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Decision No. 8099

BEFORE THE RAILROAD COMMISSION
OF THE STATE OF CALIFORNIA

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ORIGINAL

In the Matter of the Application of SOUTHERN COUNTIES GAS COMPANY OF CALIFORNIA for authority to increase its rates for gas supplied to its consumers in the County of Ventura and in the Cities of Ventura, Oxnard, Santa Paula and other unincorporated towns and communities of the County of Ventura.

Application No. 5692

LeRoy M. Edwards for Southern Counties Gas Company;
E. F. Orr, for City of Ventura;
Arthur Blanchard, for City of Santa Paula;
Chas. F. Blackstock, for City of Oxnard.

BRUNDIGE, Commissioner:

O P I N I O N

Southern Counties Gas Company, applicant herein, requests authority for an increase in its rates for gas service supplied in its Ventura district. In its petition for such authority applicant alleges that since the taking over of the gas system supplying the cities of Ventura, Santa Paula and Oxnard and intervening territory, it has introduced natural gas in place of the artificial gas formerly served; expended during the first 13 months, ending March 31st, 1920, approximately $190,000 in improvements and betterments; has made large replacements and extensions to the system, so that a first-class service is being rendered; that the rates charged per thousand cubic feet are the same as those charged for artificial gas formorly served; that it has expended all reasonable effort to obtain a dependable supply of natural gas and to enlarge the business so that an adequate return on its investment could be obtained from existing rates, but, owing to conditions existing, this has been impossible and it has operated at an actual loss during the entire period since the property was taken over; that the cost of money is in excess of the 8 percent return generally allowed by the Commission and that due to this fact and the hazard of the business of supplying natural gas it should be allowed a rate of return in excess of that normally allowed in order that it may finance the necessary additions and betterments to its system required to continue a good standard of service. It requests further that it now be allowed to amortize the deficit incurred in the past in addition to a fair return upon its property.

The rates for gas service for domestic purposes now in effect in the Ventura division of Southern Counties Gas Company, and which applicant alleges are unremunerative, are:

First	2,000	cu.ft.	per	meter	per	month	..	$1.25	per M cu.ft.
Next	3,000	"	"	"	"	"	..	1.00	per M cu.ft.
"	5,000	"	"	"	"	"	..	.90	per M cu.ft.
"	10,000	"	"	"	"	"	..	.80	per M cu.ft.
"	30,000	"	"	"	"	"	..	.70	per M cu.ft.
All over	50,000	"	"	"	"	"	..	.60	per M cu.ft.

Minimum Charge $1.00 per Meter per Month.

At the hearing in this proceeding applicant submitted a proposed schedule of rates which it asks the Commission to approve. The rates so proposed for domestic service are as follows:

CONSUMER CHARGE:

$1.00 per Meter per Month.

CONSUMPTION CHARGE:

First	2,000	cu.ft.	per	meter	per	month	..	$2.00 per M cu.ft.
Next	3,000	"	"	"	"	"	..	1.80 per M cu.ft.
"	5,000	"	"	"	"	"	..	1.65 per M cu.ft.
"	10,000	"	"	"	"	"	..	1.50 per M cu.ft.
All over	20,000	"	"	"	"	"	..	1.40 per M cu.ft.

Applicant requests no increase in its industrial rates, urging that such gas as it sells under these rates is in competition with fuel oil; that at the present time it has a surplus of gas which it cannot dispose of and that a further increase in industrial rates would probably not result in any increase in the net revenue of the company.

The proposed increase in rates requested by applicant would represent, on the average, an increase in the cost of service to the consumers of approximately 100 percent over that under the present rates but would represent no increase in the cost for the same service over that for artificial gas as it was charged for prior to the purchase of the system, owing to the fact that the natural gas served in Ventura has a heat content in excess of twice that of artificial gas.

Southern Counties Gas Company purchased the gas properties of the Southern California Edison Company serving the towns in Ventura as of March 1st, 1919. At the time of the purchase the properties were in a very run-down condition due to failure on the part of the Edison Company to maintain the properties or render adequate service, and, in fact, the service of artificial gas then rendered was so poor, due to poor pressure conditions, poor quality of gas and interruptions to service, that steps were being considered by the municipalities toward the installation and ownership of municipal plants. The property was not only in a bad physical condition but the service was in disrepute.

The property had also been operated at a loss during the period prior to the transfer and no apparent attempt had been made by the predecessors toward either rendering adequate service and obtaining such rates as would result in a reasonable return. Upon the taking over of the property by applicant at a price which the Commission could not consider as reasonable, applicant introduced natural gas, which resulted almost immediately in a reduction in the cost of service to the consumers of approximately 50 percent, at a time when practically all other commodities were increasing in price.

Applicant commenced the rehabilitating of the properties and has expended in gross additions and betterments since that date in excess of $200,000; has negotiated with local oil companies and obtained a fairly adequate supply of natural gas for domestic purposes; has improved the quality of the service until at the present time a very high grade of gas service is being rendered in the district. This improved service has been made at a large cost to the applicant due to the necessity of replacing a large proportion of the gas mains, the repairing of services and meters and a general overhauling of the entire plant. The record conclusively shows that applicant has exerted every reasonable effort to render good service to its consumers. It is entitled, under the circumstances, to a fair return for its service.

The historical cost of the property of applicant at the time it was taken over on March 1st, 1919 was reported in Application No. 4440 as $228,343.80, while the depreciated historical reproduction cost was at that time found to be $147,286. The historical cost new above set forth plus the net additions and betterments to capital results in an average rate base for the period ending March 31st, 1920 of $355,757.70. The operating revenues and expenses for the same period are as follows:

Revenue, March 1, 1919 to April 30, 1920	...	$63,220
Total Operating Expenses	...	74,282
Deficit	...	$11,062

If depreciation and interest charges, based upon the average cost of money to applicant of 6.9 percent, be computed, the deficit is increased during the period as follows:

Depreciation	$11,707
Interest	26,592
Total Deficit . . .	$49,361

Applicant estimates that up to June 30th, 1920 it will have failed to earn the average cost of money on the property by the amount of $57,000, and urges at this time that it be allowed to amortize this deficit in rates to be collected from the consumers over a period of 5 years.

Applicant should, if possible, be allowed to amortize any reasonable deficit which was incurred in the rendering of service. In this particular instance it does not appear reasonable that applicant should be allowed to amortize the deficit incurred during the period immediately following the purchase of the property.

At the time the property was purchased the service, considered in the broader sense, was far below standard - in fact, the company then serving was in disrepute, justly, for the treatment it had given the public. The value of the property at the time of purchase was, therefore, less than the depreciated cost of the property. Applicant purchased the property when it was in a condition which would justify no increase in rates until service was improved, and it should have contemplated in the purchase of that property a deficit which would have to be incurred before it could justly claim a reasonable return. In this particular instance it appears that at least a six months' period elapsed after the purchase of the property before the service was adequately improved and the company in a position to be entitled to a reasonable return upon its investment.

Applicant's claim for amortization of deficit should be modified, therefore, by the deduction of all losses occurring during the first six months of operation after the acquisition of the property. These losses must be absorbed by the company where it has paid more for the property than it was reasonably worth. During the remaining period applicant has rendered good service and it would appear that the losses which have been incurred up to the effective date of the rates which are to be fixed herein should be refunded to applicant through the rates to be charged if such can be done and still maintain rates which are reasonable. The exact deficit cannot be determined until analysis of the books has been made after the rates herein fixed have been put in effect. However, based upon the company receiving its out-of-pocket cost, including depreciation and the cost of money at 6.9 percent, a deficit of approximately $35,000 will exist.

An analysis of the capital additions and betterments of applicant together with estimates of additions and betterments to cover an average year ending March 31st, 1920, which has been set forth in applicant's exhibit, together with an estimate of depreciation for a 12 months' period, based upon the evidence herein, is as follows:

SOUTHERN COUNTIES GAS COMPANY

VENTURA DISTRICT

SUMMARY OF RATE BASE YEAR ENDING 3/31/21

	Historical Cost New	Depreciation Annuity - 6% Sinking Fund Basis
Organization and Franchise	$ 2,139.00	
Land	10,940.65	
Production	781.00	$ 20.00
Transmission	197,437.03	4,720.00
Distribution	171,394.83	8,872.00
General	7,820.43	330.00
Total Capital	390,512.94	
Materials and Supplies	23,500.00	
Working Cash Capital	12,280.00	
Total Rate Base	$426,292.94	$13,942.00

The above summary of rate base is based upon the original historical cost of the properties less the cost of property rendered non-operative by the introduction of natural gas plus the net additions and betterments to April 30th, 1920 and the estimated average capital additions and betterments for the year ending March 31st, 1921. The allowance for working cash capital and materials and supplies has been made based upon a consideration of the evidence in this proceeding. The depreciation annuity is based upon a 6% sinking fund determination, shorter lives being used for equipment than in general found necessary in other districts owing to the special conditions existing on this property.

Applicant urges that it be allowed to amortize in the future the historical cost of certain gas production equipment which has been made non-operative by the introduction of natural gas. The historical cost of the property which was estimated to become non-operative was set forth by the Commission's engineers, in Application No. 4440, as $36,278. It has been found, however, that less equipment than was originally anticipated has now been made non-operative. The historical reproduction cost of this property is $26,246 and the depreciated historical cost less salvage at date of purchase is found to be $11,929. Depreciation since the date of purchase is included in the determination of the deficit, and the amount to be amortized at this time is $10,600.

As a matter of equity, it appears to me that the reasonable depreciated cost of the production equipment should be paid to applicant in the form of rates by a method of amortization of this amount over a period of years in view of the service improvements by applicant. This amount so reserved shall be set in a cash reserve for future use in plant development.

Applicant's contention that it should be allowed to amortize the historical cost is, in my opinion, unsound, as this property was purchased in a depreciated condition. If the former owner had not earned sufficient to amortize this, the present company or the consumers of the company are not to be held accountable, especially in view of the conditions existing.

The supply of natural gas obtained by applicant for delivery on its Ventura system has not been as dependable as it was originally expected and the source from which the gas is obtained has been somewhat erratic. Applicant has found it necessary at certain times to supply oil to the oil companies for field operation in order to obtain sufficient natural gas for its consumers, and, at other times, has found it necessary to waste a certain amount of natural gas owing to a lack of sufficient demand. Due to these conditions it has been impossible to accurately estimate the operating expenses of applicant, especially as regards the cost of gas supplied.

Although conditions of gas supply have improved up to the time of the hearing, it is very evident from the testimony in this proceeding that the cost of operation and the net revenue to applicant may be materially modified by conditions occurring. The Commission's engineers and the witnesses for applicant both agree that the return is more or less problematical. The use of natural gas is still in the development stage, but the field for use of gas is not as extensive as other territory and applicant must at present depend on sales of gas to domestic and commercial consumers for most of the revenue. If a large supply of gas of a dependable nature is obtained applicant may be able to develop additional industrial business and thus increase its net revenue and ultimately make possible a reduction in the necessary rates. Applicant's estimate of sendout and sales appears acceptable as a basis for estimating the possible rates.

The following may be considered as an approximation of the conditions which will exist both as regards supply of gas and operating costs:

<u>SOUTHERN COUNTIES GAS COMPANY</u>

<u>VENTURA DISTRICT</u>

<u>ESTIMATED OPERATING STATISTICS, 1920-21</u>

Mean Active Meters	2,800
Domestic Sales	58,800 M cu.ft.
Industrial Sales	38,295 " "
Total Sales	97,095 " "
Gas Sendout	176,895 M cu.ft.
Gas Purchased	281,050 M cu.ft.
<u>Operating Expenses</u>:	
Natural Gas Purchased	$28,000
Other Production Expense	590
Transmission Expense	11,800
Distribution "	13,000
Commercial "	13,150
General "	6,690
Depreciation	13,942
Uncollectible Bills	590
Total Operating Expenses	$87,762
State, Franchise & General Taxes	10,750
TOTAL EXPENSE	$98,512

Applicant urges a 10 percent return upon the rate base on the ground that natural gas service is a more hazardous business than the general class of public utility service, and also, that on the basis of an 8 percent return applicant will not be able to finance the additions and betterments and improvements to its system.

The transmission and distribution of natural gas is, in general, considered to be more hazardous than other public utility service due to the fact that the supply of gas is not constant or uniform and is limited as to life. In the special case of the Ventura County service, the continuity of supply appears quite problematical and it is not possible to estimate what the future might bring.

The service of gas by a public utility is not a business which may be discontinued with the discontinuance of gas supply. Applicant has invested large sums of money in a permanent business which must be continued whether the supply of natural gas continues or suddenly ceases. The transition period between natural gas and artificial gas must be gone through without a decrease in the service condition. Applicant's financial stability must be maintained then so that such changes as are necessary may be readily made. Were the natural gas supply to suddenly cease at this time applicant would be required to expend a large sum of money in the installation of gas producing equipment, and, without an adequate return or a cash reserve to take care of this contingency, serious results might occur.

The granting of a higher rate of return in itself will not, in my opinion, solve the problem, as it will not guarantee the company against a period of transition and at the same time will not guarantee to the consumers that in return for the payment of a higher return they will be assured of adequate service with the diminution of the present supply. A greater return, unless used for the protection of service and in that way the guaranteeing of continued return to the company, would appear to be of little value to either the consumers or the permanent benefit of the utility. I believe applicant should be granted sufficient return to enable it to create a reserve for possible future contingencies if, with reasonable rates, this can be done.

Applicant's new money is costing it approximately 7.9% while the average cost has been 6.9% according to the evidence. I believe that if applicant is allowed an 8% return upon the historical cost of the property at the time of the purchase plus 9% return upon additions and betterments, which total represents an average of 8½%, that at this time this return should be considered as a reasonable return in view of the fact that at the present time service is still in the development stage, as shown by the fact that in other districts where applicant has changed from artificial to natural gas there has been a continuous increase in sales per consumer after the first year of change. Further, where applicant is reimbursed for early losses as herein contemplated, it cannot in addition expect a return based on assumption of hazard.

The increased business of applicant which will in all probability occur, and which will result in an increase in net revenue in excess of this amount in the future, should, in my opinion, be set aside, first, for the amortization of the deficit heretofore incurred at a rate greater than herein proposed, and also for the creation of a reserve to guarantee the continuance of good service and the company against future contingencies.

Applicant urges the amortization of accrued deficit and the abandoned property value on a basis of 5 years, computing the same upon a 6% sinking fund basis. It is advisable that any deficits to be amortized be wiped out as rapidly as possible providing the same can be done without too great a burden upon existing consumers. In this instance it would appear that applicant's rates for gas must be increased at this time approximately 80 percent and it does not appear advisable to burden the consumers with any such additional amount, especially in view of the fact, as above pointed out, that in all probability there will be further development of gas and possible increase in net earnings. In view of these facts the amounts to be included in the determination of rates for the amortization of such deficit will be $4,760 per annum and for the amortization of abandoned property $1,440.

The summary of the estimated cost of service for the year ending March 31st, 1921 is as follows:

Operating Expenses, including Depreciation and Taxes	$98,512.00
Amortization of Deficit	4,760.00
" " Abandoned Property	1,440.00
Return at 8½% on Rate Base	36,234.00
	$140,946.00
Less Revenue from Industrial Sales and Merchandise Profit	16,600.00
Net Cost of Service - Domestic and Commercial Service	$124,346.00
Estimated Sales - Domestic-Commercial Gas	58,800 M cu.ft.
Average Rate Required	$2.12 per 1,000 cu.ft.

The above represents a cost of service approximately 80% in excess of the average revenue obtained under the present rates. The cost under such a rate will, however, be approximately 90% of the cost of similar service of artificial gas at the rate of $1.25 per 1,000 cu.ft. previously charged owing to the fact that from each cubic foot of natural gas there is over twice as much heat obtainable by the consumer than from a cubic foot of artificial gas. This relation between the cost of artificial gas service and natural gas at the increased rate may not be entirely apparent as, in general, due to the cheaper and better service, consumers have increased their use of natural gas over that formerly made of artificial. This Commission has found that under present prices of oil and labor artificial gas service in communities similar to those in Ventura costs approximately $2.00 per 1,000 cu.ft. to deliver. This rate is equivalent to from $3.50 to $4.00 per thousand for the quality of natural gas served in Ventura County.

Applicant has suggested a rate known as a readiness-to-serve charge plus consumption rate, under which each consumer is charged $1.00 per month to cover certain fixed charges and operating expenses incurred by the company due to its being ready to serve its consumers regardless of whether or not gas is consumed. If the rate requested was granted, consumers using 1,000 cu.ft. per month would have their rates increased from $1.25 as at present to $3.00 per thousand, or an increase of approximately 240 percent.

Although the proposed form of rate may be correct it does not appear to me that such a form of rate is advisable under the conditions, especially in view of the rates charged by applicant in the past and the rates charged by it in other districts. Applicant is still developing its natural gas business and it also appears advisable in this case not to increase the rates at this time to the full amount herein estimated but so increase them that with the expected growth of business it may be in a position to earn the revenue herein set forth. The rates herein set forth will result in applicant earning an average rate of [illegible] approximately $2.00 per thousand cubic feet.

I recommend the following form of Order:

O R D E R

Southern Counties Gas Company having applied to the Commission for authority to increase its rates for gas for domestic and commercial service in the towns of Ventura, Oxnard, Santa Paula and Fillmore and intervening territory included in Ventura County, a public hearing having been held and the matter being submitted and now ready for decision,

The Railroad Commission hereby finds as a fact that the existing rates and charges of Southern Counties Gas Company for domestic and commercial gas service in its Ventura district are unjust and unreasonable and inadequate in that they do not adequately compensate applicant for the service rendered, and that the rates for domestic and commercial service hereafter set forth are just and reasonable rates.

Basing its order on the foregoing finding of fact and on the findings of fact contained in the opinion which precedes this order, IT IS HEREBY ORDERED that Southern Counties Gas Company be, and it is hereby, authorized to charge and collect for gas served in the County of Ventura the following rates, to become effective based upon all regular meter readings taken on and after the 20th day of September 1920:

SCHEDULE NO. 1

DOMESTIC AND COMMERCIAL SERVICE

CLASS OF SERVICE:

Applicable to domestic and commercial service for lighting, cooking and heating, including restaurants, apartment houses, hotels, hospitals, sanatoriums, business buildings of all kinds, schools and churches.

TERRITORY:

Applicable to the Ventura division, including Ventura, Oxnard, Santa Paula, Fillmore and adjacent territory.

RATE:

First	3,000	cu.ft.	per	meter	per	month ..	$2.00	per M cu.ft.
Next	7,000	"	"	"	"	" ..	1.80	per M cu.ft.
"	10,000	"	"	"	"	" ..	1.60	per M cu.ft.
All over	20,000	"	"	"	"	" ..	1.40	per M cu.ft.

MINIMUM CHARGE:

$1.50 per Meter per Month.

SPECIAL CONDITIONS:

Consumers served under this schedule have priority in the use of gas over consumers served under other schedules of rates.

PROVIDED, Southern Counties Gas Company shall file with the Commission, on or before September 20, 1920, the schedule of rates herein authorized.

IT IS HEREBY FURTHER ORDERED that Southern Counties Gas Company shall set aside for depreciation reserve, in addition to the annuity heretofore estimated, 6 percent per annum upon the accrued depreciation during each year.

IT IS HEREBY FURTHER ORDERED that Southern Counties Gas Company shall set aside in a special reserve fund each year the amount herein allowed for amortization of abandoned property, same to be expended as may hereafter be directed by this Commission.

IT IS HEREBY FURTHER ORDERED that all net earnings of Southern Counties Gas Company from its Ventura district in excess of the amount herein computed, plus 9 percent per annum upon average additions and betterments, be set aside for the refunding of the deficit of $35,000 set forth in the opinion herein and such other purposes as may be approved.

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 13th day of September, 1920.

Edwin O. Edgerton

H. D. Loveland

Frank R. Devlin

H. W. Brundige

COMMISSIONERS