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Report to Rep. John E. Moss; Rep. Harold T. Johnson; Rep. John J. McFall; Rep. Robert L. Leggett; Rep. Don Edwards; Rep. Norman Y. Mineta; Rep. Paul N. McCloskey, Jr.; by Monte Canfield, Director, Energy and Minerals Div.

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Congressional Relevance: House Committee on Public Works and Transportation; Senate Committee on Energy and Natural Resources. Rep. John E. Moss; Rep. Harold T. Johnson; Rep. John J. McFall; Rep. Robert L. Leggett; Rep. Don Edwards; Rep. Norman Y. Mineta; Rep. Paul N. McCloskey, Jr.

The Central Valley Project (CVP) is a large multiple-purpose water resources development project in California consisting of 19 dams with related water conveyance systems, power generation, and transmission facilities. The project's primary purpose is to provide irrigation water to the Sacramento and San Joaquin Valleys. Its secondary purposes are to provide municipal and industrial water, flood control, fish and wildlife enhancement, and hydroelectric power generation. In December 1976, the Department of the Interior announced an adjustment in the rate for Northwest power sold to the Pacific Gas and Electric Company (PG&E) by the Central Valley Project retroactive to April 1, 1976. Findings/Conclusions: The Bureau of Reclamation did not jointly review the rate with PG&E to negotiate a change in the rate for Northwest power sold to PG&E as of April 1, 1971, as required by the contract. A compromise rate adjustment was negotiated in December 1976 which established a split rate based on charging the full cost for Northwest energy to PG&E but dividing the capacity into two components: the first component, with energy associated at 60% load factor, is charged at the pass-through rate; the second component, consisting of the remaining Northwest capacity available to PG&E, is sold at the CVP system power rate. The decision to approve the split-rate appears to be a compromise that would be acceptable to PG&E. Because there was a disagreement of the affected parties and, under the contract, the matter could have been referred to the Federal Power Commission for a decision, such a referral was in order. However, the records do not show the rationale for not taking

this course of action. (SC)

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UNITED STATES
GENERAL ACCOUNTING OFFICE

04254

Rationale For Power Rates Charged By The Central Valley Project To Pacific Gas And Electric Company

The Central Valley Project is a large multiple purpose water resources development project in California. It consists of 19 dams with related water conveyance systems, power generation and transmission facilities. This report discusses the rate determining process for power sales from the project to the Pacific Gas and Electric Company.

EMD-78-18

NOVEMBER 21, 1977

UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

ENERGY AND MINERALS DIVISION

B-125042

The Honorable John E. Moss
The Honorable Harold T. Johnson
The Honorable John J. McFall
The Honorable Robert L. Leggett
The Honorable Don Edwards
The Honorable Norman Y. Mineta
The Honorable Paul N. McCloskey, Jr.
House of Representatives

In accordance with your request, and subsequent discussions with your liaison, we obtained information on the rate determining process for power 1/ sales from the Central Valley Project (CVP) by the Department of the Interior's Bureau of Reclamation to the Pacific Gas and Electric Company (PG&E) under sales contract number 14-06-200-2948A.

In December 1976 the Department announced an adjustment in the rate for Northwest power sold to PG&E, retroactive to April 1, 1976. CVP customers expressed concern with this decision because they believed that (1) the adjusted rate did not reflect the full cost of Northwest power; (2) the rate should have been adjusted on April 1, 1971, as provided for in the contract, to reflect the cost of Northwest power; (3) the failure to adjust the rate on April 1, 1971, resulted in the Bureau incurring a loss of $70 million on Northwest power sold to PG&E; and (4) any loss will result in higher rates for the preference customers.

On the basis of these concerns, you requested that we determine (1) why the Department did not increase the rate for Northwest power on April 1, 1971, in accordance with the contract; (2) the extent of the loss incurred by the Government because the rate was not adjusted on April 1, 1971; and (3) the rationale behind the decision to adjust the rate in December 1976 at less than the full cost of Northwest power.

1/The term "power" is used in a broad sense and includes capacity and energy.

EMD-78-18
(00858)

Our review was conducted primarily at the Bureau's regional office in Sacramento, California. We examined pertinent documents concerning the power rates and discussed our work with Bureau and PG&E officials. In addition, we previously issued a report on CVP power rates ("California's Central Valley Project-Proposed Power Rate Increase," B-125042, 11/19/73) which pertains to this matter.

BACKGROUND

CVP is a large multipurpose water resources development project in California, consisting of 19 dams and related water conveyance systems and power generation and transmission facilities. CVP's primary purpose is to provide irrigation water to the Sacramento and San Joaquin Valleys. Its secondary purposes are to provide municipal and industrial water, flood control, fish and wildlife enhancement, and hydroelectric power generation.

CVP power generation began in 1944 and for the first several years, virtually all power output was sold to PG&E, an investor-owned California utility company. In 1951 the Bureau and PG&E entered into two contracts. The first provided for partial integration of the two electrical systems and delivery of CVP power over PG&E transmission lines to CVP preference customers 1/; the second permitted PG&E to purchase surplus CVP power not required by preference customers.

Although the two contracts were modified from time to time, they remained in effect until July 31, 1967, when the Bureau and PG&E entered into a new sales and transmission contract (14-06-200-2948A). The new contract, which basically is a continuation of the previous two contracts, runs through the year 2004.

The contract provides that, among other things, power generated by the CVP system, along with power imported from the Pacific Northwest over the Pacific Northwest--Southwest Intertie, which is in excess of the Bureau's requirements, be sold to PG&E. The contract also provides that the Bureau can purchase an equivalent amount of power from PG&E at times and in amounts required when the CVP power supply is insufficient to meet its customer requirements. These provisions

1/Customers served by CVP which include municipalities, cooperatives, irrigation districts, and Federal and State agencies in northern California. These customers are established by legislation.

are referred to as the banking arrangement. Energy sold to PG&E and banked before July 31, 1967, is referred to as Energy Account No. 1, and sales since that date are in Energy Account No. 2. Capacity sold to PG&E after January 1, 1965, is in a Capacity Account.

With the banking arrangement, CVP estimated it would be able to meet its customers' firm (consistently relied on) load of 1,050 megawatts 1/ from 1980 through 2004; without it, CVP estimated it could not. The Bureau estimated that the banking arrangement would allow CVP to satisfy a firm load of 925 megawatts and to meet the load growth (increased demand for power) of certain customers up to a total of 1,050 megawatts.

To meet its power commitment, the Bureau entered into an arrangement with a group of Pacific Northwest public and private utilities on December 26, 1967, to purchase about 400 megawatts for the period 1972 through 1981. The power source was a new coal-fired steamplant near Centralia, Washington, and the Bureau agreed to pay the utilities the actual costs for its share of the plant's output and Bonneville Power Administration 2/ for a standby source of power. The contract between the Bureau and PG&E provided that Northwest power be sold to PG&E at the established CVP system power rate. 3/ It further provided that:

> "Rates and charges under this contract shall be fair and equitable and shall * * * be jointly reviewed, and adjusted as appropriate on April 1, 1971, and every five years thereafter * * *. Such review shall take into account substantial savings accruing to either party and applicable costs of construction and production, including changes therein and appropriate service charges during the preceeding five years."

1/1 megawatt equals 1,000 kilowatts.

2/An Interior Agency responsible for marketing power in the Pacific Northwest from the Federal Columbia River Power System.

3/The rate charged for all power from the CVP system and same rate for all customers. The system power rate at that time was $0.75 a month per kilowatt for capacity and a sliding charge of 4, 3, and 2 mills per kilowatt-hour for energy. This rate had been in effect since 1945.

If no agreed upon rate can be developed, the case is to be referred to the Federal Power Commission (FPC) for decision.

RATE ADJUSTMENT NOT MADE APRIL 1, 1971

The Bureau's regional officials told us that they did not jointly review the rate with PG&E to negotiate a change in the rate for Northwest power sold to PG&E as of April 1, 1971, because (1) the general concept was to charge all customers, including PG&E, the CVP system power rate rather than the specific cost of Northwest power; (2) the cost of Northwest power was not known because CVP did not begin receiving the power until January 1972; and (3) by selling the power at a low rate, CVP could buy it back at a low rate in the future. 1/ The regional officials acknowledged that sometime before April 1971 they had an indication that the cost of Northwest power would be higher than originally estimated, but they did not know how much higher and thus had no firm figures for reviewing and revising the rate with PG&E.

An official of the Bonneville Power Administration told us that before April 1, 1971, it was known the construction cost of the Centralia plant was going to be higher than originally estimated, but information indicating that fuel and operating costs were going to be substantially higher than originally estimated was not available.

LOSS ON THE SALE OF NORTHWEST POWER

CVP first began receiving power from the Northwest in January 1972, and most of the power was sold to PG&E. The following schedule shows the loss incurred by the Bureau from the sale of Northwest power during the period January 1, 1972 through March 31, 1976.

1/The rate for power bought by CVP from PG&E in the Capacity Account and Energy Account No. 2 is to be calculated on the basis of a formula which takes into consideration the original price PG&E paid for the power.

Losses to CVP on Northwest Power for Period January 1, 1972 to March 31, 1976 (note a)

	PG&E	Preference customers	Totals
Cost of purchases of Northwest power:			
Capacity (note a)	$ 63,284,488	$ 3,023,072	
Energy (note a)	42,845,455	22,761,481	
TOTAL	$106,129,943	$25,784,553	$131,914,496
Revenues from sales of Northwest power:			
Capacity	$ 13,334,412	$ 536,974	
Energy	19,619,887	10,242,637	
TOTAL	$ 32,954,299	$10,779,611	$ 43,733,910
Loss on sales:			
Capacity	$ 49,950,076	$ 2,486,098	
Energy	23,225,568	12,518,844	
TOTAL	$ 73,175,644	$15,004,942	$ 88,180,586

a/The rate for electric power is made up of two components, capacity and energy. In accounting for the cost of Northwest power, the capacity component generally consists of the annual fixed, operating, and maintenance costs of the generating plant that produces the power. The energy component generally consists of the annual fuel cost of the generating plant.

According to the Department, when the Centralia plant was placed in service in the fall of 1971, its output was restricted to meet air pollution control requirements, which resulted in increased per unit power costs. Other pollution abatement equipment was later installed at an added cost of about $42 million, about one-fifth of the plant cost. After the plant began operation, the actual cost of coal to operate the plant was more than twice the initial estimated cost. Also because of air pollution control regulations, the plant operated at lower than capacity, further increasing the per unit cost which CVP had to bear.

At the same time CVP was paying higher costs for Northwest power, it was selling the power to PG&E at a contractual sales rate that had not been adjusted as of April 1, 1971, and could not be adjusted until April 1, 1976. Rate and repayment studies 1/, made by CVP in 1973 in determining the CVP system power rate, indicated the existing system power rate would have to be increased. According to the Department, the high cost of Centralia power was the principal reason for CVP needing a rate increase. The CVP system power rate was increased on April 1, 1974 2/. However, the rate to PG&E for Centralia power remained at the old system rate because of the contract restrictions.

Since the sum of revenues from PG&E and CVP customers for Centralia power must reimburse the Government for its

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1/To determine whether power rates are adequate for recovering the Federal investment in a system within the required repayment period, each Federal power agency generally makes and publishes periodically consolidated rate and repayment studies covering all power projects in the system. These studies show actual costs and revenues for all projects through the current fiscal year and projected estimated costs and revenues through the remainder of the repayment period.

2/The April 1, 1974 rate increase was the first step of a two-step increase. The second increase was to go into effect April 1, 1977. However, in February 1975 the United States District Court, District of Columbia, found, as a result of a suit filed by the CVP preference customers, that proper procedures had not been followed and the customers had been denied due process of law in the rate adjustment procedure and ordered the rate set aside.

out-of-pocket costs, the amount which PG&E pays for this power affects the rate to be paid by the preference customers. The losses in the previous table have been included in rate and repayment studies made by CVP in determining the CVP system power rate for preference customers. These rate and repayment studies indicate that a system rate increase of about 180 percent will be needed.

RATE ADJUSTMENT

In August 1975 the Bureau presented a tentative power rate adjustment study for PG&E and CVP customers as part of its rate adjustment procedure. The study presented two rate alternatives for the sale of power to PG&E. Alternative 1 assumed that PG&E would be charged the full cost or "pass-through" rate for Northwest purchased power. Alternative 2 assumed that PG&E would continue to pay the CVP system power rate for Northwest power.

These options were evaluated and on February 20, 1976, the Department's Assistant Secretary for Land and Water Resources (see app. I for organization of positions at Department of the Interior pertaining to this report) announced that the Department proposed to support the pass-through rate to PG&E and implement the rate effective April 1, 1976. On March 30, 1976, PG&E met with Department officials and requested the postponement of the rate increase for at least 30 days to permit further study. Reasons given by PG&E for a delay were:

--The pass-through proposal is unfair and inequitable because they would be paying a full rate for capacity without receiving the energy.

--There is mutual advantage in taking the time now to attempt to resolve differences rather than turning it over to FPC with an attendant long delay.

--Extension does not increase the risk of later legal action.

The request was granted on March 31, 1976, by the Under Secretary of the Interior. On April 1, 1976, the Under Secretary instructed the Bureau to develop options to the pass-through rate that would be mutually agreeable to both PG&E and the Bureau. Subsequently, a compromise rate, alternative 3, was developed and referred to as the "split"

rate. In December 1976, following several months of comment from PG&E and the preference customers and deliberation by the Department, the split rate was established by the Under Secretary and agreed to by PG&E.

The split rate is based on charging the full cost for Northwest energy 1/ but dividing the capacity 2/ into two components. The first component, with energy associated at 60-percent load factor 3/ is charged at the pass-through rate. The second component is the remaining Northwest capacity available to PG&E and is sold at the CVP system power rate.

Rationale for the split-rate decision

In Congressional hearings held during January 1974 concerning a CVP proposed system power rate increase, the concept of proportionate allocation of power costs was discussed. During the hearing both the Bureau and PG&E presented testimony implying that Northwest capacity should be allocated proportional to the Northwest energy sold to PG&E. Any additional capacity and energy sold to PG&E would then be deemed to have been provided from the CVP hydroplants. This method of allocating capacity and energy would have no effect if both PG&E and the preference customers paid the same rate for all power.

1/Energy is the amount of power used.

2/Capacity is the rate at which a generating unit produces, or is capable of producing energy. The following is an illustration explaining the distinction between energy and capacity.

A chandelier with 10 100-watt bulbs is a 1,000-watt, or 1 kilowatt, light fixture. To illuminate all 10 bulbs at the same time, a power source with the capacity to produce 1 kilowatt is required. If the chandelier is illuminated for 1 hour, 1 kilowatt hour of energy is consumed; if it is illuminated for 2 hours, 2 kilowatt hours of energy are consumed. Energy is the amount of power used, and capacity is the rate at which the power is produced. The capacity stays the same but the energy changes depending on the length of time the lights are on.

3/The ratio of the average load over a designated period to the peak or maximum load occurring in that period.

This method was in contrast to the actual procedure used by the Bureau in billing PG&E for the sale of Northwest power and CVP hydropower. Monthly bills submitted to PG&E by the Bureau were based on the contractual concept that CVP capacity is used to meet project and preference customer loads first, and Northwest capacity is used to supplement the CVP capacity. Additionally, since all CVP capacity was used for project and customer load at that time, the only capacity that could be sold to PG&E was Northwest capacity.

During late 1974 the Bureau and PG&E's push for such a method was curtailed. In November 1974 the Assistant Solicitor for Power, in an opinion concerning the "proportionate" method of allocating capacity, stated that this method was not provided for in the Interior's contract with PG&E. However, the final paragraph in his opinion stated:

> "Even though it is quite clear that the contract provides for the allocation of capacity separately from energy, it is perhaps useful to point out that the use of this method of allocation is one of the factors that may be taken into consideration in the ongoing review under Article 32 in determining what rates for Centralia capacity and energy would be fair and equitable."

PG&E continued to advocate the proportionate allocation method after the Bureau's proposed power rate increase announcement of February 20, 1976. Their position was that the proposed pass-through rate combined with the "separate" allocation method would result in PG&E consumers paying an inequitably high price for power they were not receiving, and thereby subsidizing the preference customers. The California Public Utilities Commission expressed similar problems with the proposed Northwest pass-through rate.

PG&E officials informed us that during a March 1976 meeting with Interior they proposed that they would pay the pass-through rate for Northwest capacity associated with energy at 80-percent load factor (the typical Northwest delivery level to the Bureau). For all other capacity they would pay the CVP system power rate. After this meeting the Bureau was instructed by the Under Secretary to develop options to the pass-through rate that would be acceptable to both the Bureau and PG&E. The Bureau looked at split rates for capacity with energy at 40-, 60-, and 80-percent load factors. This analysis showed that the higher the load factor, the lower the rates would be to PG&E.

Interior chose the 60-percent split-rate as the alternative to discuss with the preference customers. Separate meetings between Interior and representatives of the preference customers were held on April 26 and May 14, 1976, where the 60-percent split rate alternative was discussed.

Representatives of the preference customers disagreed with the alternative. They stated that PG&E, upon entering into the contract in 1967, was aware there was no assurance that capacity associated with energy at 80- or 60-percent plant factor would be available to them. They further argued that it is not uncommon for utilities to sell capacity and energy as separate components 1/ at the same price as capacity with energy. They cited Bonneville Power Administration and other Bureau projects as examples that market capacity and energy in this manner.

The preference customers opposed the split-rate alternative on the basis that (1) PG&E paid less than cost for Northwest power in the period between 1972 and 1976 and accrued savings of about $73 million, and (2) PG&E enjoys great savings in the purchase of Centralia power as compared to the costs it would experience if power was purchased from alternative sources.

With regard to past savings, PG&E said that any retroactive adjustment in the Northwest rate to them is prohibited by the contract. They added that the contract provides for prospective rate adjustments on a 5-year basis, and when the last opportunity for rate adjustments occurred (April 1971), neither PG&E nor the Bureau requested a change.

The banking arrangement was also used by PG&E as an argument against retroactive adjustment. PG&E argued that the estimated losses it will suffer under Energy Account No. 1 far outweigh the Bureau's past Northwest losses. Under Energy Account No. 1, PG&E must provide the Bureau, upon demand, energy at the set rate of 2.81 mills per kilowatt-hour. The average cost to PG&E for power generation in 1976 was about 20 mills per kilowatt-hour. CVP estimates that Energy Account No. 1 will provide CVP its additional energy needs from 1981, the expiration date of the Northwest contract, through 1985.

1/Although energy cannot physically be separated from capacity, utilities do enter into agreements where capacity with energy is delivered and the energy is later returned.

Concerning alternative costs, PG&E asserted that the preference customers had overestimated PG&E's alternative costs in lieu of Northwest power. PG&E did not consider alternative cost a proper measure of a "fair and equitable" rate and suggested the proper way to set rates which permit the Bureau to recover its costs of Centralia power is by fairly allocating these costs to its customers.

After hearing the arguments of both PG&E and the preference customers, the Bureau believed that PG&E should pay the pass-through rate for Northwest power rather than the split-rate. This position was taken in a draft paper prepared by the Bureau entitled "Final Position on an Adjustment in Rates to the Pacific Gas and Electric Company for Northwest Capacity and Energy." The draft document is dated July 1, 1976, and states their position as follows:

> "In general, PG&E argues that the proposed capacity and energy charges for the pass-through rate are too high and that it should be charged the same rate for Northwest power as for project power. Most of the preference customers contend that the pass-through rate is too low and that any split-rate is completely inappropriate. *** After reviewing the arguments pro and con, we have concluded that our proposed rate was a proper one and here reaffirm it with several minor clarifications. This position has been discussed with PG&E which informally advises us that it cannot agree to it. Consequently, if this PG&E position is confirmed, the matter will be submitted to the Federal Power Commission for final decision in accordance with article 32 of the contract.
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> * * * * *
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> We therefore, reaffirm that the rate to PG&E for Northwest capacity and energy will be as announced on February 20, 1976."

The July 1, 1976 draft position paper was not finalized or issued. Then on July 9, 1976 the Deputy Under Secretary requested the Assistant Secretary, Program Development and Budget, to review the arguments for and against the pass-through and the split-rate. The Deputy Under Secretary's letter stated that "* * *based on your review, you should recommend to me the basis for the final rate to PG&E." The Program Development and Budget analysis staff presented the

results of their review on July 22, 1976. They recommended that PG&E be charged the pass-through rate plus past losses of about $73 million incurred by the Bureau in sales of power to PG&E. They referred to this rate as the "pass-through plus savings" rate. The Deputy Under Secretary subsequently requested a solicitor's opinion concerning this interpretation of the contract. The Deputy Solicitor's opinion, dated August 10, 1976, considered the Program Development and Budget staff analysis of that contract improperly restrictive.

In arriving at its position the Program Development and Budget staff also stated:

> "Aside from the proper rate, which we have discussed, there may be some interest in charging a lower than proper rate in order to avoid an appeal to the Federal Power Commission. We recommend against such a course, because: (1) the costs of an appeal are negligible to the Reclamation compared to the revenues at stake, (2) the ability of Reclamation to hold contractors to their contracts in the future will be weakened, and (3) the decision will probably be appealed in any case."

After receiving the staff analysis and solicitor opinion, the Deputy Under Secretary requested the Deputy Assistant Secretary, Land and Water, to prepare an option paper setting forth the pass-through and split-rate alternatives and the principle arguments for each. This option paper was to serve as a decision document for the Under Secretary's review.

On August 25, 1976, the Executive Secretary acting on behalf of the Deputy Under Secretary issued the option paper to the Assistant Secretaries, Land and Water Resources and Program Development and Budget; the Solicitor; and the Commissioner, Bureau of Reclamation. His accompanying memorandum stated:

> "* * * each of your offices has played an important role in the analysis. In order to permit the Under Secretary to know which option you recommend please indicate in a memorandum to the Deputy Under Secretary * * * the option you recommend with a succinct statement describing the rationale for your position."

Subsequent memorandums were received from each of the four officials all recommending the pass-through rate.

--The Acting Commissioner of Reclamation recommended the pass-through rate on the basis of cost of service, past savings to PG&E, and PG&E's alternative cost of power.

--Assistant Secretary, Program Development and Budget, recommended the pass-through rate on the basis that capacity, even at low load factor, has significant value to PG&E, and that PG&E had already received lower-than-cost rates between 1972 and 1976.

--Assistant Secretary, Land and Water Resources, recommended the pass-through rate after considering the benefits that had accrued to PG&E and the Department.

--The Solicitor recommended the pass-through rate on the basis that it was the only rate that could be fully supported on the record. In addition, the Solicitor stated:

"If the only provision in Article 32 was that the rate should be 'fair and equitable' for the next 5 years, then there would be some merit to PG&E's argument that the pass-through rate is too high because it receives a low, varying and unreliable quantity of energy with each kilowatt of firm capacity that it is required to purchase under the contract. However, by PG&E's own calculations, this fact is more than offset by the 'substantial savings' that accrued to it in the 1972-76 period. * * * Thus, when past savings are taken into consideration, as required by Article 32, using the company's [PG&E] figures, the pass-through rate favors the company and discriminates against the preference customers."

The Deputy Under Secretary, after receiving the above recommendations favoring the pass-through rate, submitted his September 1, 1976 memorandum recommending the split-rate to the Under Secretary. The basis for his recommendations is as follows:

"I believe that the test of 'fair and equitable' under the terms of the contract can best be met by setting rates for Northwest capacity and energy that

reflect the alternative costs to PG&E of capacity and energy similar in amount and dependability to that which will be provided to PG&E over the next 5 years. The alternative costs concept requires that the rates we set for PG&E accurately reflect the value of Northwest energy and capacity it receives. The rate, therefore, should appropriately account for capacity with energy at low-load factors on an undependable schedule. I would not provide special rate adjustments for savings inasmuch as substantial savings under the Northwest power arrangement have accrued to both parties in amounts that appear to be approximately offsetting. In light of this, I recommend that you select Option 2--the split-rate."

On September 8, 1976, after reviewing the above input and recommendations from his staff, the Under Secretary was prepared to make a decision; however, he again solicited legal advice concerning whether both rate options could be supported on the record. The draft response, written by the Assistant Solicitor reiterated that from a legal standpoint the split-rate could not be supported on the record. On September 24, 1976, the Deputy Associate Solicitor disagreed with the Assistant Solicitor for Power's conclusion and said that in his judgment the draft opinion represented the views of an advocate and not the balanced legal advice the Under Secretary has a right to expect from the Solicitor's office. He went on to say that:

"Both the pass-through rate and the split-rate are discussed at length in the record. While the weight of opinion in the Department seems to favor the pass-through rate, this does not mean that the Under Secretary is precluded from choosing the split-rate based on the record."

Subsequently, the Solicitor submitted to the Under Secretary a memorandum dated September 28, 1976, stating that after reviewing the file again, he was of the opinion that, from a legal point of view, both rates could be supported on the record.

On November 9, 1976, the Deputy Under Secretary announced that the Under Secretary had decided on the split-rate and requested the Solicitor to prepare a final rate statement to reflect the decision. The final decision was formally announced by the Under Secretary on December 14. PG&E agreed with the decision on December 20, 1976.

In the final position statement the Under Secretary stated:

> "I have examined the record regarding the February 20, 1976, proposed decision on PG&E power rates, reviewed both oral and written comments presented by the preference customer and PG&E, considered internal staff documents concerning the proposed rate adjustment, and have concluded that the "split" rate is the appropriate rate for PG&E to pay for Northwest power."

OBSERVATIONS

The pros and cons of the split- and pass-through rates are documented in records. PG&E and the preference customers were given opportunity to present their views which provided input to the Under Secretary in arriving at the split-rate decision. In addition, records show that the Under Secretary requested input, advice, and counsel from high-level Department officials.

With one exception, the Interior officials advising the Under Secretary recommended the pass-through rate, if not the pass-through plus savings rate. PG&E was opposed to the pass-through rate and indicated a preference for the system rate or a split-rate. The decision to approve the split-rate, therefore, appears to be a compromise that would be acceptable to PG&E. It is also a decision that does not appear to be a compromise with Interior officials advising the Under Secretary. Because there was a disagreement of affected parties and under the contract, the matter could have been referred to the FPC for a decision, we feel such a referral to FPC would have been in order. However, records do not reflect the rationale for not taking this course of action. The only disadvantage of such a course mentioned would be a considerable delay. However, since PG&E and the Department had agreed that the final rate would be retroactive to April 1, 1976, the delay would not have been an important consideration.

The current drought in California has had a serious impact on CVP's capability to produce hydropower and, consequently, its ability to satisfy the power needs of the preference customers has been significantly reduced. The effect of the reduction in hydrogenerating capability is that Northwest power will be needed to satisfy the requirements of the preference customers rather than being sold to PG&E at the split-rate.

As a result, the losses on the sale of Northwest power to PG&E will be considerably less than originally estimated. Original estimates indicated that the loss would be in the neighborhood of $30 million for the period 1976 to 1981. It is now estimated that the loss will amount to about $12 million on the sale to PG&E of which about $10 million has already been incurred since the split-rate went into effect on April 1, 1976. The following schedule shows the losses which CVP is estimated to incur on the sale of Northwest power to PG&E and CVP customers (on the basis of current rates) during the period April 1, 1976, and December 31, 1981, the expiration date of the Centralia power contract, based on CVP's reduced hydrogenerating capability. The loss on sales to preference customers will be reduced, depending on the amount of the anticipated system rate increase.

Estimated Losses to CVP on Northwest Power for Period April 1, 1976, to December 31, 1981 (note a)

	PG&E	Preference customers	Totals
Cost of purchases of Northwest power:			
Capacity	$21,281,875	$109,772,681	
Energy	39,489,315	153,307,328	
TOTAL	$60,771,190	$263,080,009	$323,851,199
Revenues from sales of Northwest power:			
Capacity	$ 9,321,206	$ 17,263,471	
Energy	39,489,315	32,098,637	
TOTAL	$48,810,521	$ 49,362,108	$ 98,172,629
Loss on sales:			
Capacity	$11,960,669	$ 92,509,210	
Energy	- - -	121,208,691	
TOTAL	$11,960,669	$213,717,901	$225,678,570

a/Based on current rates.

Effective October 1, 1977, energy functions within the Department of the Interior were transferred to the newly created Department of Energy. The functions discussed in this report are among the programs included in the transfer from the Department of the Interior. We discussed the information in this report with Department of Energy officials and their views have been considered.

Monte Canfield, Jr.
Director

Enclosure

APPENDIX

ORGANIZATION OF DEPARTMENT OF THE INTERIOR PERTAINING TO THIS REPORT