

Decision No. ✓

ORIGINAL

BEFORE THE RAILROAD COMMISSION
OF THE STATE OF CALIFORNIA.

---oOo---

CITY OF MONTEREY, a Municipal
Corporation,

Complainant,

vs.

COAST VALLEYS GAS AND ELECTRIC
COMPANY, a Corporation,

Defendant.

Case No. 499.

ESHELEMAN, Commissioner.

OPINION ON APPLICATION FOR REHEARING.

On June 30, 1914, this Commission rendered its decision in the above entitled case and an order was entered establishing certain specified rates to be charged by the defendant company. The rehearing was asked in a petition filed on July 18th on various grounds specified therein. Many of the grounds specified in the application do not need comment, but some are of sufficient importance to require a review.

First taking up the statement on page 4 of the petition that Mr. Millard's examination was not made in a hasty manner and that he spent as much time in Monterey as did Mr. Kelley. The best evidence on this point is the report itself which presents no details and which is referred to in the letter of transmittal as a "general examination of the property". The duration of Mr. Kelley's stay in Monterey is no indication of the time expended on this valuation. Both Mr. Kelley and Mr. Hoar spent the better part of a month on it - Mr. Kelley in his preparation of unit costs, etc.,

Decision No. 1697

and later this department in comparing the various estimates.

It appears that Mr. Millard made no effort to obtain the local costs of construction or even compare them with his estimates based on other valuations.

Petitioner, on page 5, refers to the scant weight given this report by the Commission and the fact that since both these appraisals check quite closely, great consideration should be accorded them. It is well to note at this point that Mr. Kelley's report is also practically identical with that of Ford, Bacon and Davis with the exception of the following items, - mains, services, meters, paving over mains and overhead. Of these, paving over mains, amounting to \$26,352.22, was excluded entirely from the value used for rate purposes, and the last item is one upon which the greatest differences of opinion ordinarily exist.

Referring to the matter of sinking fund, taken up on page 7 of petitioner's brief: The conveyance referred to here is the common basis for the purchase of public utility property and gives no indication of the financial transactions of the predecessor companies.

In regard to petitioner's contention for an allowance for accrued depreciation not cared for in past operations - the evidence on this point was insufficient to justify such allowance. The books should show whether depreciation was charged off as such or whether capital investments were made from earnings, which should have gone into the depreciation fund.

In regard to paving over mains: There can be no doubt that on a strict reproduction new theory this item is a proper one. Mr. Kelley in omitting it from his report was merely adhering to the Commission's previously established policy in not allowing it for rate purposes, and in accordance with his statement that he had adopted the historical method in estimating reproduction cost wherever possible.

Petitioner requests that it should be allowed to earn on 100% of the value of its property if its plant is maintained at 100% operating efficiency. That such a condition does not obtain in this case, is evidenced by the reported loss of 42% in gas distribution. The allowance of the Commission was 15% which is rather in excess of a normal loss in a well operated plant.

In connection with unit costs we have already referred to the fact that neither the engineers of Ford, Bacon and Davis ~~Company~~ nor Mr. Millard attempted to obtain actual costs on local construction. Mr. Kelley's unit costs were obtained both by comparison between the cost of doing such work in Monterey and elsewhere in California. The actual cost of main extensions during the past two years, as furnished by the company, show labor costs materially lower than those used by Mr. Kelley. Some evidence was introduced by the defendant to show that the cost of these extensions was not representative, but taking this exhibit in connection with the Commission's Exhibit #2, which is a map of Monterey and Pacific Grove on which is located the character of the soil encountered in the various districts, Mr. Kelley's costs seem more ample.

The actual costs are tabulated as follows and compared with Mr. Kelley's figures:

			Material		Labor		Total	
			Total	¢ per ft.	Total	¢ per ft.	Total	¢ per ft.
1 - 760'	1-1/2" Pipe		\$ 78.07	10.272	\$44.27	5.825	\$ 122.34	
2 - 1500'	"	"	147.22	9.814	39.27	2.618	186.49	
P.G3 - 500'	"	"	51.47	10.348	24.76	4.952	76.50	
4 - 250'	"	"	17.66	7.064	14.34	5.736	32.00	
5 - 330'	"	"	26.08	7.903	20.07	6.081	46.15	
6 - 390'	"	"	30.17	7.736	27.85	7.141	58.02	
7 - 234'	"	"	23.35	9.978	17.76	7.589	41.11	
8 - 222'	"	"	20.10	9.054	12.79	5.761	32.89	
P.G9 - 114'	"	"	10.42	9.140	7.23	6.342	17.65	
10 - 124'	"	"	10.72	8.645	6.86	5.532	17.58	
11 - 250'	"	"	<u>25.86</u>	<u>10.344</u>	<u>22.90</u>	<u>9.16</u>	<u>48.76</u>	
4674			\$441.39		\$238.10		\$679.49	
Total including contingencies				9.443¢		5.094¢		14.537¢
Costs Used by Kelley Net Cost				9.050¢		6.500¢		15.550¢
Including Contingencies				9.955¢		7.150¢		
Including Contingencies and Superintendence				10.950¢		7.865¢		
Total Unit Costs				11.278¢		8.101¢		19.379¢

In regard to labor cost of installing meters, after comparison with considerable data on this item, the figure used appears ample.

As previously stated, overhead percentages and intangibles, such as rights and organization, are speculative and the mere opinion of a witness on such matters, even though uncontroverted by other expert testimony, need not be followed. When, as here, however, other engineers disagree, the Commission certainly is not bound to accept any testimony on these intangibles with which it does not agree. We have every reason to believe that the figures used in this case are sufficient to cover all items of this character. The rate of return obviously more than covers the cost of obtaining capital.

It is not deemed necessary to discuss further the question of going value, as the Commission has already fully explained its position on this point.

The actual rate of return allowed is subject to dispute inasmuch as the gas sales were incompletely reported by the company. They did not include sales to flat rate consumers which were therefore estimated. ^{Upon the} basis of our calculations the return will be at least 8%.

As regards the general criticism of the decision, little need be said. The Commission used the language therein found advisedly and used the mildest term that seems applicable to such a case when it designated as mental dishonesty the practice of engineers in attempting to affect values by every conceivable addition that can be thought of through the means of multifarious intangibles. I reiterate the statement made in the previous opinion that the valuation presented in this case does violate the principles of consistency, and while I regret that such language should wound the feelings of any one, still I believe that this Commission is in duty bound to call attention to the tendency on the part of public utility engineers, acting as witnesses, invariably to exaggerate their values.

Mr. Woodbridge, the engineer who made the valuation herein, testified that the overhead percentages and the intangibles were put in by engineers other than himself, and it is not at his valuation that the Commission complains but at that which was figured by the financial engineers of this concern in an endeavor, no doubt, to have this Commission establish principles in this relatively unimportant case which, if followed out generally, would unjustly increase the valuation of utilities in this State.

I cannot see why a public tribunal should be criticized merely because of the fact that it is awake to a program that is being conceived and carried forward before its very eyes. That there is a program on the part of large financial concerns interested in public utility securities, particularly in the stock of public

utilities for which ordinarily no money has been paid, to exaggerate the value of the property of these public utilities, in my opinion, admits of no doubt. That their procedure is but natural makes it none the less necessary for public authority to be on its guard. These interests find themselves in the following condition:

The uniform practice has been in the past to construct their properties largely from the proceeds of bonds, and to give as bonus the stock of the corporation, except that which should be withheld by the promoters. Thus the actual property cost originally has been less than the face value of the outstanding bonds, - to say nothing of the stock - because under this method bonds are usually sold at less than par. The problem of those in control, therefore, has been to pay the bond interest and gradually build up a value behind the stock which originally, of course, had no value. Now they find themselves halted in this program in many instances, and by valuations by commissions the real relationship between the obligations and the assets is disclosed. Almost frantic endeavors, therefore, are being made to persuade public authority to place values upon the property of these utilities which shall be sufficient to cover the bonds and leave if not enough to represent par for the stock at least enough to represent something, otherwise such stock will be seen to have no value. Furthermore many of these utilities expect, and I imagine a great many desire, public ownership of their properties. In anticipation of such public ownership, in rate investigations they do not have the rate inquiry alone in mind, but with an eye to the future seek for this reason too to import elements of value that have no other foundation than in the desire of the utility to get the highest possible price for its property.

Concerning this matter, Dr. Delos F. Wilcox, a well known consulting franchise and public utility expert of New York City, in the May issue of the Annals of the American Academy of Political and Social Science, says:

"Valuations have come to be the big thing in the public utility world. Though for the present these valuations are usually made to serve as a basis for rate regulation, it is clear from the attitude of the courts that still higher valuations would be required in many cases as a basis for municipal purchase. In the play for advantages in the regulatory system now being established, the public service corporations have not been slow to see the critical importance of the valuation. Accordingly, all their ingenuity, power and influence, direct and indirect, are being brought to bear upon the problem of discovering new elements of value, and of persuading or coercing the commissions and courts to recognize them. In this way, the almost inevitable trend of valuation is upward. Commissions, both out of the desire to be fair and even liberal to the companies, and also out of fear that their decisions may be upset by the courts, are continually giving the benefit of the doubt in valuation cases to the corporations owning the property. It seems reasonably certain, therefore, that, while the most scandalous abuses in capitalization will be corrected by means of regulation, nevertheless the recognized value of the actual property will be gradually swollen until it includes every conceivable element of 'overhead charges' so-called, with certain additions thrown in for good measure."

In passing it might be well to state that Dr. Wilcox has made an exception in favor of the California Railroad Commission in this regard, and up to the present time this Commission, according to him, has not fallen into the error to the same extent as other commissions.

I repeat, as was in substance said in the main opinion, that this valuation is so inflated that it is impossible for me to conclude that there was any other design than to induce this Commission to place a value which is unwarranted upon the property of this company. If I am unjust to anyone connected with this company I regret it, but I am plainly of this opinion and it should be no more of an affront to the gentlemen connected with this institution for me to express the opinion which I have concerning their valuation than to have such opinion without expressing it.

Concern also seems to be given to the defendant because of certain language used in the opinion in this case and which is quoted out of its connection.

The following statement appears in the application for rehearing:

"Neither is the defendant company content to rest their case upon the theory expressed in the opinion that it and its properties are 'literally at the mercy of the state' and that by inference legal considerations touching the rights and protection to private property are to have no consideration from governmental agencies."

What the Commission said, with its connection, is as follows:

"It should be understood by utilities and the public alike and recognized by commissions and courts that when you take away from an enterprise the right to determine for whom and for what price it will conduct its business, you have eliminated the possibility of applying the same rules of value as obtain in an unregulated enterprise. Value, as commercially understood, is something which cannot be determined until after the earning power is determined and the fact upon which commissions are asked to find, when asked to find value as commercially understood, is a fact which finally has no existence until after the authority of the state has been exercised in determining the proper conditions upon which the business shall be conducted, the proper rates, and so the earning power. The sooner it is understood by the utilities that under modern conditions they are literally at the mercy of the State, the sooner they will realize that only equitable considerations are the ones that will finally have weight, and until commissions and courts representing the sovereignty of the State realize that always they should make the 'ought' determine the 'must' such governmental agencies have not become equal to their task. I do not mean to suggest that any agency should be subject to the caprice of governmental authority, but I do insist that it should be recognized as a plain fact by the utilities that they are subject to regulation and that the character of such regulation and its extent will be largely determined by the attitude of the utilities themselves."

I have recited the entire paragraph because apparently the attitude of the Commission in this regard has been misunderstood. What I had in mind was the fact, as I thought was plainly stated in the language used, that the beneficial value of a utility property to its owners is determined by what it can earn and that this earning is determined by the State, through commissions under the check of the courts, and that finally when the determination shall rest in the tribunal having the last ~~xx~~ say such determination inevitably and fixedly establishes the value of the property of the utility to its owners. Why, under these circumstances, there should be a hesitancy on the part of utilities to accept a doctrine which urges that equitable considerations in favor of as well as

against the utility should be considered, I cannot understand. It cannot be that this utility, or any other, contends that considerations of equity when they are favorable to it shall not have weight. Conversely then if this doctrine is to apply at all it must apply in favor of the public if it is to be applied in favor of the utility. It is not possible to have general rules that shall be adopted to apply in all cases and to every state of facts. Necessarily, discretion must exist somewhere or injustice will result. It being established and admitted that utilities are subject to regulation as to their rates and earning power and that discretion exists in commissions and courts in determining these, necessarily it must follow that such commissions and courts representing the state control the welfare of utilities.

The warning thrown out in the paragraph in question cannot, by fair inference, be construed as having any bearing upon the attitude of this Commission. It is specifically stated that caprice shall not be followed, and of course sound economics and sound judgment the utilities have a right to expect. But the warning held out and the suggestion that the attitude of the utilities, as regards fairness, might ultimately affect their fate arose from several concrete illustrations that have come to the attention of this Commission illustrating the folly of a course of conduct on the part of a utility which leads a community to believe that such utility is unfair. One of these illustrations will suffice to make clear just what the Commission has in mind.

A certain water company serves territory within the State of California. For a long time this water company has been in trouble with its consumers until a feeling of mutual antagonism has grown up. Recently one of the municipalities served by this water company decided that to relieve itself of further annoyance it would install its own water system, it having the legal right, of course, to do so and there being a supply of water available.

When it installed its water system it refused to pay one cent for the system of the utility theretofore serving it, with the result that such utility lost its entire investment within such municipality.

In another case now pending before this Commission, the water company, the evidence shows, has always been careful and considerate of its patrons, and in this case the municipal authorities express a desire to the Commission to secure for an adequate price the property of the utility in question although another source of supply is available.

I suppose this defendant here does not appreciate any suggestion from this Commission as to the proper attitude a utility should assume toward the public and believes that this Commission is not within its province when making such suggestions, just as I assume the water company in the first instance would have said if such advice had been given to it. But such water company applied to this Commission for relief, which this Commission had no power to give it, and was bitterly indignant at the alleged unfair treatment given it by the municipality which refused to purchase its system.

I have gone more at length into this application for rehearing than is perhaps necessary, but I want to make it very plain that this company is considered by this Commission exactly as every other company which comes before this Commission, and this Commission has just as much the interest of this company in mind as it has the interest of any company doing business within the State, and is willing at all times to do anything in its power and consistent with its duty to be helpful to this company, just as it is with reference to all utilities, but the requirement that justice be done between utilities and their consumers will not permit this Commission to approve values such as here presented.

I see nothing further in the application requiring comment and I recommend that the same be denied and submit the following order:

O R D E R .

The defendant herein having applied for a rehearing within the time allowed by law, and the same having been fully considered and being fully apprised in the premises,

IT IS HEREBY ORDERED that the application for rehearing be and the same is hereby denied.

The foregoing opinion and order are hereby approved and ordered filed as the opinion and order of the Railroad Commission of the State of California.

Dated at San Francisco, California, this 30th day of July, 1914.

John M. Eschlin
Alex Gordon
Max Shelton

Commissioners.