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ORIGINAL

Decision No. 88835 MAY 16 1978

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into a natural gas supply adjustment mechanism for Pacific Gas and Electric Company, San Diego Gas & Electric Company, Southern California Gas Company, Southwest Gas Corporation, and California-Pacific Utilities Company, respondents.	Case No. 10261 (Filed February 15, 1977)

(See Appendix A for appearances.)

INTERIM OPINION

On February 15, 1977 this Commission issued an Order Instituting Investigation (OII) in Case No. 10261 into a natural gas supply rate adjustment mechanism for natural gas public utilities.

The respondents were Pacific Gas and Electric Company (PG&E), San Diego Gas & Electric Company (SDG&E), Southern California Gas Company (SCG), Southwest Gas Corporation (SWG), and California-Pacific Utilities Company (CPU).

In its OII the Commission stated:

"The Public Utilities Commission recognizes that periodic adjustment procedures have a useful application in effective regulation. The Commission has adopted such procedures with respect to electric utility energy costs and gas utility purchased gas costs, on the basis that short-term control of these expenses is largely outside the control of utility management.

"Our recent experience with gas utility rates suggests that estimation of test year gas supply may be a similar element of ratemaking that requires a periodic adjustment procedure including an adjustment to depreciation rates. The declining

> gas supply, coupled with the emerging rate design, makes the accuracy of the adopted supply estimate the critical fact in calculating gas rates. Meanwhile, short-term gas supply estimates are increasingly difficult to make accurately with the requisite degree of certainty that supports ratemaking-as-usual. Therefore, we find it appropriate to open an investigation into whether conditions do in fact warrant the adoption of a supply adjustment mechanism, which would include any necessary rules, underlying criteria, and procedures to be followed, and include a mechanism to adjust depreciation rates for gas utilities. Suitable provisions for such mechanisms, and proposed tariff filings should also be included."

Further the OII required each respondent to submit "a comprehensive report considering the adoption of a supply adjustment mechanism for gas utilities, including an adjustment to depreciation rates, and proposed tariff filings." Publicly owned gas utilities and others were invited to participate.

Six days of public hearing in this matter were held before Administrative Law Judge John J. Doran in Los Angeles on July 25, 1977, in Chula Vista on July 27, 1977, and in San Francisco on September 13, 14, 15, and 16, 1977. The matter was submitted on closing briefs filed November 18, 1977.

The investigation examined proposed procedures to periodically increase or decrease natural gas rates to reflect decreases or increases in the natural gas supply. Included in the examination was whether or not natural gas rates should be periodically increased or decreased to recover the loss or gain in net revenue due to the decline or increase in the supply of natural gas and further should there be an adjustment to increase depreciation expense due to the change in the remaining supply of natural gas.

Parties Presenting Evidence

SCG presented a witness and a number of exhibits including a response to the OII, a proposed gas supply adjustment mechanism (SAM),

a proposed depreciation rate adjustment (DRA) on a unit of production basis (UOP), and estimates of revenue effects. SCG revised its exhibit to combine the SAM adjustment (rate and balancing account) with the present purchased gas adjustment (PGA) on a prospective basis by two filings per year based upon forecasted data.

SDG&E, CPU, and SWG each presented a witness and a report in response to the OII and a proposed tariff based upon forecasted data. SDG&E also presented estimates of revenue effects. CPU only proposed a depreciation adjustment at this time. CPU has not determined what the revenue loss would be as a result of conservation and reduced supply.

PG&E presented three witnesses and a number of exhibits including a response to the OII, proposed SAM tariffs (with and without a volumetric DRA), and estimates of revenue effects. Although PG&E's proposal is to use SAM only without incorporating UOP depreciation and is based upon forecasted data, it has no objection to the use of historical data for SAM.

The Commission staff presented two witnesses and exhibits including statistical data on the changing gas supply and depreciation. The staff concluded that SAM is not necessary at this time and that the present depreciation methods should not be changed.

The SAM Proposals

The utilities propose to file SAM adjustments twice a year to coincide with the PGA filings. They propose to base the adjustment on the forecast year when the rates would be effective. The utilities propose using a balancing account to accumulate under- or over-collections and then reduce the balancing account to zero through future rate changes as part of periodic SAM adjustments in rates. SCG further proposes to combine SAM with the PGA filings.

The Commission staff's position is that a SAM coupled with the PGA would significantly lower the risks of doing business and would be a large step in guaranteeing a rate of return for the

utilities. Further, the staff is of the opinion that supplemental supplies from untraditional sources, such as LNG and coal gasification, will pick up a large amount of the projected decline in supplies and will permit virtually unlimited interstate market service at 12-14 trillion cubic feet per year, the 1975 level. The staff recommendation is that a SAM not be authorized.

The cities of San Diego and San Francisco state that it could be argued that the risk reduction of having a SAM would be taken under consideration by the Commission in its next rate of return determination. They further state that it should be pointed out that had a SAM been in effect for the past few years the ratepayers would have benefited. This was due to the utilities' and staff's continuing underestimation of natural gas supplies. Thus, on a theoretical basis, the cities can support the SAM concept. If the SAM procedure were placed into effect on a very simple, uncomplicated, and very narrow basis, with the assurance that the Commission staff would thoroughly investigate each filing, the cities contend that they could support a SAM. However, their support is conditioned on assurances that the Commission would recognize the SAM's risk reduction through rate of return adjustments. The cities foresee no such assurances and therefore oppose a SAM.

The city of Los Angeles states that a SAM has the effect of reducing risk and guaranteeing the utilities their rate of return This undesirable result, according to Los Angeles, become a reality because a SAM will be triggered to recoup all fixed expenses and will tend to level the fluctuation in seasonal sales. Since SAM could be guaranteeing that the utilities recover their fixed costs, it will also act as a disincentive for prudent management. The city concludes that a SAM is unnecessary, guarantees the utilities their rate of return, and reduces the risk of doing business to an unacceptable level.

Toward Utility Rate Normalization states that there is no precedent for a SAM, that there is no need for it, that it would come close to providing a guaranteed rate of return, and that it is an incentive for utilities to underestimate supply.

Discussion of SAM

Supply has always proven to be a troublesome issue in rate proceedings. While we can safely predict that, on a long-term basis, supplies from traditional sources are declining,[1/] short-term fluctuations resulting from factors such as climatic conditions or the market price of alternate fuels can be both unexpected and dramatic.

Our analysis in the instant proceeding must be addressed not to "supply" but rather to sales. The validity of the traditional notion that all of a gas utility's supply can and will be sold disappeared with the declining block rate structure. We recently recognized that our abandonment of the traditional declining block structure could, in combination with unusual market conditions for alternate fuels, impair utility revenues to such a degree that some form of increase to non-interruptible customers would be required. In Decision No. 88664 in Case No. 9851 et al, we said (at mimeo. p. 2):

> "We are presently evaluating the relationships between the costs of related fuels and natural gas sales. When there is sufficient gas to serve low priority users without jeopardizing higher priorities, it is not necessarily in the best interest of all customers to have a low priority rate higher than that of alternate fuels causing those customers who have the capability to convert to do so. The resultant loss in revenue would necessitate higher rates to the remaining customers. These rates might very well be higher

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1/ Staff Exhibit 21, Page 1, Paragraph 2 states that gas supply has been declining since 1971, with an estimated statewide decline rate of 4.3 percent through 1986 based upon traditional sources.

than those that would be required if low priority customers continued to burn gas because their rates were competitive with alternate fuel costs. We are currently evaluating various rate design proposals that would take this into consideration."

In wholly different market and climatic conditions a utility will be able to easily sell all the gas that it can obtain from suppliers. Thus any significant increase in supply, and consequently sales, over the test year volume will result in a gas margin[2/] substantially in excess of the test year margin. A small increase in sales will produce a large increase in the gas margin for the same reason that a small decrease in sales will produce a significant reduction in the margin: the gas in question is generally sold or not sold to low priority customers who pay, under our inverted rate structure, the highest rates.[3/]

That the effects of sales fluctuations can be significant was amply demonstrated in this proceeding. For example, SCG's 1978 estimated gas margin was shown to be $48.8 million less than the $442.5 million 1976 test year gas margin. The test year sales revenues totaled $912 million. Assuming that 1978 expense levels other than the cost of purchased gas have not decreased (not an unreasonable

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2/ Revenues from the sale of gas less the cost of that gas equals the gas margin.

3/ We do not intend to suggest that reduced sales are solely the product of reduced sales to low priority users. Conservation in the residential class has occurred and warrants our recognition as well as our commendation. However, since high priority residential customers pay significantly lower rates for gas than do the low priority customers, large deviations from test year estimates of sales to the residential class are required before a utility's test year gas margin will not be met or will be exceeded. However, future changes in rate design could result in the residential use playing a greater role in margin fluctuation (see footnote 4 below).

assumption), then SCG's revenue would be $48.8 million deficient when compared with the 1976 test year. Other utilities submitted similar data.

A SAM is thus viewed by many a logical concomitant of our policy of inverted rates. We share this view.[4/] We recognize that supply (or more correctly, sales) volume has become at once (1) a factor of extraordinary impact on the gas margin as well as (2) an element of ratemaking that cannot be quantitatively predicted with the precision required to assure that a utility neither grossly exceeds nor falls far short of its authorized gas margin. In short, like the purchased cost of gas, supply fluctuation must be accorded special treatment between general rate proceedings.

The principal argument advanced by opponents of a SAM is that adoption of a SAM will constitute a step in the direction of a guaranteed rate of return. This argument ignores the fact that a SAM

4/ This discussion should not be construed to suggest that we have arrived at a final optimum formula for gas rate design. While we reaffirm our desire to make the first therm a customer conserves result in the greatest savings, we recognize that a rate structure in which residential customers will always pay less for their last therm than non-residential and/or lower priority customers will pay for their first therm may not provide an adequate economic signal to the residential customer. Therefore, in our recent SDG&E rate order, Decision No. 88697 (April 11, 1978), we priced residential use over 162 therms per month at the same cents per therm as P-5 use. Residential use over 81 therms (but less than 163) was formerly priced at about 94 percent of high priority non-residential and 90 percent of P-3 and P-4 use. Decision No. 88697 increased that rate such that it is now 97 percent of non-residential and 94 percent of the P-3 and P-4 rate. As future increases are warranted (we know of nothing to suggest that the cost of natural gas to California utilities will do anything but escalate), we will consider further modifications in rate design to encourage the realization of the potential for conservation that we know exists in the residential class.

will merely insure that gas utilities achieve the gas margin last found necessary and limit the utility to that margin. Utility expenses other than the purchased cost of gas can and will change between general rate proceedings and those changes will determine whether the gas margin maintained by a SAM will actually produce a rate of return that meets or exceeds the utility's authorized rate of return. These other expenses, unlike supply volumes and gas costs, do not fluctuate in such an unpredictable and dramatic fashion as to require offset treatment. Traditional consideration of these expenses, i.e., only in a general rate proceeding, is thus appropriate, while traditional treatment of purchased gas cost and supply volumes will produce revenues which will only by chance result in the rate of return found reasonable for the test year. A SAM will thus not guarantee a rate of return but only insure that a utility's exceeding or failing to meet that return will not be the result of extraordinary and unpredictable fluctuations in sales or supply.

We do recognize, however, that our adoption of a SAM will reduce the risk to the utility shareholder. That reduction in risk will be considered in setting a reasonable rate of return in future general rate proceedings as well as those currently pending before the Commission.

Further, we are convinced that a SAM could encourage conservation, a matter of highest priority to this Commission and to many of the parties to this proceeding. Current results indicate that conservation efforts initiated over the last few years have been somewhat successful. But, obviously, conservation efforts must continue. In this regard we have been troubled by the apparent inconsistency between traditional ratemaking and the utility's incentive to promote conservation. As we have noted earlier, sales in excess of the volume employed for the test year will result in a gas margin significantly larger than that authorized.

A SAM will remove the risk to the utility of promoting conservation, while not allowing for the recovery of additional operating expenses. There would no longer be a conflict between the interests of the ratepayers and shareholders. Meanwhile, the

possibility that a utility might have a tendency to curtail expenses or service to new customers can be obviated by allowing for growth in the system in general rate proceedings. Quality of service will continue to be an issue in setting the overall rate of return.

Adopted SAM

With a gas SAM balancing account, excess gas margin collections could be returned to the ratepayer and deficiencies could be charged to the ratepayer. Such a system would reduce the importance of estimating gas supply in ratemaking. Establishing such a procedure to insure that gas utilities will recover the test year level gas margin and no more is reasonable and will be adopted.

Twice a year application filings on a current period supply basis to coincide with the PGA are reasonable and will be adopted. The filings will require earnings tests on the period covered by accruals to the balancing account to assure that the rate of return last found reasonable was not exceeded on a SAM and decision adjusted basis. Filing a SAM and PGA at the same time will permit us to consider the two filings in a consolidated proceeding. We will also consider SCG's proposal to combine the SAM and PGA filings. (See discussion under "Implementation of SAM".)

SAM Rate Spread

SCG originally proposed to spread the SAM charges to wholesale customers on a uniform system average percentage basis and the remaining SAM revenue requirement to retail customers on a uniform cents-per-therm basis. SCG contends that all its retail rates are now relatively level, but that its wholesale rates that only apply to two customers are significantly different than the retail rates and that a percentage increase is justified. Subsequently, SCG proposed combining the SAM and DRA filings into one filing and spreading the impact of such filing to the retail and wholesale customers, alike, on a uniform cents-per-therm basis.

SDG&E states that the SAM revenue should be spread on the basis of the percentage that the wholesale and retail customers contribute to the margin as opposed to SCG's original proposal which is based upon the percentage that such customers' revenues bear to the utility's test year revenue requirement.

PG&E proposes to spread the system SAM revenue to resale service on the percentage of revenue that resale bears to total revenue and the remaining SAM revenue to retail customers on a uniform cents-per-therm basis. This is similar to SCG's original proposal.

The Commission staff would apply the percentage increase rather than a uniform cents-per-therm increase to lessen the economic impact on the wholesale customers. There were no other rate spread recommendations.

As we noted earlier (footnote 4), we cannot claim to have arrived at any optimum formula for gas rate design. Given the myriad considerations which must attach to any rate design formulation, we would be remiss if we did not eschew any fixed formula for spreading SAM increases or reductions. As we have noted earlier, rate design can often provide an impetus for the sales fluctuation which necessitates a SAM increase or reduction. It would be counter-productive, therefore, for the Commission to commit itself to a particular rate design for a SAM when that rate design, in certain circumstances, might perpetuate or exacerbate the deviation from the test year gas margin which requires us to adopt a SAM.

Instead, we will consider semi-annually a rate adjustment for the revenue increase or reduction required by the SAM. Such consideration will occur at the time of each utility's PGA filing which will be consolidated with the SAM. The Commission at that time will consider what changes may be required in rate design. The preliminary statements of PG&E, SCG, SDG&E, SWG, and CPU may require modification to accommodate changes in rate structure as a result of Commission action. These modifications should eliminate any restrictions on rate design which are in the present tariffs.

Implementation of SAM

Our adopted SAM will be tied to the gas margin authorized in each gas utility's most recent rate decision.

The implementation of SAM will be effective by authorizing each utility to establish the new balancing account effective June 1, 1978 on the basis set forth in Appendix B and requiring each utility to establish the account not later than January 1, 1979. Amortization of accumulations in the balancing account and estimated supply adjustments will thereafter be considered at the same time as proposed changes for purchased gas cost adjustments. The Commission will then be in a position to consider changes in rate structure covering both SAM and purchased gas cost adjustments in one proceeding and will do so thereafter for each utility on a semi-annual basis. Further, since we are of the opinion that SCG's proposal to combine the SAM and PGA filings warrants our further consideration, we will direct each utility to immediately file, within 30 days after the effective date of this order, tariff proposals for the consolidation of the two procedures under one balancing account. Preliminary statements will conform to our decision, discussed earlier, to delete specific requirements on rate structure which will instead be adjusted as appropriate in each proceeding.

Depreciation

This Commission has mandated the use of straight-line remaining life (SLRL) depreciation method, which provides for the recovery of the undepreciated investment in each plant account, adjusted for salvage, over the remaining life of such plant. This method

provides the opportunity for an annual review by plant account including recent plant age determinations, long-term indications of average service life and mortality characteristics, as well as salvage. Selection of the required depreciation factors are based on judgment for each account. Results of the reviews are annually submitted to the Commission for approval.

SCG proposes to revise its current method of depreciation to apply a UOP method to its transmission facilities and to apply a five-year life for that portion of distribution plant that may be directly assignable to large customers. This method would result in about a $22 million additional revenue requirement for 1978. Its proposed DRA would be submitted by advice letter and reviewed and adjusted annually. The increase would be spread as covered under SAM. The total long-term future gas supply used to develop the additional depreciation and revenue was noted by SCG as follows: "Assumed for illustration in this study only, not to be used for any other purpose." Future gas supply is even speculative in the short-term. The utilities' forecast submitted annually to the Commission extends out for 10 years and not the 22 years used in SCG's illustrative study. No reasonable estimate of long-term gas supply was submitted to use in UOP depreciation. The record does show that $2.15 of revenue is required for each additional $1.00 of depreciation because of taxes and uncollectibles.

SDG&E proposed to revise its current method of depreciation by basing all gas plant depreciation on gas supply forecasts during the remaining life of the utility's total gas plant, but not less than the amount derived from the SLRL formula. It proposed to adjust depreciation twice annually to coincide with the PGA. SDG&E qualified its forecasted gas supply with a note similar to the SCG disclaimer. Its proposal would result in nearly a $4 million additional revenue requirement for 1977.

SWG proposed to revise its current method of depreciation to one based upon periodically reviewing and adjusting depreciation rates to a specific index determined from the remaining years of supply or contracts of each distribution company's supplier or suppliers.

CPU proposed to revise its current method of depreciation to one based on consideration of the remaining life span of their pipeline suppliers.

PG&E included an adjustment mechanism for UOP depreciation. Its proposal would result in a $104 million additional revenue requirements by 1980. It was of such magnitude that it proposed to phase the increase in over a three-year period. However, PG&E does not recommend a change from SLRL depreciation to UOP depreciation at the present time. It believes that further studies should be made before changing methods. PG&E recommends that under a SAM, depreciation expense as adopted by the Commission in the most recent general rate decision be included as part of the fixed costs.

Should natural gas utilities be allowed to change their method of book depreciation and periodically increase the revenue requirement and rates to consumers outside of a general rate proceeding--all because of a change in the long-term forecast of present connected supplies? The UOP depreciation method has not been shown to be reasonable and will not be adopted. The current Commission prescribed SLRL rates are based upon a theoretically and procedurally sound basis. These estimates consider all depreciation elements, including the exhaustion of natural resources. The SLRL depreciation method is reasonable and will continue to be the requirement.

Finally, we conclude that we may need to modify the operation of the SAM as dictated by our initial experience over the next 18 months. Circumstances could require that we implement the SAM balancing accounts earlier than our presently required date of January 1, 1979. For these reasons we will leave Case No. 10261 open.

Further, we are of the opinion that the utilities should begin immediately the internal procedures necessary for the implementation of SAM. Accordingly, we will make the effective date of this order the date hereof. We note that since no actual SAM rate adjustments are likely to occur until late this year, an immediate effective date should not prejudice any party who may wish to appeal this interim order.

Findings

1. An investigation was conducted as to whether or not to adopt a SAM in light of the increasing impact of long-term gas supply declines and short-term variations, coupled with emerging rate design trends.

2. Gas margin was defined as gross revenues less cost of gas at the test year level adopted in the last general rate proceeding.

3. Small deviations in actual sales from adopted test year sales may result in significant deviations from adopted test year gas margins.

4. Traditional ratemaking treatment of supply and sales has proven to be an inadequate method of considering the fluctuations described in Finding 3. Offset treatment between general rate proceedings is required.

5. A SAM will insure that each gas utility recovers the gas margin authorized in its last general rate case but no more than the last authorized gas margin.

6. Establishing a procedure by which a SAM will insure that utilities recover their authorized gas margin and return over-collections to the ratepayers is reasonable.

7. Twice a year filings for a SAM on a current period supply basis to coincide with the PGA are reasonable and will be adopted.

8. The establishing of a SAM balancing account whereby excess collections will be applied as a credit to reduce future gas rates and deficiencies will be applied as a debit to increase future gas rates is reasonable.

9. An earnings test should be included in the filing to assure that the rate of return last found reasonable will not be exceeded.

10. A rate design formula should not be adopted here but specific changes in rates will be adopted with respect to individual SAM filings.

11. A SAM will reduce the risk to utility shareholders. That reduction in risk should be considered by the Commission in setting a reasonable rate of return in rate proceedings.

12. The proposal of SCG to combine a SAM and a PGA requires further consideration.

13. Each gas utility should be authorized to implement a SAM balancing account effective on June 1, 1978. All gas utilities should be required to establish SAM balancing accounts on or before January 1, 1979.

14. A review was conducted as to whether or not to adopt a mechanism to adjust depreciation rates and increase customer charges therefor outside of general rate proceedings.

15. The UOP depreciation method has not been shown to be reasonable and will not be adopted.

16. Current SLRL depreciation practices consider all depreciation elements including the exhaustion of natural gas resources.

17. Annual review of depreciation accruals will permit timely adjustment of depreciation rates to reflect changed depreciation elements.

18. Case No. 10261 should remain open.

INTERIM ORDER

IT IS ORDERED that:

1. Within thirty days of the effective date hereof, each respondent is ordered to file, under General Order No. 96-A, the Supply Adjustment Mechanism set forth in Appendix B. The effective date of said adjustment mechanism shall be not earlier than June 1, 1978 nor later than January 1, 1979.

2. In its initial filing for rate change under the Supply Adjustment Mechanism procedure, each utility shall include a proposal for consolidating the Supply Adjustment Mechanism with its purchase gas adjustment clause.

3. Case No. 10261 shall remain open.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 16th day of MAY, 1978.

I will file a dissent
William Symons Jr.

Robert Batinovich
President

Vernon L. Sturgeon

Richard D. Gravelle

Leonard J. Weiss

Commissioners

C. 10261 - D.
OII into a Natural Gas Supply Adjustment Mechanism

COMMISSIONER WILLIAM SYMONS, JR., Dissenting

This is a black day for California's consumers. Today's majority decision establishes a distinctly unhealthy system for gas utilities in California which substantially guarantees their profit margins.

It is misleading to label this a "Supply Adjustment Mechanism". If it were truly confined to unpredictable variations in supply, I could support it. However S.A.M. goes further. It kicks into operation even when supply is ample, but sales are a problem. It is rather a "Sales Indifference and Profit Assurance Mechanism". Whether the utility is selling gas or not, under S.A.M. a surcharge will be levied on customers to insure the collection of a target revenue margin between theoretical sales and cost of gas. It is weird business to be assured of your profit margin on sales, even if the sales do not occur.

This anti-consumer surcharge scheme is a desperate act. The Commission majority's sweeping redesign[1/] of natural gas prices ten months ago has been a crashing failure. Our major gas distributing utilities are threatened with financial havoc. Improperly priced gas is not selling and, startlingly, a gas glut now exists. Yet the Commission majority refuses to admit its radical rate structure is the problem and so no action is taken to correct unrealistic rates. Instead, the majority tries to shore up its deteriorating fantasy world with this surcharge scheme. The earnings deterioration of our major utilities under present regulation has been so severe that without this mechanism PG&E sees its return on equity falling from

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1/ Gas Rate Inversion Decisions 87585, 87586, 87587, July 12, 1977.

10.5% in 1977 to 1% in 1978 and 4% in 1979. The example of Consolidated Edison makes us appreciate the catastrophe the Commission is courting. Today the Commission bails out the utilities it has damaged by having the ratepayers pick up the expense.

One can see that this order takes care of the utilities; it also takes care of the politicians. Now it will be possible to go through the November elections without the "uncomfortable" experience of a major correction in rates. But the problem will not go away and deficits will stack up. This joy ride will continue until January 1979 when the first S.A.M. surcharge hits the consumer like a New Year's Day hangover. It is not politic to ask which consumers will be hit hardest. The order says this will be known in the future, but it is unlikely to be the industrial customer whose rates are so high now that he has already stopped purchasing gas. The residential and small commercial customers can expect to bear the brunt of the burden.

Worthy of note is the fact that, aside from the utilities, no party of record in this case supported S.A.M. The Commission staff described S.A.M. as a large step toward guaranteed profits for our utilities. TURN and the cities of San Diego, San Francisco and Los Angeles took similar positions. Los Angeles said, for example, that S.A.M. would be a "disincentive for prudent management".

I agree that S.A.M., as proposed, guarantees too much to the utilities. Nor is it cheap. Best estimates for Southern California

Gas Company indicate a $67 million dollar rate increase on an annual basis to pay off S.A.M. in 1979; the figure for Pacific Gas and Electric is larger -- about $85 million dollars.

The people of California pay a very high price for inverted rates. That price includes not only the increased costs of goods they buy in stores. It also extends to confusion such rates create for businesses and regulatory agencies.

When the Commission inverted rates, less than a year ago, it forced many larger users off of natural gas. Those companies then were forced to absorb the expense of switching to alternative fuels. Now California has surplus natural gas, and the Commission is considering how to entice the companies back to system use.

The current surplus may have been amplified by the end of the drought, but the periodic crises as to utility profit levels which occur under inverted rates will continue even in normal weather. The cost of such instability, which ultimately paid by the consumer, would not occur under cost of service rates. Nor would a guarantee on margin be necessary. Once again the Commission must ask itself the question: are inverted rates worth the price? I believe the answer to this question is a clear "no".

Also of concern to me is the way the majority takes the fundamental question of rate design out of general rate cases and relegates these issues to offset cases. This practice of course is exemplified by the decisions on gas rate inversion themselves (previously cited). Those orders issued out of offset cases, which are abbreviated, rather than full scale inquiries. The public was

inadequately notified as to magnitude of the changes under consideration and the record was bereft of supporting evidence. As today's opinion states, page 10, this practice is to continue, with changes in rate design to be handled in joint P.G.A.-S.A.M. offset hearings. The practice of avoiding serious rate design determination in the general rate cases, and instead, shunting these issues into the abbreviated offset cases, gives short shrift to the members of the public who stand to be adversely affected.

San Francisco, California
May 16, 1978

William Symons, Jr.

WILLIAM SYMONS, JR.
Commissioner

APPENDIX A

LIST OF APPEARANCES

Respondents: Thomas D. Clarke, John S. Fick, Jeffrey A. Meith, by Jeffrey A. Meith, Attorney at Law, for Southern California Gas Company; Malcolm H. Furbush, Robert Ohlbach, Peter Hanschen, and Kermit R. Kubitz, by Peter Hanschen, Attorney at Law, for Pacific Gas and Electric Company; Gordon Pearce, C. Edward Gibson, and Vincent P. Master Jr., by Vincent P. Master, Jr. and Stephen A. Edwards, Attorneys at Law, for San Diego Gas & Electric Company; John P. Vetromile and Arthur C. Fegan, for California-Pacific Utilities Company; and Richard J. Tetreault, for Southwest Gas Corporation.

Protestants: Herman Mulman, for Coalition for Economic Survival and Citizens for Political Action; and Sylvia M. Siegel and Robert Spertus, Attorney at Law, for TURN.

Interested Parties: Ed Perez, Deputy City Attorney, for Burt Pines, City Attorney of Los Angeles; Robert W. Russell, by Manuel Kroman, for Department of Public Utilities and Transportation, City of Los Angeles; Henry F. Lippitt, 2nd, Attorney at Law, for California Gas Producers Association; W. Randy Baldschun, Attorney at Law, for the City of Palo Alto; Thomas M. O'Connor, City Attorney, by Leonard L. Snaider, Deputy City Attorney, and Robert R. Laughead, P.E., for the City and County of San Francisco; Gordon E. Davis and William H. Booth, Attorneys at Law, for California Manufacturers Association; Downey, Brand, Seymour & Rohwer, by Richard R. Gray, Attorney at Law, for General Motors Corporation; John W. Witt, City Attorney, by William S. Shaffran, Deputy City Attorney, for the City of San Diego; and Glen J. Sullivan, Attorney at Law, for the California Farm Bureau Federation.

Commission Staff: James S. Rood, Attorney at Law, and Robert Durkin.

PROPOSED PRELIMINARY STATEMENT

SUPPLY ADJUSTMENT MECHANISM (SAM)

1. Applicability. This Supply Adjustment Mechanism (SAM) provision applies to bills for service under all rate schedules and contracts for gas service.

2. Base Rates. The Base Rates are the gas rates effective _____ (excluding the Monetary Exchange Adjustment rates then in effect*).

3. Base Costs. The Base Cost Amount included in base rates is $_____ per year. The Base Weighted Average Cost of Gas included in Base Rates is _____ cents per therm, as specified in Part ____ of this Preliminary Statement.

4. Current Period. The volumes of gas, expressed in therms, to be utilized hereunder shall be those estimated to be sold during the twelve calendar month period beginning with the applicable Revision Date.

5. Revision Dates. The Revision Dates are _____ and _____ of each year. On such dates, or as soon thereafter as the Commission may authorize, the utility shall, in accordance with the provisions hereof, increase or decrease the SAM Rates applicable to each rate schedule and contract.

6. SAM Rates. The Commission shall determine and fix applicable SAM Rates to be placed into effect for each revision period. The utility shall file one or more exemplary SAM Rates.

7. Current Supply Recovery Amount. The Current Supply Recovery Amount shall be the difference between Current Period revenues calculated at Base Rates and the product of Current Period sales multiplied by the Base Weighted Average Cost of Gas.

*Applicable to PG&E only.

8. Supply Adjustment Amount. The Supply Adjustment Amount shall be the difference between the Base Cost Amount and the Current Supply Recovery Amount, plus the balance in the Supply Adjustment Account, determined as specified in Section 9 below, at the end of the latest available month at the time of the computation being made under the provisions of this Section.

9. Supply Adjustment Account. Beginning as of the date this Supply Adjustment Mechanism provision becomes effective, the utility shall maintain a Supply Adjustment Account. Entries shall be made to this account at the end of each month as follows:

   (a) A debit entry equal to, if positive (credit entry, if negative):

      (1) One-twelfth of the Base Cost Amount, less

      (2) The amount of Gas Department revenue billed during the month at Base Rates minus the product of the applicable volumes of gas sold during the month multiplied by the Base Weighted Average Cost of Gas, less

   (b) A credit entry equal to the amount of revenue billed during the month under SAM Rates if positive (debit entry, if negative).

   (c) An entry equal to 7/12 percent of the average of the balance in the account at the beginning of the month and the balance in the account after entries (a) and (b) above.

10. Time and Manner of Filing and Related Reports. The utility shall file revised Adjustment Rates with the California Public Utilities Commission at least 30 days but not more than 90 days prior to the Revision Date. Each such filing shall be accompanied by a report which shows the derivation of the adjustment to be applied. A results of operation report for the prior year will be filed by April 15, of each year.