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ORIGINAL

Decision No. 92304 OCT 8 1980

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC GAS AND ELECTRIC COMPANY for authority to revise its gas rates and tariffs effective July 1, 1980, under the Gas Adjustment Clause, to change gas rate design, and to modify gas adjustment clause included in its gas tariffs.
(Gas)

Application No. 59695
(Filed May 28, 1980)

(Appearances are listed in Appendix A.)

OPINION

I. Introduction

By Application No. 59695 Pacific Gas and Electric Company (PG&E) seeks authority to increase its gas rates pursuant to its Gas Adjustment Clause by $589.3 million on an annual basis, based on six months' amortization of its balancing account undercollection.

Public hearing was held in San Francisco, beginning July 14, 1980, before Administrative Law Judge Patrick J. Power. The matter was submitted following 13 days of hearing, with briefs filed on August 25, 1980.

There was a large public turnout at the first day of the hearing and a number of people made statements on the record. Additional members of the public appeared during the hearing and a number of letters and petitions from ratepayers were received. The overwhelming sentiment of the public response was opposition to the proposed rate increase.

Direct evidence was presented by PG&E, the Commission staff, Canners League of California (Canners), California Manufacturers Association (CMA), Kerr-McGee Chemical Corporation (Kerr-McGee), and the California Gas Producers Association (CGPA). Various parties participated by way of cross-examination. Briefs were filed by PG&E, staff, CMA, General Motors Corporation (GM), Cut Utility Rates Today (CURT), Toward Utility Rate Normalization (TURN), and Southern California Gas Company (SoCal).

II. Issues Presented

The central issue is the matter of the additional revenue required by PG&E. Underlying issues are the reasonable test year gas supply mix and the appropriate balancing account amortization period. The major gas supply questions involve PG&E's purchases of Canadian gas.

Typically rate design issues are the subject of extensive evidence and argument in the record. As discussed herein, we have decided to defer any change in rates to PG&E's next GAC filing. Therefore these matters are discussed only briefly.

Additionally, there is the matter of a tariff change proposed by PG&E to recover certain transportation costs and several adjustments offered by the staff accountant.

III. Revenue Requirement

PG&E's request is based on its estimated test year gas supply and six months' amortization of its balancing account undercollection. As of April 30, 1980, the recorded undercollection was $391.2 million.

Two other positions emerged during the hearing. The Gas Branch of the Commission staff recommended that a rate increase of $194.4 million be authorized, based on 12 months' amortization

of the balancing account. The Gas Supply and Requirements witness of the Commission staff recommended that the increase be deferred until January 1, 1981. Each of these positions received additional support by other parties.

GM joined with the Gas Branch to support 12 months' amortization and an immediate increase, in recognition of PG&E's substantial undercollection. Twelve months' amortization is supported because of the consensus prevailing among the major parties that the current level of alternate fuel prices precludes the recovery of any significant portion of the increase from industrial boiler fuel customers.

TURN joins in the recommendation that there be no rate increase at this time. In support of this position the staff in its brief makes three major points:

1. "The record clearly shows that the undercollection balance in the company's GCBA is presently being drawn down and, barring any unforeseen extraordinary circumstance, will continue to decrease through December 31, 1980. PG&E's rates presently in effect are more than sufficient to recover the costs that result from present gas prices."

2. The "continued existence (of the take-or-pay and minimum take provisions currently included in the Canadian gas contracts and tariffs) is currently an issue in the Federal Energy Regulatory Administration (ERA) Docket No. 80-01-NG, _et al._ and the subject of discussions between Canadian and United States government officials. A significant change in PG&E's current take-or-pay and minimum contractual obligations would have a substantial effect on the company's present and future revenue requirements."

3. "Because the costs of alternate fuels used by PG&E's commercial and industrial customers have risen very little if at all over the past six months, almost all of the increased revenue requirement would have to be assigned to residential customers. Such increases would come in the wake of very large recent gas rate increases to residential customers and would be unduly burdensome."

Staff recommends that this proceeding be kept open as a procedural vehicle for further hearings in November or December 1980, so that the Commission will be able to react on a timely basis.

In support of immediate relief PG&E contends that the "persistent, extraordinarily large undercollections create additional interest costs for ratepayers and needlessly expose PG&E to difficulties that can arise in unfavorable financial markets." It cites delay as a major cause of the undercollections and urges prompt action in this and future matters.

We have decided to adopt the basic recommendation of the Gas Supply and Requirements witness and defer the recovery of the balancing account undercollection. Procedurally, we prefer to deny the application rather than keep this matter open.

The major consideration is the unsettled state of the record in regard to a reasonable future test year gas supply. The pending federal action with regard to take-or-pay provisions has possibly substantial consequences for California. We will defer any consideration of action by this Commission with regard to the contract provisions until after the federal posture is resolved.

Furthermore, the record reflects negotiations undertaken with Canadian producers to reach an agreement regarding modification of contracts, as well as a study initiated by PG&E of the economics of a take-or-pay situation. Until these matters are resolved it is premature to adopt test year gas supply estimates.

Depending on the outcome of these issues there could be a major change in rate design policy. Based on the record information and existing policy the major burden of an immediate increase would fall on high priority customers. Deferring the increase allows us the opportunity to complete our examination of the residential rate schedules in OII 77 and related matters.

We are concerned about substantial undercollection and the associated burden on the utility. However, present rates are

high enough to cover current costs and make a positive contribution to the balancing account; and, in spite of PG&E's expressed concern about the level of undercollection, it has made no particular effort to minimize undercollection in its operation of its gas system.

We deny this application rather than defer it for administrative reasons, rather than substantive. PG&E's next scheduled revision date is January 1, 1981, and its next filing is the appropriate vehicle to again examine these matters. Our decision in this proceeding does not deny recovery of the balancing account undercollection except as expressly provided for herein.

This decision to defer consideration of the reasonable test year gas supply necessarily defers consideration of associated issues such as the appropriate level of California purchases. We addressed these matters at some length in the last PG&E GAC decision (D.91720), and the burden of proof remains on PG&E to support the reasonableness of its actions in this regard.

IV. Rate Design

Our decision to deny the application eliminates the need to discuss at length the various rate design considerations. In this context we will provide for no change in rates and defer to the next proceeding staff proposals for adjustments to lifeline allowances for central facilities and the residential block limits.

In the next proceeding we would also expect to see some refinement on PG&E's part of its showing with regard to alternate fuel prices, particularly with respect to the impact on the spot market of its own actions in arranging its fuel oil supplies.

V. Balancing Account Adjustments

A. Canadian Gas Purchases

The appropriate level of PG&E purchases of Canadian gas has been a major issue in these proceedings for some time, both in absolute terms and relative to the appropriate level of California purchases. In the course of this proceeding, several parties also focused on a particular increment of PG&E's Canadian purchases over a limited period of time. TURN and staff counsel recommend that this Commission find PG&E imprudent with respect to these particular purchases and that an appropriate adjustment be made to the balancing account.

The basic facts are not in dispute. The chain of contracts between PG&E, its affiliates, and Canadian producers contain certain provisions imposing daily, monthly, and annual minimum purchase obligations. Based on a fixed volume as the contract amount, PG&E's daily minimum is 75 percent of the contract amount, its monthly minimum is 80 percent of the contract amount, and its annual minimum is 90 percent of the contract amount. A reasonable construction of the contracts is that purchases below 75 percent daily or 80 percent monthly would amount to "breach", but that purchases between 80 percent and 90 percent annually would trigger the take-or-pay provisions in the contracts. The contract year is the year from July 1 to June 30. PG&E's monthly level of Canadian purchases for the year ending June 30, 1980 was high enough that by February 1, 1980 PG&E was in a position to reduce its purchases to the 80 percent contract monthly minimum for the remaining months of the contract year and still attain an annual contract volume in excess of the 90 percent annual minimum.

The ratemaking issue is framed by TURN in the following excerpt from its brief:

> "On February 17, 1980 the Canadian government's previously-announced increase in the international border price to $4.47/MMBtu became effective. (Tr. 97). That action increased PG&E's price for Canadian gas to $4.5806 per dth, which remains the current price.
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> "On the very last day before the increase was to become effective, February 16, 1980, the U.S. Economic Regulatory Administration issued Opinion and Order No. 14, temporarily authorizing the importation of Canadian gas at the newly-established price. The ERA's decision contained very strong language regarding the new price, however:
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> > "'...we have determined that this price is not reasonable and that it is consistent with the public interest to allow U.S. firms to temporarily import the gas at that price only if there is also a compelling showing that the gas is needed immediately to prevent a severe adverse impact on the public health, safety or welfare.' (p. 14).
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> "As of February 17, 1980 PG&E had already purchased enough Canadian gas in the July to June contract year to meet its 90 percent annual take-or-pay obligation, even if only the 80 percent monthly contract minimums were taken for the rest of the annual period. (Ex. 3). Further, PG&E had already taken enough gas in February to meet the 80 percent monthly requirement with only minimum 75 percent daily purchases for the rest of the month. (Ex. 32).
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> "In February 1980, PG&E's average purchase price for No. 6 fuel oil was 44.37 cents per therm. In March it was 45.23 cents. (Ex. 2, Tab C, P. 5).
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> "From February 17th through the end of March, PG&E provided virtually full gas service to its priority 5 electric generating boilers, with only minor curtailments on seven particular days. (Ex. 32, pp. 3-4). The company continued to purchase Canadian gas at above the contract minimum level until March 22nd, except for a few days when low demand necessitated a reduction. (Ex. 32, pp. 1-2).
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> "TURN contends that all Canadian purchases during this period above the contract minimum level were imprudent, and the resulting costs should be disallowed."

TURN proceeds to quantify the amount of the adjustment as $5,913,000. Staff counsel recommends that PG&E be ordered to prepare an analysis of the period, quantifying the effects on the balancing account of the imprudency.

TURN goes beyond the staff and also recommends that an adjustment be made to reflect PG&E's decision to reduce California purchases in April, 1980 rather than burn the gas in its power plant:

> "As a result of this policy decision, California purchases in April totalled only 7832 MMcf (Ex. 3), 6118 MMcf less than the 13,950 MMcf estimated a few months earlier to be the maximum placeable. (Ex. 5).
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> "If this 5947 Mdth of California gas had been purchased at the then-current California price of $1.8031 per dth (D.91720, p. 9) and sold to G-55 at $3.387 per dth, a net cost saving to the gas department of $9,419,000 would have resulted. (Tr. 273). TURN contends that this amount should be deferred to the next ECAC proceeding.
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> "This 5947 Mdth of gas equates to 915,000 barrels of oil. (Tr. 270). Exhibit 16 shows that PG&E's power plants could easily have burned that much additional gas in April 1980. Indeed, if excess Canadian gas had not been purchased in February and March, an almost offsetting 762,000 barrels of oil would have been consumed by the power plants during that period. Had that prudent scenario been followed, no California gas cutback would have been required in April.
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> "The basic economics do not support PG&E's decision. California gas costing 18 cents per therm was turned back so that fuel oil, which cost 45 cents per therm in April (Ex. 2, Tab C, P. 5), could be burned in the power plants instead. Even if oil storage costs of $5.82 per barrel, or 9 cents per therm per year, were added on to the gas price, the oil would have to be kept in storage for three years before the cost of choosing gas would exceed the cost of oil."

TURN warns that PG&E recovers its gas costs from ratepayers, but that shareholders pay for the cost of fuel oil storage.

PG&E asks that the Commission find its past purchases reasonable and allow recovery of the associated costs. It states that:

> "PGandE's general energy purchase policy is to try to acquire the most economic energy mix on a total company basis that is consistent with the provision of reliable utility service. To this end, PGandE watches its energy supplies and costs as well as customer demands to attain the most economical mix of energy supplies sufficient to insure reliable service under the conditions then foreseen for the system. (Tr. 1424) Of course, as time goes on, more information becomes available and conditions change, necessitating modifications in PGandE's strategy. (Cf. Tr. 164-166) February and March of this year offer interesting examples of the variety of changing factors to which PGandE must adjust its operations."

It goes on to describe the changing conditions in February and March and its corresponding changes in strategy. It concludes that "the overwhelming trend...clearly demonstrates that PG&E has operated its system to maximize El Paso and California purchases while reducing Canadian takes to the minimum level allowed by its regulatory-contractual constraints and consistent with the energy supplies and demand forecasts prevailing at different points in time."

We are persuaded that the record supports a finding of imprudence on the part of PG&E and that an appropriate adjustment to the balancing account is required.

Our basic concern is with PG&E's lack of response to the Canadian price increase. There was no recognition that national energy policy supported the reduction of purchases to the level "needed immediately to prevent a severe adverse impact on the public health, safety or welfare." This last increment of Canadian supply was plainly unnecessary for planning purposes

except to provide additional service to priority 5, thereby displacing less expensive fuel oil on a Btu equivalent basis, with additional carrying costs for oil storage. There was no recognition that it had the opportunity to relay a meaningful price signal to Canadian authorities by reducing its purchases to the contract minimum. PG&E has been quick to respond to its own customer's actions in reducing purchases, thereby delivering price signals. Why should Canada be insulated from the economic dislocation brought about by its high prices? In a paraphrase of the eloquent electric conservation message offered by PG&E, "What's the point in turning off the juice, if PG&E won't turn back the tankers?"

We have examined this issue in terms of the longer term, companywide basis that PG&E asserts is appropriate. Our conclusion is based on the original policy judgment, not any quirks or anomalies. Simply put, we find that as of February 17 and thereafter PG&E should have considered its minimum Canadian takes as 80 percent of the contract amount, rather than 90 percent as was its practice. This judgment is based entirely on facts and circumstances known at that time.

As indicated above, the "company-wide" argument fails at the outset because of lower cost fuel oil. We are also not convinced that changing circumstances obscured these facts or the emerging fuel excess. We note that during this time PG&E was removing gas from storage and serving power plants - admittedly an unusual practice - but undertaken to provide some room for storage of El Paso gas during the summer. This practice seems inconsistent with the notion that there was any perceived need for this last increment of Canadian gas. How much additional gas might have been removed from storage if the Canadian purchases had been reduced? Could more El Paso gas have been purchased? These are issues raised by PG&E's imprudent policy.

The failure to react to the price increase is symptomatic of PG&E's attitude toward its Canadian purchases. It has undertaken negotiations with producers, but not until June when the clear possibility of federal action appeared. It initiated a study into economic consequences of a take-or-pay situation, but not until the hearings were underway and the interest in the issue obvious, to indulge in understatement. We find that the ratepayers' stake in these matters requires a greater effort.

TURN's brief has rigorously calculated the costs of PG&E's actions and we adopt its method as reasonable with some modification. We find it reasonable to limit the opportunity to purchase additional California gas in April to the amount of excess Canadian gas that was purchased in February and March - 4954 Mdth - rather than the 5947 Mdth proposed by TURN. The effect of this adjustment is to simply substitute California gas for Canadian gas in the balancing account calculation. The amount of the adjustment is derived by applying the difference between the two prices to the volume of gas:

($4.5806 - $1.8031) (4954) = $13.8 million

This amount, with associated interest, should be removed from the balancing account (by a corresponding credit to the account).

B. Accounting Adjustments

The staff accounting witness proposes several adjustments. These include a reduction in the balancing account to correct PG&E's accounting treatment of sales to SoCal, an interest accrual adjustment, and a facilities credit adjustment. Each of these is reasonable and adopted herein.

The matter of the appropriate accounting treatment of PG&E sales to SoCal was discussed at length in D.91720 and resolved as proposed by the staff witness. The recommendation in this proceeding is consistent with the method adopted in D.91720. The

amount of this adjustment is $20.1 million, as of April 30, 1980. By D.92168 dated August 19, 1980, we denied PG&E's petition for rehearing of D.91720, and we reaffirm our decision in this proceeding.

The interest accrual adjustment simply recognizes the interest effect of D.90424 dated June 19, 1979, and a resulting adjustment to reflect the federal income tax rate reduction to 46 percent. There is no opposition.

The facilities credit adjustment applies to billing credits from certain gas suppliers as compensation for PG&E's costs associated with installing and maintaining facilities to gather the gas of these suppliers. The proposed revision more accurately matches costs and revenues and is not opposed by PG&E if a corresponding change in its gas margin is recognized concurrently. This is reasonable and is adopted.

VI. Tariff Changes

As indicated above, staff's proposed tariff changes relating to rate design are deferred to the next proceeding. PG&E requested a tariff change to allow for recovery of certain transmission costs.

This matter is summarized in this excerpt from the staff brief:

> "PG&E proposes to modify its Gas Tariff Preliminary Statement Part C to include certain variable transmission costs associated with purchases of gas from the Rocky Mountains. The staff agrees that these transmission costs are entirely variable with the volumes of gas purchased. PG&E's proposal is, therefore, acceptable and should be adopted. The staff accountant, Mr. Pulsifer, recommends, however, that the proposed revision specifically set forth on page 7 of Table C of Application No. 59695 be modified to read after enumeration of the includable accounts: '(That portion attributable only to directly variable transmission charges related to Rocky Mountain gas purchases not otherwise recoverable).'"

There is no apparent opposition from PG&E and the tariff change is adopted, as modified by staff.

Findings of Fact

1. By A.59695 PG&E seeks authority to increase its gas rates by about $589 million on an annual basis.

2. PG&E's present gas rates recover current gas costs and make a positive contribution to existing undercollection.

3. The elimination or modification of PG&E's take-or-pay and minimum obligations in its Canadian contracts is an issue pending before the Economic Regulatory Administration.

4. PG&E has entered into negotiations with Canadian producers regarding possible modification of its contract obligations.

5. PG&E has undertaken an economic analysis of the consequences of a take-or-pay position.

6. Prevailing alternate fuel prices are such that any substantial rate increase at this time would be borne primarily by high priority customers.

7. As of February 1, 1980 PG&E's purchases of Canadian gas for the contract year ending June 30, 1980 had been sufficient to allow PG&E to take only 80 percent of its contract amount for the remainder of the contract year without either breaching its contracts or incurring take-or-pay liability.

8. From February 17, 1980 through March 31, 1980 PG&E purchased at least 4954 Mdth more Canadian gas than it was required to purchase under its contracts, that was disposed of by sale to priority 5.

9. The price of such Canadian gas exceeded the cost of the oil that it displaced, independent of the carrying costs of the oil in storage.

10. In April, 1980 PG&E responded in part to its excess oil situation by reducing California gas purchases and burning oil in its power plants instead.

11. The amount of additional California gas that could have been burned in power plants if the Canadian purchases had been reduced in February and March was at least 4954 Mdth.

12. The savings to the ratepayer from the substitution of California gas for Canadian is about $13.8 million, plus interest.

13. The adjustment to reflect the appropriate accounting treatment of PG&E sales to SoCal gas as proposed by staff is reasonable.

14. The interest accrual adjustment proposed by staff is reasonable.

15. The facilities credit adjustment proposed by staff is reasonable.

16. The request to modify PG&E's tariffs to include certain variable transmission costs as modified by staff is reasonable.

Conclusions of Law

1. The rate relief requested by PG&E should be deferred until more certain test year gas supply estimates may be adopted.

2. PG&E has been imprudent in the operation of its gas system in regard to purchases of Canadian gas in February and March of 1980 and reduced California gas purchases in April 1980.

3. The balancing account adjustments found reasonable should be reflected in PG&E's Gas Cost Balancing Account.

O R D E R

IT IS ORDERED that:

1. Pacific Gas and Electric Company's (PG&E) application to increase its rates is denied.

2. PG&E's Gas Cost Balancing Account shall be adjusted consistent with Findings of Fact 12 through 15.

3. PG&E is authorized to modify its tariff as found reasonable in Finding of Fact 16.

The effective date of this order shall be thirty days after the date hereof.

Dated OCT 8 1980, at San Francisco, California.

John E. Bryson
President

Richard D. Gravelle

Leonard M. Grimes, Jr.
Commissioners

I dissent
Vernon L. Sturgeon

Commissioner Claire T. Dedrick, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

LIST OF APPEARANCES

Applicant: Robert Ohlbach, Daniel E. Gibson, and Shirley A. Woo, Attorneys at Law, for Pacific Gas and Electric Company.

Protestants: Michel Peter Florio, Attorney at Law, for Toward Utility Rate Normalization (TURN); William B. Hancock, for Cut Utility Rates Today (CURT); and Ken Davis, for Prune Bargaining Association.

Interested Parties: Ken Davis, for Prune Bargaining Association; Henry F. Lippitt, 2nd, Attorney at Law, for California Gas Producers Association; Morrison & Foerster, by John M. Adler and Charles R. Farrar, Jr., Attorneys at Law, for Kerr-McGee Chemical Corporation; Chickering & Gregory, by Edward P. Nelson and Kent E. Soule, Attorneys at Law, for Stanford University; Brobeck, Phleger & Harrison, by Gordon E. Davis and James M. Addams, Attorneys at Law, for California Manufacturers Association; William H. Seaman, Robert H. Bridenbecker, and Michael E. Smith, for Southern California Edison Company; Douglas Kent Porter, E. R. Island, Michael Gayda, and John H. Craig, Attorneys at Law, for Southern California Gas Company; George P. Agnost, City Attorney, by Leonard L. Snaider, Deputy City Attorney, and Robert Laughead, P.E., for the City and County of San Francisco; and Downey, Brand, Seymour & Rohwer, by Philip A. Stohr and Richard R. Gray, Attorneys at Law, for General Motors Corporation, Otis M. Smith, General Counsel, Julius Jay Hollis, Esq.

Commission Staff: Thomas F. Grant, Attorney at Law, Raymond A. Charvez, and S. Robert Weissman.