	101,574	101,574
3	Oil-Distillate	$6.0452	13,094	13,094
4	Geothermal	3.632¢	233,080	233,080
5	Purchased Power(c)	2.682¢	328,546	395,891
6	Total Fuel Expense		$2,446.871	$2,365,785
7	Allocation to CPUC Jurisdictional(d)		2,348,262	2,270,444
8	Two Percent of Fuel Expense(e)		46,965	45,409
9	Franchise Fees and Uncollectible Accounts Expense(f)		372	360
10	Revenue Requirement		$ 47,337	$ 45,769

(a) In dollars per million Btu or cents per kilowatt-hour
(b) Includes Conventional and Refinery Oil
(c) Excludes M&O for Irrigation Districts
(d) Line 6 x 0.9597
(e) Line 7 x 0.02
(f) Line 8 x 0.00793

Now that each of the elements has been resolved the following table shows the final calculation of the AER.

Reasonableness of Past Actions

Under current ECAC procedure, the reasonableness of incurred energy expenses is reviewed once each year. This proceeding is the annual reasonableness review for PG&E. One of the most important actions that we can take in a reasonableness proceeding is a disallowance of an expense that we find has been incurred unreasonably. This type of action is an adjudication of past actions and akin to a quasi-judicial proceeding. Accordingly the evidence supporting a finding that a particular action was unreasonable must be very persuasive. Also, a quantification of a disallowance must logically be supported.

The burden of proof on the utility is correctly stated by PG&E in its brief pages 52-53 as follows:

> "...Decision No. 92496 requires the utility to make a 'substantial affirmative showing.' PG&E interprets this standard to be somewhat greater than the typical civil standard of a preponderance of the evidence, but less than the standard of 'clear and convincing' evidence necessary in such relatively unique situations as establishing fraud (34 Cal.Jur.3d, Fraud and Deceit, § 88, pp. 346-49); proving malice in a libel action (Belli v. Curtis Publishing Company (1972) 25 Cal.App.3d 384, 102 Cal.Rptr. 122); or proving by oral testimony the execution or

contents of a lost instrument. (Nemo v. Farrington 7 Cal.App. 443, 94 P.874, hg. den. by Supreme Ct. as reported in 7 Cal.App. 451, 94 P.877 (1908))."

The major significance of the burden of proof is the guidance it offers in ruling upon competing evidence after the applicant has made its substantial affirmative showing. Imposing the burden on the utility does not relieve any other party which comes forward to challenge the utility's past actions of the obligation of fully supporting its recommendation.

In this proceeding the major contested disallowance other than those previously resolved involved a staff recommendation to disallow $25 million because PG&E turned down relatively inexpensive power from the Pacific Northwest, the Geysers, and Rancho Seco while failing to reduce fossil thermal operations to minimum levels during certain days. Rebuttal testimony by PG&E showed that the fossil thermal units were indeed reduced to lowest level possible whenever possible. The staff recommendation will not be adopted.

A corollary issue raised by TURN is that during this same period PG&E reduced the power output of Rancho Seco to avoid spilling its own hydro. TURN calculated the costs of such dispatching to be $4.5 million. The argument is summarized in its brief as follows:

"During a day on which backdowns are anticipated that night, Rancho Seco is kept at full power. That generation, costing 8.05 mills per KWH (Tr. 1483), displaces thermal power costing 45 to 50 mills (Tr. 1484), a saving of at least 37 mills per KWH. At night, since Rancho

TURN recommends that no interest expense be recovered by PG&E and that the entire $13.1 million be absorbed by the shareholders. TURN makes the recommendation because prior to September 1979, PG&E had pursued the matter in a dilatory fashion and to allow any of the interest expense would be an improper award to PG&E. In the discussion in D.91335, we stated that:

> "For approximately three years now the Commission has effectively allowed PG&E's ratepayers to absorb SMUD's capacity charges covering a period of 11-12 months in 1975-1976 during which Rancho Seco was, in fact, not commercially operative and for which PG&E now has a $35 million claim outstanding. The staff's position that PG&E's ratepayers have been called upon to bear the cost of this pending matter too long already and should not now be called upon to continue to bear such costs for a future one or one and one-half years is persuasive. It is the staff's view that PG&E's stockholders should now come forward and share in this burden pending final disposition of the utility's claim against SMUD. We agree. Therefore, in our determination of PG&E's ECAC billing factors for the immediate future we shall exclude any consideration of the pending $35 million claim against SMUD as proposed by the staff."

While PG&E was slow in pressing its claim prior to D.91335 we find that since the decision PG&E has acted in a reasonable manner in arriving at a fair settlement. However, a partial disallowance of interest related to the settlement is appropriate based on PG&E's earlier lack of vigor in pursuing its claim.

Allowance of interest on the difference between the claimed amount and the recovery will compensate PG&E shareholders for the removal from ECAC of costs which, based on the arbitration results, appear to have been reasonably incurred. No interest

reasonable causes for those events. These issues are in a gray area. Although PG&E has met its burden of proof, there still exists substantial doubt regarding the reasonableness of its operations in these areas. We expect that these issues will be primary issues in PG&E's next reasonableness proceeding.

Rate Design

In this proceeding PG&E made several minor rate design adjustments. The proposals concern (1) industrial time-of-use (TOU) rates and (2) agricultural TOU rates. PG&E's proposal regarding the industrial TOU rates involves adjusting the on/off-peak differentials to their original levels. The purpose of the proposal is to provide the proper incentive to shift usage from on-peak to off-peak hours. CMA contends that it is the absolute difference in rates that provides the incentive rather than the on-peak/off-peak ratios. We agree with PG&E and will authorize the proposed TOU adjustments to the A-21, A-22, and A-23 schedules.

The agriculture rate proposal is discussed in our decision in A.60153 (rate design phase) wherein PG&E's proposal is adopted. The reasoning for the agriculture TOU rate proposal is similar to the industrial TOU proposal discussed above.

Concerning other schedules, we will maintain our current policy of applying rate decreases on an equal cents-per-kWh basis.

Future Proceedings

This proceeding was PG&E's second reasonableness review under our current ECAC procedures. With this experience, several problems have come to light which principally involve PG&E's relationship with our staff in preparation for the reasonableness review.

PG&E is the sole party in possession of evidence regarding the reasonableness of its past actions. Our staff must have complete access to this information in order for the staff to formulate its recommendations. Also, the staff must not only have free access to the data, but also, PG&E must provide more complete data in its reasonableness report. The format of the reasonableness report should, therefore, be reformed. We will direct PG&E to begin to work with our staff within 30 days to develop a new format for the next reasonableness report. The types of information that we wish to see in future proceedings are:

1. Economic analysis of low cost (surplus power, geothermal, and nuclear) power turndowns or backdowns.
2. Cost/benefit analysis of reliability criteria.
3. Documentation and explanation of its relevant computer programs.

Rate Structure Effects

In D.91335 dated February 13, 1980 we ordered PG&E to study the effects of rate structures on customer usage patterns. Exhibit 20, introduced in this proceeding, is PG&E's most recent study on this subject. This stuudy by PG&E witness Robert Howard measures the effect of a three rate structure. The "rate structure" effect is isolated from "rate level" effects. The "rate structure" effect is the conservation that results solely from a three-tier structure while the "rate level" effects are the conservation caused by an overall increase in rates.

The study calculates that the "rate structure" effects of a three-tier rate design produce a savings in the range of 3.3% to 5.5%

8a. It is reasonable to require PG&E to remove its debit of $3,218,000 from the ECAC balancing account in March 1982 due to interest costs on the $9.2 million recovery from SMUD.

9. PG&E's operations of its gas and electric departments during the record period were sufficiently reasonable so that no disallowances other than that described in Finding of Fact 8a.

10. The development of the AER rates, as calculated in this decision, is reasonable.

11. Rate Schedules A-21, A-22, and A-23 should be adjusted so that the on-peak/off-peak ratios are as originally established.

12. With the exception of the adjustment of A-21, A-22, and A-23 schedules, the equal cents-per-kWh method is reasonable to implement rate changes.

13. Because the revision date for these rate changes is past, this order should be effective the date of signature.

14. The cost to ratepayers of the amended PG&E/Chevron Gas Purchase Agreement would be approximately $20 million in the forecast year.

15. The costs of the PG&E/Chevron amendment to the Gas Purchase Agreement outweigh the benefits.

16. The three-tier rate structure results in a 3.3% to 5.5% conservation effect.

Conclusions of Law

1. PG&E should be allowed to establish the AER rate set forth in the following order. These rates are just and reasonable.

2. The amendment to the PG&E/Chevron gas Purchase Agreement is not reasonable.

3. Inclusion in ECAC of interest calculated from September 30, 1979 on the amount of PG&E's settlement with SMUD is not reasonable.

FINAL ORDER

IT IS ORDERED that:

1. Pacific Gas and Electric Company (PG&E) is authorized to establish and file with this Commission, in conformity with the provisions of General Order 96-A, revised tariff schedules for the