

Decision No. 37336

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 Coast Counties Gas and Electric Company covering gas and electric service.

Case No. 4738.

ORIGINAL

Felix T. Smith, for Coast Counties Gas and Electric Company.
J. J. Deuel, for California Farm Bureau Federation.
W. D. MacKay, for C. B. Gentry.
Ralph H. Wight, City Attorney, for the City of Martinez.

SACHSE, COMMISSIONER:

O P I N I O N

This is an investigation upon the Commission's own motion into the reasonableness of the rates charged by the Coast Counties Gas and Electric Company in the service of gas and electricity.

A public hearing was held in the courtroom of the Commission at San Francisco, California, on Wednesday, August 30, 1944, at which time and place evidence was taken and the matter was submitted for decision.

The Coast Counties Gas and Electric Company distributes electric energy, natural gas, butane-air gas and water in several separate areas of California. Electric service is rendered in the company's Southern Division, comprising all or parts of Santa Cruz, Monterey, Santa Clara and San Benito Counties. In this area approximately 28,000 customers are served and in 1943 their use approximated 77,360,000 kilowatt-hours, for which the company received somewhat over \$1,800,000 in gross revenue. Of these customers approximately 93 per cent were classified as domestic and commercial and accounted for 59 per cent of the revenue. Of the remaining service general power accounts for about 20 per cent and agricultural service for approximately 17 per cent. Revenue from street lighting and other miscellaneous sources is about 4 per cent of the total.

Natural gas service is likewise rendered in the Southern Division and, in addition, limited service is supplied in the Valley Division covering parts of Merced County. The company's largest gas business is in its Contra Costa Division. Industrial gas sales in this division were very sharply increased when the Coast Counties Gas and Electric Company took over the business of the Coast Natural Gas Company in September, 1942 (Decision No. 35669). Approximately 9 per cent of the total domestic and commercial revenue is received in the West Side Gas Division, in the counties of Kern and Kings. The respondent utility likewise serves butane gas in the Northern and Imperial Divisions, which accounts for less than 6 per cent of its general gas revenue. Of the total gas revenue for 1943 51 per cent was received from general domestic and commercial service, 10 per cent from other firm service, and the balance, or 39 per cent, was from so-called surplus gas sales.

Evidence as to the probable results of operations for the year 1944 was presented by Roy A. Wehe, Assistant Director of the Commission's Utility Department, and is summarized as follows:

	<u>Electric Department</u>	<u>Gas Department</u>	<u>Water Department</u>	<u>Total All Departments</u>
Operating Revenues	\$1,974,639	\$4,536,224	\$44,006	\$6,604,869
Operating and Maintenance Expenses	1,055,874	3,337,461	29,934	4,423,269
Depreciation - 5% Sinking Fund	109,594	105,717	2,764	218,075
Taxes Other Than Federal Income	161,975	132,906	1,534	296,415
Subtotal Expenses before Federal Taxes	1,327,443	3,576,084	34,232	4,937,759
Net Revenue before Federal Income Taxes	\$647,196	\$1,010,140	\$9,774	\$1,667,110
Federal Income Tax:				
Normal and Surtax	169,996	134,910	2,500	307,406
Excess Profits Tax	26,792	373,102	-	399,894
Total Federal Income Tax	196,788	508,012	2,500	707,300
Net Revenue for Return	\$450,408	\$502,128	\$7,274	\$959,810
Rate Base	\$7,027,665	\$7,423,577	\$173,000	\$14,624,242
Rate of Return	6.41%	6.76%	4.20%	6.56%

The record shows that our staff and that of the utility are in agreement in reference to the revenue and expense estimates. The rate base

is developed by the company on the usual historical cost basis and is used for the purposes of this proceeding for comparison with earnings on a similar basis in prior years. No specific finding of a rate base for the operative property or of a specific reasonable rate of return is made by us at this time. Such findings are left for future determination.

While a fairly complete record is in evidence as to the basis of the revenue and expense estimates, it is not believed necessary to review these in detail. The gross revenue estimates for 1944 indicate for the Electric Department an increase of nearly 8 per cent over the preceding year, and for the Gas Department an increase of 14 per cent. Such increases must be looked upon as much more than normal and reflect, in part, added growth in load due to war conditions.

Operating expenses, other than depreciation and taxes, show no changes other than would be expected because of the increase in sales. There is a sharp increase in taxes, while depreciation expense has been reduced. The latter change warrants further comment.

Coast Counties Gas and Electric Company has, over a long period of years, accrued its annual depreciation on the 6 per cent sinking fund basis. This Commission has used the same basis in the making of rates. Due to improvements in both the design and use of construction materials, the apparent lessening in the effects of inadequacy and from other causes, depreciable plant facilities last longer at the present time than has been the experience in earlier years.⁽¹⁾ Heretofore both the Commission and the utility, in the sinking fund method, have used a 6 per cent interest rate. Mr. Wehe testified that, in his opinion, a 5 per cent interest rate would be more appropriate at this time and the record shows that the estimates for depreciation in the above tabulation have been predicated on the 5 per cent

⁽¹⁾ Under date of August 28, 1944, the utility submitted by letter a proposed new schedule of lives of depreciable property groups by capital account classifications and segregated to the gas, electric and water departments. These schedules of lives were made a part of this record by reference and have been used in determining the 1944 estimate for depreciation.

sinking fund method. These changes appear appropriate and are incorporated in this decision.

It will be observed from the summary of operations above that the rate of earnings in the 1944 estimate varies from 6.41 per cent on the Electric Department to 6.76⁽²⁾ per cent on the Gas Department, with an over-all system return of 6.56 per cent on the indicated base.

It is apparent from this earning statement that a substantial reduction in rates is justified. The record shows the Commission's and the utility's staffs to be in agreement that a reduction in gross revenue amounting to \$500,000, on an annual basis, is warranted at the present level of earnings. Exhibit No. 2, introduced at the hearing, is an estimate of the operating results for the year 1944 before and after a \$500,000 rate reduction.⁽³⁾ The comparison is as follows:

	<u>Before Reduction</u>	<u>After Reduction</u>
Estimated Gross Revenue	\$6,604,869	\$6,604,869
Reduction - Proposed		500,000
Estimated Gross Revenue after Reduction		<u>\$6,104,869</u>
Estimated Total Operating and Maintenance Expenses	\$4,423,269	\$4,418,279
Depreciation Annuity - 5% S.F.	218,075	218,075
Taxes Other Than State Corporation and Federal Income	250,264	250,264
State Corporation Franchise Tax	46,151	29,321
Subtotal Expenses	<u>4,937,759</u>	<u>4,915,939</u>
Net before Federal Income Tax	\$1,667,110	\$1,188,930
Federal Income Tax:		
Normal and Surtax	307,406	303,219
Excess Profits Tax	399,894	-
Subtotal Federal Income Tax	<u>707,300</u>	<u>303,219</u>
Net Revenue for Return	\$959,810	\$885,711
Rate Base	\$14,624,242	\$14,624,242
Rate of Return	6.56%	6.06%

(2) The estimated earnings for the Gas Department are 6.82 per cent for the Coast area, 9.76 per cent for the West Side Division and 5.21 per cent for the Butane Division, resulting in an average of 6.76 per cent. This Commission has heretofore considered each of these three gas divisions more or less separately for rate purposes and it is not intended that the present opinion and order, issued during a war period and dealing with unusual circumstances, shall be considered as a change in its general rate-making policy.

(3) The testimony accompanying this exhibit shows that, inasmuch as under the Federal Revenue Act no excess profit taxes will be payable by this utility above a rate of return of approximately 6 per cent, it follows that after the \$500,000 reduction the utility's net taxable revenues fall below the excess profit bracket and no such taxes will be paid on the basis of the estimate in Exhibit No. 2.

As to the manner of distribution of the half-million-dollar reduction, the record indicates that approximately \$150,000 should be assigned to the Electric Department and the balance, or \$350,000, to the Gas Department.

On the question of form of rate reduction and its allocation to classes of service, it was Mr. Wehe's recommendation that, due to the recent large growth in revenues with the attending uncertainties as to whether the present rate of earnings could be maintained, a discount form of rate should be applied, with a provision permitting adjustments in such discount if conditions warranted in the future and that such a discount should be applied to the general service schedules of both the Natural Gas and the Electric Departments, including the services to two large military establishments. The discount rates herein proposed, during the period in which they are in effect, are intended to produce the net revenue after reduction indicated in Exhibit No. 2 and such discount rates will remain in effect for the duration of the war, plus six months. However, notwithstanding the aforesaid plan of adjusting the discount rates, this Commission may at any time, on its own initiative and after full and proper hearing, set aside the order hereinafter made and establish such other rates as it may deem just and reasonable.

An analysis of the customers' sales record of the services involved indicates that for the Electric Department a flat discount of 15 per cent can be applied to all billings beyond the minimum charge for the domestic and commercial services and yield approximately the \$150,000 annual reduction. For the Gas Department a reduction of 21 per cent beyond the minimum can be made on all natural gas general service tariffs, including special services to the military establishments, and yields the balance of the contemplated annual reduction of approximately \$350,000.

It is my view that the record not only clearly justifies the proposals herein reviewed, but that the somewhat expedited procedure adopted in this case is fully warranted when the utility has declared its willingness to make a very substantial reduction in its rates, which can immediately be made effective for the benefit of its customers without the necessity of protracted rate case hearings. The unusual problems of this unprecedented period and the difficulty of forecasting future economic conditions should not deter us from making the necessary and reasonable rate adjustments, upward

or downward, that can be justified at this time. In this case these objectives appear to be fairly well accomplished through the proposed means of distributing a \$500,000 annual rate reduction and this utility is to be commended for its cooperation. The following form of order is recommended.

O R D E R

The Commission having instituted this proceeding on its own motion, a public hearing having been held, the matter having been submitted for decision, the Commission finding that an over-all reduction in gas and electric rates of \$500,000, on an annual basis, can be made without in any degree impairing this utility's ability to render efficient and adequate service and without impairing its ability to earn a fair and reasonable return and that such reduction is acceptable to the respondent utility, and the Commission being of the opinion that such reduction as herein distributed between the gas and electric rates is warranted, and the Commission finding further:

1. that the plan of rate adjustment set out in the opinion is reasonable;
2. that the change in the method and rate of depreciation accrual is justified and reasonable and that the same should be effective as of January 1, 1944; and
3. that the discount form of rate, as set forth in the opinion is justified and reasonable; and

Basing its order upon the foregoing findings of fact and upon the opinion preceding this order,

IT IS HEREBY ORDERED that the Coast Counties Gas and Electric Company be and it is hereby directed to refile with this Commission, within twenty (20) days after the effective date of this order, electric Schedules D-1, D-2, L-1 and L-2 providing for a fifteen (15) per cent discount to be applied to all customer bills in excess of the minimum charge and to likewise refile its natural gas Schedules G-1, G-2, G-1V, G-2V, G-1C, G-2C, WS-1, WS-2 and WS-3, and also the special rates to Camp McQuaid and Camp Stoneman, incorporating therein a twenty-one (21) per cent discount to be applied to all

customer bills in excess of the minimum charge and all such discount billings to become effective with meter readings taken on or after September, 15, 1944.

Each customer bill coming under the discount provisions of this order shall show on its face, by appropriate wording, that the amount shown therein reflects a war-time discount authorized by this Commission.

The effective date of this order shall be the date hereof.

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

Dated at San Francisco, California, this 13th day of September, 1944.

Richard Kachse

Francis R. Havens
Francis W. Allen

Commissioners.

Dissent by Commissioner Rowell:

I regret that I cannot concur. One should hesitate, of course, to challenge the propriety of a rate reduction to which the utility itself appears to agree, and were this the usual type of rate reduction I would not do so. But this is not such a case. It is most unusual both in the procedure followed and in the results arrived at. The decision does not fully reveal these facts. The customers of the utility have a right to know just what is here being done.

The Commission finds that the Coast Counties Gas and Electric Company is annually charging \$60,000 too much as a depreciation expense. After reflecting this deduction in operating expenses, it is found that the Company's net revenue, in all its utility operations, will yield this year a return of 6.56% upon a rate base of \$14,624,242. A return of 6.06% is deemed reasonable. Hence it is concluded that net revenues should be reduced by one-half of one percent upon that rate base, or by exactly \$73,121. After thus determining the reasonableness of net revenue, the Commission proceeds to fix as just and reasonable a schedule of rates which will produce this net result. But the rate cut actually made bears little relation to the excess in net revenue the company is found to be enjoying. The cut in rates is approximately seven times that amount. Such a result would not in other times have been the consequence of a finding of too high net earnings by that amount. It is a consequence only of the peculiar Federal tax laws now in effect. The utility's net revenue will be reduced by only the nominal sum above stated, while the loss to the Federal treasury will be nearly six times as much.

The economics of the tax laws in relation to utility rates need not be dwelt upon here. All that need be pointed out here is that the customers of this particular utility are by this decision led to believe that just and reasonable rate exactions from them for the immediate future should total at least \$500,000 less than the rates they are now charged, with a consequent reduction of 21% in their gas rates and 15% in electric rates. This representation is made in spite of the findings made that the company's present sales of gas and electricity are greatly augmented by war conditions. It is inferentially recognized that such

large gross sales cannot be permanent and that this artificial rate reduction cannot long continue. So the Commission makes the rate reduction in the form of a discount rate, the discount to be reduced or withdrawn if the net revenue should at any time fall below the accepted amount which yields a 6.06% return upon the rate base.

The customers of this utility have not been advised of nor have they agreed to any such rate fixing formula. From the mere pro forma nature of the hearing had in this proceeding, it is evident that the utility consumers had no fair opportunity to learn what the plan really is, nor to understand the factors which bring such a large rate reduction about.

Without in any way challenging the right of this utility or others to propose rate reductions in any amount deemed to be wise in the broad economic view, I consider it the right of consumers to know what the proposal really is and what the Commission's reasoning processes are. In my view, it should be the objective of all to secure rate stability, not to promote wide rate fluctuations. Abnormal reductions lead inevitably to abnormal increases. From the facts set forth in this decision it becomes evident that if the company's gross sales should fall even to the level of the year 1943, its net revenue would be such as to compel a rate increase of even more than the amount of the reduction here made. What is more, that increase would fall wholly upon the remaining domestic and commercial consumers of the company and would not be shared by the war industries. Moreover, that increase undoubtedly will come at a time when customers are least able financially to bear it. The Commission should be far more concerned in obtaining utility rate reductions at a time in the near future when reductions will really aid in our post-war reconversion program. More important, it should strive to prevent rate increases that may then become imminent. It would be far wiser, in my view, to set up reserves against that contingency. In that way both utility and consumer interest can be fully safeguarded.


J. H. Ruddle,
Commissioner.