Decision No. 38638

ORIGINAL

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 Pacific Gas and Electric Company covering gas service.	Case No. 4749

R. W. DuVal and Robert H. Gerdes for Pacific Gas and Electric Company, Respondent; John J. O'Toole, Dion R. Holm and Paul L. Beck, by Paul L. Beck, for the City and County of San Francisco; J. J. Deuel and Edson Abel, for California Farm Bureau Federation; W. D. MacKay, for Felice and Perelli Canning Company; Earl C. Cooper, for Northern California Electrical Consumers Association; Don McMillan, City Manager, for City of Alameda; W. C. Stone, for Sacramento Chamber of Commerce; Lester S. Ready, for City of Palo Alto.

BY THE COMMISSION:

OPINION

This is a proceeding on the Commission's own motion instituted on November 28, 1944, into the reasonableness of the rates of the Pacific Gas and Electric Company in the service of gas. This matter was heard by Commissioners Sachse and Clark. The first public hearing was held in the Commission Courtroom in San Francisco on December 14, 1944, and subsequently thereto hearings were held on forty-six different days. Extensive exhibits and testimony were presented by the staff of the Commission, as well as the Respondent utility, covering capital base, revenues, expenses, cost of money, rate of return, and general financial condition of the company.(1) In all, sixty-seven exhibits were introduced, and in excess of 4,000 pages of testimony were taken.

(1) Witnesses testifying on the various phases of the Company's operations were as follows: CAPITAL AND RATE BASE, for P.G.&E.: G.M.Thomas, Valuation Engr.; E.W.Hodges, Comptroller; E.J.Beckett, Treasurer--Comm. Staff: C.T.Mess, Chief, Div. of Valuation; R.A.Wehe, Asst. Director; P.E.Dufour, Sen. Engr.; Jos. Waithman, Sen. Engr.; E.P.McAuliffe, Sen. Land Appraiser; C.W.Mors, Research Engr. DEPRECIATION EXPENSE AND RESERVE, for P.G.&E.: G.M.Thomas--Comm. Staff: R.A.Wehe; C.T.Mess; L.E.Cooper, Gas Engr. OPERATING REVENUES, for P.G.&E.: J.W.Ellis, Asst. Engr.; G.M.Thomas--Comm. Staff: L.E.Cooper. OPERATING EXPENSES, for P.G.&E.: J.W.Ellis; G.M.Thomas; E.W.Hodges; R.S.Fuller, Engr. of Gas Oper.;
(Continued)

While the order of investigation is limited to the Company's gas business, nevertheless quite extensive testimony, particularly by Respondent utility, was introduced in reference to its electric properties, and for its operations as a whole, which include, in addition to the electric department, relatively minor departments of water and steam heat.

The Respondent has taken the position that the earnings from its gas department are not excessive nor unreasonable, and particularly if its over-all earnings be considered, and asks that this pending proceeding be dismissed. The representatives for the City and County of San Francisco ask that lower gas rates be established.

The Pacific Gas and Electric Company is one of the largest operating utilities in the nation. It was incorporated under the laws of the State of California on October 10, 1905. Its service area now covers a large portion of central and northern California, with service in forty-six counties. Its business is principally that of distribution and sale of electricity and natural gas to domestic, industrial, commercial, and agricultural customers. The following tabulation of gross revenues and customers served for the year 1944 is indicative of the relationship in coverage as to these two services as well as to a small amount of water and steam sales included as "other departments."

	Gross Operating Revenues	Per Cent	Number of Customers	Per Cent
Electric Department	$107,798,920	68.8%	1,009,570	57.1%
Gas Department	47,929,003	30.6	744,402	42.1
Other Departments	870,257	0.6	13,321	0.8
Total	$156,598,180	100.0%	1,767,293	100.0%

L.J.Nevraumont, Personnel Mgr.--Comm. Staff: L.E.Cooper; C.W.Mors; S.Weber, Sen. Engr. PENSIONS, for P.G.&E.: E.W.Hodges--Comm. Staff: C.W.Mors; L.N.Rice, Assoc. Engr. TAXES, for P.G.&E.: K.C.Christenson, Asst. Treas.; E.W.Hodges--Comm. Staff: S.Weber; C.W.Mors. GAS RESERVES AND COST OF GAS, for P.G.&E.: W.G.Vincent, V.P. & Exec. Engr.--Comm. Staff: R.A.Wehe. GAS USAGE AND RATES, for P.G.&E.: W.G.Vincent; B.B.Beckett; J.W.Ellis; J.H.Gumz, Sales Engr.--for California Farm Bureau Federation: J.J.Deuel--Comm. Staff: R.A.Wehe; L.E.Cooper. COST OF MONEY, for P.G.&E.: E.J.Beckett; L.A.Reynolds, Auditor--Comm. Staff: J.T.Jordan, Prin. Accountant. RATE OF RETURN, for P.G.&E.: E.J.Beckett. GENERAL OPERATIONS AND FUTURE TRENDS, for P.G.&E.: W.G.Vincent; B.B.Beckett; G.M.Thomas--Comm. Staff: R.A.Wehe.

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During the calendar year 1944 the utility's total gas sales were in excess of 160,000,000 Mcf. The following tabulation indicates the disposition of such sales and the average rate paid by classes of service:

Classifications	Sales Mcf	Sales Per Cent	Average Revenue per Mcf
Firm Sales			
General Service	61,192,815	37.8%	51.7¢
Commercial Building Heating	8,033,011	5.0	28.7
Resale	667,139	0.4	26.1
Special Industrial	11,663,744	7.2	23.0
Subtotal Firm Sales	81,556,709	50.4	45.1
Surplus and Interruptible Sales	43,806,197	27.1	14.4
Total Sales to Customers	125,362,906	77.5	34.4
Interdepartment Sales	36,428,555	22.5	12.7
Total Gas Sales	161,791,461	100.0%	29.5¢

Since taking of evidence and the submission of this matter, the war in which the nation was then engaged has come to a close. The Commission must take cognizance of subsequent events that materially affect the operations of this utility and others in the future. Amendments of the federal tax laws have brought about a reduced tax burden. On the other hand, prices for both materials and labor appear to be moving upward, and the process of reconversion from a war to a peacetime economy is proceeding with many uncertainties.

In the discussion to follow, relating to the results of gas operations for the years 1944 and 1945, the Commission's adopted figures for the year 1945 are to be taken as a fair basis upon which to determine the reasonableness of rates for a future period in the light of changed conditions.

CAPITAL AND RATE BASE

Capital and rate base figures were submitted for the years 1944 and 1945 on the historical cost basis with land at present market value. The evidenc of record clearly shows there is little difference between the estimates submitted by the Company and by the staff of the Commission in respect to the average operative fixed capital but there are differences with respect to the so-called excess acquisition costs and working cash capital.

There is included in the capital base by both the Company and Commission staffs a proration of common utility capital that is used jointly by all departments as well as approximately 9 million dollars of capital investment in the manufacturing gas plants now used for standby purposes. The Company's depreciation reserve accruals against this manufacturing gas capital will be completed in 1946.

In the following tabulation there is set forth a comparison of the Company's and the Commission staff's figures for the rate base applicable to the gas department for the year 1945:

Item	CRC Staff Exhibit 42A	Company Exhibit 27A	Difference - Company Exceeds CRC Staff
INTANGIBLE CAPITAL			
Organization and Franchise	$ 671,650	$ 675,000	$ 3,350
TANGIBLE CAPITAL			
Departmental Capital	140,540,311	140,630,000	89,689
Common Utility - Pro rata	6,412,860	6,438,000	25,140
Subtotal	147,624,821	147,743,000	118,179
ADJUSTMENTS	(994,910)	(969,000)	25,910
Avg. Oper. Fixed Capital	146,629,911	146,774,000	144,089
EXCESS OF COST TO P.G.& E. CO.			
Over amounts at which certain merged properties are included above		1,196,000	1,196,000
WORKING CAPITAL			
Material and Supplies	901,000	1,100,000	199,000
Working Cash	-	3,553,000	3,553,000
Total Working Capital	901,000	4,653,000	3,752,000
Avg. Historical Cost Rate Base	$147,530,911		
Total Cost of Properties Plus Working Capital		$152,623,000	$5,092,089

(Red Figure)

Excess Capital Costs

The Company's claim of "excess cost" as shown in above table, amounting to $1,196,000, includes $176,000 representing certain distribution mains in the old San Joaquin properties which had previously been deducted under the heading of "adjustments" in its Exhibit 27A. This leaves a balance of $1,020,000 apportioned to its gas properties which is the allocated part of a much larger amount ($33,217,471) claimed for the system as a whole. This "excess cost" represents the total of the amounts claimed to have been paid for certain acquired properties in excess of their reported original cost, it being the position of the Company that it is entitled to a fair return upon the purchase price of such properties.

Such "excess cost" of $33,217,471 arises from the purchase and acquisition of four groups(2) of utility properties during the ten-year period dating from 1928. The estimated original cost, as of dates of acquisition, of the properties acquired is given as $232,340,938 and the total charge to fixed capital on the books of the utility amounts to $265,558,409, which latter figure reflects credits to the depreciation reserve in an amount of $33,654,587. The difference between the total charged to fixed capital ($265,558,409) and the original cost ($232,340,938), or $33,217,471, is the "excess cost" under consideration.

The total purchase price of the acquired properties is a derived figure predicated on cash advances to redeem bonds and preferred stock, funded debt assumed, acquisition of preferred and common stocks, and the excess of current liabilities over current assets acquired, together with the amounts credited to the depreciation reserves on the books of the acquired utilities. The witnesses for the Company were unable to state what segregation of this "excess cost" was proper as between tangible and intangible capital other than the opinion that a part of said "excess cost" was assignable to tangible plant, including water rights. The record is clear that no portion of this "excess cost" has been written off at the time of retirement of tangible plant.

It is further a fact that the Company was unable to establish identity of this added claim in reference to its physical properties. The Commission likewise has in mind that subsequent to its approval of the Company's reclassification of its capital accounts there should be developed a plan for accounting disposition of the difference between the purchase price and the original cost of acquired properties.

(2) The four groups of properties include: Great Western Power Company, acquired as of 3/31/36 (Dec. No. 28517, 39 CRC 522); Standard Gas and Electric, acquired as of 6/30/28 (Dec. No. 19590, 31 CRC 516 and Dec. No. 28518, 39 CRC 539); San Joaquin Light and Power Corp., acquired as of 12/31/38 (Dec. No. 31354, 41 CRC 609); and Midland Counties Public Service Corp., acquired as of 12/31/38 (Dec. No. 31355, 41 CRC 616).

Inasmuch as the claimed "excess cost" for the gas department is but an allocated part of the much larger amount claimed for the system as a whole - in fact less than 4 per cent - the disposition of this matter will be held in abeyance until the Commission considers the question of reclassification of Respondent's capital accounts for all departments.

Working Cash Capital

There is no difference in view between the Company and Commission witnesses as to the need of working cash in order to carry on and conduct a utility business. There was, however, some difference in view as to the gross amount required and a general disagreement as to the net amount to be added to the capital base upon which the owner of the utility could expect to earn a return. As to the first, the utility's witness estimated that the Company as a whole needed not less than $12,000,000 of which something over 3½ million dollars was assigned to the gas department on the gross revenue basis. The Commission staff, on the other hand, followed the long-established practice of this Commission in allowing the sum of one month's cost of purchased gas and fuel and two months' other operating expenses, exclusive of uncollectibles, taxes and depreciation, increased by about 3 per cent to give recognition for bimonthly billing. Such a gross working cash requirement of the gas department for the year 1945 worked out to be approximately 2½ million dollars. In addition, the witness for the Commission staff gave recognition to the average monthly balance of taxes accrued ahead of payments, which the Company witness entirely ignored. Since such average balance of tax accruals ahead of payments for the year 1945 was estimated to be approximately five times the gross working cash allowance by the Commission staff and 3½ times the Company's estimate, no additional working cash allowance was included in the Commission staff estimate of the rate base.

It is our view that inasmuch as the record clearly shows tax accruals ahead of payments were intermingled and used by the Company in part as working cash, it is necessary that the Commission take cognizance of such use when making allowance for that portion of the cost of working cash that should be borne by the ratepayer. It is our view, however, that in this case, under present conditions, special treatment should be given to working cash capital and some allowance therefor will be made in the rate base.

After giving due consideration to all the claims and elements that are proper and fair to be included in a rate base, it is the conclusion of the Commission that it is fair to adopt as the rate base for the average year 1945 the amount of $149,000,000.

GAS OPERATING REVENUES

The record in this case contains considerable testimony and several exhibits relative to the recorded, adjusted, and estimated operating revenues for the years 1944 and 1945, as well as views as to the probable trend in gas sales and revenues in subsequent years.

The summary statement of the 1944 recorded and adjusted revenue is as follows:

Item	As Recorded (Exhibit 14)	After Adjustment: Company (Exhibit 14)	After Adjustment: CRC Staff (Exhibit 50)
OPERATING REVENUES			
From Customers	$43,122,136	$42,252,107	$42,081,939
Interdepartment Sales	4,636,163	4,695,163	2,332,163
Miscellaneous	170,704	369,504	369,504
Total	$47,929,003	$47,316,774	$44,783,606

The estimates for 1945 are as follows:

Item	Company (Exhibit 27A)	CRC Staff (Exhibit 42)	CRC Staff Above Company
OPERATING REVENUES			
General Service	$33,178,000	$33,281,124	$103,124
Special Industrial	1,876,000	1,966,511	90,511
Commercial Building Heating	2,319,000	2,297,999	(21,001)
Resale	174,000	175,643	1,643
Total Firm Sales	37,547,000	37,721,277	174,277
Surplus & Interruptible Sales	7,057,000	7,128,259	71,259
Total Rev. From Customers	44,604,000	44,849,536	245,536
Interdepartment Sales	2,596,000	2,472,669	(123,331)
Miscellaneous Revenue	213,000	194,944	(18,056)
Stanpac Dividends	199,000	199,000	-
Total Operating Revenue	$47,612,000	$47,716,149	$104,149

(Red Figure)

Because of the close agreement of the estimates, further discussion is not warranted and an adjusted gross revenue figure of $47,664,000 will be adopted.

GAS OPERATING EXPENSES

The record indicates that the operating expense estimates, before taxes, as presented by Company and Commission staff witnesses, were in substantial agreement. There were differences in individual items, some of which involved matters of principle. In respect to federal income taxes substantial differences exist in the estimates. A summary comparison of the estimates, along with the adopted figures for the year 1945, before taxes and depreciation, is as follows:

Item	Company 1945 Estimate (Exhibit 27A)	CRC Staff 1945 Estimate (Exhibit 42A)	Adopted
OPERATING EXPENSES			
Maintenance	$ 1,134,000	$ 1,047,500	$ 1,134,000
Production Operation:			
Cost of Purchased Gas	13,209,000	13,317,137	13,298,000
Other	311,000	305,800	306,000
Total Production Operation	13,520,000	13,622,937	13,604,000
Transmission Operation	379,000	477,000*	411,000
Distribution Operation	1,950,000	1,965,000	1,965,000
Customers' Acctg. & Collectg.:			
Total, excl. Uncollectibles	1,850,000	1,893,000	1,893,000
Uncollectibles	29,000	73,900	30,000
Total Cust. Acctg. & Coll.	1,879,000	1,966,900	1,923,000
Sales Promotion	501,000	494,500	495,000
Administrative & General:			
General & Administrative	1,251,000	1,199,100*	1,265,000
Insurance	71,000	70,900	71,000
Injuries & Damages	97,000	97,200	97,000
Pensions	436,000	298,000	298,000
Total Admin. & General	1,855,000	1,665,200	1,731,000
Total Operating Expenses, excl. Taxes and Depn.	$21,218,000	$21,239,037	$21,283,000

* If adjusted for transfer of $66,000 of gas dispatchers' salaries, to conform to the Company's treatment, these estimates become: transmission operation, $411,000, and general and administrative, $1,265,000.

While the record indicates that the Commission staff's estimate for maintenance appears reasonable for what will actually have been expended in 1945, yet maintenance expenditures have been subnormal during the war period and the amount claimed by the Company will be allowed. This treatment looks to the future.

Under administrative and general expenses there was a difference of opinion as to the method of handling dues, donations, subscriptions and contributions. The Commission staff's estimate will be increased by $20,000 for these items.

Pensions

Pension costs are divided into two parts: current service and past service. Since January 1, 1937, when the Company's present retirement plan became effective, the full costs in respect to current service have been covered by actuarially determined payments to the underwriters, with the employees paying a portion of such cost. For service prior to 1937 the Company has undertaken to pay past-service pensions, without cost to the employees. From 1916 to 1936, Pacific Gas and Electric Company had a non-contributory pension plan, financed on the pay-as-you-go basis.

The Company's pension consultants estimated that a reserve of $14,588,000 as of January 1, 1937, earning 3½ per cent interest, would be adequate to pay all past-service pensions. The Company established a pension reserve of $3,000,000 as of December 31, 1936 by transfer of that amount of excess federal income tax accruals. The reserve has since been built up, from such sources as excess tax accruals, tax savings from bond refundings and gas rate refunds, nonrecurring electric department earnings, and accruals in lieu of interest, to a balance of $8,063,254 as of December 31, 1944.(3) Witnesses for both the Company and the Commission staff estimated the reserve requirement to be approximately $13,000,000 at the end of 1944, based on 3½ per cent interest.

(3) The Commission has since authorized further transfers of tax savings from bond refundings to increase the pension reserve balance to approximately $12,500,000.

Accruals of about $500,000 per year (approximating $3\frac{1}{2}$ per cent interest on $14,588,000) have been credited to the reserve each year. Such accruals were charged to operating expense until August, 1943, since which time they have been charged to "other interest charges" in accordance with a letter of instruction from this Commission. Since the pension reserve was established, past-service pension payments have been charged to it.

The Company witness' estimate of gas department pension expense for 1945 included $290,000 for current service and $146,000 for past service. The Commission staff estimated current service expense at $298,000, but excluded the past-service accrual. The Company's claims do not give recognition to the earnings of the pension reserve. This reserve has been invested in the Company's assets, and the Company's return on its total investment, as shown by its own exhibits, is considerably greater than the assumed $3\frac{1}{2}$ per cent interest.

Inasmuch as the claimed item of expense for past-service pensions in the fixing of this Company's rates will no longer exist, now that the funding of its pension reserve has been completed, the staff's estimate will be used.

Depreciation Expense

There is but small difference in the estimates as to the annual depreciation requirements. Both estimates reflect the use of the sinking fund method, predicated on lives for each capital group and with interest at 6 per cent per annum. A summary comparison of the respective estimates as finally made for the year 1945 is as follows:

Annuity for	Company	CRC Staff	Adopted
Depreciable Capital as of December 31, 1944	$2,390,565	$2,326,805	$2,326,805
Capital Adjustments	(9,158)	(8,362)	(8,362)
Estimated Net Average Additions 1945	58,781	57,871	57,871
Pro Rata Common Plant	84,391	81,217	81,217
Defense Projects	-	70,358	---
One-half Stanpac Line - Gas Operations	36,500	30,092	30,092
Total Gas Department Estimated 1945	$2,561,079	$2,557,981	$2,487,623
		Used	$2,488,000

(Red Figure)

From the record it appears unnecessary for the year 1945 to provide other than the normal annuity for defense plant projects and the normal accrual will be used. The other principal difference results from using a slightly longer life for transmission mains and the evidence supports this longer life.

It is our conclusion that the depreciation expense required by the gas department on the 6 per cent sinking fund basis is not more than $2,488,000 for the year 1945.

Attention should be directed to the fact that the above allowance includes about $215,000 for standby manufacturing gas plants upon which the depreciation will become fully accrued during the year 1946.

It is believed that, while a 6 per cent interest rate has been used in determining the sinking fund annuity for the estimated year 1945, the Company should adopt a 5 per cent interest rate for accruing the depreciation on its books effective January 1, 1946, and likewise make appropriate adjustments, subject to review by the Commission, as to the lives used in setting up the annuities.

Taxes

During the year 1944, taxes assigned to the gas department, as recorded by the Company, amounted to $13,695,363 or 28.6 per cent of the gross revenue. The 1945 estimate of the Company was $14,706,000 or 30.9 per cent of gross revenue and that of the Commission staff $13,944,700 or 29.2 per cent of the gross revenue. In each of the above periods, federal income and excess profits taxes amounted to more than three-fourths of the total taxes. The 1945 estimates for all other taxes total $3,244,000 as made by the Company, and $3,241,100 as estimated by the Commission staff.

Substantial differences developed between the Company and Commission staff in the computation and allocation of federal taxes on income. The principal causes of these differences were: (1) differences in the estimates of revenues and expenses, (2) different treatment of certain income and expense items which are not recognized in like amounts in both the rate of return and income tax computations, (3) differences in allocation percentages, and (4) use of different amounts for excess profits credit and exempt income from natural gas transportation. The greater part of the over-all difference in the tax estimates is due to the last three causes.

As to the items treated differently for income tax and rate fixing, the Company took the position that the tax effects of nonoperating income, other income deductions, and charges excluded from operating expense should not be reflected in taxes assignable to the operating departments. After considering the problem the Commission believes that, as a general rule, nonoperating income and expenses and amounts recognized as tax deductions but excluded from operating expenses in determining rate of return should not affect the amount of taxes assignable to utility operations. However, there are certain such items which are properly reflected in the computation of income taxes, the largest of which is bond interest. It appears that the treatment of bond discount and expense and tax savings resulting from bond refundings warrants further consideration.

Other tax differences between the Company and Commission staff relate to the excess profits credit and the amount of exempt income from natural gas transportation under Section 735 of the Revenue Code. The Collector of Internal Revenue had, early in 1945, notified the Company of tax deficiencies for the years 1942 and 1943, based, among other things, upon the contention that the excess profits credit claimed was too high. The Company conceded certain items but contested others involving approximately $1,636,000 of excess profits credit for the Company as a whole. The case is now before the Tax Court.

In his computations, the Commission staff witness used as excess profits credit the amount claimed by the Company before the Tax Court, and for exempt income under Section 735, $500,000. The Company witness, on the other hand, assumed a 50-50 settlement in the Tax Court, and $250,000 for Section 735 exempt income.

In oral argument, counsel for the Company repeated a stipulation he had made during the course of the hearings. It is quoted below:

> "I stated several times during the course of this proceeding the Company has no desire to make a profit from its tax accruals; neither does it desire to suffer a loss. Premised on the Commission's acceptance of the Company's treatment on the items of Section 735 and the base period credit in the computation of taxes for its Gas Department, year 1945, it stipulates that if accruals for taxes made by the Company as respects these two items shall be in excess of its liability as finally determined the amount of such excess accrual will be credited to the Company's pension reserve for past service benefits, or be subject to disposition in manner as this Commission may direct."

In view of the stipulation made by counsel, we shall adopt the Company's estimates for excess profits credit and Section 735 exempt income in computing federal taxes on income for the estimated year 1945.

A revised estimate of taxes on income for the year 1945, based upon the revenue and expense figures adopted for this decision and reflecting the Company's assumptions as to excess profits credit and exempt income under Section 735 of the Revenue Code, is set forth in the following tabulation. In allocating the income and excess profits taxes to departments, the required allocation factors have been developed by using for the gas department the figures adopted herein and for other departments the Company's 1945 estimates, adjusted in certain instances to correspond with the amounts adopted for the gas department. The tabulation presents a comparison of the Company and Commission staff estimates and the adopted tax figures for the year 1945.

Class of Tax	Company 1945 Est. (Ex. 27A)	CRC Staff 1945 Est. (Ex. 42A)	Adopted
Fed. Excess Profits Tax	$ 9,592,000	$ 8,396,500	$9,480,000
Fed. Normal and Surtax	1,870,000	2,307,100	1,815,000
Fed. Capital Stock Tax	202,000	202,900	203,000
State Corp. Franchise Tax	581,000	570,600	572,000
All Other Taxes	2,461,000	2,467,600	2,467,000
Total Taxes	$14,706,000	$13,944,700	$14,537,000

It may be observed that the $14,537,000 becomes $9,077,000 under the 1946 federal tax rates.

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NET REVENUE AND RETURN

In the following tabulation there are brought together the basic figures heretofore presented, along with the estimated net revenue and rate of return for the year 1945.

Item	Company Estimate	CRC Staff Estimate	Adopted
OPERATING REVENUE	$ 47,612,000	$ 47,716,149	$ 47,664,000
OPERATING EXPENSES			
Total Oper. Expenses Excl. Taxes & Depreciation	21,218,000	21,239,037	21,283,000
Taxes, Excl. Fed. Income	3,244,000	3,241,100	3,242,000
Taxes, Federal Income	11,462,000	10,703,600	11,295,000
Total Taxes	14,706,000	13,944,700	14,537,000
Depreciation	2,561,000	2,557,981	2,488,000
Total Oper. Expenses	38,485,000	37,741,718	38,308,000
NET REVENUE	9,127,000	9,974,431	9,356,000
RATE BASE			
Average Year	$152,623,000	$147,531,000	$149,000,000
RATE OF RETURN(4)	5.98%	6.76%	6.28%

For the year 1944 the adjusted rate of return as computed by the Company is 5.95 per cent and that by the Commission staff 6.55 per cent.

COST OF MONEY

Testimony and exhibits pertaining to the cost of money were introduced by both the Commission's staff and the Company. The cost submitted may be summarized as follows:

Item	Commission Witness (1)	Commission Witness (2)	Company Witnesses
Bonds	3.00%	3.42%	3.86%
Preferred Stock	6.11	6.11	6.25
Reserves	6.00	6.00	6.00
Weighted Average	4.57%	4.80%	5.08
Common Stock Equity	-	-	9.23
Weighted Average	-	-	6.22%

In arriving at the percentage expressed for bond money in Column 1, the Commission witness took into consideration the expenses incurred in con-

(4) If a modified sinking fund method be used by deducting the depreciation reserve and augmenting the depreciation annuity by interest on the reserve at 6 per cent, the rate of return on the staff's estimate is 7.19 per cent and the 6.28 per cent on the adopted basis becomes 6.43 per cent.

nection with the issue of the then outstanding bonds, the discounts incurred and premiums received by the Company; while in Column 2 he considered, in addition, the redemption premiums and the balance of the unamortized discount and expense at the time of payment, which pertained to redeemed issues formerly outstanding but which premium, discount and expense are being amortized by the Company by charges to income over the lives of the bonds now outstanding. The percentage for preferred stock was determined by the Commission witness by considering the amount of stock discounts and premiums actually set up on the Company's books.

The Company's witness developed his cost of 3.86 per cent for bond money and 6.25 per cent for preferred stock money by including in his calculations duplicate interest incurred during refunding operations, bond discount, expense and premium heretofore written off, unamortized bond discount, expense and premiums on bonds redeemed, preferred stock discount and expense of predecessor companies, and other items.

The percentage of 9.23 urged by the Company's witness for common stock equity was derived through the use of the so-called earnings-price ratio method, whereby earnings per share for common stock outstanding, as reflected by the income accounts, are related to the average market price of such stock over a period of years, the weighted average of such annual ratios being adjusted for financing costs estimated at 6 per cent. The calculation, according to the Company's witness, is "merely an effort to establish what a common stockholder expects in the way of return on his investment, based on the market price he is willing to pay." On or about June 1, 1945, the Company's common stock was selling on about a 5 per cent basis.

Based on the over-all average percentage cost of capital of 6.22 per cent developed by the Company's witness, it is urged that the Commission should recognize a return of from 6.2 per cent to 6.3 per cent for the Company as a whole, and a return of 6.5 per cent for the gas department considered alone.

The Company's claims as to return required cannot be allowed as they are at variance with the facts. Proper consideration will be given to the Company's financial experience and requirements in arriving at our conclusions.

FUTURE TRENDS

Since the rate changes resulting from this proceeding will be effective in the future, it is important to view briefly some of the changes in earnings which may be anticipated. We take judicial notice that the close of the Pacific war came earlier than was generally expected, thereby advancing the reconversion from a war to a peacetime economy, and also of the tax change herein mentioned. There is testimony on all these subjects in the record, although no one ventured to predict when the war would end or the extent to which taxes would be reduced.

The trend in revenue from sales to domestic and commercial customers is still upward. Indications point to a continued growth in population and in the number of customers served. On the other hand, certain industrial gas sales used in military and war production establishments are being decreased and will be further curtailed and, in some instances, stopped altogether. The record shows, however, much of the curtailed service applies to low-rate revenue loads and, after giving consideration to the savings in cost of gas purchased and in taxes, the effect on net revenue will be small. Similarly, new business that is replacing this loss carries a much higher rate and results in a proportionately higher net earning. In addition, there will be a substantial decrease in interdepartment sales for electric generation as more fuel oil becomes available. This will also result in loss of a low-earning revenue load, inasmuch as this class of sales is at a low rate.

Testimony was adduced that over a longer term period there may be a decline in the low rate sales to the larger industries on a surplus or interruptible basis in order to conserve better the gas supply for the general service and firm industrial customers.

After considering the many factors that will affect the trend in gas revenues, it is our view that though there may be some minor periods of decline, the general trend is upward for firm gas service (predicated on present rate levels). There should be but small change in industrial sales on a surplus basis in the more immediate future.

Operating expenses, exclusive of taxes, in the future will be sharply higher. While the 1945 estimates provide for some pay roll increases, the Company's personnel director outlined the possibility of further increases in labor costs. The Company also has the problem of taking care of the returning veterans and reestablishing them in their proper positions in the organization.

The Company is also faced with an increase in maintenance costs, due in part to deferment during the war period. This is especially true in reference to meters and to a lesser extent for gas mains. The return of the Standard-Pacific gas pipe line from oil transport service during the war will eliminate the earnings from the present lease arrangement and will likewise require the restoration of maintenance costs applicable to the line. Use of larger quantities of oil in the steam-electric generating plants will decrease the credit from the handling of such gas, and it is expected that there will be a loss in gas transport revenues.

The field cost of gas to the Company will be higher when the Office of Price Administration removes its restrictions. However, this change will be offset initially by a concurrent increase in the industrial gas sales rates in accordance with fuel oil clauses in each such tariff. In addition, the basic or floor price of gas paid to producers has been increasing.

There are, however, two very important factors tending to increase substantially the net operating revenue: first, the elimination of depreciation expense on the standby gas plant investment of approximately 9 million dollars; second, the new tax law, whereby the excess profits and capital stock taxes are eliminated and normal and surtax reduced to 38 per cent, became effective January 1, 1946.

After considering that there will be increases in the types of expense shown above in the near future, it is concluded these increases will be more than outweighed by the savings in taxes and that a greater net revenue may be expected in 1946 than is apparent in the figures shown herein for 1945.

EARNINGS OF OTHER DEPARTMENTS

The present proceeding being one involved with rates for gas service, the Commission staff did not present estimates on the operations of other departments for the year 1945. The Company, however, presented such estimates for consideration on the basis that a gas rate reduction should not be considered which would adversely affect the Company's over-all earnings. The following table presents the estimates for the other departments, the electric department, of course, being by far the largest, although the steam and water departments are included. The table shows: first, the estimates as presented by the Company; second, an adjustment to the Company's rate base to exclude the "excess costs" claimed by the Company; and third, a further adjustment to show taxes modified to the basis of the new tax law.

Item	(1) Company Estimate	(2) Company Est. (Excl. Excess Costs)	(3) Same as (2) but using 1946 Tax Rates
Revenues	$112,721,000	$112,721,000	$112,721,000
Expenses	37,590,000	37,590,000	37,590,000
Depreciation Annuity	7,571,000	7,571,000	7,571,000
Taxes	34,041,000	34,041,000	25,475,000
Net Revenue	33,519,000	33,519,000	42,085,000
Rate Base	$667,803,000	$635,605,000	$635,605,000
Rate of Return	5.0%	5.3%	6.6%

The above net earnings and rate of return should not be taken as indicative of the probable 1946 earning level inasmuch as only one item of expense has been adjusted, namely taxes, and that downward. There are other items of expense that will be sharply upward. Likewise, there has been no adjustment in revenues.

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CONCLUSIONS

Considering the entire record in the proceeding, it is concluded that a reduction in gas rates is justified. In making the reduction hereinafter ordered, the Commission has considered the sharply rising levels of operating costs as well as many of the uncertainties of the future. It is our opinion, for the purpose of this decision, that a rate reduction lessening gross revenue by not less than $3,500,000 should be made. Such a reduction, in our opinion, will leave the Company in an earning position sufficient to meet its financial requirements, and will provide not less than a reasonable return on the fair value of its gas properties devoted to and necessary for the rendering of public utility gas service.

SPREAD OF RATES BETWEEN AREAS AND SCHEDULES

In a prior decision (Cases No. 4621 and 4622, Decision No. 36082) relating to the gas tariffs of the Pacific Gas and Electric Company, certain definite basic rate structures and a plan for rate zoning were adopted. The principles set forth at that time will be carried forward in this decision. The earning level of the San Joaquin Power Division appears to be fairly comparable with that of the remaining system.

Fairly extensive testimony was presented by both the Commission and Company witnesses on this subject. The record shows that the Company's witness was in general accord with the principle of the plan outlined by the Commission's witness. The Commission's witness, in making his recommendations, indicated that a part of any rate reduction might be made in the form of discount rates. Having in mind the changed conditions as well as the magnitude of the reduction, it is our view now that a discount form of rate is unnecessary. After giving careful consideration to the record and inherent conditions relative to these matters, it is our conclusion that the following treatment of the various classes of service is fully warranted and that the resulting rates will be reasonable.

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General Service (G - Schedules)

General service tariffs provide for both base and effective rates. The following tabulation indicates the base rates to be ordered in the decision that are applicable to each of the six principal rate zones. In addition three localities heretofore omitted in the master zoning plan are now included. These comprise Bakersfield (3.2 zone), Eureka-Arcata (4.3 zone), and Willows (5.3 zone). These base rates are predicated upon a service of natural gas having a heating value of 1100 Btu per cubic foot. In addition, for all use in excess of 20,000 cubic feet per month, except for the new 3.2 zone, the effective rates are geared to the posted price of fuel oil.

Zone No.	Description*	First 300 Cu.Ft. or Less: Inc.	First 300 Cu.Ft. or Less: Uninc.	Base Rate - Cents per 100 Cu.Ft.: Next 2,200	Next 7,500	Next 10,000	Next 80,000	All Over 100,000
1	San Francisco & Daly City.	$0.65	$ -	3.8¢	3.7¢	3.6¢	3.5¢	3.2¢
2	East Bay Cities.	.70	.80	3.9	3.8	3.6	3.5	3.2
3	Cities of 50,000 to 100,000 Population: Sacramento, Stockton, San Jose, Richmond, El Cerrito, San Mateo, Burlingame.	.75	.85	4.2	3.9	3.6	3.5	3.2
3.1	Fresno.	.68	.85&.90	4.6	3.9	3.6	3.5	3.2
3.2	Bakersfield.	.70#	.85#	6.25ϕ	4.2	3.75	3.65	2.6
4	Cities of 5,000 to 50,000 Population: South San Francisco, Hayward, Petaluma, San Rafael, Salinas, Vallejo, Monterey.	.80	.90	4.5	4.1	3.7	3.5	3.2
4.2	Marysville, Chico.	.80	-	6.8	4.8	4.0	3.6	3.3
4.3	Eureka, Arcata.	.85	1.05	10.0	6.0	5.5	5.0	4.5
5	Cities and Towns under 5,000 Population: Sunnyvale, Fowler, Davis, Mill Valley, Sausalito, Carmel, Tracy.	.85	.95	4.8	4.3	3.8	3.5	3.2
5.2	Biggs, Colusa, Oroville.	.85	-	6.8	4.8	4.0	3.6	3.3
5.3	Willows.	.90	1.00	8.0	7.0	5.5	4.0	3.5
6	Rural Areas	-	1.05	5.0	4.5	4.0	3.5	3.2
6.2	Rural Areas (Special)	-	1.05	7.8	4.8	4.0	3.6	3.3

\# Minimum charge per meter per month. ϕ For first 2500 cubic feet.

* Population is but one of the factors considered in zone classification and is set down merely as a convenience for descriptive purposes. The cities and communities shown are not necessarily all-inclusive but serve merely as a guide to the class of areas included.

The effective rates, that will be ordered filed along with the base rates, differ from the base rates to the extent that the heating value of gas served and the current price of fuel oil vary from the standards and as provided for in the rate controls affecting these two factors.

The Bakersfield area is assigned to Zone 3, along with Fresno, but due to the historical development of the rate, certain portions are lower than the Zone 3 rate and these are maintained through a sub-zone classification of 3.2. A heating value clause has been added. While the operation of such a clause in the future may either raise or lower the effective rates, yet actually there will be no change on the average in customer billing for total heating units of gas received. This change is found to be justified and reasonable.

In the Humboldt area, Arcata and Eureka are assigned to Sub-zone 4.3 and given material reductions. In addition, the Willows area, only recently cut over to natural gas, is placed in the 5.3 zone which will result in lower customer billings. The automatic heating value clause is incorporated in each of these new tariffs and the fuel oil clause is standardized.

The other principal change having to do with reclassification relates to the transfer of Richmond, Richmond Annex, El Cerrito, San Mateo and Burlingame from the No. 4 zone to the No. 3 zone.

In addition, Sub-zones 4.1, 5.1, and 6.1 are consolidated with each of their principal zones and Sub-zones 4.2, 5.2, and 6.2 have been maintained as to zone classification and the territory served but accorded the new base rates as set forth. Likewise, certain portions of rural Zone No. 6 areas, that are adjacent to cities, and that have grown in density so as to qualify for reclassification, have been assigned to the appropriate zone level for built-up unincorporated areas. Each of these changes has resulted in lower rates and the allowance for these reductions has been made.

The territory served under each of the new tariffs that will be ordered shall be the same as specified in the presently effective general service tariffs, except for the incorporation of the territorial modifications hereinbefore discussed.

As this general service group represents the backbone of the Company's gas business, accounting for over 99 per cent of the customers served, substantially all of the reduction has been accorded to this group. In total amount this represents approximately $3,485,000, and when these rates become effective, customer billings on the average will be reduced approximately 10.3 per cent.

Firm Industrial Service (G-40 Schedules)

Proposals were made by the Company that would combine the firm industrial and general service schedules into a single schedule. While the plan has some advantages, it is believed more desirable to maintain the currently effective series of G-40 schedules for firm industrial service. As these schedules are now filed, the first 100,000 cubic feet per meter per month must be computed from the rates of the applicable general service schedules. If the charge for this amount of gas could be shown on the schedules, it would lead to an easier application of the schedules. In this respect, either the average rate should be shown or the dollar amount inserted for the first 100,000 cubic foot consumption.

Commercial Building Heating Service (CH Schedules)

This service is used essentially by the larger apartment houses, theaters, and medium-sized hotels. The schedule is a two-part rate made up of a fixed charge based upon burner capacity and a sliding scale commodity rate. The record before us is strong in substantiating the elimination of the last commodity block rate, as that rate is not only below the actual cost of rendering the service, but is also lower than the terminal block rate on the interruptible schedules. At the present time the effective terminal CH rate for San Francisco is 15.2 cents per Mcf. Inasmuch as this service is not subject to discontinuance and reaches its maximum use in the winter season, it is clear that the rate is much too low. The original commercial building heating schedules were introduced in the early period of the natural gas development, when gas was vented to the air and the utility had considerable excess in transmission line capacity.

It is of record that if such terminal block rates are removed, there will result an estimated average increase of about 3 per cent. To large users, however, the increase would be greater. While we conclude that the commercial building heating rate is too low, yet because this group of customers was not specifically notified that evidence relating to increases as well as decreases in rates would be received, we are of the opinion that no action raising rates should be taken at this time.

Interruptible Gas Service (GI Schedule)

The record stands as suggesting the elimination of the third block in this series of schedules. In view of the fact that the whole industrial rate situation, including the gas sold under the surplus tariffs, will come under review in another proceeding, it is believed unwise to make material changes now that might interfere with a more comprehensive plan. The Order herein will not provide for the elimination of the third block but will provide a reduction of 2½ cents in the base rate of that block (except Schedule GI-60) with an appropriate change downward in the effective rate. The estimated reduction is $5,000.

Agricultural Power Service

This service at the present time is limited to the San Joaquin Power Division and is supplied under Schedules No. G-44, G-45 and G-46. It is of record that there are but nine customers served.

The representatives of the California Farm Bureau Federation asked that these tariffs, or their equivalent, be extended throughout the territory in which the Company renders natural gas service. Such a uniform practice is held warranted and the Order will so provide.

Resale Service

The Company renders wholesale gas service to the City of Palo Alto in accordance with the rates and conditions of a special contract which does not expire until April 22, 1947. At the hearing the city filed a letter memorandum urging that it should participate in any rate reduction ordered. Having in mind the background of the rate, it does seem appropriate that a new and lower contract rate should be worked out between the two parties. In this instance, considering that this is a resale service, it seems that a reduction of about 7 per cent would not be unreasonable. Such a reduction would amount to approximately $12,000.

ORDER

A public hearing having been held in the above proceeding, the matter having been submitted for decision, and the Commission being fully advised in the premises,

IT IS HEREBY FOUND AS A FACT that the rates now being charged by Pacific Gas and Electric Company for its natural gas service, in so far as they differ from the rates herein established, are unjust and unreasonable rates for the future, and that the rates and special conditions herein established are just and reasonable, and basing this Order upon the foregoing findings of fact and upon the factual findings contained in the foregoing opinion,

IT IS HEREBY ORDERED that Pacific Gas and Electric Company shall file on or before February 20, 1946, and to become effective with meter readings taken on and after February 28, 1946, the appropriate revised rate tariffs herein and hereby established as follows:

1. General Service (G Schedules) incorporating the new base rates and reclassified zoning as set forth in the Opinion, along with the corresponding new effective rates. In reference to new Zone 3.2 for Bakersfield, the filing shall be in accordance with the rates and special conditions set forth in Exhibit A attached hereto and made a part of this Order.

2. Firm Industrial Service (G-40 Schedules) incorporating the dollar amount or the average rate for the first 100,000 cubic feet of consumption.

3. Interruptible Gas Service (GI Schedules) reducing the third block (1,750,000 cubic feet), except on Schedule No. GI-60, by 2½ cents per thousand cubic feet.

4. Gas Engine Agricultural Power Service incorporating the three tariff schedules in accordance with those set forth in Exhibit B attached hereto and made a part of this Order.

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IT IS HEREBY FURTHER ORDERED that Pacific Gas and Electric Company shall charge and collect at and in accordance with the schedule of rates ordered filed herein for all gas service rendered thereunder and effective with the meter readings taken on and after February 28, 1946.

The Secretary shall cause a certified copy of this Order to be served upon the Pacific Gas and Electric Company and this Order shall become effective twenty (20) days after such service.

Dated at San Francisco, California, this 23rd day of January, 1946.

R. Harold Anderson
Justus F. Craemer
Franklin Davis
Ira H. Rowell
Harold P. Huls

EXHIBIT A

General Service
Schedule G-3.2A

Bakersfield

SCHEDULE G-3.2A

GENERAL SERVICE

NATURAL GAS

Applicability:

Applicable to domestic and general service of natural gas for cooking, water heating, space heating and other domestic and commercial uses.

Territory:

Within the incorporated city limits of Bakersfield and adjacent unincorporated territory.

Rate:

		Base Rates	Effective Rates
First	2,500 Cu.ft./meter per mo.	6.25¢ /100 Cu.ft.	6.00¢ /100 Cu.ft.
Next	7,500 Cu.ft./meter per mo.	4.20¢ /100 Cu.ft.	4.03¢ /100 Cu.ft.
Next	10,000 Cu.ft./meter per mo.	3.75¢ /100 Cu.ft.	3.60¢ /100 Cu.ft.
Next	80,000 Cu.ft./meter per mo.	3.65¢ /100 Cu.ft.	3.50¢ /100 Cu.ft.
All Over	100,000 Cu.ft./meter per mo.	2.60¢ /100 Cu.ft.	2.50¢ /100 Cu.ft.

Minimum Charge:

Per meter per month:

Incorporated territory	$ 0.70
Unincorporated territory	.85

The effective rates are based on an average monthly heating value of 1050 B.t.u. per cu. ft.

Special Condition:

The above base rates for natural gas are subject to an adjustment of 4% for each 50 B.t.u. change in the heat content from the base of 1100 B.t.u. and as set forth in Rule and Regulation No. 2.

EXHIBIT B

Gas Engine Agricultural Power Service

Schedules G-44, G-45, and G-46

SCHEDULE G-44

GAS ENGINE AGRICULTURAL POWER SERVICE

NATURAL GAS

Applicability:

Available, upon application, to customers located along existing mains having a delivery capacity in excess of the then existing requirements of domestic and commercial customers for natural gas of a heating value of 1050 to 1150 B.t.u. per cubic foot, used in gas engines for agricultural power service.

Territory:

Applicable in the entire territory served by the Company with natural gas of a heating value of 1050 to 1150 B.t.u. per cubic foot, except in the Bakersfield District of the San Joaquin Power Division.

Rate:

First	12,600 cu. ft. per hp. per year	38.2¢ per 1000 cu. ft.
Next	12,600 cu. ft. per hp. per year	23.8¢ per 1000 cu. ft.
All over	25,200 cu. ft. per hp. per year	17.2¢ per 1000 cu. ft.

Minimum Charge:

May to October, inclusive	$5.00 per meter per month
November to April, inclusive	$1.00 per meter per month

Special Conditions:

(1) For the purpose of this schedule, the horsepower of engine capacity will be determined by manufacturer's rating, or at the option of the Company, by test or estimate.

(2) Under this schedule the agricultural or service year shall commence with the regular meter reading in April and end with the regular meter reading taken in April of the succeeding year.

(3) Minimum charges for twelve months continuous service are to be accumulated, and will be $36.00 per year.

(4) Customers served under this schedule have priority in the use of gas over customers served under industrial schedules carrying lower rates, at times when there may be insufficient gas to supply demands of all customers.

(5) Service to domestic, commercial and essential industrial customers, and service to other public utilities, have priority over service under this schedule in case of a shortage of gas.

SCHEDULE G-45

GAS ENGINE AGRICULTURAL POWER SERVICE

NATURAL GAS

Character of Service:

This schedule is available, upon application, to customers located along existing mains having a delivery capacity in excess of the then existing requirements of domestic and commercial customers for natural gas of a heating value of 925 to 1100 B.t.u. per cubic foot, used in gas engines for agricultural power service.

Territory:

This schedule is applicable in Bakersfield District of San Joaquin Power Division.

Rates:

Annual Consumption:

First	12,000 cu. ft. per hp.............	35¢ per 1000 cu. ft.
Next	12,000 cu. ft. per hp.............	21¢ per 1000 cu. ft.
All over	24,000 cu. ft. per hp.............	15¢ per 1000 cu. ft.

Minimum Charge:

May to October, inclusive........................$5.00 per meter per month.
November to April, inclusive......................$1.00 per meter per month.

Special Conditions:

(1) For the purpose of this schedule, the horsepower of engine capacity will be determined by manufacturer's rating, or at the option of the Company, by test or estimate.

(2) Under this schedule the agricultural or service year shall commence with the regular meter reading in April and end with the regular meter reading taken in April of the succeeding year.

(3) Minimum charges for twelve months continuous service are to be accumulated, and will be $36.00 per year.

(4) Customers served under this schedule have priority in the use of gas over customers served under industrial schedules carrying lower rates, at times when there may be insufficient gas to supply demands of all customers.

(5) Service to domestic, commercial and essential industrial customers, and service to other public utilities, have priority over service under this schedule in case of a shortage of gas.

SCHEDULE G-46

GAS ENGINE AGRICULTURAL POWER SERVICE

NATURAL GAS

Applicability:

Available, upon application, to customers located along existing mains having a delivery capacity in excess of the then existing requirements of domestic and commercial customers for natural gas of a heating value of 950 to 1050 B.t.u. per cubic foot, used in gas engines for agricultural power service.

Territory:

Applicable in the entire territory served by the Company with natural gas of a heating value of 950 to 1050 B.t.u. per cubic foot, except in the Bakersfield District of the San Joaquin Power Division.

Rate:

First 14,000 cu. ft. per hp. per year..............34.5¢ per 1000 cu. ft.
Next 14,000 cu. ft. per hp. per year..............21.6¢ per 1000 cu. ft.
All over 28,000 cu. ft. per hp. per year..............15.5¢ per 1000 cu. ft.

Minimum Charge:

May to October, inclusive..............................$5.00 per meter per month
November to April, inclusive..............................$1.00 per meter per month

Special Conditions:

(1) For the purpose of this schedule, the horsepower of engine capacity will be determined by manufacturer's rating, or at the option of the Company, by test or estimate.

(2) Under this schedule the agricultural or service year shall commence with the regular meter reading in April and end with the regular meter reading taken in April of the succeeding year.

(3) Minimum charges for twelve months continuous service are to be accumulated, and will be $36.00 per year.

(4) Customers served under this schedule have priority in the use of gas over customers served under industrial schedules carrying lower rates, at times when there may be insufficient gas to supply demands of all customers.

(5) Service to domestic, commercial and essential industrial customers, and service to other public utilities, have priority over service under this schedule in case of a shortage of gas.