

Decision No. 36909

BEFORE THE RAILROAD COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Investigation Upon
the Commission's Own Motion Into the
Reasonableness of the Rates, etc., of
the Vallejo Electric Light and Power
Company covering Electric Service

Case No. 4688

Reginald L. Vaughan, for Vallejo Electric
Light and Power Company

ORIGINAL

SACHSE, COMMISSIONER:

O P I N I O N

This is a proceeding on the Commission's own motion into the reasonableness of the rates, charges, rules and regulations, classifications, contracts and practices of the Vallejo Electric Light and Power Company, hereinafter referred to as the company. Public hearings were held on August 25, 1943, at Vallejo and September 1, 1943 at San Francisco, and the matter submitted. A brief was filed by respondent.

The company furnishes electric service to residential and commercial customers in the City of Vallejo and vicinity. Except for the Mare Island Navy Yard and the Sperry Flour Mill, neither of which is served by the company, there is little industrial development in the company's service area.

History

The company commenced rendering service in Vallejo in 1897. Its affairs have been under the jurisdiction of this Commission since 1912. During the early years of its operation the company generated all of its electric energy requirements in a small steam plant located in Vallejo. In April 1912 a contract was signed for the purchase of power from Pacific Gas and Electric Company and all purchased power has since been bought from that company. The steam plant was taken out of active service but was retained for standby purposes

until its retirement from capital in 1936 and subsequent removal.

The company has had a remarkable growth with very high net earnings and reflects an interesting utility development under Commission regulation. From 1913 to 1942 the investment in electric plant increased ninefold from \$148,591 to \$1,372,144, each year showing an increase over the preceding year. The plant investment increased by \$442,000, or 33 per cent in the 3-year period 1939 to 1941. As of December 31, 1942 electric plant in service totaled \$1,372,144.

The number of customers has increased steadily since 1913, except for two short periods, 1922-1923, and 1930-1931, and the gain was very rapid in 1941 and 1942. Sales of electric energy in 1942 were almost 17 times as great as in 1918. Kilowatt-hour sales more than doubled in the 4-year period 1918-1921. In the 3-year period 1940-1942 they increased 91 per cent. The company's 1942 energy requirements purchased from Pacific Gas and Electric Company amounted to 29,003,000 kwh, and its total sales for the year amounted to 26,871,000 kwh. Company use amounted to 146,000 kwh and the remaining 1,986,000 kwh, or 6.8 per cent of the total purchased, represented distribution losses and unaccounted for energy.

Since 1912 a number of formal proceedings have been before the Commission, involving rates, rules and regulations, certificates of public convenience and necessity, territorial disputes and a capital stock dividend proceeding. In 1929, in Decision No. 21695 (33,CRC,641) the Commission authorized Pacific Gas and Electric Company to acquire 4,583-1/3 shares, out of a total of 10,000 shares (\$10 par value per share) of the company's outstanding capital stock, at a price of \$110 per share, exchanging two shares of Pacific common stock for one share of Vallojo common stock. The Pacific Gas and Electric Company at that time offered to purchase the remainder of the company's stock at the same price per share, but did not acquire control. On December 31, 1942 Pacific Gas and Electric Company owned 45.8 per cent of the company's stock.

In Decision No. 33734 (43,CRC,915), in December 1940, the Commission authorized the issue of \$500,000 par value common stock (50,000 shares at \$10 a share) to reimburse the treasury for surplus earnings theretofore invested in company property and to be distributed as a stock dividend to the owners of the then outstanding stock.

The total outstanding stock at the present time is 60,000 shares at a par value of \$600,000. The company has no bonded debt. A \$20,000 unsecured note, at 4 per cent interest, was paid off subsequent to December 31, 1942.

The trend of rates for domestic and commercial lighting service over the past 29 years has been steadily downward, while the customer use of electric energy has increased. During this period the monthly bills in the 100 kwh and 500 kwh groups were reduced by more than 60 per cent. The average monthly consumption in 1942 was 85 kwh by domestic users and 601 kwh by commercial lighting users. The last rate decision of this Commission was made in July 1929,⁽¹⁾ resulting in a reduction of \$50,000 annually. Reductions principally based upon studies made by the Commission's staff have added approximately \$100,000 annually since that date.

The company has experienced a very rapid growth in the past two years as the result of the great expansion of the Mare Island Navy Yard, which now employs approximately 40,000 people. The population of the Vallejo area, it is estimated, has increased from about 25,000 in 1939 to between 90,000 and 100,000 at the present time. Much of this expansion has been in the shape of government housing projects. Five projects have been completed and are occupied and three additional ones are under construction.

(1) Decision No. 21341, in Case No. 2684 (33,CRC,360)

Balance Sheet and Income Statement

As of December 31, 1942 the company's books show assets and liabilities as follows:

| | | <u>Assets</u> | |
|--|-----------------|---------------|-----------------------|
| Electric Plant | | | \$1,372,144.47 |
| Investments: | | | 85,432.19 |
| Capital stock of Alca Electric Co. | \$ 41,116.53 | | |
| Capital stocks of other corporations | 41,488.16 | | |
| Bonds | <u>2,827.50</u> | | |
| Current and accrued assets: | | | 123,381.19 |
| Cash | 28,172.32 | | |
| Special deposits | 514.55 | | |
| Working funds | 1,250.00 | | |
| Accounts receivable | 60,445.95 | | |
| Interest and dividends receivable | 37.50 | | |
| Materials and supplies | 28,029.76 | | |
| Prepayments | 4,931.11 | | |
| Deferred debits: | | | 4,797.70 |
| Other work in progress | 140.00 | | |
| Excess profits taxes - post-war refund | <u>4,657.70</u> | | |
| Total Assets | | | <u>\$1,585,755.55</u> |

| | | <u>Liabilities</u> | |
|--|-----------------|--------------------|-----------------------|
| Common capital stock | | | \$ 600,000.00 |
| Current and accrued liabilities: | | | 194,606.72 |
| Notes payable | \$ 20,000.00 | | |
| Accounts payable | 34,224.84 | | |
| Customers' deposits | 22,415.54 | | |
| Taxes accrued | 108,502.71 | | |
| Interest accrued | <u>9,463.63</u> | | |
| Reserves: | | | 502,306.92 |
| Reserve for depreciation of electric plant | 498,124.17 | | |
| Reserve for uncollectible accounts | 2,540.10 | | |
| Insurance reserve | <u>1,642.65</u> | | |
| Contributions in aid of construction | | | 161.01 |
| Earned surplus | | | <u>288,680.90</u> |
| Total Liabilities | | | <u>\$1,585,755.55</u> |

The condensed income statement for the year 1942 is shown below:

| | |
|---|-------------------|
| Operating Revenues | \$673,917.83 |
| Operating Revenue Deductions | |
| Operating Expenses - Purchased Power | 233,739.88 |
| Distribution Expenses - Operation | 28,863.73 |
| Distribution Expenses - Maintenance | 13,817.02 |
| Customers' Accounting and Collecting Expenses | 27,883.85 |
| Sales Promotion Expenses | 6,984.90 |
| Administrative and General Expenses | <u>47,242.52</u> |
| Total Operating Expenses | 358,531.90 |
| Depreciation | 69,309.52 |
| Property Losses Chargeable to Operations | 592.18 |
| Taxes - City and County | 33,838.43 |
| Taxes - State Franchise | 4,854.13 |
| Taxes - Federal Income and Capital Stock | 103,214.17 |
| Taxes - Pay Roll Taxes on Officers' Salaries | 174.00 |
| Taxes - Electric Energy | <u>17,572.42</u> |
| Total Operating Revenue Deductions | <u>588,086.75</u> |
| Net Operating Revenues | 85,831.08 |
| Other Income | |
| Dividends Received | 4,150.00 |
| Interest Earned | <u>150.00</u> |
| Total Other Income | <u>4,300.00</u> |
| Gross Income | 90,131.08 |
| Income Deductions | |
| Other Interest Charges - Consumers' Deposits | 1,325.28 |
| Other Interest Charges - Alca Electric Co. | 1,237.50 |
| Other Interest Charges - Other | 1,412.43 |
| Donations | 2,999.57 |
| Cash Shortage or Overage | <u>110.38</u> |
| Total Income Deductions | <u>7,085.16</u> |
| Net Income to Surplus | \$ 83,045.92 |

Service

The service furnished by the company to its consumers is good and no complaint was received in this proceeding. There were requests for additional extensions to war housing developments and the company is making every reasonable effort to meet such demands within its service area.

Past Earnings

Mr W. C. Fankhauser, in charge of the Commission's Department of Finance and Accounts, testified as follows:

"The balance sheet of the Vallejo Electric Light and Power Company which is in evidence, indicates that its properties of all kinds costing about \$1,585,000 have, except for \$177,000, been financed from income. The \$177,000 consists of \$100,000 of stock issued prior to the effective date of the Public Utilities Act, to wit, March 23, 1912, and \$77,000 of current indebtedness.

"Since 1911 the Company has paid dividends in the sum of \$1,918,600, consisting of \$1,418,600 of cash dividends and \$500,000 of stock dividends. Both the cash and stock dividends were charged to surplus."

Exhibit 7 was introduced by this witness and shows the company's net earnings and financial condition from 1912 to 1942, inclusive.

Statement showing Net Income, Dividends paid, Accumulated Surplus, Capital Stock Outstanding, Capital Stock and Surplus, Rate of Dividend paid, Rate of Dividend on Stock and Surplus.

| :Year: | Net Income | Dividends | Surplus : January 1 | Stock : January 1 | Capital : January 1 | Rate of Dividend : on Capital Stock & Surplus | Rate of Dividend : on Capital Stock |
|--------|--------------|------------------------|---------------------|-------------------|---------------------|---|-------------------------------------|
| (1) | (2) | (3) | (4) | (5) | (6) | (7) | (8) |
| 1912 | \$ 16,883.91 | \$ 13,250 | \$ 39,185.89 | \$100,000 | \$139,185.89 | 13.25 | 9.52 |
| 1913 | 15,593.76 | 10,750 | 42,819.80 | 100,000 | 142,819.80 | 10.75 | 7.53 |
| 1914 | 19,305.88 | 13,500 | 42,910.13 | 100,000 | 142,910.13 | 13.5 | 9.45 |
| 1915 | 19,237.05 | 17,000 | 47,821.99 | 100,000 | 147,821.99 | 17.0 | 11.50 |
| 1916 | 21,084.48 | 18,500 | 54,740.23 | 100,000 | 154,740.23 | 18.5 | 11.96 |
| 1917 | 33,438.29 | 21,000 | 57,495.14 | 100,000 | 157,495.14 | 21.0 | 13.33 |
| 1918 | 36,153.90 | 22,200 | 70,167.79 | 100,000 | 170,167.79 | 22.2 | 13.05 |
| 1919 | 37,199.33 | 14,000 | 86,051.48 | 100,000 | 186,051.48 | 14.0 | 7.52 |
| 1920 | 55,107.62 | 20,000 | 81,977.52 | 100,000 | 181,977.52 | 20.0 | 10.99 |
| 1921 | 60,516.66 | 27,000 | 119,322.47 | 100,000 | 219,322.47 | 27.0 | 12.31 |
| 1922 | 62,524.42 | 29,000 | 154,734.52 | 100,000 | 254,734.52 | 29.0 | 11.38 |
| 1923 | 58,981.39 | 34,000 | 190,116.12 | 100,000 | 290,116.12 | 34.0 | 11.72 |
| 1924 | 60,091.61 | 36,000 | 216,699.38 | 100,000 | 316,699.38 | 36.0 | 11.37 |
| 1925 | 64,631.64 | 40,000 | 243,325.96 | 100,000 | 343,325.96 | 40.0 | 11.65 |
| 1926 | 72,820.51 | 44,000 | 264,661.25 | 100,000 | 364,661.25 | 44.0 | 12.07 |
| 1927 | 92,712.12 | 44,000 | 273,747.30 | 100,000 | 373,747.30 | 44.0 | 11.77 |
| 1928 | 99,220.19 | 132,000 | 322,692.49 | 100,000 | 422,692.49 | 132.0 | 31.23 |
| 1929 | 90,501.79 | 52,000 | 292,361.14 | 100,000 | 392,361.14 | 52.0 | 13.25 |
| 1930 | 81,869.52 | 52,000 | 330,217.94 | 100,000 | 430,217.94 | 52.0 | 12.09 |
| 1931 | 79,606.04 | 48,000 | 359,065.40 | 100,000 | 459,065.40 | 48.0 | 10.46 |
| 1932 | 89,942.88 | 52,000 | 391,093.52 | 100,000 | 491,093.52 | 52.0 | 10.59 |
| 1933 | 92,088.43 | 60,000 | 430,705.25 | 100,000 | 530,705.25 | 60.0 | 11.31 |
| 1934 | 57,331.94 | 98,000 | 466,913.16 | 100,000 | 566,913.16 | 98.0 | 17.29 |
| 1935 | 94,533.73 | 64,000 | 476,526.41 | 100,000 | 576,526.41 | 64.0 | 11.10 |
| 1936 | 97,647.24 | 80,000 | 510,157.82 | 100,000 | 610,151.82 | 80.0 | 13.11 |
| 1937 | 101,180.58 | 68,000 | 527,837.35 | 100,000 | 627,837.35 | 68.0 | 10.83 |
| 1938 | 115,311.51 | 68,000 | 566,738.23 | 100,000 | 666,738.23 | 68.0 | 10.20 |
| 1939 | 121,153.75 | 70,000 | 594,394.19 | 100,000 | 694,394.19 | 70.0 | 10.08 |
| 1940 | 130,903.54 | 560,000 ⁽¹⁾ | 646,717.54 | 100,000 | 746,717.54 | 560.0 ⁽²⁾ | 8.04 |
| 1941 | 88,699.26 | 60,000 | 217,730.68 | 600,000 | 817,730.68 | 10.0 | 7.34 |
| 1942 | 85,600.87 | 50,400 | 246,396.72 | 600,000 | 846,396.72 | 8.4 | 5.95 |

(1) Includes \$500,000 stock dividend.

(2) Includes stock dividend of \$300,000.

Column (2) of Exhibit 7 shows the net income, after payment of operating expenses, depreciation and taxes, earned in each of the years 1912 to 1942, inclusive, on the original investment plus the invested surplus. Column (3) shows the dividends paid each year on the outstanding capital stock (column (5)), and in column (7) the rate of dividend is shown. It will be noted that the dividend rate in the 28-year period 1912 to 1939, inclusive, averaged 44.6 per cent per year. In 1940, \$560,000 of the accumulated surplus of \$646,717.54 was distributed in the form of a 560 per cent stock dividend, raising the average annual rate of dividends paid for the 29 years 1912 to 1940, inclusive to 62.3 per cent.

Revenues, Expenses and Earnings

Exhibit 1 sets forth in a comprehensive manner a summary of the study made by the Commission's staff of the operations of the Vallejo Electric Light and Power Company. (2) Further study of the staff, and as reflected in Exhibit 4, modified and reduced the earnings available for rate reductions by making provision for an amortization of defense capital and by an increase in federal taxes to reflect an agreement reached by the utility and the Bureau of Internal Revenue. Likewise, while the exhibits referred to use an interest rate of 6 per cent in certain depreciation computations, the following summary of operating figures for 1943 uses a 5 per cent interest rate for depreciation accumulations, which latter rate is also of record.

(2) Chapters included in Exhibit 1: Introduction, History and Present Operations, Balance Sheet, Income Statement, Depreciation Reserve, Operating Revenues, Production, Distribution, Customer Accounting, Sales Promotion, Administration and General Expenses, Operating Taxes, Fixed Capital, Present Value of Lands, Depreciation Reserve Requirements, Depreciation Annuities, Rate Base, and Summary of Earnings. The investigation was prepared by the Public Utilities Department under the direction of E. F. McNaughton in collaboration with the Department of Finance and Accounts. Testimony was given by L. W. East, Research Engineer; R. A. Wehe, Gas and Electric Engineer; C. T. Mess, Valuation Engineer; and R. P. O'Brien, a Senior Engineer in the Valuation Division.

| | <u>Depreciation Methods</u> | | |
|---------------------------|-----------------------------|---------------------------------|----------------------|
| | <u>5% Sinking Fund</u> | <u>5% Modified Sinking Fund</u> | <u>Straight Line</u> |
| (1) Operating Revenues | \$ 732,912 | \$ 732,912 | \$ 732,912 |
| (2) Operating Expenses | 387,857 | 387,857 | 387,857 |
| (3) Taxes | 194,486 | 194,486 | 194,486 |
| (4) Depreciation Expense | 27,456 | 38,206 | 47,320 |
| (5) Amortization Expense | 10,000 | 10,000 | 11,000 |
| (6) Amortization Interest | - | 430 | - |
| (7) Subtotal | 619,799 | 630,979 | 640,663 |
| (8) Net Revenue | 113,113 | 101,933 | 92,249 |
| (9) Rate Base | \$1,447,000 | \$1,232,000 | \$1,097,000 |
| (10) Rate of Return (3) | 7.82% | 8.27% | 8.41% |

A brief explanation of several items in the preceding estimate is desirable and the reasons for certain changes based on the record will be noted.

Item 1, operating revenues from electric energy sales, is segregated under the regular classifications in the following table, showing the 1942 recorded revenue and the staff's estimate for 1943:

| Classification of Revenues | 1942 Recorded | 1943 Estimated | Increase Over | |
|-----------------------------|------------------|-------------------|----------------------------------|-----------|
| | | | Recorded Year of 1942: Amount | Per Cent: |
| Domestic | \$322,365.73 | \$341,793.55 | \$19,427.82 | 6.0% |
| Commercial | 202,748.31 | 207,705.66 | 4,957.35 | 2.4 |
| Cooking and Heating | 5,622.71 | 5,571.60 | (51.11) | (0.9) |
| Power | 52,884.38 | 53,760.12 | 875.74 | 1.7 |
| Street Lighting | 39,740.86 | 37,729.19 | (2,011.67) | (5.1) |
| Federal Government | 48,739.60 | 85,301.75 | 36,562.15 | 75.0 |
| Subtotal Sale of Elec. | 672,101.59 | 731,861.87 | 59,760.28 | 8.9 |
| Rent from Electric Property | 300.00 | 300.00 | - | - |
| Miscellaneous Electric Rev. | 1,516.24 | 750.00 | (766.24) | (50.5) |
| Subtotal Miscellaneous | 1,816.24 | 1,050.00 | (766.24) | (42.2) |
| Total Revenue | \$673,917.83 | \$732,911.87 | \$58,994.04 | 8.8% |

(Decrease)

A large increase in revenue (75%) for 1943 over 1942 is estimated to be derived from the federal housing projects being served. However, the total defense housing revenue is but a small portion of the total gross revenue,

(3) The rates of return shown above are not the only indication of the earning position or the amount of possible rate reduction for any given rate of return. Both the rate base and the rate of return must be viewed together. For any return within the limits of 5 and 6 per cent, the magnitude of the reduction on the basis of the figures given will be approximately the same by any one of the three depreciation methods.

namely, 11.6%. The estimated revenues shown in the preceding tabulation are slightly lower than the actual recorded revenue for the first half of 1943.

The major groups of Item 2, operating expenses, excluding taxes and depreciation, appear in the following table:

| : Classification of Expenses : | : 1942 : | : 1943 : | : Increase Over : | |
|---|---------------|--------------|---------------------------|--------------|
| | | | : Recorded Year of 1942 : | : Per Cent : |
| : Recorded : | : Estimated : | : Amount : | : Per Cent : | |
| Production Expense | \$233,740.00 | \$262,000.00 | \$28,260.00 | 12.1% |
| Distribution Expense | 42,681.00 | 41,764.00 | (917.00) | (2.1) |
| Customers' Accounting and Collecting Expense | 28,051.00 | 29,393.00 | 1,342.00 | 4.8 |
| Sales Promotion Expense | 6,985.00 | 6,200.00 | (785.00) | (11.2) |
| Administrative and General Expense | 47,243.00* | 48,500.00 | 1,257.00 | 2.7 |
| Total | \$358,700.00 | \$387,857.00 | \$29,157.00 | 8.1% |

* Adjusted 1942 figure is \$44,168.

(Decrease)

Production expense covers the power purchased plus costs for items such as transformation and other costs incident thereto. This expense is a considerable part of the total inasmuch as the company does not generate its own power and the cost of purchased energy includes not only the direct cost of production and transmission but also the fixed costs to the selling utility, including any profit made on the transaction.

During the 12-month period ending December 31, 1942, 29,003,000 kwh were purchased, an increase of 30 per cent over the previous period in 1941. The company's distribution expenses have shown a slight decrease. The plant is in good condition and only normal maintenance is necessary. Customers' accounting and collecting expense for 1942 was \$2.34 per customer served. For 1943 this expense will be slightly higher and is estimated at about \$2.37 per customer. Sales promotion expense for 1942 was \$0.58 per customer served and for 1943 is estimated at about \$0.50 per customer.

The total 1943 estimated administrative and general expense is about 2.66 per cent over the 1942 recorded expense of \$47,242.52 and a 9.81 per cent increase over the 1942 adjusted figure of \$44,168.

Taxes

Considerable dispute revolves around the item of taxes in this

proceeding. The taxes accrued by the company in 1942 amounted to \$159,653.15 and the Commission's staff in Exhibit 4 estimates that taxes for 1943, under present rates, would be \$194,486. This is approximately a 22 per cent increase over 1942. The company, in Exhibit 11, presented its estimate that the 1943 tax payments would total \$215,808.

Considerable space in the company's brief is devoted to arguing various points in reference to taxes.

Judicial notice may be taken of the fact that the Congress has now enacted the internal revenue bill into law. Its terms are not retroactive to 1943. Moreover, the corporate income tax rate applicable to 1944 remains at 40 per cent. Therefore, the company's contention in respect to a prospective 50 per cent rate may be disregarded.

It is unnecessary herein to rule on the question of whether the excess profits tax should be computed at 90 per cent or at 81 per cent (or at the new rate of 95 per cent gross or 85.5 per cent net) for the reason that the rates to be fixed herein to yield a fair return on the property will reduce the earnings of the company to a point where no such payments will be made.

It is stated in the company's brief that ". . . there would be no justification for this Commission to reduce the rates of respondent for the purpose of eliminating these excess profits tax payments." However, in a case such as this, where a reasonable and fair rate of return to the utility reduces income to a point where excess profits taxes would have no application, this Commission would not be pursuing its proper responsibilities should it not reduce respondent's rates, which reduction in this instance will eliminate the payment of this tax.

A different situation, the Commission is aware, may exist in other California utilities under our jurisdiction.

The record in this case shows adjusted taxes based on income for 1942 and estimated taxes for 1943 as shown below:

Computation of Taxes Based on Income

| Item | 1942 | 1943 | 1943 |
|---|-------------|---------------|--------------------------------|
| | : Adjusted* | : Estimated** | : Estimated : (Exhibit #1): |
| (1) Operating Revenues | \$673,918 | \$732,912 | \$732,912 |
| (2) Less: Operating Expenses (Excluding Depreciation and Taxes) | 355,627 | 387,857 | 387,857 |
| (3) Depreciation (Straight Line) | 69,153 | 55,000 | 75,000 |
| (4) Taxes (Excluding Taxes Based on Income) | 54,397 | 58,316 | 58,316 |
| (5) Net for State Corporation Franchise Tax | 194,741 | 231,739 | 211,739 |
| (6) Corporation Franchise Tax at 4% | 7,790 | 9,270 | 8,470 |
| (7) Excess Profits Net Income | 186,951 | 222,469 | 203,269 |
| (8) Less: Excess Profits Cr. (Income Method) | 134,284 | 130,000 | 134,284 |
| (9) Adjusted Excess Profits Net Income | 52,667 | 92,469 | 68,985 |
| (10) Excess Profits Tax at 90% | 47,400 | 83,222 | 62,087 |
| (11) Less: 10% Post War Refund Credit | 4,740 | 8,322 | 6,209 |
| (12) Net Excess Profits Tax (81%) | 42,660 | 74,900 | 55,878 |
| (13) Excess Profits Net Income (Above) | 186,951 | 222,469 | 203,269 |
| (14) Less: Adjusted Excess Profits Net Income (Above) | 52,667 | 92,469 | 68,985 |
| (15) Normal Tax and Surtax Net Income | 134,284 | 130,000 | 134,284 |
| (16) Normal Tax and Surtax at 40% | 53,714 | 52,000 | 53,714 |

* Adjusted for carry-over credit from 1941 of approximately \$5,100, which is a nonrecurring item.

** These are computations in support of Exhibit No. 4.

In the instant proceeding there is included in operating expenses the full federal income and surtax tax allowance of 40 per cent. With the rates fixed herein the company, after paying all local, state and federal taxes, will earn an adequate net return and, under its financial structure, will not be liable for any excess profits tax payments.

Depreciation

The matter of depreciation is before us here, as in other rate cases, in two aspects: the annual amount to be allowed as an operating expense to reimburse the company for the cost of depreciation and, second, the actual and accumulated depreciation in the operative property with the effect of such depreciation on the rate base used to determine rate of return and net earnings. Depreciation is an important item of continuing operating expense. There must be a proper and reasonably definite relationship over the life of the depreciable

property between, on the one hand, the annual amounts allowed to meet the necessary expense of depreciation and, on the other hand, the actual plant depreciation taking place during the life cycle of the several property items. If the depreciation expense allowance is greater than required, then the rates the customers must pay will be too high and the required net earnings and rate of return will be greater to that extent than necessary. If insufficient provision is made for depreciation, the net earnings are fictitiously inflated and a loss of plant capital eventually will result.

The uncontradicted record shows that an excessive amount of depreciation expense has in the past been collected and included in operating expenses each year. The company's accumulated depreciation reserve on December 31, 1942, was \$498,124.17 which has been set up on a modified straight-line basis. The depreciable capital for the same period was given as \$1,358,979.48, or a relationship of reserve to capital of over 36 per cent. The setting aside of excessive depreciation allowances and the inclusion of such excess in annual operating expenses (as distinguished from charges to surplus) is tantamount to an arbitrary shortening of the normal service life of the depreciable plant and to a too rapid amortization of the investment at the expense of the rate payers.

However, the Commission cannot allow a continuation of these practices and should make such adjustments and changes as will assure the charging to future utility customers of only such depreciation as is reasonably necessary, after giving consideration to over-accruals. In other words, the cost of future depreciation on the portion of the undepreciated plant must be paid by present and future customers and an adequate allowance will be made for that requirement in the rates. Such a procedure is fair to the utility and the rate payers. When the entire cost of depreciable investment is returned to the owner, surely no further contribution for depreciation should be exacted from the utility customer.

Commissions and courts have clearly distinguished in this respect between operating expenses and net income (the fair return), the latter representing profit and depending upon the rate of return. The cost of future depreciation on the portion of the plant remaining to be depreciated must be paid by present and future consumers and allowance for that cost will be made in the rates. But when the total plant or a portion of the plant has fully depreciated, and payment has been made by the rate payers in operating expenses for such depreciation, the law does not require the setting up of a second or third depreciation reserve for the same items of property. When the cost, or investment, is returned in full to the owner, surely no further contribution for depreciation should be exacted from the ratepayers. The Public Utilities Act places the duty on this Commission to make certain that this practice does not obtain in utilities operating in California (Sections 13 and 49 of the Public Utilities Act).

The United States Supreme Court in Hope Natural Gas Case, supra, has conclusively and definitely disposed of this depreciation issue. With reference to accrued depreciation the Court said:

"In determining the amount of accrued depletion and depreciation the Commission, following Lindheimer v. Illinois Bell Telephone Co., 292 U.S. 151, 167-169; Federal Power Commission v. Natural Gas Pipeline Co., 315 U.S. 575, 592-593, based its computation on 'actual legitimate cost.' It found that Hope during the years when its business was not under regulation did not observe 'sound depreciation and depletion practices' but 'actually accumulated an excessive reserve'⁴ of about \$46,000,000. Id., p. 18. One member of the Commission thought that the entire amount of the reserve should be deducted from 'actual legitimate cost' in determining the rate base.⁵ The majority of the Commission concluded, however, that where, as here, a business is brought under regulation for the first time and where incorrect depreciation and depletion practices have prevailed, the deduction of the reserve requirement (actual existing depreciation and depletion) rather than the excessive reserve should be made so as to lay 'a sound basis for future regulation and control of rates.'" (Footnote 4 omitted.)

Footnote 5 reads as follows:

"(5) That contention was based on the fact that 'every single dollar in the depreciation and depletion reserves' was taken 'from gross operating revenues whose only source was the amounts

charged customers in the past for natural gas. It is, therefore, a fact that the depreciation and depletion reserves have been contributed by the customers and do not represent any investment by Hope.' Id., p. 40. And see Railroad Commission v. Cumberland Tel. & Tel. Co., 212 U.S. 414, 424-425; 2 Bonbright, Valuation of Property 1937 p. 1139."

With regard to a fair and reasonable allowance for accrued depreciation, and the proper operating expense basis for the calculation of such allowance, the decision of the Supreme Court contains the following language:

"Only a word need be added respecting depletion and depreciation. We held in the Natural Gas Pipeline Co. case that there was no constitutional requirement 'that the owner who embarks in a wasting asset business of limited life shall receive at the end more than he has put into it.' 315 U.S. p. 593. The Circuit Court of Appeals did not think that that rule was applicable here because Hope was a utility required to continue its service to the public and not scheduled to end its business on a day certain as was stipulated to be true of the Natural Gas Pipeline Co. But that distinction is quite immaterial. The ultimate exhaustion of the supply is inevitable in the case of all natural gas companies. Moreover, this Court recognized in Lindheimer v. Illinois Bell Tel. Co., supra, the propriety of basing annual depreciation on cost.¹⁰ By such a procedure the utility is made whole and the integrity of its investment maintained.¹¹ No more is required.¹² We cannot approve the contrary holding of United Railways v. West, 280 U.S. 234, 253-254. Since there are no constitutional requirements more exacting than the standards of the Act, a rate order which conforms to the latter does not run afoul of the former."

Footnotes 10, 11, and 12 read as follows:

"¹⁰ Chief Justice Hughes said in that case (292 U.S. pp. 168-169): 'If the predictions of service life were entirely accurate and retirements were made when and as these predictions were precisely fulfilled, the depreciation reserve would represent the consumption of capital, on a cost basis, according to the method which spreads that loss over the respective service periods. But if the amounts charged to operating expenses and credited to the account for depreciation reserve are excessive, to that extent subscribers for the telephone service are required to provide, in effect, capital contributions, not to make good losses incurred by the utility in the service rendered and thus to keep its investment unimpaired, but to secure additional plant and equipment upon which the utility expects a return.'"

"¹¹ See Mr. Justice Brandeis (dissenting) in United Railways v. West, 280 U.S. 234, 259-288, for an extended analysis of the problem."

"12 It should be noted that the Act provides no specific rule governing depletion and depreciation. Sec. 9(a) merely states that the Commission "may from time to time ascertain and determine, and by order fix, the proper and adequate rates of depreciation and amortization of the several classes of property of each natural-gas company used or useful in the production, transportation, or sale of natural gas."

The total rate base for property subject to depreciation, according to the record as of December 31, 1942, is \$1,358,979. Deducting the unexpended accumulated depreciation reserve (\$498,124) from the latter figure leaves \$860,855, for which amount provision for future depreciation will be made after adjustment for amortization of defense capital. In accordance with Exhibit 6 the estimated probable loss in so-called defense capital (to be discussed under that heading) will amount ~~to~~^{to} \$40,265, of which \$7,150 has heretofore been amortized, leaving a balance of \$33,115 to be written off in the short period of three years. Eliminating this latter item from the depreciable capital leaves \$827,740 as the amount to be provided for in future operating expenses.

Inasmuch as an undepreciated rate base is hereinafter used in fixing the rate of return, provision will be made in operating expenses for an annual allowance on a sinking fund basis, together with the interest accrual at 5 per cent on the reserve balances, sufficient to return the total sum of \$827,740 over its expected service life. The accumulated reserve, it will be recalled, is invested in the company's operative property and participates in the full rate of return. A liberal allowance for such provision is the amount of \$13,500^(3a) a year. The necessary accounting procedure will be decided upon in conference between the company and the Commission.

(3a) This corresponds to an annuity allowance of \$27,456 on the 5 per cent sinking fund basis, calculated upon total life expectancy. Such annual allowance would disregard the actual past provision for depreciation and the present depreciation reserve and would result in a duplication of payments by future customers for depreciation already fully paid for. This would result in grave injustice to present and future consumers of electric energy.

Amortization of Defense Capital

In addition to the depreciation allowance above referred to, provision is made in this decision for an operating cost of \$10,453 annually for the three years 1943 to 1945, inclusive, for the write-off of the balance of \$33,115 of so-called defense capital. This allowance will be conditioned upon the filing by the company of a stipulation in form acceptable to the Commission, to the effect that at the end of the three-year period when the full amount shall have been returned, the full principal amount shall be eliminated from the capital investment upon which a net return is computed (the rate base) and that no further depreciation expense will be charged against the property represented by such defense capital.

This method of reimbursing a utility in a short space of time for specific capital expenditures for property of limited life and usefulness, and caused by the war, and in this manner relieving the utility of practically all risk connected with such capital outlay is, if properly safeguarded, desirable and in the public interest. The manner of determining the amount of such amortization is of moment and brief reference will be useful for future disposition of this matter.

Exhibit 6 was introduced by Witness Mess, valuation engineer for the Commission. He testified in part:

"In this study the term defense capital is taken to mean the sum total of the capital expenditures for plant which is wholly or partially required to render electric service during the war emergency and which plant will become prematurely nonoperative with the cessation of these abnormal demands.

"The plant investment is an accomplished fact and the need for the investment is amply attested by the demands imposed and the service rendered. The amount of capital loss, however, and hence the annual expense of amortizing that loss is entirely a matter of judgment. The length of the emergency period, the amount of excess plant construction which can be absorbed by future normal demands, the net salvage to be recovered from nonoperative equipment together with the amount of normal depreciation accruals during the period of emergency service are all pertinent factors in the final determination of this problem.

"In the present instance it is felt that this capital loss arises in one of three ways, namely:

- a. Plant installed solely for a defense load will become

totally nonoperative and subject to removal and salvage. Plant in this category included certain distribution lines, services, and primary meter installations.

- b. Plant installed partially for a defense load will become partially nonoperative with the termination of the defense demand, the amount of loss being in this case the difference between the initial cost and the cost of substitute facilities sufficient to supply the subsequent normal demand. Certain distribution feeder lines were of this type.
- c. Equipment purchased for defense loads which upon the cessation of emergency demands may be easily substituted for older less efficient equipment remaining in service. The loss in this case being the difference between the original cost of the old equipment, the depreciation accrued up to the date of displacement and the realizable net salvage. Meters and transformers were the types of equipment in this classification."

The following tabulation shows the statistical results of this study:

| Item | Original Cost | Capital Loss | Remainder to Amortize |
|--------------------------------|-----------------|-----------------|-----------------------|
| <u>Distribution Facilities</u> | | | |
| B-1 Feeder | \$24,200 | \$16,155 | \$13,130 |
| Sacramento Street | 10,670 | 7,100 | 5,100 |
| Miscellaneous Jobs | 3,850 | 2,890 | 2,530 |
| Per Meter Installed | 1,170 | 570 | 500 |
| <u>Line Transformers</u> | <u>7,640</u> | <u>3,030</u> | <u>2,650</u> |
| Cons. Meters | 20,600 | 7,650 | 6,695 |
| Services | 5,400 | 2,870 | 2,510 |
| Total | \$73,530 | \$40,265 | \$33,115 |

Investment and Rate Base

The fixed capital considered by the Commission's staff is the same as recorded on the books of the company, except for land. The total fixed capital shown on the company's records for 1941 and 1942, and estimated for 1943, is as follows:

| Item | Total December 31, 1941 | Total December 31, 1942 | Estimated December 31, 1943 |
|-----------------------------------|-------------------------------|-------------------------------|-----------------------------------|
| Intangible Electric Plant | \$ 196.25 | \$ 196.25 | \$ 196.25 |
| Tangible Electric Plant | | | |
| Land | 29,498.90 | 29,440.40 | 29,440.40 |
| Distribution Plant | 1,139,997.03 | 1,187,579.60 | 1,222,579.60 |
| General Plant | 151,731.67 | 154,928.22 | 155,928.22 |
| Total Tangible Elec. Plant | 1,321,227.60 | 1,371,948.22 | 1,407,948.22 |
| Total Electric Plant | \$1,321,423.85 | \$1,372,144.47 | \$1,408,144.47 |

The landed capital, except for rights of way, is included in the rate base at market value, the total for this class of property amounting to \$45,052. The comparable book cost figure, it will be noted, is \$29,440.

For the purpose of this proceeding an allowance for working cash and materials and supplies will be made and included in the rate base in accordance with the gross amounts set forth in Exhibit 1 without further adjustments.

On the basis indicated, the undepreciated rate base predicated on historical cost and with no diminution for capital supplied over the years by the rate payers in excess of a reasonable rate is for the years 1942 and 1943 as follows:

| Item | Average for Year 1942 | Average for Est. Year 1943 |
|------------------------|--------------------------|-------------------------------|
| Average Electric Plant | \$1,379,807.43 | \$1,421,003.58 |
| Working Cash | 40,005.00 | 42,409.00 |
| Materials and Supplies | 28,480.27 | 25,600.00 |
| Average Rate Base | \$1,448,292.70 | \$1,489,012.58 |
| Use | \$1,448,000 | \$1,489,000 |

The depreciated rate base may be estimated by deducting from the undepreciated 1943 base the accumulated actual depreciation and amortization reserve in the amount shown on the company's balance sheet (\$498,124) on December 31, 1942, or by deducting an estimated accrual amount of depreciation on a sinking fund basis. Neither of these methods would necessarily reflect the actual present depreciated condition of the operative plant and its equivalent depreciated cost or value. In view of the method used in making allowance for the annual expense of depreciation, the undepreciated rate base is used in determining the earning position under the rate of return allowed. Reference has been made to the record as showing that a very large part of the present plant capital and rate base was contributed by the rate payers of this utility over and above a high rate of annual return upon the owner's investment. That fact has not, however, in this decision, reduced the present rate base of this property and has not influenced the determination of a fair rate of return.

Rate of Return

The uncontradicted testimony of Mr. Fankhauser shows that the company could today be refinanced on an over-all $5\frac{1}{2}$ to $5\frac{1}{2}$ per cent basis and that his calculations pointed to the lower figure.⁽⁴⁾ He assumed 50 per cent of the depreciated cost of the property could be financed through a bond issue, the remainder to be represented by common stock with a dividend rate of 6 per cent. The amount available for dividends and surplus would be 6 per cent plus the differential between the rate of return allowed by the Commission and the 4 per cent interest on the bonds.

(4) His testimony is in part as follows:

"The company has had a good earning record. From the standpoint of financing new construction it occupies the envious position that it has no indebtedness other than current accounts payable.

"We have, in this case, no recorded historical cost of money. The rate of dividends paid by the utility on its common stock does not establish, in my opinion, the cost of money. Except for its initial issue of \$100,000 of stock no capital has been raised through the sale of stock. The property, except for that stock issue and its current indebtedness of about \$77,000, has been financed through the use of earnings, appropriated on account of depreciation and other reserve accruals and surplus.

"During the past 10 years we have witnessed a continuous decline in interest rates and today they are, generally speaking, at the low point. Following the bank holiday in 1933 the Board of Governors of the Federal Reserve Bank fixed the maximum rate of interest that the member banks might pay on savings deposits. The maximum rate was 3 per cent from November 1, 1933 to January 31, 1935, and since then has been $2\frac{1}{2}$ per cent. But the banks are not paying the maximum rates. One of the larger San Francisco banks is currently paying $1\frac{1}{2}$ per cent on savings deposits, with the right to pay a lesser amount on large deposits. Another large San Francisco bank paid $1\frac{1}{2}$ per cent during the first 6 months of the current year and is now paying but 1 per cent.

"In the State of California we have a State Employees' Retirement System to which the employees contribute. The Board of Administration accrued interest on the employees' contribution at the rate of 4 per cent to June 30, 1938; at the rate of $3\frac{1}{2}$ per cent from then to June 30, 1941 and at the rate of 3 per cent since June 30, 1941. It has served notice that if interest rates do not increase a further reduction is imminent.

"If one looks at the annual reports of the major public utilities of, say, 10 year ago, he will observe 5 per cent and 6 per cent bonds outstanding. During the 10-year period the utilities have substituted 3 per cent, $3\frac{1}{2}$ per cent and 4 per cent bonds for the 5 per cent and 6 per cent bonds. The 3 per cent bonds now outstanding are selling on about a 2.7 to 2.8 per cent basis. Preferred stocks which, 10 years ago, were selling around a 6 per cent basis are now selling from a 4 per cent to $4\frac{1}{2}$ per cent basis. Common stocks which were then selling on a basis ranging from 7 to 10 per cent or more, are today selling on a 6 per cent to $6\frac{2}{3}$ per cent basis. Recently a California utility has entered into an agreement to sell to a life insurance company \$900,000 of $3\frac{1}{2}$ per cent bonds at par and has entered into a further agreement to loan from a bank \$250,000 on unsecured serial notes bearing interest at the rate of $2\frac{1}{2}$ per cent.

"Another utility, about 4 months ago, issued two and a half million dollars of serial installment, 3 per cent notes to refund a 5 per cent bond issue."

A $5\frac{1}{2}$ per cent return on the undepreciated rate base, \$1,489,000, would on Mr. Fankhauser's computation produce an annual net return and a net income for interest, depreciation reserve requirements, dividends and surplus as follows:

| | | |
|--|--------------|---------------|
| (1) Net return of $5\frac{1}{2}\%$ on \$1,489,000 equivalent to | | \$81,895 |
| (2) 5% interest on \$498,000 (depr. reserve) | \$24,900 | |
| (3) 4% interest on \$495,000 (bonds) | 19,800 | |
| (4) 6% dividend on \$496,000 (stock) | 29,760 | |
| (5) Surplus | <u>7,435</u> | <u>81,895</u> |
| (6) Available for stock | \$37,195 | or 7.5% |

Merchandising and Jobbing (Alca Electric Co.)

It should be noted that the net revenue accruing to the company from merchandising and jobbing operations have not been included in the net earnings set forth above and is not reflected in the rate of return. These activities have been carried on since 1931 by a wholly-owned subsidiary, Alca Electric Co. On the company's books its investment in Alca is carried, as of December 31, 1942, in the amount of \$41,116.53. Exhibit 2 shows Alca operating at a net profit after all charges, including interest and other income charges, in 1940 of \$3,185; in 1941 of \$5,415; in 1942 of \$7,175 and for the first five months of 1943 in the amount of \$943. The accumulated surplus on May 31, 1943 was \$16,674.

The Commission in Decision No. 21341, supra, determined that the net revenue from such operations should be included as operating income. The Commission said:

"It is suggested by the company that miscellaneous jobbing and merchandising revenue should not be considered as operating income. It has always been the practice of the Commission in rate proceedings to consider this as part of the operating revenue. The same quarters and the same employees are used to carry on this branch of the business; it is a mere incident of the business and is used to attract business; and the expenses of conducting it are largely absorbed in various operating expense accounts. It is neither practicable nor reasonable to set this activity of the utility off by itself."

The company did not comply with the Commission's determination of this matter, and instead, organized a subsidiary, Alca Electric Co., to take over such operations. There is no reason why we should now alter the conclusion reached by the Commission in 1929. In the future the company will be expected to conduct the so-called merchandising and jobbing operations, now carried on by its wholly-owned subsidiary, as an integral part of its over-all electric business, and to enter the revenues and expenses assignable to that business under the appropriate accounts prescribed in the classification of accounts for electric utilities.

Future Trend

The company presented 15 witnesses, businessmen of Vallejo, who testified to adverse conditions and the shrinking of business in Vallejo following the First World War. The actual record, however, of the growth and earnings of this utility discounts their evidence as applied to the electric power business. Testimony was also given with reference to the possibility of relocation of the Navy Yard at some date in the future.

Mr. H. G. Butler, consulting engineer for the company, testified to what he termed a normal earnings basis, projecting into the future the trends of increase experienced before the present war. Exhibit 9 shows on this basis a return of 6.4 per cent. This exhibit ignores the company's actual recent experience and present conditions.

There are, of course, uncertainties in the future of this utility and it is likely that several housing projects will be removed subsequent to the end of the war. We may, however, also take note of what is common knowledge regarding the tremendous and continuing increase of our Navy on this coast and the accompanying expansion of shore facilities. Mare Island is a long-established base and one of the largest Navy Yards in the country, and we can not, on the basis of this record, conclude that the Yard, and Vallejo with it, will, after the war is ended, fall into decline or be given over to abandonment.

Rate Reduction

The Commission desires to accord this and other utilities continued fair treatment in their rate structures and at the same time carry out its responsibilities to the public under the Public Utilities Act. The record here developed shows the present rates to be unreasonable, unjust and unfair to the customers of this utility, based upon any reasonable standard as to earnings, and a substantial reduction in rates is fully justified on the record. On the basis of a 5½ per cent return on the undepreciated rate base, the reduction in net revenue would amount to \$44,670 or \$148,753 in gross revenue per year. With such a reduction the company's operations on the volume of business estimated by our staff are expected to be approximately as follows:

| | |
|---------------------------------------|----------------|
| (1) Operating Revenue - 1943 estimate | \$732,912 |
| (2) Gross Reduction | <u>148,753</u> |
| (3) Operating Revenue after reduction | 584,159 |
| (4) Operating Expenses | 387,370 |
| (5) Taxes | 90,890 (5) |
| (6) Depreciation Expense | 13,500 |
| (7) Amortization of Defense Capital | <u>10,504</u> |
| (8) Total Expense | 502,264 |
| (9) Net Revenue for return | 81,895 / |
| (10) Rate Base, Undepreciated | \$1,489,000 |
| (11) Rate of Return | 5.50% |

Material reductions in electric rates usually result in increased use of electric energy. There is no reason why a similar effect should not be experienced in the service area of this company. Nor is there any ground for expecting any material lessening in the number of customers during the war period.

After the war there unquestionably will be available new electric appliances and with lower rates customer usage will increase. The revenue and

(5) In the estimates full allowance has been made for every dollar of tax that will be paid under effective tax laws. However, since no excess profits taxes will be paid by the utility on any rate of return less than approximately 7½ per cent, it follows that on the return allowed of 6 per cent all excess profits taxes automatically drop out.

expense estimates shown herein make no allowance for increased business resulting from reduced rates and must, accordingly, be considered conservative from this viewpoint. It is true, however, there are other elements that make for possible uncertainty in the present situation and the order will provide for a gross reduction of only \$135,000 resulting in a rate of return of 6 per cent.

A rate of return of 6 per cent will enable the company to meet all of its financial obligations and leave a substantial balance for surplus. The indicated rate of return will produce the following financial result:

| | |
|---|----------------------------|
| (1) Net return of 6% on rate base of \$1,489,000 | \$89,340 |
| (2) Interest Requirement: | |
| (3) Depreciation Reserve, \$498,124 at 5% | \$24,906 |
| (4) Dividends on \$600,000 of common stock outstanding at 6% | 36,000 |
| (5) Balance for surplus | <u>28,434</u> 89,340 |
| (6) Available for stock and surplus | \$64,434 or 10.7% on stock |

The rates recommended for adoption by the Commission are based on the preceding estimates and findings of revenues, expenses, depreciation, taxes, rate base and rate of return and are believed to be just and reasonable rates and fair alike to the utility and to its customers and consumers. The company will continue in a healthy and prosperous financial condition and will be able to meet future requirements of service and operation.

Rates to be Established

As heretofore pointed out, the service area of this utility is limited to the city of Vallejo and to the thickly built-up territory immediately adjacent thereto. The load served is of a high density and the investment per customer and cost to serve per customer are low. Of importance, too, is the fact that 65 per cent of its sales are made to the higher revenue producing commercial and domestic users. These are some of the factors that have in the past produced, and in the future will continue to produce, favorable earnings and low rates.

In Exhibit "A," attached to and made a part of the order, a revised schedule of rates is established for the following services:

Domestic
Commercial Lighting
Commercial Light and Power
General Power
Cooking and Heating

Certain features in these new tariff schedules are of special interest. The \$135,000 reduction in gross revenue is divided into two parts: approximately \$70,000 is assigned to and made a part of what may be looked upon as the permanent rates, while the balance or \$65,000 is applied in the form of a discount to the schedules shown.

The character and the form of the revised rate tariffs are substantially the same as now effective on the systems of other electric utilities in the central and northern portions of the State. The following tabulation shows the allocation of the \$135,000 reduction divided among the six tariff schedules. The division in the reduction results in approximately 52 per cent of the total amount as applicable to the basic rates for domestic, commercial, street lighting and a new tariff for combination commercial lighting and power service. The latter schedule has been set up especially to provide a filed tariff for federal housing projects now served under special contracts. The balance of the reduction is provided by a billing discount of 10 per cent to be applied to the schedules set forth in the tabulation, and each of the tariff schedules provides that such percentage discount shall be applied to each customer billing and as set forth in the schedule.

| Item | Reduction in: | | Total Reduction | |
|----------------------------|-----------------|------------------|------------------|--------------|
| | Basic Rates: | Discount : 10.0% | Amount | Per Cent |
| Domestic | \$33,660 | \$30,857 | \$64,517 | 18.9% |
| Commercial | 18,950 | 18,902 | 37,852 | 18.2 |
| Commercial Light and Power | 15,390 | 5,721 | 21,111 | 24.7 |
| Cooking and Heating | - | 558 | 558 | 10.0 |
| Power | - | 5,384 | 5,384 | 10.0 |
| Street Lighting | 2,000 | 3,578 | 5,578 | 14.8 |
| Total | \$70,000 | \$65,000 | \$135,000 | 18.4% |

This brief review of the character and effect of the proposed rates explains our purpose to guard against possible loss in revenue from a declining war load especially as reflected in the sale to federal housing projects. If a portion of such revenue should disappear, there would go with that loss in revenue that portion of the reduction here assigned. The portion of the total reduction made in the form of a discount rate may, if necessary, be changed under an appropriate order of the Commission to meet future conditions and needs with a very minimum of disturbance to the utility and to its customers.

The following form of order is recommended.

O R D E R

The Commission having instituted this proceeding on its own motion, public hearings having been held, the matter having been submitted for decision, the Commission being fully advised, it is hereby found that the electric rates now charged by the Vallejo Electric Light and Power Company, in so far as said rates differ from those incorporated in Exhibit "A" attached to this order, and likewise Street and Highway Lighting Schedule L-2 and Ornamental Street Lighting Schedule L-3, not included in Exhibit "A," are all unjust and unreasonable and that said rates in Exhibit "A" with those rates for Schedules L-2 and L-3, to be refiled in accordance with the order herein, are just and reasonable for electric service to be charged by the Vallejo Electric Light and Power Company.

Based upon the foregoing findings and upon the findings contained in the opinion preceding this order;

IT IS HEREBY ORDERED that the Vallejo Electric Light and Power Company be and it is hereby directed to file with this Commission, within twenty (20) days after the effective date of this order, the schedule of rates set forth in Exhibit "A" and to refile its two street lighting Schedules L-2 and L-3, incorporating in the latter schedules lower basic rates to the extent of

approximately \$2,000 on an annual basis, and also providing for a discount provision in said street lighting schedules of 10 per cent. Vallejo Electric Light and Power Company shall apply and charge the schedule of rates herein ordered on all meter readings taken on and after the 1st day of April, 1944.

IT IS HEREBY FURTHER ORDERED that the Vallejo Electric Light and Power Company shall account for its depreciation on the 5 per cent sinking fund basis in accordance with the principles set forth in the opinion preceding this order.

IT IS HEREBY FURTHER ORDERED that the Vallejo Electric Light and Power Company shall file a stipulation, duly authorized by its Board of Directors, in reference to the amortization of so-called "Defense Capital" in accordance with the requirements stated in the opinion preceding this order.

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.

The Secretary is directed to cause a certified copy of this opinion and order to be served upon Vallejo Electric Light and Power Company and this decision shall become effective on the twentieth day after the date of such service.

Dated at San Francisco, California, this 7th day of March, 1944.


Richard L. Jackson


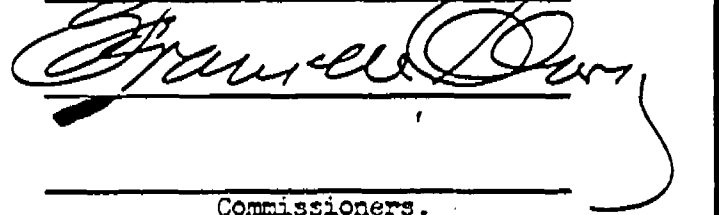

Francis R. Hageman

Francis W. Derry
Commissioners.

EXHIBIT "A"

SCHEDULE NO. D-1

DOMESTIC SERVICE

DESCRIPTION OF SERVICE:

This schedule is applicable to domestic lighting, heating, cooking and single phase domestic power service (not exceeding five horsepower) in single family dwellings and in flats and apartments separately metered by the company.

TERRITORY:

Entire territory served.

RATE:

| | <u>Per Meter</u> <u>Per Month</u> |
|---|--------------------------------------|
| Service Charge: | 40¢ |
| Energy Charge (to be added to service charge): | |
| First 40 kwhr, per kwhr | 2.8¢ |
| Next 60 kwhr, per kwhr | 2.0¢ |
| Next 100 kwhr, per kwhr | 1.8¢ |
| All excess kilowatt hours | 1.0¢ |
| Minimum Charge: The service charge set forth above constitutes the minimum charge for no consumption of energy. | |
| Billing Discount: A discount of 10.0% is to be applied and shown on each bill computed under this schedule of rates. This discount provision will continue in effect until changed by an appropriate order of the Railroad Commission of the State of California. | |

SPECIAL CONDITIONS:

- (a) Any apartment house or group of apartments may receive service under this schedule through one meter, provided that for this purpose the first energy block only will be increased and will be made equal to the sum of the first energy blocks separately calculated for the individual apartments included. The rate of 2.8¢ per kwhr will be applied to the kilowatt hours thus determined in the same manner as if they were the consumption of an individual service separately metered.

SCHEDULE NO. L-1

COMMERCIAL LIGHTING SERVICE

DESCRIPTION OF SERVICE:

This schedule is applicable to commercial lighting service, including lamp socket appliances and, at the customer's option, for single phase power (not exceeding five horsepower) and heating alone or combined with lighting through the same meter.

TERRITORY:

Entire territory served.

RATE:

| | <u>Per Meter</u> <u>Per Month</u> |
|--|--------------------------------------|
| Service Charge: | \$ 0.40 |
| Energy Charge (to be added to service charge): | |
| First 50 kwhr, per kwhr | 2.8¢ |
| Next 150 kwhr, per kwhr | 2.5¢ |
| Next 800 kwhr, per kwhr | 2.3¢ |
| Next 2,000 kwhr, per kwhr | 2.0¢ |
| Next 7,000 kwhr, per kwhr | 1.6¢ |
| All excess kwhr, per kwhr | 1.3¢ |

Minimum Charge: The service charge set forth above constitutes the minimum charge for no consumption of energy.

Billing Discount: A discount of 10.0% is to be applied and shown on each bill computed under this schedule of rates. This discount provision will continue in effect until changed by an appropriate order of the Railroad Commission of the State of California.

SCHEDULE NO. C

COMMERCIAL LIGHT AND POWER ALTERNATING CURRENT

DESCRIPTION OF SERVICE:

This schedule is applicable to lighting and, at the customer's option, for heating, cooking and/or power service (either single phase or polyphase) alone or combined with lighting.

TERRITORY:

Entire territory served.

RATE:

| | <u>Per Meter</u> <u>Per Month</u> |
|--|--------------------------------------|
| Service Charge: | \$ 1.60 |
| Energy charge (to be added to service charge): | |
| First 1,000 kwhr, per kwhr | 2.3¢ |
| Next 2,000 kwhr, per kwhr | 2.0¢ |
| Next 3,000 kwhr, per kwhr | 1.6¢ |
| All energy in excess of 6,000 kwhr per month: | |
| First 50 kwhr per kw of maximum demand | 1.4¢ |
| Next 150 kwhr per kw of maximum demand but not more than 100,000 kwhr | 1.1¢ |
| All excess | 0.7¢ |
| Minimum Charge: 50¢ per month per horsepower of all polyphase motors that may be connected at the same time, but in no case less than \$1.60 per month. | |
| Billing Discount: A discount of 10.0% is to be applied and shown on each bill computed under this schedule of rates except that no discount is to be applied to the 0.7¢ portion of the rate. This discount provision will continue in effect until changed by an appropriate order of the Railroad Commission of the State of California. | |

SPECIAL CONDITIONS:

- (a) Whenever the monthly use of energy has exceeded 6,000 kwhr for three consecutive months, a maximum demand meter will be installed as promptly as is practicable and thereafter continued in service until the monthly use of energy has fallen below 6,000 kwhr for 12 consecutive months, whereupon at the option of the company, it may be removed. If a maximum demand meter is not in service, then all energy in excess of 6,000 kwhr per month will be billed at the rate of 1.4¢ per kwhr.
- (b) The maximum demand in any month will be the average kw delivery of the 15 minute interval in which such delivery is greater than in any other 15 minute interval in the month.
- (c) Voltage: Service on this schedule will be supplied at the primary voltage available.

SCHEDULE H

COOKING AND HEATING SERVICE

DESCRIPTION OF SERVICE:

Applicable to heating and cooking service.

TERRITORY:

Entire territory served.

RATE:

| | Per Meter Per Month |
|--|------------------------|
| First 150 kwhr, per kwhr | 3.0¢ |
| Next 850 kwhr, per kwhr | 1.5¢ |
| All over 1,000 kwhr, per kwhr | 1.2¢ |
| Minimum Charge: First 10 kw or less of heating and cooking service | \$2.50 per mo. |
| Over 10 kw of heating and cooking service | .50 per kw per mo. |

When the consumer signs a contract for service for a period of one year the minimum charge will be made accumulative for the service year. The minimum charges are payable in monthly installments until such time as the accumulative energy charges equal the annual minimum charge.

Billing Discount: A discount of 10.0% is to be applied and shown on each bill computed under this schedule of rates. This discount provision will continue in effect until changed by an appropriate order of the Railroad Commission of the State of California.

SPECIAL CONDITIONS:

- (a) Service will normally be 110-220 volts, three-wire, alternating current.
- (b) Minimum charges are based on the total active connected load of heating and cooking capacity which may be connected at any one time.
- (c) Commercial installations will qualify for, and receive service under this schedule, provided that heating and cooking apparatus (other than lamp socket devices) of at least 2 kw capacity are permanently installed and used.

SCHEDULE P-1

GENERAL POWER SERVICE ALTERNATING CURRENT

DESCRIPTION OF SERVICE:

Applicable to general commercial and industrial power service and to commercial heating and cooking service and rectifier service. Alternating current service will be supplied at any standard voltage from 110 to 2200 volts in accordance with Rule and Regulation No. 2(b).

TERRITORY:

Entire territory served.

RATES:

| Hp. of Connected Load | Rate per kwhr for monthly consumption of | | | |
|--------------------------|--|----------------------------|-----------------------------|---------------------------------|
| | First 50 Kwhr per hp. | Next 50 Kwhr per hp. | Next 150 Kwhr per hp. | All over 250 Kwhr per hp. |
| 2-4.9 hp. | 3.2¢ | 2.0¢ | 1.2¢ | .9¢ |
| 5-9.9 hp. | 3.0 | 1.9 | 1.1 | .8 |
| 10-24.9hp. | 2.7 | 1.8 | 1.0 | .7 |
| 25-49.9hp. | 2.5 | 1.7 | 1.0 | .7 |
| 50-99.9hp. | 2.2 | 1.6 | 0.9 | .7 |
| 100 hp. and over | 2.0 | 1.4 | 0.9 | .7 |

Minimum Charge: Fifty (50) cents per horsepower per month, but in no case less than \$1.00 per month for single phase service nor less than \$2.50 for polyphase service.

Billing Discount: A discount of 10.0% is to be applied and shown on each bill computed under this schedule of rates, except that no discount is to be applied to a rate lower than 1.0¢ per kwhr. This discount provision will continue in effect until changed by an appropriate order of the Railroad Commission of the State of California.

SPECIAL CONDITIONS:

- (a) This schedule of rates will apply to service rendered at any standard voltage in accordance with the rules and regulations of the company. All necessary transformers to obtain such voltage will be supplied, owned, and maintained by the company.
- (b) When the installation consists of two or more motors, rates and minimum charges may, at the option of the consumer, be based upon the maximum demand instead of connected load, such maximum demand to be determined in accordance with either of the following bases:

1. Load Limiting Devices:

Consumer may contract for a certain predetermined maximum demand

of not less than fifteen (15) horsepower and the company will, at the consumer's expense install and maintain a suitable load limiting device which will prevent the use of connected capacity in excess of the predetermined amount.

2. Measured Maximum Demand:

In which case the horsepower of demand on which the rates and minimum charges will be based will not be less than forty (40) per cent of the connected load, and the minimum charge will not be less than fifty dollars per month.

The maximum demand in any month will be the average horsepower input (746 watts equivalent) indicated or recorded by instruments to be supplied by the company in the 15-minute interval in which the consumption of electric energy is more than in any other 15-minute interval in the month for installation of less than 750 horsepower and a thirty (30) minute interval for larger size installation or at the option of the company the maximum demand may be determined by test.

In the case of hoists, elevators, welding machines, furnaces, and other installations where the energy demand is intermittent or subject to violent fluctuations, the company may base the consumer's maximum demand upon a 5-minute interval instead of a 15 or 30-minute interval.

Demand for installations in excess of 750 horsepower of connected load occurring between the hours of 10:30 p.m. and 6:30 a.m. of the following day and on Sundays and legal holidays will not be considered in computing charges under this schedule.

Note: In no case will rates and minimum charges determined in accordance with (b) 1 or (b) 2 above, be based upon a connected load of less than the rated capacity of the largest motor installed.

(c) Optional Rate for Larger Installations:

Any consumer may obtain the rates and conditions of service for a larger installation by guaranteeing the rates and minimum charges applicable to the larger installation.

(d) Rectifier Heating and Cooking Service:

Mercury arc rectifiers and commercial heating and cooking installations may obtain service under this schedule. For the purpose of determining rates and minimum charges, each kilowatt of connected load will be considered as equivalent to one horsepower. Connected load will be taken as the name plate rating of all heating and cooking apparatus permanently connected and which may be connected at any one time, computed to the nearest one-tenth of a kilowatt, and in no case less than two kilowatts. All equipment assumed as operating at 100 per cent power factor.

CONCURRING OPINION

I concur in the order in this case reducing the electric rates of this utility on a present annual basis by \$135,000, approximately 18.4 per cent. After such reduction the company is left with a somewhat higher than six per cent rate of return on its undepreciated rate base, in addition to full allowance for all operating expenses, depreciation and amortization of so-called defense plant capital, and all taxes; federal, state and local.

I am unable, however, to see eye to eye with my fellow Commissioners in their elimination from my opinion, as submitted to them, of my discussion on war taxes.

The matter of war taxes not only amounts to a large contested operating expense item, to which testimony was addressed in the record, but it also occupies an important part in the company's brief.⁽¹⁾

I felt it would be helpful, and due the company and its customer rate payers, to state clearly what is done by us and why. If then we should be found in error, we will know why and can mend our ways; if our position is sound and understood, the public, the utilities and our staff will know what to expect under similar circumstances and what to do.

The tax dispute concerns the so-called war taxes and whether a distinction is to be made between normal or pre-war taxes (including the pre-war federal income tax) and the special war levies, particularly the net

(1) In the "Summary of the Argument" of the company's brief the matter of taxes is referred to as follows:

"A. The estimated rates of return shown in Exhibit 4 cannot be used as a measure of the reasonableness of respondent's rates upon which to predicate a reduction because * * * * *

"4. The actual amount which respondent will be required to pay in taxes to the Federal Government has not been allowed as an operating expense.

"B. Assuming that, based upon the present record, the Commission may lawfully compel a reduction in respondent's rates, it would be unfair to respondent and contrary to the public interest to compel such reduction because * * * * *

"2. A rate reduction should not be ordered until determination is made of the actual taxes which respondent will be required to pay under the new revenue laws.

"3. There is no justification under the law to compel a reduction in respondent's rates so that the liability for payment of excess profits taxes will be eliminated."

In the body of the brief the tax question is discussed at length.

excess profits tax. The second and related problem is whether in computing the excess profits tax the 81 per cent rate (now 85.5 per cent) on the "adjusted excess profits net income" base is to be used or the 90 per cent rate (now 95 per cent) as claimed by the company. Referring to the first question, the company contends that there is no justification in the law for ordering a reduction of electric rates as presently charged which would result in a reduction of the company's total tax liability.⁽²⁾ The quotation in the margin leaves no doubt that there is a basic misunderstanding on the part of the company as to this issue. The Commission, I am sure, has no thought of creating, if it could, a condition that would, in effect, exempt public utilities from the operation of the excess profits tax. The sole question is who is to pay this tax; the rate payer under the guise of an additional utility "operating expense," or the utility out of its "adjusted excess-profit net income," as defined in

(2) Mr. R. L. Vaughan, counsel for respondent, in his brief at page 25 says:

"During the course of the hearings presiding Commissioner Sachse indicated that in his opinion Congress did not intend, under the Revenue Acts, that excess profits taxes would be passed by the utility on to the consumer or that the utility was intended to act as a collection agent of these taxes (R. 128 et seq.). In Decision No. 36613, of September 21, 1943, in Application No. 25727, in re Mare Island Ferry, the Commission, speaking through Commissioner Sachse, had this to say:

'I can find no indication of any purpose or intent on the part of Congress, in its enactment of the present war tax legislation, that regulated utilities should act as collectors of indirect war taxes, or that such war tax should be levied on the rate payer in the guise of added charges for transportation or utility services, or that such war taxes must then become "operating expenses," forcing the additional burden on the rate payer but not on the utility corporation.'

"This construction of the Internal Revenue Code, as amended, is erroneous and cannot be justified either from the language of the Code itself or from the antecedent legislative history thereof.

"The Revenue Act of 1942 amended section 710(a)(1) of the Internal Revenue Code (relating to rate of excess profits tax) to read, insofar as is here pertinent, as follows:

'(1) General Rule. There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess-profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser: "(A) 90 per centum of the adjusted excess-profits net income ***" (Italics ours. Citations)

"The Commission's interpretation of the excess profits provisions of the Act could be justified only upon the theory that Congress intended to limit the operation of the Act so that it would not apply to public utilities. Such a limitation would, in effect, create an exemption of public utilities from the operation of the excess profits clause. An exemption in a taxing act must rest upon more than a doubt or ambiguity; it must be clearly defined and founded upon plain language." (Citations)

subsection (b) of the 1942 Revenue Act, amended Section 710(a)(1). The matter of the reasonable rate of return is apart from, though influenced by, the treatment of taxes and is considered separately in the preceding decision. I am in accord with the Commission's findings on the rate of return and should like to emphasize that a net rate of somewhat in excess of six per cent on an undepreciated rate base is, in my opinion, a generous and liberal return for this utility in view of its rate and financial history.

The company's brief, p. 26, reads "Public utilities have always been tax collectors for the various federal, state, county and city taxing agencies. After all, whatever taxes a utility pays come out of the rates paid by its "consumers." This observation, I think, misses the point. The rate payer, of course, pays for the total cost of his utility service, including the profit to the utility. But there is a very real difference, to the rate payer as well as to the utility, in the several possible treatments of a payment such as the excess profits tax, and whether that tax is paid out of net earnings (defined in this instance by Congress as "adjusted excess-profit net income") or whether it is passed on to the consumer rate payer as an "operating expense," relieving the company of that burden and leaving its net earnings undisturbed. The matter may be simply put. Before the war the utility here before us earned a very high rate of return on its total actual investment (Exh. 7). The investment itself, the record shows, was over the years almost entirely paid out of excess earnings.⁽³⁾ During the pre-war period all taxes were considered by

(3) The most significant finding of fact in this case is that this utility under Commission regulation has been able in a period of 31 years to add, out of rates paid by its electric customers, to the owner's actual cash investment of \$100,000 a total amount of \$1,585,000, a fifteenfold increase, averaging \$48,000 per year. It is assumed here that cash was paid for the \$100,000 par value of stock issued prior to the effective date of the Public Utilities Act. In addition the owners have received in the same period cash dividends, not reinvested in the utility plant, totaling \$1,418,600, an average of \$45,760 per year, and equal to an average annual dividend rate of 45.8 per cent on the original investment. The combined total of capital and dividend payments made by the rate payers amounts to \$3,003,600, an average annual contribution of \$94,000; i.e., 94 per cent compared with the single original capital investment by the owners of \$100,000. The rate payers contributed these amounts, in part, through excessive operating expense charges to depreciation and, in part, through excessive net earnings and rates of return. More than half of this accumulation occurred within the last twelve or thirteen years. I am unable to conceive of such a rate-fixing policy as sound regulation in accordance with the letter or the spirit of the Public Utilities Act. Nor has regulation proved itself in this case an acceptable or effective substitute for free competition. The speculator would look for such excessive profits only in a business beset with extreme risk or in an unregulated and highly specialized monopoly. Regulated utilities belong in neither class, (Continued on page 4.)

the Commission as operating expenses and the excessive rate of return was earned in addition to all such expenses.

The war now is the foremost concern of the Nation and demands greater than peace time tax contributions from all of our people. The increased financial burden is to be borne and distributed according to the acts of Congress. The Congress has decreed that if an "adjusted excess-profits net income" is earned by a corporation, then part of such net income is to be contributed as a special tax for the winning of the war. Congress has not singled out the utility corporations and exempted them from making this contribution. Congress has not said that if a utility enjoyed a specific rate of return, six, eight, or any other percentage, before or during the war, that rate is not to be reduced by any war or defense tax levied during the emergency. On the contrary, the law is specific that utility corporations (as distinguished from utility rate payers) are to contribute in the same measure as other corporations.

This being clear, the question before us is, should this Commission attempt, through the exercise of its rate-making powers, to nullify an act of Congress by removing the burden of a specific war tax from the owners of the utility and shift this burden to the rate payers? This Commission, I am sure, should not do that unless there is a specific mandate from the Congress providing for such action. And there is no such mandate, direct or implied.

This Commission has no power to levy taxes, or shift taxes from one tax payer to another, nor has it the power to grant tax exemptions. If a tax in our opinion places too great a burden on utilities, or on rate payers in the case of direct utility service excise taxes on electricity, transportation, communication messages or other payments for services, we have the right

(3) (Cont'd)

The rate payers have made these excessive contributions through the imposition of unjust and unreasonably high rates. The property paid for by the rate payers is now in the legal ownership of this utility and the future rate payers, apparently, will have to pay a continuing fair rate of return on the total property, irrespective of the source of the investment funds. We are not required, however, to impose upon the rate payers a second operating charge for property fully or partially depreciated and for which the owner has been reimbursed.

and perhaps the duty to inform or petition the Congress, but we can not circumvent the tax laws. And I think we should meet and decide this issue when it is before us in this formal proceeding.

This question is not new. It came before this Commission during the First World War. In November 1918, in a unanimous decision fixing the electric rates of the Western States Gas and Electric Company (16 CRC 197,198) the Commission said:

"The federal taxes to which applicant is liable show an enormous increase over those paid in preceding years, resulting from present and proposed higher rates of federal taxation to meet war expenses. Considerable discussion has been had and some difference of opinion exists as to who should ultimately pay what may be called the war tax charged a public utility; that is, whether the consumers should pay the same by allowing such taxes to the utility as operating expenses, or whether they should be borne by the utility itself.

"What may be termed ordinary taxes, federal, state and municipal, have been uniformly recognized as proper operating expenses and such taxes will be allowed herein as operating expenses. It does seem illogical, however, that when the federal government attempts to impose upon the security holders of a corporation, whether public utility or non-public utility, a certain tax upon income for war purposes or to meet a national emergency, that the purpose and spirit of such law should be thwarted by the utility passing such taxes along to its consumers as an operating expense to be collected in rates.

"The question then arises as to where the line should be drawn to distinguish between the ordinary federal, state and municipal taxes and the war emergency taxes. The answer to this, it seems to me, is in the act of Congress passed October 3, 1917, entitled 'An Act to Provide Revenue to Defray War Expenses and for Other Purposes,' which is supplementary to the act of Congress entitled 'An Act to Increase the Revenue, and for Other Purposes,' approved September 8, 1916. This act, by its title and text, declares for the collection of taxes for war purposes.

"Previous to the enactment of the act of October 3, 1917, the federal income tax assessable against applicant was on the basis of 2 per cent per annum; by the terms of said act such tax was increased to 6 per cent per annum. At the present time legislation is pending before Congress which, when finally enacted, will undoubtedly result in a very substantially increased tax rate over that provided for in the act of October 3, 1917.

"I am compelled to take the view that both the letter and the spirit of the existing federal war revenue law (and it is but fair to assume likewise of any new law enacted for the same purpose during the present session of Congress) clearly contemplates the payment by the owners of utilities of that part of the tax assessed for war purposes provided for therein. This purpose would be defeated by allowing same as operating expenses and thereby imposing same on the consumers of utilities through rates.

"I have, therefore, made a segregation of the income taxes allowing as operating expenses so much thereof as was assessed against applicant by federal law prior to the act of October 3, 1917. Any increases over that, due to war conditions, should be borne by the security holders of the utility. Likewise, and for the same reasons, the increased taxes on capital stock, coupons, and other increases of a similar character are chargeable to the utility and not to the consumer thereof."

In February 1919, in a gas rate case of the Los Angeles Gas and Electric Corporation, Decision No. 6139, the Commission again disallowed the so-called war taxes as an operating expense and held that "a utility should stand the burden of war taxes imposed upon its net income" and that "the consumers should not be required to pay income tax or capital stock tax in excess of pre-war rates" (16 CRC 487).⁽⁴⁾

Distinction must be made, I repeat, between what may be termed normal income taxes, payable in times of peace, and excess profit taxes especially levied to pay for the cost of the war.

In the Galveston Case (258 U.S. 388), the United States Supreme Court held that the federal ten per cent net income tax might, in the circumstances of that case, be considered an operating expense item. The proceeding involved street railway fares. The lower court had disallowed the entire federal income tax in operating expenses. The tax, it should be noted, was not a war tax; it was a normal tax. On this question the Supreme Court said:

"The remaining item as to which the master and the court differed relates to the income tax. The company assigns as error that the master allowed, but the court disallowed, as a part of the operating

(4) "Applicant has included in its estimate of operating expenses the sum of \$289,926.00 for taxes. This estimate includes both state and federal taxes. The Commission, in its Decision No. 5889, in Application No. 3962 of Western States Gas and Electric Company, decided that a utility should stand the burden of the war taxes imposed upon its net income, allowing, however, prewar federal taxes as well as state, county and municipal taxes as operating expenses. Of the total taxes estimated for the year 1919 by applicant, \$100,279.24 are federal taxes, consisting of federal capital stock tax, net income tax, income tax on tax-free bonds, war stamp tax and excess profit tax. From a study of the act of congress passed October 3, 1917, entitled, 'An act to provide revenue to defray war expenses and for other purposes,' it is apparent to me that both the letter and the spirit of the existing federal war revenue law (and it is but fair to assume likewise of any new law enacted for the same purpose) clearly contemplates the payment by the owners of utilities of that part of the tax assessed for war purposes provided for therein. Applicant's consumers should not pay the excess profit tax, and as stated above, the consumers should not be required to pay the income tax or capital stock tax in excess of prewar rates. The taxes other than state gross revenue tax which should be chargeable to the operation of the utility for 1919 are \$14,886.00 as against \$100,729.24 claimed by applicant. I will allow 5.6 per cent of the estimated gross revenue plus \$14,886.00 as the taxes chargeable to operation."

expenses for the year ending June 30, 1920, the sum of \$16,254, paid by the company during that year for Federal income taxes. The tax referred to is presumably that imposed by the Act of February 24, 1919, chap. 18, Secs. 230-238, 40 Stat. at L. 1057, 1075-1080, Comp. Stat. Secs. 6371-3/4a, 6336-1/8nn-6336-1/8rr, which, for any year after 1918, is 10 per cent of the net income. In calculating whether the 5-cent fare will yield a proper return, it is necessary to deduct from gross revenue the expenses and charges; and all taxes which would be payable if a fair return were earned are appropriate deductions. There is no difference in this respect between state and Federal taxes, or between income taxes and others. But the fact that it is the Federal corporate income tax for which deduction is made must be taken into consideration in determining what rate of return shall be deemed fair. For, under Sec. 216, the stockholder does not include in the income on which the normal Federal tax is payable dividends received from the corporation. This tax exemption is therefore, in effect, part of the return on the investment." (258 U.S. at 399-400.)

In the Georgia Case (262 U.S. 625), the United States Supreme Court stated, in part, as follows:

"The companies contend that there was error, also, in estimating the amount of the probable net income. One objection relates to the Federal corporate income tax (10 per cent) assumed to be \$45,364. The commission treated the tax as a proper operating charge. The court disallowed it, and thus increased its estimate of probable net income. In this the court erred. Galveston Electric Co. v. Galveston, supra."

These cases, if they are considered as sanctioning the inclusion of normal, pre-war income taxes in operating expenses, are clearly distinguishable from the tax issue in the present proceeding. This Commission has always allowed "normal" taxes as operating costs and I have adhered to the long-established practice in this case. Here we are considering not the normal ten per cent income tax of two decades past but a special war tax imposed by Congress over and above the normal income tax, designated as "net excess profits tax" and based on a prescribed and specified net income amount designated as "adjusted excess-profits net income." Clearly this tax is a special tax and is a war burden, in addition to the ordinary tax. Further, the rates fixed in this case will leave the company, after the payment of all taxes, in a satisfactory earning position and with a rate of return of more than 6 per cent on an undepreciated rate base.

In the Georgia Case, supra, it is to be noted, the Commission allowed the 10 per cent federal income tax as an operating expense and the lower court disallowed it. The United States Supreme Court sustained the Commission.

The Federal Power Commission in Detroit v. Panhandle Eastern Pipe Line Co. (1942), 45 P.U.R. (N.S.) 203, considered the matter of war emergency taxes and said:

"Thus it appears that the doctrine of unjust enrichment as well as equity and good conscience compel the conclusion that a utility should not be permitted to thwart the purpose and spirit of the war price control legislation and the revenue laws by passing such abnormal tax requirements along to its consumers as an operating expense to be collected in increased rates. Indeed, we feel increased rates on such a basis would be unjustifiable. To allow them would in effect impose upon the consumers a sales tax.

"So that there may be no confusion concerning the tax situation in connection with the companies subject to our jurisdiction, where necessary to stabilize utility rates at reasonable levels during the war emergency period, we propose to allow as proper operating expenses only such taxes as may be termed ordinary or normal. For the purpose of distinguishing between ordinary or normal and war emergency or abnormal taxes, we conclude that the basis prescribed in the 1940 Revenue Act establishes the highest possible level of Federal taxes which may be allowed as an element of operating expense for such purpose. The 1941 Revenue Act and the pending 1942 proposal certainly reflect abnormal tax requirements for war purposes.

"The conclusions we here express find validity in utterances of other regulatory bodies who were confronted with the problem of abnormal tax requirements in dealing with the utility industry as a result of the First World War." (Citations)

In Hope Natural Gas Co. v. Federal Power Commission (1943), 134F.

(2d) 287, the Circuit Court, reversing the Commission, stated in part as follows:

"Federal income tax. It is elementary that taxes, including income taxes paid the federal government, are proper elements of expense of operation. The Commission found that \$76,579 was a proper amount to allow for federal income tax for the future, although the evidence was that Hope paid \$912,313 in federal income tax in 1940. Hope contends that the Commission, in adjudging its 1940 rates to be unreasonable, computed its income tax liability at a figure no greater than that estimated for the future, notwithstanding it had actually paid \$912,313 on account of federal income tax in that year. As we have reached the conclusion, as stated more fully hereafter, that the Commission was without power to make findings as to the reasonableness of past rates, except as incidental to fixing rates for the future, we need not determine what allowance should be made for income tax in 1940. So far as rates for the future are concerned, changes in tax laws render irrelevant a discussion of the Commission's figures. In further proceedings to establish rates for Hope, due consideration will doubtless be given to federal income tax liability in estimating necessary expenses of operation, based upon what income tax Hope will be required to pay on income derived from rates found to be reasonable." (134 F. (2d) 287,308.)

On January 3 of this year the United States Supreme Court reversed the lower court (Federal Power Commission, etc. v. Hope Natural Gas Co.) and sustained the Federal Power Commission's decision. The question of federal taxes

is not discussed in the decision of the Court. There is found, however, in that epoch-making decision a carefully reasoned consideration of the argument by the State of West Virginia that gas rates should be fixed on a higher level than otherwise necessary in order to produce state taxes that, with lowered rates, might be reduced or lost to the state. The Court says:

"We cannot find in the words of the Act or in its history the slightest intimation or suggestion that the exploitation of consumers by private operators through the maintenance of high rates should be allowed to continue provided the producing states obtain indirect benefits from it. That apparently was the Commission's view of the matter, for the same arguments advanced here were presented to the Commission and not adopted by it."

And, further,


"Thus Congress was quite aware of the interests of the producing states in their natural gas supplies.⁽²³⁾ But it left the protection of those interests to measures other than the maintenance of high rates to private companies. If the Commission is to be compelled to let the stockholders of natural gas companies have a feast so that the producing states may receive crumbs from that table, the present Act must be redesigned. Such a project raises questions of policy which go beyond our province." (Footnote 23 omitted.)

Our Public Utilities Act does not, in the quoted language of the Supreme Court, contain the slightest intimation or suggestion that war taxes levied by Congress on the owners of public utilities may be transferred by us, through the maintenance of high rates, to the patrons and rate payers of public utilities.

Within the week Congress has increased the corporation excess profits tax to 85.5 per cent (after refund provisions). It is conceivable that not eighty-five or ninety, but one hundred per cent of a specified excess profit might be taken to carry on the war. In such an event it would become impossible for a utilities commission to shift the tax burden from the designated tax payer (the corporation) to the rate payer. There is no more justification in an eighty-five and one-half per cent shift than in an one hundred per cent transfer.

With the war in progress, at an ever increasing strain on all of the Nation, for more than two years, the time is late, and overdue, ~~too~~ *MSM*

for us to face this issue and make our decision. The millions of California utility rate payers are entitled to know whether, in addition to their own war taxes, they must continue to pay, as operating expenses, the war excess profits taxes of California utility corporations, and the utilities are equally entitled to our answer.


Commissioner.