

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA.

In the Matter of the Application of
CITY OF PALO ALTO, an incorporated
city, for an order of the Railroad
Commission fixing and determining
the just compensation to be paid to
PALO ALTO GAS COMPANY for its property
and rights.

ORIGINAL

Application No. 1760.

Norman E. Malcolm, City Attorney, for City of Palo Alto.
Chickering & Gregory, by Allen L. Chickering, and
L. P. Lowe for Palo Alto Gas Company.

THELEN, Commissioner.

O P I N I O N.

This is a proceeding to fix and determine the just compensation to be paid by City of Palo Alto for the property and rights of Palo Alto Gas Company, hereinafter referred to as the Gas Company, a public utility engaged in the business of selling artificial gas in the City of Palo Alto and in adjacent unincorporated territory, principally in the communities known as North Palo Alto and South Palo Alto, and on the grounds of Leland Stanford Junior University.

This proceeding is brought under the provisions of Section 47 of the Public Utilities Act, which section provides, in part, that any public authority of the kinds therein specified, including an incorporated city or town, may file with the Railroad Commission a petition setting forth the intention of such public authority to acquire, under eminent domain proceedings, or otherwise, "any existing public utility and the lands, property and rights of any character, whatsoever, connected with such existing public utility or any part or portion thereof." Upon the filing of such petition, the Railroad Commission is charged with the duty, after appropriate proceedings, to "fix and determine the just compensation which shall be paid" by such public authority"

for said public utility and said lands, property and rights thereof, or the parts or portions thereof sought to be acquired." The findings of the Railroad Commission are made conclusive in such eminent domain proceedings as may thereafter be instituted by the public authority.

The second amended petition herein was filed on April 21, 1916. The Gas Company at that time consented to the filing of the petition as then amended and waived verification thereof.

The second amended petition alleges that it is the intention of the City of Palo Alto "to acquire under eminent domain proceedings, or otherwise, that certain existing public utility known and designated as the Palo Alto Gas Company, and the property and rights of any character whatsoever connected with said existing public utility or any part or portion thereof as operated, and maintained and necessary to the operation and maintenance thereof in said City of Palo Alto, and that certain suburb of the City of Palo Alto lying adjacent thereto ^{and} known as South Palo Alto, and that certain suburb of the City of Palo Alto lying adjacent thereto and known as North Palo Alto, and also any right, title and interest held by the said Palo Alto Gas Company in and to its property located on the campus at the Leland Stanford Junior University, and also the storage tanks of the said property located outside of the City of Palo Alto on what is known as University Avenue Extension Roadway." The petition alleges that a full and complete description of said public utility and its property and rights proposed to be acquired is as follows:

"A gas distributing system partially completed located in the City of Palo Alto, and in that certain suburb known as South Palo Alto, and in that certain suburb known as North Palo Alto and consisting of all pipes, mains and service laterals now lying in the streets and avenues of said city and said suburbs, together with the meters and the necessary appurtenances and equipments of said gas distributing system, also the storage

tanks of said company located in the roadway of University Avenue Extension outside the city limits, also all rights, titles and interest which the said Palo Alto Gas Company owns and can legally convey to the City of Palo Alto in and to all pipes, mains and service laterals, together with the meters and necessary appurtenances to said system in its service extending from the City of Palo Alto to the Leland Stanford Junior University and the home of Charles G. Lathrop and campus homes."

The second amended petition further alleges that it is the intention of the City of Palo Alto to acquire "all the property of the Palo Alto Gas Company in and to its gas distributing system in the territory described herein both within and without the corporate limits of the City of Palo Alto."

The prayer asks that the Railroad Commission fix and determine the just compensation which shall be paid by the City of Palo Alto "for said public utility sought to be acquired by said city." While there were some suggestions in the original petition and the first amended petition and during the progress of the hearings that the City of Palo Alto desired the Railroad Commission to fix and determine the just compensation to be paid for some portion or portions of the property of the Gas Company in addition to the just compensation to be paid for the entire property, the jurisdictional facts set forth in the second amended petition are such as to justify the Railroad Commission, under Section 47 of the Public Utilities Act, in fixing and determining only the just compensation to be paid for the property and rights as a whole, excluding only the right of the Gas Company to be a corporation. It may be proper to say here that if the Railroad Commission were being asked to fix and determine the just compensation to be paid merely for the property and rights in the City of Palo Alto, or for such property and rights and also the compressor tanks located outside the limits of the City of Palo Alto,

the severance damages which would be determined by reason of the fact that the remaining property of the Gas Company would be rendered practically valueless would be so large as almost to make up for the reduction in the just compensation to be paid for the property actually taken.

A motion by the Gas Company to dismiss this proceeding on the ground that the Railroad Commission does not have jurisdiction, was denied and the Gas Company now agrees that the Railroad Commission's decision was proper (Vol. 8, Opinions and Orders of the Railroad Commission of California, 448).

Public hearings in this proceeding were held in San Francisco on April 20, 21, 27 and 28 and May 6, 1916. On June 15, 1916, the presiding Commissioner herein, acting under stipulation of the parties and accompanied by representatives of both parties, made a personal inspection of the mains and services of the Gas Company at some 20 points in the territory served by the Gas Company, which points were agreed upon by the parties ^{to be} ~~typical~~ typical of the various conditions existing under this system. On July 5, 1916, subsequent to this inspection and after the filing of briefs herein, the Railroad Commission made its order submitting this proceeding for decision.

The Gas Company owns the gas distributing system described in the second amended petition herein. The Gas Company does not own a generating system, but receives artificial gas from Pacific Gas and Electric Company at the compression tanks of the Gas Company located just outside the city limits of Palo Alto.

in the extension of University Avenue. The Gas Company distributes this gas at high pressure to its customers in the City of Palo Alto, the adjoining unincorporated communities of North Palo Alto and South Palo Alto and on and adjacent to the grounds of Leland Stanford Junior University. With certain exceptions, the gas distributing system on the grounds of Leland Stanford Junior

University is owned by the University and rented by it to the Gas Company for an annual rental of 10 per cent of the agreed cost of installation.

The Gas Company owns no land.

The property of the Gas Company as it existed at the time, and the operations of the company, are fully described in this Commission's Decision No. 499, rendered on March 12, 1913, in Case No. 286, City of Palo Alto vs. Palo Alto Gas Company (Vol. 2, Opinions and Orders of the Railroad Commission of California, 300). By stipulation of the parties herein, the evidence in Case No. 288 is to be considered as a part of the evidence in the present proceeding.

For a general discussion of the principles which govern in a proceeding of this nature, which is, in effect, a part of an eminent domain proceeding, reference is hereby made to this Commission's Decision No. 3625, rendered on September 6, 1916, in Application No. 1424, being an application of the City of Los Angeles for an order of the Railroad Commission fixing and determining the just compensation to be paid by the City of Los Angeles for a part of the property of Southern California Edison Company employed in the transmission and distribution of electric energy.

We shall consider the subject matter of this opinion under the following heads:

1. Investment in physical property.
2. Estimated reproduction cost of physical property.
3. Estimated reproduction cost of physical property less accrued depreciation.
4. Going value.

1. INVESTMENT IN PHYSICAL PROPERTY.

The evidence does not show satisfactorily the actual investment in the Gas Company's property.

Mr. E. S. Bryant, one of the Railroad Commission's assistant engineers, presented an estimate of the amount of the investment, based upon the prices for labor and materials which prevailed at the time the various portions of the system were installed. As the installation is comparatively recent, approximately 75 per cent thereof having been made between January 1st and June 30th, 1905, and the remaining 25 per cent subsequent thereto, the preparation of such estimate was not particularly difficult. Mr. Bryant estimated that the investment in the physical property to January 1, 1916, has been \$63,187.00 (Railroad Commission's Exhibit No. 1, p. 38). This sum does not include the sum of \$1100.00 which was paid for the Gas Company's franchise nor the sum of \$1554.00 claimed by the Gas Company to have been expended in connection with its organization.

The property installed subsequent to June 30, 1905, has been installed from the earnings of the Gas Company, being in part from moneys/~~properly~~^{properly} chargeable to the depreciation reserve and in part from net earnings applicable to the payment of dividends. No part of the investment subsequent to June 30, 1905, has been made from the sale of bonds or capital stock.

2. ESTIMATED REPRODUCTION COST OF PHYSICAL PROPERTY.

Estimates of the cost to reproduce the Gas Company's physical property were presented by Mr. C. L. Cory, Mr. F. C. Millard and Mr. L. P. Lowe for the Gas Company, and Mr. E. S. Bryant for the Railroad Commission.

These estimates all dated as of January 1, 1916. Mr. Cory's estimate was based on prices for labor and material

prevailing on January 1, 1916, with the exception of stores, supplies and storage tanks, with reference to which he took the actual cost. Mr. Millard's estimate was based on prices for labor and material prevailing on January 1, 1916, except as to meters and regulators, with reference to which he took the actual cost as shown by the company's books over a number of years in the past. Mr. Lowe's estimate was based on his experience in constructing gas plants but did not go into details. Mr. Bryant's estimate was made as of January 1, 1916, but was based on average prices for mains, meters and compression tanks prevailing in San Francisco in 1914 and 1915 and on the weighted prices for regulators, fittings and specials taken from the Gas Company's vouchers.

With reference to paving over mains, Mr. Cory included only the sum actually expended by the Gas Company in the cutting of pavements, which sum he reported to be \$1644.65. Mr. Millard included in his report the estimated cost of replacing all the pavement now lying over the Gas Company's mains and services, including the pavement laid by the City with reference to which no expenditure was incurred by the Gas Company. He reported that the amount hitherto expended by the Gas Company in connection with pavement was \$1644.65 and that the remaining sum representing pavement installed at the expense of the City was represented under a reproduction cost estimate by the sum of \$37,211.55. Mr. Bryant included in his estimate of the cost to reproduce gas mains an item of \$1536.00, which he reports to have been the total expenditure made by the Gas Company in connection with pavement.

That the rate base in a rate proceeding should include no allowance for paving in excess of the actual expenditures incurred by the utility is clearly established by the authorities. (See Decision No. 2279, rendered on April 9, 1915, in Application No. 1141, Marin Municipal Water District, and cases there cited.

Vol. 6, Opinions and Orders of the Railroad Commission of California, 507, 518). No good reason appears why, in an eminent domain proceeding, any allowance should be made under the head of paving in addition to the allowance which would be made in a rate case. Accordingly, in Application No. 1141, supra, in which Marin Municipal Water District asked the Railroad Commission to make its order fixing and determining the just compensation to be paid to Marin Water and Power Company for its lands, property and rights, and in Application No. 1562, being an application of the City of Santa Monica for an order of the Railroad Commission fixing and determining the just compensation to be paid to Irwin Heights Water Company for its lands, property and rights (Vol. 7, Opinions and Orders of the Railroad Commission of California, 444, 447), both being eminent domain proceedings, this Commission allowed under the head of paving only the expenditures actually incurred by the utility. We see no reason to change the conclusions which we have heretofore reached on the subject. The decision in the Marin Municipal Water District case was affirmed by the Supreme Court of this State (171 Cal.706).

Mr. Cory applied to his unit costs for labor and materials the following percentages for undistributed construction expenditures: mains, 16.2 per cent; services, 15.2 per cent; meters and regulators in service, 14.4 per cent.

Mr. Millard added to his unit costs for labor and materials, for everything except working equipment, 10 per cent for "contractor and incidentals" and an additional 10 per cent on the amount thus obtained for "engineering, contingencies, administration, taxes and interest during construction." Mr. Millard's unit costs for labor and materials were not lower than those used by the other engineers herein. The percentage applied by him to his unit costs for labor and materials, being 21 per cent, ~~but~~ is considerably higher than the percentages heretofore found by this

Commission to be justified with reference to properties of this character.

Mr. Bryant applied the following percentages to his unit costs of labor and materials under the head of undistributed construction expenditures: distribution mains, 16 per cent; services, regulators, meters and equipment, 11 per cent.

The following table shows the estimates of cost to reproduce as of January 1, 1916, presented by Mr. Cory, Mr. Millard and the Railroad Commission's engineers:

ESTIMATED REPRODUCTION COST OF PHYSICAL PROPERTY

	Cory		Millard		Railroad Commission's Engineers
Storage Tanks	\$5040	\$5040	$\$4457+10-10\%=\5393	$\$3249+16\%=\3769	
Gas Mains	$24283+16.2\%=28217$		$24932+10-10\%=30168$	$24117+16\%=27976$	
Gas Services	$6162+15.2\%=7099$		$6162+10-10\%=7456$	$6020+11\%=6683$	
Gas Meters	$12834+14.4\%=14682$		$12852+10-10\%=7636$	$12893+11\%=14311$	
Gas Regulators	$6130+14.4\%=7013$		$6311+10-10\%=15551$	$6859+11\%=7613$	
Distribution Equipment				2114)	
Materials and Supplies				1140)	3254
Gas Meters in stock	373	373			
Gas Regulators in Stock	132	132			
Furniture and Fix- tures	1502	1502		1482	
Office Supplies	487	487		521	
Stable	478	478			
Tools	803	803		750	
Meters and Services distributing equipment	35	35			
Paving over mains		1644		38856	
Stock				539	
Transportation				479	
		<u>\$67,505</u>		<u>\$108,831</u>	<u>\$63,606</u>

Mr. L. P. Lowe testified that, in his opinion, the mains of the Gas Company were worth \$2500.00 per mile, the services \$10.00 each, the meters in place \$10.00 each, the governors in place \$5.00 each and the four storage tanks \$1200.00 each. Based on these estimates, he testified that any person reproducing the Gas Company's physical property would have to "actually pay" ~~approximately~~ the sum of \$89,515.00. Mr. Lowe did not present any further detailed estimate.

3. ESTIMATED REPRODUCTION COST OF PROPERTY
LESS ACCRUED DEPRECIATION.

The engineers herein all testified that the Gas Company's property has been well constructed and maintained and is in good operating condition. My inspection of the property convinces me that this is undoubtedly the fact.

The engineers also agreed that the physical condition of the property is not as good ~~xxx~~ as new, but they disagreed widely with reference to the so-called estimated cost to reproduce ^{physical} new less accrued depreciation of the property.

Mr. Cory urged that accrued depreciation should be estimated on the sinking fund basis and not by the straight line method. He accepted the figure of 7.7 years reported by the Railroad Commission's engineers as being the weighted average life of the property now installed, but assumed a composite total life of the property of 35 years instead of 24.54 years reported by the Railroad Commission's engineers. Using a ^{6%} sinking fund basis, Mr. Cory estimated that the present value of the property, as based on its present physical condition, is 91 per cent to 92 per cent of the estimated cost to reproduce the property new.

Mr. Millard testified that the property is in as good a physical condition to-day as it was 11 years ago and that obsolescence and inadequacy should not be considered in connec-

tion with this particular property. He testified that to the eye the mains and services appeared to be ⁱⁿ 100 per cent condition. He testified further that this system is in the best condition of any system in the State. Mr. Millard did not use life tables but testified from his inspection and certain estimates which he made that the property is worth to-day 95.3 per cent of the estimated cost to reproduce new. On cross-examination, he testified that this is the first proceeding in which he has applied the methods herein used by him to determine accrued depreciation.

Mr. L. P. Lowe, President of the Gas Company and half owner therein, testified that the elements of obsolescence and inadequacy have no application to a high pressure gas system. He stated that the only remaining element of depreciation to be considered is deferred maintenance and that he was unable to find any on this system.

Mr. Bryant used life tables and the straight line method of depreciation in presenting his estimate. He testified that the weighted average of the properties installed is 7.7 years and that the composite total life of the property is 24.54 years. He testified that certain deductions should also be made for obsolescence and inadequacy for certain of the 1-inch and 1 1/4-inch mains; the tin meters and the old style regulators. Using the straight line method of depreciation and making further deductions for obsolescence and inadequacy, as testified to, Mr. Bryant reported that the condition per cent of the property resulting from a comparison of the estimated reproduction cost new and the estimated reproduction cost new less accrued depreciation, is 68 per cent and that the estimated cost to reproduce the physical property new less accrued depreciation is the sum of \$43,377.00.

Mr. Arthur R. Kelley, formerly assistant engineer of this Commission, reported in Case No. 288, City of Palo Alto vs. Palo Alto Gas Company, that the ratio of present condition to the

cost of reproduction new as of September 4, 1912, was 77 per cent, this estimate being prepared on the straight line method by using life tables.

In Case No. 288, supra, Mr. John A. Britton, Vice President and General Manager of Pacific Gas and Electric Company, was called as a witness by Palo Alto Gas Company. On examination by the presiding Commissioner, he testified (Transcript, pp. 293 to 297) as to the lives which he assumed would be proper to be applied to the various portions of a gas distributing system. These lives are considerably less than those used by Mr. Cory herein and more nearly approach the lives used by the Railroad Commission's engineers. Referring to the lives used by engineers in cases in some of the eastern states, Mr. Britton, at page 297 of the transcript, testified:

"They are talking in the east generally, those engineers, of the old time installation, sir, that is the cast iron pipe; and I stated that in my judgment cast iron pipe would last fifty years. They have had little or no experience in the eastern states with the conditions in California--that is, the general distribution of gas under high pressure. It has been tried but very little in the eastern states. We have been the pioneers out here in that matter, Mr. Lowe especially. The Palo Alto plant is a high pressure plant all the way through, their service there is all high pressure, and its life, therefore, would be much less on the average, their distributing system, by reason of that fact very much less than the old style installation of cast iron pipe under low pressure."

By reason of the wide diversity of opinion with reference to the present condition of the system, the presiding Commissioner, under stipulation by the parties, and accompanied by representatives of both parties, made an inspection, as hereinbefore stated, at typical points, of the condition of the distributing system. This inspection showed that the condition of the property is far from ^{the} almost perfect condition testified to by certain witnesses for the Gas Company. On the other hand, while the protective coating had disintegrated in a number of instances, and while the mains themselves were affected in certain instances, including

a number of cases of leaks, the inspection showed that to a very considerable extent both the mains and the protective coating are still in first class condition. The inspection showed that considerable care has been taken by the Gas Company in installing and preserving its mains. It must be remembered that although during the first few years a gas distributing system which has been carefully installed will appear to be as good as new, the deterioration which is actually going on, year by year, will, particularly in a high pressure system, make itself very manifest when its effects begin to be observed. This is in accordance with Mr. Britton's testimony that the life of a high pressure gas system will be very much less, on the average, than a low pressure gas system.

I have been much impressed by the Gas Company's argument that in view of the fact that in a rate case the depreciation annuity in this State must be estimated on the sinking fund basis (Sec. 49, Public Utilities Act; Town of Antioch vs. Pacific Gas and Electric Company, Vol. 5, Opinions and Orders of the Railroad Commission of California, 19, 39, 40), the same basis should be applied, in depreciating the property, in an eminent domain proceeding. While not intending to lay down any rule which must be uniformly followed hereafter by this Commission, I have given due weight to the Gas Company's contention on this point.

After giving careful consideration to all the evidence herein on this subject, and bearing in mind the observations on my inspection of the Gas Company's distributing system, I am of the opinion that substantial justice will be done to both parties by assuming that the estimated cost to reproduce this property less accrued depreciation, is 80 per cent of the estimated cost to reproduce the property new. It must be remembered, of course, that this is only one of the elements in determining just compensation to be paid to the Gas Company for its property and rights.

I am becoming increasingly impressed with the absolute

necessity on the part of all parties of a consistent treatment of the subject of depreciation, irrespective of the nature of the particular proceeding which is being considered and of the interest of the parties therein. The Railroad Commission has found in a number of instances that while in rate cases in which it is to the interest of the utility to secure as large an allowance as possible for depreciation annuity, the utility has eloquently presented the need for a large depreciation reserve, yet, when it came to the declaration of dividends and the place of apparent additional value on common stock, the utility has insisted that its property depreciates but very little and that only a small depreciation annuity and depreciation reserve are necessary. Likewise, we have had instances in which the same utility has claimed a large depreciation annuity in a rate case and later, when its property was being condemned, has claimed that its property is in almost 100 per cent physical condition and that only a small deduction should be made for accrued depreciation. It is unnecessary to point out that a utility will gain nothing in the long run with the public authorities by making such conflicting claims.

While the City of Palo Alto still had jurisdiction to establish the rates of the Gas Company herein, the Gas Company claimed in a statement filed with the City on February 20, 1909, that the probable depreciation of its property amounted to about \$4000.00 per annum. Later, the Gas Company estimated that an allowance of about \$3600.00 per annum should be set aside annually. In Case No. 288, hereinbefore referred to, the Railroad Commission found that the Gas Company had set up on its books during the preceding year the sum of \$4240.08, which sum was frankly admitted by Mr. Lowe to be too high. In Case No. 288, the Railroad Commission allowed a depreciation annuity of \$2748.00, which allowance was liberal.

When the attention of Mr. Lowe was drawn, in this pro-

ceeding, to the inconsistent position on the subject of depreciation formerly taken by the Gas Company in the rate proceeding and now taken by it in this condemnation proceeding, Mr. Lowe testified that his former views had been in error and that the allowances heretofore claimed by the Gas Company for depreciation annuity have been too high. Referring to the attitude of a number of utilities on this question, Mr. Lowe frankly testified as follows:

"As I said, there was a time a few years ago when we were trying to carry water on two shoulders; that when it came to a question of rate fixing we attempted to jam up our ideas on depreciation just as far as we possibly could, and when it came to a question of condemnation, we pulled it down as far as we could. I think it was absolutely unfair. I think we have reached that conclusion now. I think that fair minded men must ultimately come to that conclusion. I think if we continue making the mistakes we have in the past, then I do not blame the Commission for spanking us."

The utilities should not expect to urge successfully before this Commission in a rate proceeding that there is heavy depreciation requiring a large depreciation annuity, and in a condemnation proceeding that time is dealing lightly with the particular property, and that there is little or no depreciation, and when it comes to the declaration of dividends, that there is but little necessity for a depreciation reserve and that to this extent much larger earnings are available for the declaration of dividends on capital stock. The time has come for an honest and consistent treatment of depreciation by the utilities, bearing in mind all the various phases of the situation and the various classes of cases in which the question of depreciation becomes material. It is useless to try to convince this Commission that there is no such thing as depreciation. It will be far wiser to recognize candidly that depreciation exists and that it must be properly provided for and to try to reach a fair solution of the problem, bearing in mind all its various aspects.

4. GOING VALUE.

It is the duty of the Railroad Commission herein to fix and determine the just compensation to be paid by the City of Palo Alto to Palo Alto Gas Company for all its property and rights, except the right to be a corporation; viewing the property as a going concern with its business attached and including its franchise rights.

The Gas Company has been doing an increasingly profitable business.

The Gas Company has had an increasing number of meters connected, as follows: on July 1, 1907, 799 meters; on December 31, 1912, 1350 meters; on December 31, 1913, 1421 meters; on December 31, 1914, 1482 meters; and on December 31, 1915, 1549 meters.

The number of cubic feet of gas sold annually has increased as follows:

<u>Period of Time</u>	<u>Cubic Feet of Gas Sold</u>
Year ending June 30, 1906	6,171,800
Year ending June 30, 1907	14,843,600
Year ending June 30, 1908	21,369,000
Year ending June 30, 1909	21,114,800
Year ending June 30, 1910	22,076,300
Year ending June 30, 1911	24,030,400
Year ending June 30, 1912	26,746,900
Year ending June 30, 1913	31,798,800
Year ending June 30, 1914	34,529,300
Year ending June 30, 1915	40,798,500
9 months ending March 31, 1916,	34,581,800

The gross revenue received by the Gas Company from the sale of gas has increased as follows:

<u>Period of Time</u>	<u>Gross Revenue</u>
Year ending June 30, 1906	\$ 9,187.85
Year ending June 30, 1907	22,135.40
Year ending June 30, 1908	31,972.30
Year ending June 30, 1909	31,672.20
Year ending June 30, 1910	33,114.45
Year ending June 30, 1911	36,045.60
Year ending June 30, 1912	40,120.35
Year ending June 30, 1913	45,420.15
Year ending June 30, 1914	41,435.16
Year ending June 30, 1915	48,958.20
9 months ending March 31, 1916	41,498.16

In April, 1913, the Railroad Commission's decision in Case No. 288, reducing the price charged by the Gas Company from \$1.50 per thousand cubic feet of gas, to \$1.20 per thousand cubic feet of gas, with a minimum of 50 cents per month per meter, became effective. It should be observed that this reduction in rates has been accompanied by an increase in gross revenue. Mr. Lowe testified that a part of the increase in gross revenue during the last year or so has been due to the poor quality of gas supplied by Pacific Gas and Electric Company, thus necessitating the burning of a larger amount of gas to secure the same heat value, with a consequent increase in the amount of the bills paid by the consumers.

The gross operating revenues and expenses of Palo Alto Gas Company during the years ending December 31, 1913, 1914 and 1915 are reported by the company in its annual reports on file with the Railroad Commission to have been as follows:

<u>Period of Time</u>	<u>Operating Revenues</u>	<u>Operating Expenses</u>
Year ending Dec.31,1913	\$43,339.81	\$36,868.85
Year ending Dec.31,1914	45,166.15	36,799.95
Year ending Dec.31,1915	53,274.68	37,825.80

The operating expenses shown for the year ending December 31, 1913, include an item of \$2,473.38 for depreciation annuity. The operating expenses shown for the year ending December 31, 1914 include a similar item of \$2,400.00. The operating expenses shown for the year ending December 31, 1915, do not include any item for depreciation annuity.

Mr. C. L. Cory, in Gas Company's exhibit No. 4, presented a claim of \$14,780.00 under the head of "estimated intangible capital." This sum consists of an item of \$1,554.00 for organization (Account C-1), a sum of \$1,298.00 for franchise (Account C-2) and a sum of \$12,135.00 for assumed operating deficit from July 1, 1905 to July 1, 1907, less \$207.00 for interest during construction, included in overhead percentages in connection with the estimated cost to reproduce the physical property.

The item of \$1,554.00 for organization expenses under Account C-1 is proper and will be allowed.

The Gas Company operates in the City of Palo Alto under a franchise granted by the Town of Palo Alto to Mr. D. O. Druffel by Ordinance No. 105, adopted on September 17, 1904. The rights under this ordinance were later assigned to Palo Alto Gas Company by Mr. Druffel. Ordinance No. 105 grants to Mr. Druffel and his assigns for the period of 50 years the right "to construct, equip, operate and maintain a gas plant in the Town of Palo Alto, and to lay gas pipes for the purpose of carrying gas for light, heat and power in and along the public streets and thoroughfares of the Town of Palo Alto, and to manufacture, distribute and sell gas to

the inhabitants of said town, and to receive and collect charges therefor." The ordinance contains certain conditions, including a provision under which the Town of Palo Alto after the expiration of 10 years might acquire the property at a price to be determined in the manner specified in the ordinance. The present proceeding is not brought under the provisions of Ordinance No. 105 but under the right of eminent domain vested in the City of Palo Alto and under Section 47 of the Public Utilities Act. The City of Palo Alto contends herein that the rights granted by Ordinance No. 105 are subject to forfeiture by the City of Palo Alto by reason of the failure of the Gas Company to construct a gas generating plant in the City of Palo Alto. No forfeiture has been declared, and as far as the record herein shows, no proceedings looking to a forfeiture have been initiated. Under these circumstances, I am of the opinion that the amount originally paid by the grantee of this franchise should be allowed herein. It should be observed that the Gas Company's claim is limited to the amount paid with interest thereon to July 1, 1907. I see no justification, on the facts of this case, for allowing the interest claimed.

The item of \$12,135.00 for "operating deficit" from July 1, 1905 to July 1, 1907, less \$207.00 for interest during construction elsewhere allowed, is, in effect, a claim that "development cost" should be added to capital account. The evidence herein shows clearly that the profits which the Gas Company has derived from its business, particularly during the last three years, have been considerably more than enough to repay to the Gas Company any and all development costs, in excess of a fair return on the fair value of the property. ^{under the rule established by this Commission} Hence, in Application No. 1666, San Joaquin Light and Power Corporation, decided on April 6, 1916, no allowance under this head should be added to the allowance otherwise made in a rate case. (See also Des Moines Gas Co. vs. City of Des Moines, 238 U. S. 153). I am satisfied that it

would not be proper to make an additional allowance under this head in a condemnation case. It must not be understood, however, that the going value of this property is not being considered in the finding herein made. What has been said means simply that no additional allowance should be made for "development cost".

Mr. Lowe testified that, in his opinion, this property has a "going value" of \$20,000.00 in addition to the value of the physical property in its present condition, as determined by the engineers.

In Case No. 288, *supra*, decided on March 12, 1913, the Railroad Commission found that the fair value of the property of Palo Alto Gas Company used and useful for the public service, as disclosed by the evidence in Case No. 288, "is not in excess of the sum of \$69,250.00".

The Gas Company's annual reports on file with the Railroad Commission show that additions to fixed capital have been made during the years 1913, 1914 and 1915 as follows:

<u>Period of Time</u>	<u>Additions to Fixed Capital.</u>
Calendar Year 1913	\$ 850.33
Calendar Year 1914	1,786.09
Calendar Year 1915	<u>1,694.73</u>
Total,	\$4,331.15

These additions were made out of depreciation reserve reinvested in the property and represent no additional sacrifice by the Gas Company.

Subsequent to the decision in Case No. 288, the Gas Company's property has suffered undoubted additional depreciation, which fact must also be considered herein.

The sum of \$69,250.00 included several thousand dollars under the head of "development expense", which money has been reimbursed to the Gas Company subsequent to the date of the decision in Case No. 288 by reason of excess earnings above a reasonable

return on the fair value of the property due to increased business following the reduction in rates and other causes.

I have given consideration herein to the test frequently applied by the courts in cases of this character, of estimating the cost of reproduction new less depreciation and of adding thereto an indefinite amount to represent the additional value of the business as a going concern with business attached. As pointed out in the Railroad Commission's decision in Application No. 1424, supra, the Southern California Edison case, this test is not entirely satisfactory for the reason that there is no criterion by which the amount to be added for estimated cost of reproduction new less depreciation can be measured.

I have also given consideration herein to the rate base on which the Railroad Commission would permit the Gas Company to earn. As pointed out in the Southern California Edison case, if the Railroad Commission finds a certain rate base for a public utility property, this is a very satisfactory starting point in determining the just compensation to be awarded by the same commission for the same property in an eminent domain proceeding. In applying this test, I have made an additional allowance by reason of the fact that the property is making in excess of an 8 per cent return on the fair value of the property and is steadily increasing its gross earnings without corresponding increases in its operating expenses.

I have also given consideration to all the other elements in this proceeding, in accordance with the established rules applicable to proceedings of this character. In this opinion, I have stated only a portion of the testimony presented. Nevertheless, all the testimony presented, including all the exhibits, has been carefully considered and to each part of the testimony has been accorded the weight to which it seems entitled. I have been materially assisted by the able briefs presented by counsel for both sides.

F I N D I N G S.

CITY OF PALO ALTO, an incorporated city, having filed with the Railroad Commission a petition setting forth the intention of said city to acquire under eminent domain proceedings, or otherwise, the property and rights of PALO ALTO GAS COMPANY, a public utility, engaged in the sale of artificial gas in the territory described in the second amended petition herein, and asking the Railroad Commission to fix and determine the just compensation to be paid to Palo Alto Gas Company for the public utility and the property and rights thereof, and public hearings having been held, and the City of Palo Alto and Palo Alto Gas Company having been accorded full opportunity to present such evidence as they might desire to submit, and each of said parties having taken full advantage of said opportunity and having presented all the evidence which each party desired to present, and the Commissioner who heard the evidence having made a personal inspection, in company with representatives of the City of Palo Alto and of Palo Alto Gas Company, of the property of Palo Alto Gas Company, and being fully apprised in the premises;

THE RAILROAD COMMISSION HEREBY FINDS AS A FACT that the just compensation to be paid by the City of Palo Alto to Palo Alto Gas Company for all of said company's property and rights, other than the right to be a corporation, is the sum of \$65,500.00.

The property and rights of Palo Alto Gas Company for which said compensation is hereby fixed and determined as just

and reasonable are described in Exhibit "A" which is attached hereto and made a part of these findings.

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

Dated at San Francisco, California, this 8th day
September
of ~~August~~, 1916.

Max Thelen
H. J. Loveland
Alfred Gordon

James R. Decker

Commissioners.

EXHIBIT "A"

The property and rights of Palo Alto Gas Company, except the right to be a corporation, viewed as a going concern, with franchise rights attached, more particularly described as follows:

A gas distributing system partially completed located in the City of Palo Alto, and in that certain suburb known as South Palo Alto, and in that certain suburb known as North Palo Alto and consisting of all pipes, mains and service laterals now lying in the streets and avenues of said city and said suburbs, together with the meters and the necessary appurtenances and equipments of said gas distributing system, also the storage tanks of said company located in the roadway of University Avenue Extension outside the city limits, also all rights, titles and interest which the said Palo Alto Gas Company owns and can legally convey to the City of Palo Alto in and to all pipes, mains and service laterals, together with the meters and necessary appurtenances to said system in its service extending from the City of Palo Alto to the Leland Stanford Junior University and the home of Charles G. Lathrop and campus homes.