COMMONWEALTH OF PENNSYLVANIA
PENNSYLVANIA PUBLIC UTILITY COMMISSION
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Background: Base Rates and Fuel Expenses

Base rates are tariffed charges calculated to recover a utilities expenses and rate of return. Base rates are typically designed to include a customer charge and blocked rates. The customer charge is designed to recover some portion of billing, administration, and meter reading costs. The Blocked Rates recover additional revenue based upon a flat charge or a declining rate. The calculation of the Base Rate is designed to recover the allocated revenue requirement by customer classification. The revenue requirement is calculated based upon the following equation:

Revenue Requirement = Expenses + (Rate of Return x Rate Base)

Gas utilities with greater than $40 million in revenue recover 100% of their natural gas costs through a Purchased Gas Cost Rate (commonly referred to as the PGC Rate or 1307(f) rate). The PGC Rate is designed to recover approximately 100% of natural gas expenses through a separate surcharge mechanism. This PGC Rate surcharge is annually reviewed and reconciled. The separate surcharge mechanism was developed in the mid 1980's as a process for levelizing the gas cost rate. At that time, 100% of purchased gas costs were included within base rates. During the later 1970s, natural gas costs become cyclical and volatile. Whenever gas costs changed, gas utilities would have to file a base rate filing to recover increases associated with the purchased gas. Since gas costs comprise almost 80% of Operations and Maintenance Expenses, base rates would change dramatically year to year. As a result of the volatile nature of natural gas prices during the 1980's the Commission created a mechanism that would stabilize base rates but permit the gas utilities to recover their purchased gas costs. Thus the PGC Rate was created.

Gas utilities that have less than $40 million in revenue also are permitted by the Commission to implement a reconcilable fuel cost adjustment clause. This fuel cost adjustment mechanism is called the "Gas Cost Rate" (GCR). The GCR allows the small gas operator to adjust their gas cost recovery rate annually so as to recover their projected purchase gas costs. At the end of a Commission specified twelve-month period, the actual GCR related gas costs are reconciled with actual GCR revenues, with the difference being either refunded or recouped through the subsequent annual GCR. The GCR is reviewed by the Commission's Bureau of Audits annually. The small gas utilities recover approximately 90% of their purchased gas costs through base rates and the remainder through the GCR mechanism. The GCR mechanism provides an opportunity for the small gas operators to recover their purchased gas costs on a dollar-for-dollar basis.