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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Investigation on the Commission's own motion into electric utility Energy Cost Adjustment Clause (ECAC) tariff and the changes, if any, that should be made to its provisions and procedures.	OII No. 56 (Filed August 14, 1979)

Malcolm H. Furbush and Bernard J. Della Santa, Attorneys at Law, for Pacific Gas and Electric Company; John R. Bury, David N. Barry, William E. Marx, and Richard K. Durant, by Richard K. Durant, Attorney at Law, for Southern California Edison Company; Jeffrey Lee Guttero and William L. Reed, Attorneys at Law, for San Diego Gas & Electric Company; and Patrick T. Kinney, for Sierra Pacific Power Company; respondents.

Boris H. Lakusta, David J. Marchant and Thomas J. MacBride, Jr., Attorneys at Law, for Western Mobilehome Association and California Hotel and Motel Association; Michel Peter Florio and Edward M. Goebel, Attorneys at Law, and Sylvia M. Siegel, for Toward Utility Rate Normalization; Downey, Brand, Seymour & Rohwer, by Philip A. Stohr and Richard R. Gray, Attorneys at Law, for General Motors Corporation, Otis M. Smith, General Counsel, and Julius Jay Hollis; Allen R. Crown and Glen J. Sullivan, Attorneys at Law, for California Farm Bureau Federation; William S. Shaffran, Deputy City Attorney, for City of San Diego; Leonard Snaider, Deputy City Attorney, for City and County of San Francisco; Harry K. Winters, for the University of California; Robert E. Burt, for California Manufacturers Association; Bud Dougherty, Karen Bernstein, Michael Lesser, Frank Boland, and John Rice, by David Roth, Attorney at Law, for Citizen Labor Energy Coalition; and Robert W. Schempp, for Metropolitan Water District; interested parties.

Richard D. Rosenberg and Sheldon Rosenthal, Attorneys at Law, for the Commission staff.

O P I N I O N

I. INTRODUCTION

By order dated August 14, 1979, this Commission instituted this generic investigation into the Energy Cost Adjustment Clause (ECAC). In the Order Instituting Investigation we stated:

> "Over the past three years there have been numerous hearings regarding ECAC applications from electric utilities. From the records developed in these proceedings, it appears that two issues frequently recur and are repeatedly debated. First, there appears to be considerable uncertainty as to how to properly interpret the provisions of the original ECAC decision (Decision No. 85731), particularly those provisions pertaining to what costs are to be recovered through ECAC procedures. Second, there have been a number of requests to modify ECAC to have it include certain items of cost not previously authorized."

The named respondents are Pacific Gas and Electric Company (PG&E), Southern California Edison Company (Edison), San Diego Gas & Electric Company (SDG&E), and Sierra Pacific Power Company, (Sierra).

A prehearing conference was held before Administrative Law Judge Patrick J. Power on September 19, 1979, in San Francisco. By Administrative Law Judge's rulings the scope of the proceeding was defined and a schedule set for the taking of evidence.

On November 15, 1979, Edison filed a motion and supporting papers for an order modifying the interest rate applicable to the ECAC balancing account. Replies to Edison's motion were filed by PG&E and SDG&E. Hearing on the motion was held on December 3, 1979. Additional evidence was received on January 14, 1980. The motion was the subject of an interim order, D.91269, dated January 29, 1980.

The proceeding was structured to provide for an initial utility showing, then staff comments and proposals, then third party comments and proposals, and finally, utility replies. Hearings were held on January 14, 15, 22, and 23, February 25, 26, and 27, May 1, and 20, and July 7, and 8. PG&E, Edison, and SDG&E each made initial and reply showings. The Commission staff (staff), California Manufacturers Association (CMA), and Toward Utility Rate Normalization (TURN) offered testimony. The Citizen Labor Energy Coalition (CLEC) arranged for testimony from a PG&E witness. Staff counsel furnished a statement solicited from the California Energy Commission (CEC). Following the initial utility showings the Commission issued D.91277 on January 29, 1980, providing for certain interim modifications of ECAC procedures.

The matter was submitted subject to the filing of opening and reply briefs on July 28 and August 15, 1980. Briefs were filed by PG&E, Edison, SDG&E, staff, the cities of San Diego (San Diego) and San Francisco (San Francisco), and the California Farm Bureau Federation (Farm Bureau).

II. SUMMARY

In this decision we consider the origin and operation of ECAC tariff provisions and conclude that certain procedural changes are appropriate, largely because of serious undercollection problems that have plagued ECAC.

The original ECAC clause was based on recorded data. An interim decision in this matter, D.91277, modified the clause to a more forward-looking basis. In this decision we make those changes permanent. The basic changes are as follows: from semi-annual to triannual revisions; from recorded to estimated resource mix; from recorded to estimated prices; from recorded to estimated sales; from recorded to estimated balancing account balance. Only

reasonably incurred fuel costs are recoverable in ECAC. The reasonableness of recorded fuel costs will be examined in an annual review of each utility. Additionally, the interest rate calculation adopted in D.91269 is made permanent, and a change in the franchise fees and uncollectibles expense allowance is adopted.

Substantively, a new approach for recognizing costs of managing fuel oil supplies is adopted. The base rate component of fuel oil in storage will be developed annually; ECAC recovery will be allowed for carrying costs attributable to the changes in the price of oil from the adopted price used in the base rate calculation. Gains or losses on sales of fuel oil and underlift or facilities charges will no longer be recovered in ECAC.

Certain matters are considered for ECAC recovery. Variable wheeling charges and Department of Water Resources (DWR) sales, are included in ECAC. Economy energy sales are excluded. Provisions are adopted for an orderly transition into the new procedures.

III. BACKGROUND

ECAC is the successor procedure to fuel cost adjustment (FCA) tariff provisions adopted for each of the major electric utilities subject to our jurisdiction beginning in 1972. On March 18, 1975, we instituted an investigation (C.9886) into the operation of the FCA provisions, culminating in D.85731 and the substitution of ECAC (April 27, 1976).

In D.85731 we discussed the policy considerations that supported the original FCA procedure:

> "...the fca was originally adopted because in an inflationary period, with rapid changes in the cost of fuel, an expedited method is required to permit a utility to recover these costs so its ability to function is not impaired; because such an expedited

"proceeding will lessen the frequency of general rate cases; and because it enhances a utility's position in the financial community."

The operation of the FCA provisions was described as follows:

"The fca is basically determined by deducting from the total fuel requirements (based on forecast sales, in kWh) in the forecast period (under average conditions of temperature and precipitation) the fuel requirements in the forecast period expected to be supplied by nonfossil fuels; the balance is estimated to be supplied by fossil fuels (primarily gas and oil). The fca then provides for estimating costs at the latest known prices for the oil and gas, determining total estimated fuel expenses, and deducting the base cost fuel component included in base rates. The result is those revenues to be generated under the fuel clause as a result of the increase in fossil fuel costs over the fossil fuel costs used in determining base rates."

However, as a result of our investigation we found:

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

In its place we adopted ECAC.

ECAC is different from the FCA in several respects. Whereas the FCA applied only to fossil fuels, ECAC includes all self-generated and purchased power. Instead of the "average year forecast" method, ECAC is based entirely on recorded data:

"We think the best fuel clause is that which uses recorded data over a full cycle of experience, seasons, temperature, and weather conditions. This means a 12-month moving recorded basis for sales and quantities of energy, since it will absorb all the peaks and

> valleys of a full cycle of variables. To most accurately reflect energy costs, we shall compute the costs of energy on an end of period basis." (D.85731)

And we included in ECAC a balancing account that would track the revenues and expenses and allow for periodic adjustments to provide for nothing more or less than dollar-for-dollar recovery.

Now, over four years later, we examine the operation of ECAC.

IV. THE NEED FOR A FUEL CLAUSE

The threshold question is whether a fuel clause of any kind is necessary. This is an issue raised by TURN, through the testimony of its Executive Director, Sylvia Siegel:

> "My primary recommendation is that separate fuel procedures be abolished in California and all fuel costs and issues be incorporated in general rate cases..."
>
> "Administratively feasible is a plan to review total operations annually for each utility on a staggered basis. It is clear from the testimony of both staff witnesses that one reason for the failure of fuel clauses to do the job in the past has been the lack of sufficient staff. Additional engineers and accountants will be required for fuel cost assessment regardless of what procedures exist. Sufficient fuel review staff could be assigned, on a staggered basis, to audit annually fuel costs of each company. In addition, company monitors can track full costs throughout the year. Incorporation of fuel costs in general rates and general rate case procedures will enable other staff participants to contribute their expert evaluation of total company performance."

No other party has joined in this recommendation.

We understand that there is frustration over the large increases that have been authorized pursuant to ECAC procedures,

but elimination of the clause will no more restrain the economic forces that have caused the increases than would elimination of the Commission. We cannot return to regulation of the 1960's given today's economic forces.

We find that ECAC is an essential tool that can fairly balance the interests of the utilities and ratepayers, while allowing this Commission the flexibility to recognize changes in price and resource mix that would otherwise present enormous risks or opportunities in terms of economic consequences for the utility. The dollars at stake are simply too substantial to leave to the vicissitudes of nature such as we have experienced in California during the existence of ECAC. "Feast or famine" is not a useful maxim of regulation.

As a secondary recommendation, TURN suggests that only 90 percent of the otherwise recoverable fuel expenses should be included in ECAC, leaving the other 10 percent to be recovered in a general rate case. This is essentially the position taken by CLEC, and is allegedly the practice in Michigan and South Dakota.

The argument in support of such partial pass through is that it offers the utility a direct incentive to minimize fuel costs, since not all increased costs would be recovered. Proponents apparently would be more confident that the utility was bargaining for reasonable prices if the utility had such a stake in the outcome.

In view of the difficulties and uncertainties necessarily involved in the projection of future fuel expenses in these volatile economic and political times and in consideration of the magnitude of the costs involved, we are persuaded that to permit only 90 percent of otherwise recoverable fuel expenses to be included in ECAC would impose intolerable financial risks on the utilities. However, we are persuaded of the importance of putting the utilities in a

position where they will have substantial incentive to minimize their fuel costs and, in particular, to drive hard bargains for the lowest possible prices of purchased fuel. We consider that an appropriate balance of risk and incentive is created by permitting the inclusion of 98 percent of otherwise recoverable fuel expenses in ECAC, with the remaining two percent of such expenses to be estimated on a forward looking basis once each year in the course of each utility's annual review of the reasonableness of fuel expenses included in its ECAC accounts, as discussed more fully infra.

V. PROCEDURAL ISSUES

A. Introduction

In D.85731 we stated, "Our intent is to maintain future clause revenue-expense differentials at a minimum." Instead, the evidence indicates that from its inception, ECAC has been characterized by chronic undercollection. During the pendency of this proceeding the magnitude of the undercollection combined with the unprecedented high interest rates to put a genuine strain on the financial integrity of each of the major electric utilities.

The large undercollection balances have required enormous rate increases. In decisions earlier this year we adopted the following amounts of undercollection for ratemaking purposes: PG&E - $241 million (D.91721); Edison - $255 million (D.91805); SDG&E - $69.8 million (D.91971). Certainly if large overcollection was a material consideration in our decision to substitute ECAC for the FCA, then large undercollection is equally as valid a consideration in our decision to modify ECAC.

We reaffirm our original intention - "to maintain future clause recorded revenue-expense differentials at a minimum". There are several features of the existing clause that operate to defeat

this purpose. By this decision we intend to provide for more timely, adequate relief, without sacrificing the integrity of the procedure.

B. Frequency of Revisions

Originally we provided for semiannual ECAC rate changes. We are persuaded that more frequent revisions are necessary in order to keep up with changing fuel costs.

Proposals in the record include monthly, quarterly, and semiannual revisions. By D.91277 we provided for revisions on a triannual basis, pending completion of this proceeding. Edison and staff have indicated that they each now support the triannual method; PG&E and SDG&E still prefer quarterly revisions, but agree that triannual is acceptable. San Diego and San Francisco propose to maintain the semiannual schedule. CMA cautions that too frequent rate changes are detrimental.

We find that more frequent revisions are necessary, in order to reflect changes in price and resource mix on a more current basis. While quarterly or monthly filings would be more effective in this regard, we find triannual revisions more workable and adequate for the purpose. We are concerned that more frequent revisions present administrative and legal barriers that might render the clause inoperable. We also respect CMA's concern that frequent rate changes adversely affect its members in pricing their products.

The record reflects that there have been serious delays in providing relief on a semiannual basis. Obviously, triannual revisions would be unworkable if procedures were not changed. The various changes we adopt are intended to allow for timely processing of ECAC filings. In addition, various parties have suggested that we demonstrate our commitment to ending delay by

adopting a "regulatory lag plan" for ECAC filings that would provide a specific schedule for each utility filing, staff exhibits, and Commission decision.

We find that such a rigorously structured scheduling plan is unnecessary in view of the procedural changes that we do adopt and unwise because of the limitations that it would place on our flexibility and ability to accommodate parties. On occasion we have scheduled ECAC rate changes to coincide with general rate increases, so as to provide for more stable rates. We reserve the option to similarly schedule such changes in the future.

The schedule we adopt is the schedule presently in effect. The respective revision dates are as follows:

PG&E: April 1, August 1, December 1;
Edison: January 1, May 1, September 1;
SDG&E: March 1, July 1, November 1;
Sierra: February 1, June 1, October 1.

Utility filings should be made 60 days prior to the revision date.

C. Review of Reasonableness

In D.85731 we stated:

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

In actual practice the tendency has been to examine the reasonableness of the utility fuel costs in each proceeding - semiannually, instead of annually as originally intended. There has been ambiguity, confusion, and delay associated with the actual practice, and in

this decision we reaffirm our original intent to examine the reasonableness of costs once annually.

One of the problems with semiannual examination of reasonableness has been the overlapping resulting from reviewing every six months the preceding 12 months. Thus every six-month period is examined twice, with the potential for different judgments of reasonableness, depending on the individuals who participate in a particular case. On occasion parties have sought to go back even beyond the preceding year and make adjustments to the balancing account to reflect matters that occurred in the earlier period. There appears to be an assumption that Commission discretion is unlimited in terms of our ability to go back to the very inception of the clause. We are very concerned that such a perception could be damaging to the financial standing of California utilities because of the corresponding assumption that reported earnings would be subject to possible adjustment for years in the future.

Annual review is supported by PG&E, Edison, SDG&E, and staff. San Diego and San Francisco argue that "all issues that are relevant to any particular proceeding should be addressed," and that if necessary, "the Commission must reorganize its priorities to deal with the present situation."

A thorough review of the reasonableness of energy costs sought to be recovered in ECAC is a matter of high priority for this Commission. We are convinced that this objective is more readily achieved in an annual proceeding for each utility. Annual review allows for a more comprehensive, thorough investigation by the staff and third parties, adequately protects the ratepayers, and avoids the strain on limited resources that would result from more frequent review. Annual review was intended as an adjunct to semiannual revisions; it is a necessary companion to triannual revisions as well.

The annual review will provide the occasion for the utility, the staff, and other interested parties not only to evaluate the reasonableness of recorded fuel-related expenses, but also to forecast such expenses for the coming 12-months period. Of the Commission's adopted annual forecast of these expenses, two percent will be reflected directly in rates for that year without possibility of adjustment in light of subsequent events. For the other 98 percent of forecast fuel expenses, rate recovery will take place through the ECAC mechanism, with the ultimate recovery to comprise 98 percent of otherwise recoverable actual fuel costs.

Of course, the burden of proof is on the utility applicant to establish the reasonableness of energy expenses sought to be recovered through ECAC. We expect a substantial affirmative showing by each utility with percipient witnesses in support of all elements of its application, including fuel costs and plant reliability.

For each utility there will be designated a particular revision date that will identify the annual review proceeding. These will be staggered over the year to accommodate staff review. The dates are as follows:

Edison: May 1;
PG&E: August 1;
SDG&E: November 1;
Sierra: February 1.

On an ongoing basis the "record period" that is to be examined as to the reasonableness of recorded expenses is the 12 months ending as of the preceding revision date. Except as expressly reserved, no adjustments will be considered beyond the specific record period. The matter of the transition from the present to the modified procedure is discussed later.

D. Resource Mix

As discussed above, ECAC was designed to function on the basis of a recorded resource mix - that is, the rate is set prospectively based on the relative availability of fuels that prevailed during the record period. This procedure was expressly a reaction to the overcollection and the attendant criticism that occurred with the old fuel adjustment clause.

Edison and SDG&E recommend that an estimated resource mix be adopted as the basis of the ECAC calculation. Staff, San Diego, and San Francisco argue for continued use of recorded

data and rely on the FCA overcollection as dispositive of the matter. San Diego and San Francisco warn that utilities cannot be trusted to make estimates.

We are convinced that reliance on recorded data for the prospective resource mix has contributed significantly to the intolerable level of undercollection. The extremes in weather conditions that have occurred in the last five years merely confirm the latent defect in the original ECAC clause. This problem is directly a function of the extent to which a utility's resource mix includes hydro and purchased power, and is most acute when applied to PG&E. In fact, in several instances during the drought and thereafter we modified the ECAC calculation as applied to PG&E in order to mitigate the enormous swings in under-and overcollection that would occur from a literal application of the clause.

Ironically or otherwise, we consider this matter during a "wet" year following a warm winter, with surplus natural gas and purchased power. To those parties who propose that we base rates for PG&E in 1981 on these current conditions, we can only ask "why?" What interest is served by the certain undercollection that will occur during an average or dry year? If there is a benefit to substantial undercollection it is not disclosed in the record.

Opponents emphasize that the former FCA mechanism led to overcollection. Yes, there was overcollection - during a wet year with greater than estimated P-5 natural gas. But there was then

no balancing account to provide first for recognition that over-collection was occurring and second for amortization of the overcollection. The FCA was flawed more by our failure to react than by our original action.

Having decided that the resource mix should be forward-looking, we must consider the mechanics in light of our resolve to provide timely triannual relief, with annual review of reasonableness. In the interim order we provided that each utility's fuel procurement strategy resource mix estimates would be used as the basis for ECAC calculations. We consider that to be a reasonable solution to the problem for the two annual filings for each utility in which reasonableness is not an issue.

We consider the prudency of each utility's fuel procurement strategy and underlying forecasts to be a major issue in the annual hearing. The company has the burden of proof that its past actions have been reasonable and that its strategy for the future is sound. In our decision we will judge that strategy and make appropriate allowances.

We do not propose to adopt a test year resource mix that will be applied regardless of changing conditions. We will simply validate the process. To the extent that the utility's own plans change over time these changes will be reflected in its subsequent filings.

In order to reduce uncertainty over this issue it is reasonable to limit the task to a four-month estimate - the period between revision dates, rather than twelve months as was originally undertaken with the FCA. Estimating the four-month "burn" should be much more manageable.

San Diego and San Francisco warn that "if utilities are allowed to use estimates they will always put on a worst case scenario. Underestimating revenues and overestimating expenses is a way of life for utilities and a detailed analysis of these revenues and expenses should be left for general rate cases." In the procedure adopted, San Diego and San Francisco will have the opportunity to prove the validity of their argument with regard to fuel procurement. To the extent they succeed, appropriate adjustments will be made to the utility's recovery.

E. Fuel Prices

Having decided the method for determining the quantities of the various resources that supply the electricity, we come now to the question of the price to apply to the volumes to derive the gross revenue requirement. By D.85731 we provided that only recorded prices would be used. By D.91277 we allowed the utilities to estimate the prices of fuels as of the revision date. PG&E, Edison, and SDG&E propose that the authority to estimate prices be made permanent. Staff, San Diego, and San Francisco support a return to recorded prices.

There is an obvious similarity between this issue and the resource mix problem - the question of accurate estimates. But we are absolutely certain that the use of recorded fuel prices has operated exclusively to cause undercollection. Therefore, we will provide for the use of estimated fuel prices.

The problem is best described in terms of fuel oil and natural gas. In D.85731 we stated:

> "The cost of fuel oil shall be computed on a weighted average cost basis of the inventory then existing; all other energy sources shall use the latest tariff, contract, or delivered price figure for the cost, for purposes of the energy clause."

All too often in practice this has precluded recognition in the decision of costs current as of the scheduled revision date, let alone the date of decision.

With respect to oil, the "current" price as of the end of the record period is weighed down by the inventory price. In a time of rising prices this method yields a low price relative to the current price of oil as of the revision date. All too often our decisions were delayed for some time further so that the rates in effect were based on stale oil price information.

With respect to natural gas prices the illustration is strikingly simple, with PG&E as an example. Its ECAC and PGA revision dates have been the same, with the result that there has been a built-in delay in recognizing an electric department gas rate increase until the next ECAC increase - when there is also another gas rate increase.

The objection to estimates is that they are uncertain. True, but we are willing to accept the uncertain accuracy of price estimates in preference to the certain inaccuracy of recorded prices. Every party will have the opportunity in each ECAC filing to examine in detail the assumptions underlying the utility estimates. If the problems perceived by San Diego and San Francisco are real, it will be possible for them to challenge and test the estimates.

Mechanically, we intend that prices be estimated as of the revision date and that the fuel expense for the whole four months be calculated. This allows for recognition of inventory quantities of fuel, as well as the "current" price.[1/] Estimates of fuel prices that turn out to be too high will not be a windfall to electric utilities, because the balancing account balance will ensure only dollar-for-dollar recovery occurs.

1/ The average price of fuel oil expense shall be computed by estimating the average cost of oil in inventory at the end of each of the four months using the estimated price of replacement oil as of the revision date.

F. Sales

In D.85731 we also provided that record period recorded sales would be used as the basis of ECAC calculations. In light of our substitution of estimates for recorded data with respect to resource mix and fuel prices, it is reasonable to allow for estimated sales to be used. The proponents, opponents, and arguments are essentially the same as stated for the other issues.

The task is straightforward - estimate the sales for the four-month period beginning as of the revision date. We see no point in using recorded data that may reflect extreme weather conditions.

G. Balancing Account

As discussed herein, the balancing accounts of each of the major utilities have tended to reflect substantial under-collection. In addition to all of the foregoing features that have contributed to the problem, there is the practice of basing the application on the recorded balancing account balance. During a period of ongoing undercollection the balance is greater by the hearing date, revision date, and decision date than is shown in the application. The result is that the relief granted can be readily shown to be inadequate. In D.91277 we provided that an estimated balance - as of the revision date - should be the basis of the application. Consistent with the other modifications made herein, we find that the utilities should estimate the balance as of the revision date and the accuracy of the estimates should be examined in the record in each proceeding.

Originally we provided for 12 months' amortization of the balancing account balances. In recent decisions we have shortened the amortization period in order to bring the balances closer to zero. In D.91277 we provided that each utility would be able to propose any particular amortization period.

The various proposals in this record must be understood in connection with the proponents' preferred revision schedule:

PG&E - quarterly revisions, 6 months amortization;
Edison - triannual revisions, flexible or 4 months amortization;
SDG&E - quarterly revisions, quarterly amortization;
Staff - triannual revisions, 6 months amortization;
San Diego, San Francisco - semiannual revisions, 6 months amortization.

In general we agree that the amortization period should equal the time between revision dates. However, we recognize that there may be conditions that would support some other period, in order to promote some valid purpose such as rate stabilization. Therefore, we will allow each applicant to propose any particular period and other parties to respond.

H. Interest Expense

In D.85731 we provided that "no interest charge will accrue to the amount in the balancing account." By D.86484, dated October 13, 1976, we allowed for 7 percent interest to be applied to the balancing account, compounded monthly. By D.91269, dated January 29, 1980, we provided for a variable interest rate to better reflect actual market conditions and continued monthly compounding. We required that a uniform interest rate be applied on a companywide basis.

PG&E, Edison, and SDG&E all support the procedure adopted in D.91269. Staff argues that interest should be compounded annually and that the Commission should "limit the interest rate applied to the balancing account to a rate no higher than this (sic) experienced by the utility for its short-term borrowings."

We hope that the procedural modifications adopted herein make this issue relatively less significant by reducing the dollars at stake.

The staff view is apparently that because the balancing accounts are financed by commercial paper and because commercial paper is sold at a discount, monthly compounding of interest is not appropriate. This reasoning is not supported by the record.

We are advised of no material distinction between discount rate and interest rate. In either case it seems plain enough that the utility over time must finance the debt and the carrying costs of the debt.

In our effort to provide for a fair and balanced procedure we must consider also the effects of possible overcollection. Clearly the interest applied to overcollection must be compounded monthly or we will have instilled an enormous incentive for overcollection.

We are not convinced that the utility's "short-term borrowing" rate should be used as a ceiling, instead of the published commercial paper rate. First, we are not sure which rate the staff refers to, as the record indicates that each utility has several forms of short-term credit. We also prefer to apply the independent objective standard, with the resulting risk and opportunity for each utility. The method adopted in D.91269 provides a clear incentive for each utility to minimize its interest expense and is adopted.

In D.91269 we required that the same interest calculation be applied to electric utility customer deposits. Only staff proposes a change.

Staff recommends that for customer deposits "a fixed interest rate should be assigned rather than a variable one. This could be either at a rate equivalent to the company's return

on equity allowed for common stock or an 18 percent annual interest rate, as charged by Bank Americard and Master Charge."

While we recognize the appeal of a fixed rate, we are not persuaded that either method proposed by staff yields a reasonable result. We see no connection between deposits and authorized return on equity. The "Master Charge" argument overlooks the simple matter of the value of the deposit to the utility - the marginal cost of short-term debt. Applying staff's reasoning, undercollections should accrue 18 percent interest because the customers would be able to put their money on their credit card bills, rather than utility bills. The staff's proposal does not reflect the changing value of ratepayer funds held by utilities. The variable interest rate strikes a fair balance on behalf of shareholders and ratepayers. We are not persuaded to change the method adopted in D.91269.

I. Franchise Fees and Uncollectibles

In D.85731 we stated that "a fixed one percent charge for local franchise fees and uncollectible expense will be allowed in each adjustment factor on the amount then found collectible or refundable." PG&E, Edison, SDG&E, and staff all propose that the factor found reasonable in the last general rate case should be applied. There is no objection. This recommendation is reasonable and is adopted.

VI. SUBSTANTIVE ISSUES

A. Introduction

The FAC was concerned only with increases in the cost of fuel oil. In D.85731 we stated that ECAC would include "all energy sources...except utility owned hydroelectric power." However, we went on to include or exclude certain specific categories of expense, guided by this language: "Generally, we think it reasonable to include the direct reasonable cost of fuel and energy and other variable charges directly associated therewith....

Thus, we shall exclude fixed charges, costs not directly attributable to energy sources, and costs primarily accounted for in general rate proceedings." The history of the operation of ECAC has been marked by continuous interpretation of that language.

As recited in the Order of Investigation (OII), a major consideration in our decision to institute this investigation was to respond to uncertainty regarding intended operation of the clause as well as to provide a forum to consider modifications to the basic structure of ECAC. We are convinced that certain changes are appropriate.

In deciding the scope of ECAC we start from the basic proposition that balancing account treatment reduces the incentive to control costs by reducing the risk to the utility, by providing dollar-for-dollar recovery of reasonable costs. Thus, so long as costs are managed within a zone of reasonableness, the utility is made whole. Balancing account treatment also eliminates entirely the opportunity for the utility to profit from successfully managing expenses. For these reasons we can say unequivocally that we prefer general rate case type recovery.

The major consideration that supports ECAC recovery is the volatility of fuel prices and mix. Our experience indicates that these are matters largely outside the control of the utility. The essential element necessitating ECAC recovery is the inability of management to control the expense.

This was the principle originally underlying ECAC and we affirm it. The problem is to apply it.

The general scope of ECAC is straightforward. It remains the vehicle for recovery of reasonable fuel and energy costs. Unless expressly referred to herein, matters previously included or excluded for ECAC recovery retain their current status.

Several specific issues have been identified for consideration in this proceeding. In resolving these we have followed these basic principles to their logical conclusion.

B. Excess Fuel Oil

Fuel oil is the swing fuel for each of the electric utility respondents. Fuel oil procurement policies must reflect the status of the fuel in the resource mix and provide flexibility for managing supplies to reflect changes in the availability of other resources. For various reasons, since the inception of ECAC, the ratemaking treatment of costs associated with excess fuel oil has been a major issue in several ECAC proceedings.

In the simplest of terms, the utilities have three options in an excess oil situation: take the oil and store it; take the oil and sell it (at a profit or loss as circumstances dictate); not take the oil pursuant to contract provisions that require certain payments for the oil not taken (called "underlift payments"). Each of these decisions has economic consequences and there is no question that a utility is expected to analyze its choices and to be able to support the reasonableness of its choice.

We are concerned that ECAC has introduced a distraction into the decision-making process by providing for different treatment of the dollars, depending on the choice. We have allowed ECAC recovery of losses on the sale of fuel oil (and included gains). We have allowed ECAC recovery of underlift payments pursuant to contract provisions. We have not allowed ECAC recovery of the carrying costs of excess fuel oil in storage. Thus, the procedure itself may interfere in management judgments by requiring a choice between shareholders and ratepayers for responsibility. It is axiomatic that ratemaking consequences should not provide incentives for unsound operating decisions. We find this existing inconsistency intolerable.

By way of background, traditional test year ratemaking squarely placed the costs of excess fuel oil on the shareholders. But it also allowed the shareholders the opportunity for additional earnings related to the savings resulting from substitution of a cheaper resource. For example, in a wet year the savings from hydro would exceed the costs of managing the excess oil resulting from the displacement of oil in the resource mix. Under ECAC the basic facts are the same but the consequences shift: the savings from the substitution of hydro for fuel oil are "flowed through" to the ratepayer; the costs of storing the oil are still borne by shareholders. The resulting dilemma for management has been dramatized by the low fuel oil requirements of the current year, resulting in substantial volumes of excess oil, compounded by very high financing costs (and the further strain of financing under-collection).

Since the inception of ECAC we have continued to include in base rates a component reflecting the test year value of fuel oil in storage. The calculation is twofold - first, a reasonable number of barrels of oil, and second, the value of the oil on a per barrel basis. The product of these two variables is included in rate base. In varying degrees the problem in 1980 has been a combination of the number of barrels and the cost per barrel, each substantially exceeding the amounts found reasonable in the most recent general rate case for each utility.

Based on the foregoing discussion we are convinced that current ratemaking methods do not fairly balance the risks and opportunities relating to managing fuel oil at the margin. The record contains extensive evidence and argument reflecting various proposals to resolve this matter. No consensus has emerged.

PG&E proposes to modify ECAC "to include in the balancing account the difference between the actual carrying cost of fuel in

inventory and the carrying costs of such fuel in base rates. PG&E's proposal would apply not only to price changes but also to changes in the volume of oil in inventory. It also provides for an annual independent audit of the reasonableness of such expenses." By "actual carrying costs" PG&E means the rate of return last found reasonable adjusted to recognize the income tax effect. PG&E estimates that "the shortfall in recovery of carrying costs in fuel in inventory" for 1980 and 1981 will otherwise be $64 million.

Edison has also offered a proposal that recognizes changes in volume and price, but with material differences. It suggests a mechanism that starts with the rate base value of fuel oil and tolerates a range of ±$50 million, called a "deadband":

> "Changes in price, volume or combinations of both can cause movement within the deadband without causing a Billing Factor adjustment. The amount by which the weighted average dollar inventory level is greater or less than a predetermined dollar amount...would be multiplied by the then current commercial paper rate. The result of this calculation would be accounted for in the ECAC Balancing Account, the effect of which would flow through to ratepayers. Thus, only when the shareholders have already absorbed the financing costs for the first $50 million of additional inventory expense do the ratepayers bear any additional financing cost burdens associated with changes in fuel oil inventory. Conversely, if the inventory amount decreases by more than $50 million below the rate base amount, the ratepayers then benefit to the extent of reductions below that level."

The size of the "deadband" is derived from consideration of the tolerable impact on Edison's rate of return. It proposes that a different deadband be defined for each utility.

SDG&E has proposed a more limited procedure which it calls a Fuel Oil Rate Base Adjustment (FORBA). FORBA operates as follows:

> "Using the number of barrels of fuel oil authorized in the last general rate case, price increases or decreases applicable to fuel oil should be recognized each time an ECAC adjustment is made. SDG&E proposes to apply the rate of return authorized in the utility's last general rate case to change in value of the fuel oil inventory to arrive at a FORBA revenue requirement. After adjusting for corporate taxes and the ECAC allocation ratio, this revenue requirement would be divided by the record period sales to produce the FORBA rate."

This procedure recognizes only changes in the cost of oil; it provides no recognition of changes in volume.

PG&E, Edison, and San Diego all support continued inclusion in ECAC of gains and losses from fuel oil sales and underlift or similar payments made pursuant to contract provisions.

Staff recommends that "the carrying cost of fuel in inventory should continue to be considered only in general rate proceedings and not be recovered through the ECAC balancing account." It suggests that if the Commission does decide to allow any recovery for fuel in inventory through ECAC that "recovery for the inventory value which exceeds the dollar amount authorized in the utility's last general rate case should be limited to:

> "(a) recovery for only actual price increases of oil experienced by the utility which exceed the price estimates authorized in the utility's general rate decision, and
>
> "(b) recovery for the interest expense associated with oil price increases, which should be determined by the three-month prime commercial paper rate appropriate for the particular utility over the period recovery is being sought."

The technical staff recommends that fuel oil sales and underlift charges continue to be recognized in ECAC. Staff counsel recommends that "underlift charges, fuel oil sales and carrying cost of fuel in inventory all be considered as a group in general rate proceedings and not be recoverable through ECAC procedures."

San Diego and San Francisco offer nothing affirmative on this point except the statement that they "are in general agreement with the staff on the issues of 'gains and losses on sales of fuel' and 'underlift charges'", citing the staff exhibit.

While each of these proposals has some merit, we find that each is materially flawed. We will adopt a hybrid approach, in an effort to recognize both the intricacies of fuels management decisions (as noted by PG&E witness O'Keefe) and the need to vest in the utility a direct stake in the outcome of those decisions. Our solution has three prongs.

First, since the two-year duration of base rates does not allow for timely recognition of changes in prices and reasonable storage levels of fuel oil, thereby creating unacceptable and costly financial risks for the utilities, we will now calculate annually the base rate carrying cost component for fuel oil in storage. Second, a modified FORBA-type account will allow for ECAC recovery of financing costs attributable to changes in the price of oil from the adopted price used in that base rate calculation. As explained below, the combined effect of these measures is to preserve the incentive for efficient utility management of the level of fuel oil in storage, while protecting the utility from changes in price over which it has no control. Third, we will exclude from ECAC consideration losses or gains attributable

to sales of oil [2] and underlift or other similar payments, such as Edison's facilities charge. [3] The effect of this measure is to avoid introducing into the fuels management process anomalous considerations due to differences in cost recovery mechanisms or related to specific conditions at a particular time (e.g., market prices prevailing on the date of sale). It enhances the utility's incentive for proper management of the level of fuel oil in storage.

The annual ECAC reasonableness proceeding provides an opportune forum for the first step in our adopted solution. One of the crucial variables - the reasonable test year level of oil in storage - should be examined as a matter of course in the evaluation of each utility's fuel procurement strategy and practices. The value of the oil is readily ascertained from the ECAC review of oil prices. The carrying costs are determined by the rate of return last found reasonable by the Commission.

The rate that results from this calculation is part of the base rate and is not subject to a balancing account. Thus, any variations from the test year figures represent an opportunity or risk for utility management, preserving the incentive to manage fuel oil efficiently.

We recognize a major difference between volumes of oil and value for ratemaking purposes. The management control over

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[2] All parties should be cautioned that simple exclusion of gains and losses may require more complicated economic analysis. A utility with excess fuel oil may sell its lowest or highest cost oil because of operating convenience. Basing the calculation of the gain or loss on the specific oil sold might distort the economics of the transaction. For this reason an average cost should be developed to account for the gain or loss from fuel oil sales.

[3] Edison's facilities charge is a specific contract amount that reasonably compensates its supplier for refinery fixed costs, regardless of variations in the volume of oil purchased. It allows Edison flexibility to adjust its oil purchase commitments, and does not vary with the price of oil. It is an ascertainable, certain cost that is appropriately recovered in base rates.

volumes is the major consideration supporting base rate recovery; the limitation of management control over prices is the major consideration supporting ECAC. Therefore, we provide for ECAC recovery of the changes in value (based on original cost) corresponding to changes in purchase price. This eliminates the risks existing in the present procedure for which there is no corresponding opportunity.

For the base rate calculation, we will adopt the weighted average inventory value estimated as of the ECAC revision date that corresponds with the annual reasonableness review. For the offset rate calculation, we will track the changes in value from the base rate value on a monthly basis, and provide for appropriate adjustments to the ECAC balancing account. For this purpose we assume that short-term debt is the incremental source of financing for changes in oil inventory and apply the same interest rate that is applied to the balancing account as the reasonable carrying cost, instead of the rate of return. In this way we avoid the argument that the utility is guaranteed its rate of return.

The procedure is illustrated by the following example: Assume that Utility A has revision dates of January 1, May 1, and September 1, and that January 1 identifies the annual reasonableness proceeding. We will develop a component of base rates effective January 1 based on a test year estimate of storage levels and the January 1 value. This rate is constant and remains in effect for the entire year regardless of variations in volume and price of oil. There is no associated balancing account.

Each month thereafter, the recorded value [4/] is applied to the test year volume and the carrying cost calculated based

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[4/] Actual average price per barrel of fuel oil in inventory each month.

on the increment of value above or below the value determined as of January 1. Mechanically, this calculation is the same as the interest rate calculation applicable to the balancing account. These "incremental" carrying costs are included in ECAC and recovered in the subsequent adjustments on May 1, September 1, and the following January 1, when a new base rate is desired. This offset calculation is also independent of any variations in the volumes of oil.

We are satisfied that this procedure materially improves the ratemaking treatment of fuel oil carrying costs, but we recognize that we have not succeeded entirely in balancing the risks and opportunities.

The adopted procedure appears adequate when applied to average year type conditions. We are concerned that further measures are necessary to address extreme swings in available energy mix.

We conclude that management's control of fuel oil supplies is not unlimited. Various circumstances outside management's control can interfere with the orderly management of fuel resources - particularly, weather. Abundant hydro and a warm winter can cause enormous swings in fuel oil requirements beyond the ability of management to avoid. Since we ask the utility to pass on to the ratepayers the entire benefits of lower cost energy, we find it reasonable to ask the ratepayers to share in the burdens.

The easy answer is simply to state that we recognize this risk in rate of return, but we think more tangible recognition can be achieved in the context of the procedures adopted in this decision.

However, further measures are required. Incentives can be real or illusory. An illusory incentive creates the appearance of an opportunity that is actually unattainable. This is the problem that we have with Edison's carrying costs proposal and the $\pm$ $50 million band. In extreme conditions the limit of the band is unattainable. Therefore, we find the apparent incentive ineffective and illusory.

The adopted procedure is also flawed in extreme conditions. A primary purpose of giving the utility a financial stake in its own fuels management decisions is to provide substantial incentive for the utility to devote appropriate care, attention, and resources to those decisions. There is a limit,

however, to the extent to which added risk to the utility can be expected to pay off in the form of more effective decision-making. We find that the interim procedure adopted above exposes utilities to risks in the event of unusual weather conditions which would have serious financial implications outweighing the accompanying incentives to good fuels management. It is therefore appropriate to place a cap on the magnitude of risk to which the utility will be exposed.

Our final solution involves more work and analysis. After more study we intend to implement a "floating" test year level of storage that varies from the test year level as recorded conditions vary from test year conditions. For example, suppose that favorable hydro conditons allow Utility A to substitute hydro for 8 million barrels of fuel oil. This mechanism would allow the test year storage level to rise by some portion of the 8 million so that the utility would recover some of its additional carrying costs. It would be left with a "real" incentive to minimize its costs of carrying the remaining fuel oil.

This procedure is closely analogous to the coal plant capacity factor incentive formula that is submitted for our consideration in A.59499 (Edison). Our staff resources are not sufficient to undertake the necessary study to design this mechanism; therefore we will again use a consultant to be selected by the Executive Director. Because of the relative impacts on PG&E given the interrelationship of hydro to fuel requirements in its energy mix, we designate PG&E as the appropriate utility for the initial review.

In view of the complexity of this discussion a brief summary is useful. We have removed the rate base component of fuel oil in inventory from the general rate case. Instead it will be developed annually in conjunction with the annual ECAC review. A base rate factor will be calculated, using the test year volume of oil and the estimated price as of the particular revision date. The base rate factor will remain constant for the year regardless of changes in sales, volumes of oil, or price of oil. There will be no balancing account associated with this base rate factor.

ECAC recovery will be allowed for the carrying costs attributable to changes in the price of oil from the adopted price used in the base rate calculation. The "carrying costs" will be based on the three months prime commercial paper rate that is used for the interest rate on the balancing account. This ECAC recovery does not recognize changes in the volume of oil in storage.

Gains or losses from the sale of oil, underlift payments, and facilities charges are excluded from ECAC. They will be taken into account, if appropriate, in fixing the base rate component.

Additionally, a method will be developed over the next year for recognizing changes in the volume of oil due to circumstances outside the control of the utility management. This procedure will allow the inventory level to "float" so as to recognize limitations on the ability of management to control oil volumes in extreme conditions. The result is that ratepayers and shareholders will share in the increased costs under such circumstances.

C. Variable Wheeling Charges

In D.90404 this Commission stated:

> "We determined in the generic ECAC investigation that wheeling charges should not be included in ECAC.... Wheeling charges are an expense that can be estimated on a normal year of operation basis and, as such, are most suitable for consideration in a general rate proceeding test year (where such costs are now recovered). Including these charges in ECAC burdens the proceedings and may tend to inhibit expedited consideration of semi-annual ECAC filings. . . . We shall follow this policy until it is changed in a general ECAC proceeding."

This is such a "general ECAC proceeding" and we find that a change in policy is appropriate.

Wheeling charges may be either fixed or variable. Fixed charges are generally associated with firm contracts and do not

vary depending on the amount of power delivered. Variable charges are generally associated with economy energy type transactions, so that the payments are a function of the amount of energy purchased. Fixed charges are readily recovered in base rates for the reasons stated in D.90404. Variable charges should be included in ECAC.

This is the position taken by PG&E, Edison, SDG&E, and staff. San Diego and San Francisco oppose ECAC recovery but suggest that "if the Commission desires to change its policy then the Cities recommend it follow its staff recommendations" to include variable wheeling charges.

The inclusion of variable wheeling charges in ECAC is consistent with our policy statement that ratepayers should share in costs as well as benefits. Such costs are typically incurred in connection with the substitution of a less expensive form of generation - a benefit to the ratepayers. We demand that the utility make the substitution. It should be made whole for the direct costs. The magnitude of these charges is highly speculative and not amenable to base rate type recovery.

The staff witness also recommended that the revenue collected by the wheeling utility should be included in ECAC. Such revenue is correspondingly as difficult to estimate for test year purposes as expenses.

We have decided to exclude wheeling revenue from ECAC. Our main consideration is our sense of relative incentives. ECAC treatment would remove the incentive to wheel, possibly defeating the transaction. The ratepayers are best off if the selling utility has an incentive to sell, the wheeling utility has an incentive to wheel, and the buying utility has no disincentive to buy.

D. Economy Energy Sales

The appropriate treatment of economy energy sales has been an issue in several ECAC proceedings. We have deferred a final decision to this generic proceeding.

There has been no dispute over the buyer's cost recovery in ECAC. There has been no dispute over the netting out of the seller's fuel expense and the equivalent offsetting revenue. The issue has been the ratemaking treatment of the incremental revenue above the fuel expense and whether it should be included in ECAC or base rates.

Our disposition is suggested by our discussion of variable wheeling charges. We wish to maximize the incentive for the seller - to give it an incentive to make sales that by definition are advantageous to the buyer. This result is achieved by excluding such revenue from ECAC.

E. DWR Sales

In D.85731 the Commission discussed the historic relationship of respondents and DWR as mutual buyers and sellers of electricity pursuant to long-standing contracts. Apparently our language was imprecise; there has been difficulty interpreting the decision and a disparity in the interpretation that has resulted in one treatment for PG&E and SDG&E, and another for Edison. The problem is summarized in this excerpt from PG&E's brief:

> "Under contracts between DWR and the California electric utilities, power is sold to DWR for operation of the state water project at fixed rates until April 1, 1983. Under a parallel agreement, power is purchased from DWR's Oroville-Thermalito project at comparable fixed rates. Under the present ECAC procedure, both total revenue and purchased power expense are included in the balancing account to the extent that sales do not exceed purchases. To the extent sales exceed purchases, the cost of such sales in excess

> of revenues is recoverable in base rates through a general rate proceeding. PG&E proposes that the cost of sales to DWR in excess of purchases be included in ECAC rates and not in base rates."

SDG&E has been accorded similar ratemaking treatment. Edison has been allowed ECAC recovery of the entire amount.

Only San Diego and San Francisco oppose ECAC treatment of excess DWR sales, relying on language in D.90404. We are satisfied that such sales are more reasonably reflected in ECAC.

The level of DWR sales is a matter difficult to estimate for test year purposes and beyond the control of utility management. The associated fuel expense is inherently the stuff of ECAC and we see no basis for denying its heritage. We are not persuaded that there is any "real" incentive to the utility from base rate treatment of excess sales.

This decision applies only to the existing DWR contracts. We make no judgment as to the appropriate ratemaking treatment of revenues and expenses associated with any subsequent contracts. They should be negotiated with recognition of a changing and volatile energy picture, with, for example, escalator provisions.

F. Nuclear Fuel Disposal Costs

PG&E and staff disagree over the appropriate treatment of nuclear fuel disposal costs. PG&E recommends ECAC recovery. Staff recommends base rate recovery "because the disposal methods have yet to be determined and the costs for such disposal are thus only highly speculative."

We will not include nuclear disposal costs in ECAC in this decision. This issue should be addressed by the utilities and staff in pending general rate proceedings.

G. Noneconomic Dispatch

Edison asks that ECAC recovery be allowed for expenses incurred from noneconomic dispatch of resources in order to implement a policy of this Commission or other governmental agency. Staff recommends that "special consideration" be given but that the burden be on the utility to "demonstrate that the noneconomic dispatch was reasonable under all the circumstances."

Our concern is with the degree of specificity of the expression of "policy". There is no objection to ECAC recovery where the costs result from mandatory government action. We are not prepared to excuse Edison from any economic responsibility based on its perception of general expressions of sentiment.

Edison cites its dilemma over the hypothetical substitution of gas for oil if the price of gas exceeds the incremental price of fuel oil. Gas is unquestionably a preferred fuel environmentally, but this Commission lacks jurisdiction to require the substitution. We therefore adopt the staff's recommendation.

H. Rate Design

Rate design has been a controversial issue in a number of ECAC proceedings. Several parties have suggested that we consider ECAC rate design generically in a record phase of this proceeding, so as to avoid the delay that has been associated with rate design.

We recognize the validity of these concerns, but prefer to deal with rate design on a company-by-company basis, reacting to specific circumstances. We intend to set general principles of rate design in general rate cases and apply those principles as much as possible in ECAC proceedings.

I. Staff Issues

In its opening brief staff proposes that this decision be interim, with further hearings to consider the following:

"A. Whether the Commission should establish standards for power plant reliability and efficiency for all electric utilities which would be used to determine, in part, the reasonableness of fuel related expenses recoverable through ECAC.

"B. Whether it would be desirable, and legally permissible, for the Commission to order all electric utilities to make oil purchases through a statewide committee which would also make purchases for municipally owned utilities.

"C. Whether the Commission should establish power pooling goals for each electric utility and disallow ECAC related expenses for failure to meet these goals.

"D. Whether the Commission should consider developing a more equitable assignment of risks between ratepayers and shareholders regarding the impact of forecasting resource mix.

> "E. Whether the Commission should adopt any additional rules or regulations to enhance incentives for prudent resource and fuel procurement management practices by the electric utilities."

Edison and SDG&E oppose the staff and recommend that this decision be a final order.

The issues staff raises are important and when it is ready to pursue them we can institute a proceeding to consider them. Since there is no reason now to keep this proceeding open we will issue a final order.

We are very interested in the role of incentives in ECAC. We do have under submission in A.59499 a proposed coal plant capacity factor formula for Edison that may be workable, and we agree with the Farm Bureau that "the concept embodied in the Edison coal-fired proposal might well be expanded to apply to additional fuels and to other electric utilities." We plan to pursue this in the ordinary course of ECAC.

VII. TRANSITION

The nature of the changes adopted in this proceeding requires that provisions be made for transition. Our major interest is that the transition be simple and workable while fair to utilities and ratepayers.

The procedural changes adopted are generally the interim procedures now in effect. The major remaining task is to complete the deferred reasonableness review.

The substantive changes require coordination of ECAC and base rates. For those matters presently in base rates we conclude that the transition should be prospective only. Each utility should quantify the portion of its base rates that is attributable to these ECAC matters as of its next revision date and propose an appropriate adjustment. We will not require an accounting of the difference between recorded and test year expenses and revenues.

The fuel oil problem is not so simply resolved. Losses or gains on sales, underlifts, and facilities charges should continue to be recovered in ECAC until the annual reasonableness proceeding when such matters will be recognized in setting base rates. The FORBA-type provision is effective immediately. Each utility should make the calculation of its recoverable carrying costs relating back to its most recent general rate case decision as the basis for an initial adjustment to ECAC.

Our experience with ECAC suggests that better regulation would be achieved with uniform tariff provisions for each utility. Therefore, respondents are directed to work with staff to develop such provisions.

Findings of Fact

1. ECAC is an essential tool that fairly balances the interests of utilities and ratepayers while allowing the Commission to recognize changes in price and resource mix that would otherwise present enormous risks or opportunities in terms of economic consequences for the utility.

2. It is important that utilities have incentive to minimize their fuel costs, and an appropriate balance of risk and incentive results from including 98 percent of otherwise recoverable fuel expenses in ECAC, with the remaining two percent to be forecast annually and reflected in rates on a forward-looking basis only.

3. ECAC has been characterized by chronic undercollection.

4. Future clause recorded revenue-expense differentials should be held at a minimum.

5. Triannual revisions are necessary in order to reflect changes in price and resource mix on a more current basis.

6. A rigorously structured regulatory lag program is unnecessary.

7. The following revision dates are reasonable:

PG&E: April 1, August 1, December 1;
Edison: January 1, May 1, September 1;
SDG&E: March 1, July 1, November 1;
Sierra: February 1, June 1, October 1.

8. Each utility should file its application 60 days prior to the revision date.

9. Only reasonably incurred fuel costs are recoverable in ECAC.

10. The reasonableness of recorded fuel costs can and should be examined in an annual review of each utility.

11. The following revision dates are reasonable for each utility's annual review:

PG&E: August 1;
Edison: May 1;
SDG&E: November 1;
Sierra: February 1.

12. The record period is the 12 months ending as of the preceding revision date.

13. Reliance on recorded data for the prospective resource mix has contributed significantly to undercollection.

14. The balancing account provides a vehicle for recognizing that overcollection has occurred and for amortization of the overcollection.

15. Each utility's fuel procurement strategy resource estimates will provide a reasonable basis for ECAC calculations.

16. The ECAC factor should be developed based on a four-month burn.

17. The use of recorded fuel prices in setting the prospective offset rate has induced undercollection.

18. Fuel prices estimated as of the revision date will allow recognition of current costs.

19. The use of estimated sales is consistent with estimated resource mix and prices.

20. The balancing account balance should be estimated as of the revision date.

21. The appropriate amortization period should be decided in each proceeding.

22. Updated recorded information can and should be used whenever possible, subject to later audit.

23. The commercial paper rate, adopted previously, is a reasonable indicator of the cost of financing the balancing account.

24. Monthly compounding most accurately reflects the cost or value of the balancing account balance and customer deposits.

25. The franchise fees and uncollectible expense factor found reasonable in the last general rate case can and should be applied to ECAC.

26. Balancing account treatment reduces the incentive to control costs.

27. Balancing account treatment eliminates entirely the opportunity for the utility to profit from successfully managing expenses.

28. The essential reason for ECAC recovery is the inability of management to control the expense.

29. Fuel oil procurement policies must reflect the status of the fuel in the resource mix and provide flexibility for managing supplies to reflect changes in the availability of other resources.

30. ECAC has introduced a distraction into the decision-making process by providing for different ratemaking treatment depending on the utility's choice among options for disposing of excess oil.

31. Ratemaking consequences should not encourage unsound operating decisions.

32. Current ratemaking methods do not fully balance the risks and opportunities relating to managing fuel oil at the margin.

33. Fuels management is an integral part of day-to-day utility management.

34. Our regulatory responsibility is most reasonably discharged by vesting in the utility a direct stake in its fuels management decisions.

35. Carrying costs of fuel oil in storage should be excluded from ECAC.

36. Gains or losses from sale of fuel oil should be excluded from ECAC.

37. Underlift payments and facilities charges should be excluded from ECAC.

38. The traditional rate base treatment of fuel oil in storage is an inadequate response to the issues surrounding fuel oil management.

39. The carrying cost component of base rates should be developed annually.

40. The reasonable test year level of oil in storage should be examined as a matter of course in the evaluation of each utility's fuel procurement strategy and practices in the annual review.

41. The value of the oil in storage is readily ascertained from the ECAC review of oil prices.

42. ECAC recovery for changes in value of oil in storage corresponding to changes in price is reasonable.

43. The same interest rate calculation that is applied to the balancing accounts should be applied to the changes in value of oil as the reasonable carrying cost.

44. Further measures are necessary to recognize consequences of extreme conditions.

45. Various circumstances outside management's control can interfere with the orderly management of fuel resources.

46. Since we ask the utility to pass on to the ratepayers the entire benefits of lower cost energy, we find it reasonable to ask the ratepayers to share in the burden.

47. A "floating" test year level of storage that varies from the test year level as recorded conditions vary from test year conditions would more fairly recognize the real risks and opportunities for the utilities.

48. A consultant should be retained to develop the standards for such a mechanism.

49. Variable wheeling charges should be recovered in ECAC because they are too difficult to estimate.

50. Wheeling revenues should be reflected in base rates to give selling utilities incentive to wheel.

51. Economy energy sales should be reflected in base rates in order to maximize incentive to sell surplus power.

52. The cost of sales to DWR in excess of purchases should be included in ECAC.

53. The additional costs associated with noneconomic dispatch of resources may be recovered in ECAC upon a sufficient showing.

54. Uniform tariff provisions will aid in the administration of ECAC.

Conclusions of Law

1. ECAC procedures should be substantially modified.

2. The ratemaking treatment of costs of managing fuel oil supplies should be modified.

3. ECAC recovery should be allowed for variable wheeling charges and DWR sales.

4. Matters previously included in ECAC and not excluded in this decision should remain in ECAC.

5. The procedural changes are effective immediately.

6. ECAC recovery for those matters presently in base rates should be prospective only.

7. Losses or gains on sales of fuel oil, underlifts, and facilities charges should continue to be recovered in ECAC until the annual reasonableness proceeding.

8. The recognition of changes in value of the test year volume of oil in storage is effective immediately. Each utility should calculate the appropriate adjustment from the decision on its most recent general rate case.

9. In order to implement these provisions on a timely basis, the following order should be effective immediately.

O R D E R

IT IS ORDERED that:

1. Energy Cost Adjustment Clause (ECAC) procedures are modified as follows:

   a. The tariff revision dates for the respondent utilities' ECAC billing factor shall be as follows:

      Pacific Gas and Electric Company: April 1, August 1, December 1;

      Southern California Edison Company: January 1, May 1, September 1;

      San Diego Gas & Electric Company: March 1, July 1, November 1;

      Sierra Pacific Power Company: February 1, June 1, October 1.

      Each respondent shall file its application for tariff revision at least sixty days before the revision date.

   b. The reasonableness of energy costs debited to the ECAC balancing account shall be reviewed once annually. The schedule of such review as related to ECAC proceedings for the respondents is:

      Pacific Gas and Electric Company: August 1;
      Southern California Edison Company: May 1;
      San Diego Gas & Electric Company: November 1;
      Sierra Pacific Power Company: February 1.

      The record period for ECAC balancing account review on reasonableness shall be the twelve months ending as of the preceding revision date.

c. This annual review shall also be the occasion for adoption of a forecast of fuel-related expense for the twelve-month period beginning as of such revision date, with two percent of such forecast expense to be reflected in current rates without possibility of adjustment through ECAC procedures in light of subsequent events.

d. The ECAC factor for recovering estimated prospective expense shall be based on estimated fuel and energy prices. An estimated energy mix shall be used. A four-month prospective test period, starting with the revision date, shall be used for estimated fuel and energy costs as well as energy mix. The balancing account balance shall be estimated as of the revision date.

e. Interest on the balancing account balance shall be calculated as directed in D.91269.

f. The period for amortizing balancing account over- or undercollections will be considered in each proceeding.

g. The franchise and uncollectible expense component of the ECAC offset rate shall be the factor adopted in the utility's last general rate proceeding.

2. Treatment of fuel- and energy-related costs in ECAC for particular items shall be as follows:

a. Gains or losses from the sale of fuel oil are excluded.

b. Underlift payments, facilities charges, and similar expenses are excluded.

c. Changes in the value of oil in storage corresponding to changes in price can be recovered, and the interest rate applied to the ECAC balancing account will apply as the carrying cost for the incremental change in oil value.

d. Variable wheeling charges can be recovered prospectively.

e. Revenues from wheeling are excluded prospectively.

f. Economy energy sales are excluded prospectively.

g. The cost of utility sales to the Department of Water Resources in excess of purchases (or net loss) resulting from existing contracts can be recovered.

h. Additional incremental costs associated with noneconomic dispatch of resources may be recovered only upon a showing that such dispatch was mandated by a governmental agency.

3. To provide a transition for implementing this order:

a. The procedural changes are effective immediately.

b. Recovery through ECAC of items presently underlying base rates will be prospective only, except as provided in "d." below.

c. Losses and gains on sales of fuel oil, underlift, and facilities charges shall continue to be recovered in ECAC until the annual reasonableness proceeding for each utility.

d. The recognition of changes in value of the last adopted test year volume of oil allowed in rate base is effective immediately and shall be calculated from the effective date or the utility's last general rate decision.

4. Each respondent shall make the calculations and propose corresponding adjustments consistent with this order. Each shall make future ECAC filings in conformance with this decision. Any party who thinks other classes of expenses should be included in and/or excluded from ECAC or procedures changed should petition to reopen this proceeding.

5. Upon filing ECAC applications each respondent shall serve a copy by mail on all appearances in its last general rate proceeding and the most recent ECAC proceeding.

6. The respondents and interested parties shall confer with the Commission staff on developing uniform preliminary statement tariff provisions. Within ninety days from the effective date of this order they shall submit uniform tariff language, which shall be adopted after Commission review and resolution.

7. Within sixty days from the effective date of this order Pacific Gas and Electric Company shall submit to the Executive Director for his approval a plan for selecting and hiring a consultant to prepare a report on the fuel oil

inventory adjustment procedure designed to recognize changes in volume due to variations from average year conditions.

The effective date of this order is the date hereof.

Dated DEC 5 - 1980, at San Francisco, California.

President

Commissioners

Commissioner Vernon L. Sturgeon, being necessarily absent, did not participate in the disposition of this proceeding.