Decision No. 26372.

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA.

- - -

ORIGINAL

In the Matter of the Investigation on the Commission's own motion into the reasonableness of the rates, rules, regulations, charges, classifications, contracts, practices, service and operation, or any of them, applicable to natural gas service on the system of PACIFIC GAS AND ELECTRIC COMPANY.) Case No. 3424.

***

In the Matter of the Investigation on the Commission's own motion into the reasonableness of the rates, rules, regulations, charges, classifications, contracts, practices, service and operation, or any of them, applicable to artificial gas service on the system of PACIFIC GAS AND ELECTRIC COMPANY.) Case No. 3607.

BY THE COMMISSION:

OPINION AND ORDER
ON SUPPLEMENTAL INVESTIGATION.

Under date of March 26, 1934 the Commission issued its supplemental order of investigation in the above matters to determine whether Decision No.26512 issued by the Commission on November 13, 1933 reducing natural gas rates on the system of the Pacific Gas and Electric Company should be altered, amended or rescinded and whether the above proceedings should be re-opened for further hearing and consideration. The matter was heard before the Commission on Tuesday, April 10, 1934. The specific purposes of the hearing were to consider the status of the company's rate litigation pending in the United States District Court involving the said Decision No.26512 (Pacific Gas and Electric Co., Plaintiff, vs. Railroad Commission, et al., Defendants, In Equity No.3660 S), with particular regard to the

opinion of the court rendered on the motion for interlocutory injunction; to consider the advisability of the Commission directing the preparation of an inventory and appraisals of the company's gas properties; to consider the possibility of affording substantial rate relief to the public prior to the ultimate disposition of the present litigation in the courts some years hence. Such relief could be afforded through a possible reopening of the above matters and the issuance of a further rate order or a new investigation into the gas rates of the company, or through a compromise of the litigation. The public is vitally interested in all of these matters and it was appropriate and essential that a public hearing be had at which time the city representatives and other parties in interest might be heard.

Status of federal court litigation

On November 13, 1933 the Commission issued its order in the above matters reducing the domestic and commercial natural gas rates of the Pacific Gas and Electric Company some $2,100,000 annually, directing the said rates to be made retroactive so as to apply on meter readings taken on and after July 16,1933. The company filed an action in the District Court of the United States attacking the validity of the Commission's order and on December 14, 1933 obtained an order of court restraining the effectiveness of the said order. A motion for an interlocutory injunction was argued before the three judge statutory court convened for the purpose of hearing the matter on January 19, 22, and 25. On February 5, 1934 the court filed its opinion granting an interlocutory injunction. (Pacific Gas and Electric Co. vs. Railroad Commission, 5 Fed. Supp. (Adv. Op.) 878) The decree was signed and filed on February 15, 1934, and the matter referred to Honorable H. M. Wright, Special Master, for the purpose of trial of the matter de novo. In view of this fact, new evidence will

be offered by all parties to the proceeding and the trial will necessarily be protracted. From statements of counsel given in the course of the recent hearing before the Commission it appears that it may well be three or four years hence before a final adjudication of the matter may be had in the Supreme Court of the United States. In the absence of further action by the Commission relative to the gas rates of the company, the public will not be assured of any rate relief from the present level of rates being charged, until the matter is finally disposed of by the Supreme Court. At that time such relief will be accorded in the event the Commission's order is sustained. Pursuant to a condition of the decree of the court the company has filed with the court a stipulation agreeing to refund to its consumers all sums collected in excess of the rates prescribed in the Commission order, together with such interest as the court may fix, in the event it fails to make its plea good. The performance of this obligation is secured by a surety bond on file with the court.

The Commission's rate order is now under attack on the ground that it violates the rights of the plaintiff under the 14th Amendment to the federal constitution. The issues before the court are set forth at length in the opinion of the court filed on the motion for the interlocutory injunction and need not be reviewed herein. Suffice it to say that the court in testing the validity of the rates prescribed must find the fair value of the company's properties as required by the decisions of the Supreme Court, determine expected revenues, reasonable operating expenses and whether the return to be derived constitutes a reasonable return on the fair value of the company's properties.

Preparation of an inventory will be ordered

In the proceedings before the Commission the Commission's staff offered no evidence relative to the reproduction cost new

or reproduction cost new less accrued depreciation of the company's gas properties. The company offered evidence along this line which the Commission found to be unconvincing and of no positive value, the reasons for such conclusions being set forth in the Commission's decision. The rate base used in the Commission's decision included the historical cost of the company's properties as reflected by certain company valuation studies supplemented by certain historical book figures. At the recent hearing in this matter it was shown through the Commission's Valuation Engineer C.T.Mess that an inventory and appraisals, both on historical cost and reproduction cost new bases should be prepared in order to arrive at dependable figures reflecting such costs. Without such studies accurate and dependable figures cannot be obtained and in the trial of the federal court case the Commission would be compelled to resort to the application of price translation factors to undependable base figures in an effort to reflect present prices, the method heretofore used by the company, the results of which were repudiated by the Commission in its opinion. It would be unfair to the public in the defense of the federal court action to acquiesce in results so obtained. Numerous compelling reasons for his conclusions were given by witness Mess and his views were not contradicted. It appears that a proper and sound defense of the federal court suit requires that these studies be prepared and used therein. The studies should be completed as soon as possible and the trial of the pending action should be deferred until this evidence is available.

The preparation of an inventory will entail considerable expense and the Commission cannot and should not bear the expense incident thereto. Under the Public Utilities Act it is contemplated that necessary inventories of public utility properties will be prepared by the utilities affected and the Commission is granted specific authority to compel the preparation of such inventories.

In this matter the utility will be directed to prepare the inventory, the staff of the Railroad Commission and engineers of such of the cities as care to participate, checking the work as it progresses. It appears that the necessary inventory and valuation studies can be prepared within a year or fourteen months.

The situation relative to the gas properties of this company is singular. It is the only major utility of its kind in California that does not have either an accurate inventory from which appraisals may be prepared or accurate figures reflecting book costs.

The preparation of the valuation studies herein required will not delay the final submission of the federal court case to the master for any appreciable period. Furthermore, the stipulation and bond on file with the court adequately protects the public and gives assurance that the sums collected in excess of the rates fixed in the Commission's order will be refunded with interest should the order be sustained.

The inventory and appraisals herein contemplated will be available and usable in the future regulation of this utility as well as in the trial of the suit in the federal court. The inventory can be kept current under proper accounting methods, and the company will be required to do so upon its completion.

A new proceeding before the Commission will be initiated

As above noted it will probably be some years before the validity of the rate order under attack is finally determined by the courts. This is no criticism of the courts, but rather a recognition of the fact that litigation of this type where a trial de novo is inescapable and where the testimony to be adduced is highly technical, is necessarily impossible of early determination. It is obvious that the Commission should endeavor

to effect rate relief to the public prior to the ultimate determination of the present litigation. This can be done by the medium of a new rate case, a reexamination of relevant facts and the promulgation of a new order, which order upon its issuance will supersede the order now in litigation. Such an order might effect a reduction comparable with the one now under attack or a greater or lesser reduction dependent upon the facts developed in the new record and conditions prevailing a year hence. Unless stayed by judicial process the public would obtain the full benefits contemplated forthwith upon the issuance of the order.

The opinion of the District Court of the United States on the recent motion for interlocutory injunction held that inasmuch "as the Commission has departed from the rules laid down by the Supreme Court for the determination of a proper rate base, a hearing of the case de novo is inescapable. In such a situation, it becomes our duty to grant the motion for an interlocutory injunction. Such course is approved in Ohio Oil Co. v. Conway, 279 U.S. 813, 815. * * * "

The court made specific reference to the observations contained in the Commission opinion that "During its entire history in establishing reasonable rates for utilities similar to this company, to determine a proper rate base this Commission has used the actual or estimated historical costs of the properties undepreciated, with land at the present market value. Consistent with this, it has used the sinking fund method to determine the allowance for depreciation to be included in operation expenses." The court then observed "This theory, which was followed by the Commission in determining a rate base, has been repudiated by the Supreme Court. (citing cases.)"

Relative to going concern value and the treatment accorded the subject by the Commission the court observed: "It is essential that going concern value be included in the estimate

of the fair value of the property upon which rates are to be fixed." From these observations and others contained in the court's opinion, it appears that the immediate effectiveness of the Commission's rate orders is in jeopardy so long as the so-called prudent investment theory of rate making is followed. The ruling of the court would indicate that in such a situation where the Commission departs from the rules laid down by the Supreme Court for the determination of a proper rate base, it is the duty of the court to grant the motion for an interlocutory injunction. These observations of the court, of course, do not mean that the Commission's order in the particular case will not be sustained in the trial of the case on the merits. The court in its opinion has not discussed the case on the merits, but in that regard simply stated that a trial de novo is inescapable for the final determination of the case.

Constructive action in the premises suggests and requires that a new gas rate proceeding be initiated looking to the promulgation of a new order predicated on such findings as found necessary by the court. A fair value rate base should be determined on dependable valuation evidence and the rates fixed consistent with that approach. By this action of the Commission an interlocutory injunction may well be defeated, should the new order be the subject of attack in a new court action. Cambridge Elec. Light Co. v. Atwill (1928) 25 Fed. (2d) 485. Furthermore, should a determination on the merits be unavoidable in such a new court action a trial de novo with its attendant cost and delay may possibly be avoided. Persistence in the use of past rate making policy and practice of the Commission will defeat in a large measure the effectiveness of the Commission's action inasmuch as interlocutory injunctions under such circumstances are apparently inescapable. It is better that the

practice be changed and that the rates promulgated by the Commission be tested on the fair value rate base and the benefits of rate reductions thereby made immediately available to the public.

In such a new proceeding the inventory and appraisals, as directed by the Commission herein, will be required. It is therefore reasonable to expect that the new case can be completed in a year or fourteen months and a new order then issued which with greater probability can be successfully defended upon a motion for interlocutory injunction.

A new rate order issued a year from now would supersede the order now under attack and thereby limit the scope of the present litigation to the validity of the rates under attack for a period of approximately one year and nine months, from July 16, 1933 (retroactive effective date of the Commission's order) to such date as the new order becomes effective. Thus the present litigation would involve approximately three and one-half million dollars, the right to which would be determined by the courts upon completion of the litigation some years hence. The full measure of relief to which the public would be entitled would be realized upon the issuance of a new order along the lines above indicated, it being assumed that an interlocutory injunction could in such event be defeated.

The advisability of the institution of a new rate investigation before the Commission, as well as the advisability of the Commission directing the preparation of a detailed inventory of the company's properties, from which valuation studies could be prepared for use in the trial of the federal court case, as well as in future Commission proceedings, were generally discussed and considered by participants in the course of the

hearing of April 10, 1934, and all of the city attorneys and other public representatives expressing themselves on these specific matters agreed that the action hereinabove proposed should be taken.

The company proposal of compromise.

In the course of the hearing the company filed a return to the supplemental order of investigation in which it reiterated its contentions heretofore set forth in the petition for rehearing filed with the Commission, as well as the contentions being made in the federal court action. By its return it expressed a willingness to immediately settle and compromise the litigation. Through its counsel the company specifically proposed a settlement under which (1) the company would effect an immediate rate reduction in its natural gas rates of approximately $1,050,000 annually, this being approximately 50 per cent of the reduction ordered by the Commission in its order of November 13, 1933; and (2) the company would agree to write off to surplus the so-called cut-over expense and extraordinary maintenance costs carried in suspense accounts in an amount in excess of $1,500,000. In the proceeding before the Commission, as well as in the federal court litigation, the company has contended that these sums should be amortized and included as operating expenses in measuring the results of company operation. In the Commission decision of November 13, 1933, the company claims were disallowed and the reasons fully stated in the opinion.

At the hearing of April 10th a number of attorneys representing cities served by the company urged that in no event should a company proposal of a compromise be accepted which did not accord relief to the consumers retroactively to July 16, 1933, the date to which the reduced rates in litigation were ordered to apply. The company was granted the right to enlarge upon its

proposal and comply with these suggestions of the cities, by filing with the Commission on or before April 16, 1934 any further formal proposal which it cared to submit. The company filed nothing further.

The compromise proposed by the company will be rejected. The contentions made by the company in its return and orally stated at the recent hearing were carefully considered and ruled upon in connection with the Commission's denial of the petition for rehearing filed by the company.

The opinion rendered by the District Court of the United States in granting the interlocutory injunction does not in any degree pass upon the merits of the case. The Commission in fixing rates in this matter followed the policy which it has consistently followed during the past twenty-one years in fixing rates for this and like utilities. To determine the proper rate base the Commission used the best available historical cost data reflecting cost of the properties undepreciated with land at market value. Consistent with this it used the sinking fund method to determine the allowance for depreciation to be included in operating expenses. The development of new and accurate historical cost figures as above contemplated will undoubtedly demonstrate that the cost figures used in the Commission determined rate base were liberal and in fact exceeded the cost of the properties.

Since regulation was undertaken by the Commission this company has acquiesced in the methods above described and during this long period of time has developed and prospered as have other major California utilities. We believe that the rates fixed are fair and just and will be sustained in the federal court proceeding when reenforced by the valuation studies herein directed.

Conclusions.

Consistent with the foregoing observations: (1) The

company will be directed to prepare a detailed inventory of its operative gas properties, the work to be undertaken immediately, completed within one year from date, and the staff of the Railroad Commission and the representatives of the cities affected to be accorded full opportunity to check the inventory while it is in the course of preparation. From this inventory can be prepared authentic historical cost and reproduction cost new appraisals.

(2) The Commission has todey initiated a new proceeding into the reasonableness of the gas rates of the Pacific Gas and Electric Company, this proceeding to run more or less concurrently with the federal court proceeding. In this matter the new valuation data prepared will be used. It is to be anticipated that a new order will be issued in a year or fourteen months hence fixing a new level of rates to apply forthwith - based on conditions then prevailing and likely to prevail thereafter. By this course of action it is to be expected that the rates then fixed will become effective without the intervention of injunctive process and that the subject matter of the present litigation would then be limited to the lawfulness of the rates fixed in the order of November 13, 1933, for a period of approximately one year and nine months, a much shorter period than otherwise would be the case. The institution of this new proceeding is by no means evidence of weakness in the Commission's present federal court case and should not be so viewed. It is rather a frank recognition of the practical advantages which may be obtained for the public by such course of action.

(3) Counsel for the Commission will be expected to defer the trial of the federal court case for the period necessary to permit the use of the valuation data, the preparation of which is here directed. This will assure the public the full opportunity for a proper defense to the action as more specifically outlined above.

O R D E R

Hearing having been held on the supplemental order of investigation issued in the above matters under date of March 26, 1934, for the purpose of determining whether the Commission's decision in said matters issued November 13, 1933 should in any manner be altered, rescinded or amended or the proceedings re-opened and the Commission now being fully informed in the premises, and the matter having been submitted,

IT IS HEREBY ORDERED that the Pacific Gas and Electric Company shall immediately undertake the preparation of a detailed inventory of its operative gas properties, excluding its properties leased to the San Joaquin Light and Power Corporation, but including properties owned by Modesto Gas Company, the same to be completed within one year from date. The preparation of this inventory shall be in the form and in accordance with the general method of procedure to be prescribed by this Commission. Early conferences will be had with the interested parties for the purpose of evolving an appropriate program under which this work will be carried forward.

IT IS HEREBY FURTHER ORDERED that in all other respects the supplemental order of investigation be and the same is hereby dismissed.

The effective date of this order shall be ten (10) days from date hereof.

Dated at San Francisco, California, this 23rd day of April, 1934.

Leon O. Whitsell

M. B. Harris

Commissioners.

We concur in that part of the order declining to accept the Company's proposal of compromise but dissent from that part which deals with and directs a new inventory and appraisal and promulgates a sweeping change in Commission policy.

To order the Company to make an inventory and appraisal is unnecessary and objectionable for various reasons. The cost of it (probably not less than $300,000.00) will fall upon the consumers and will have to be subtracted from the amount of any rate reduction accomplished. Despite all that is said, there is no assurance that it will result in any appreciable change in the historical cost claimed by the Company and as used by the Commission. In 1919 the Company made an inventory and appraisal of both its gas and electric properties. As to the latter, it was checked by the Commission's engineers. The change made was only about 3.5%. The property affected by the old gas inventory is relatively small (it represents only about 20% of the total claimed historical cost) and any change in that would hardly be noticed in the overall result. If it should result in any lowering of the historical base the saving in return would be offset by the cost of the inventory and appraisal, to say nothing of the detriment due to the long delay it would entail. The majority contemplate the checking of the inventory and appraisal by the Commission's staff. To do this will cost an additional amount of from $25,000.00 to $50,000.00, depending upon the securing of outside help. No funds are available for this work. Furthermore, such an inventory and appraisal with its great expense and long delay is unnecessary to the successful defense of the Federal Court suit or the conduct of a new investigation. The rates under attack may be justified by the presentation of other factors of a greater relative importance, and this at an overall cost of not to exceed $20,000.00 (rather than a probable total cost of $45,000.00 to $70,000.00 by inclusion of the inventory) and without the long and prejudicial delays

incident to the course being undertaken. This is no time to incur obligations greatly in excess of funds in sight or to impose upon consumers costs which with reasonable certainty cannot be said to be advantageous to them.

The course proper to be pursued is:

1. To proceed vigorously and at once with a defense of the Federal Court suit. There are matters which may be presented without delay or considerable expense which should lead to sustaining the rates under attack.

2. If the Johnson Bill is passed (as advices indicate it will be) to institute a new investigation, complete the taking of testimony and get out an order before the end of the current year. In this way most, if not all, of the matters in controversy may be reviewed promptly.

The Master appointed to hear this case, under instructions from the Court, has been endeavoring to bring this trial to a speedy hearing and conclusion. The Company has stated it is prepared to proceed with its showing. This Commission, which has for years been clamoring for the elimination of Federal Court delays, certainly should not lend itself to the unnecessary and tremendously expensive process which is proposed by delaying the trial a year or a year and a half for an inventory.

We do not agree to the summary discarding of the historical cost basis of measuring rates long followed by this Commission. This basis is generally favored by liberal and thoughtful students of regulation. It has worked well in California. It is in accord with accounting practices of utilities. Valuation write-ups have not been countenanced. Under the severe test of the depression years it has

proven itself as better than the so-called fair value basis with all of the latter's uncertainties and speculative features.

There is no need of discarding it. Most utilities in California have constructed sufficient of their properties during the level of higher prices so that there is little difference between their actual historical cost and what the cost would have been under current price levels. What difference there is, if any, may be determined with sufficient accuracy to avoid any danger of working a confiscation under the doctrines of the Federal Courts, and this without the costly and time consuming inventories and appraisals which generally go with the adoption of the policy advocated by the majority. By a very little change in the setups customarily used by the Commission, all the dangers adverted to in the opinion may be avoided.

C. L. Seavey

M. J. Carr

Commissioners.