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ORIGINAL

Decision No. 51361

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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| In the Matter of the Application of SOUTHERN COUNTIES GAS COMPANY OF CALIFORNIA for a general increase in gas rates under Section 454 of the Public Utilities Code. |)))))) | Application No. 35742 (Second Supplemental) |
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(Appearances and list of witnesses at the hearing
 on this Second Supplemental Application are set
 forth in Appendix A)

OPINION ON SECOND SUPPLEMENTAL APPLICATION

By its second supplemental application filed in the above-entitled proceeding January 14, 1955, Southern Counties Gas Company of California seeks authorization to increase gas rates to produce additional annual gross revenues of \$2,365,000, or 4.3 per cent of present revenues, because of further pending increase in the cost of out-of-state natural gas to become effective April 15, 1955. Applicant's present rate levels, pursuant to our Decision No. 47991, contain an offset amount for out-of-state gas cost increases placed into effect by the El Paso Natural Gas Company on January 1, 1953. The offset increases are subject to refund if the Federal Power Commission does not finally authorize the full out-of-state gas cost

increases being assessed by El Paso Natural Gas Company and requires El Paso to make refunds to its customers.^{1/}

Public Hearing

Public hearing on this matter was held on a consolidated record with Second Supplemental Application No. 34975 of Southern California Gas Company before Commissioner Ray E. Untereiner and Examiner Manley W. Edwards on February 4, 24 and 25, and March 11, 1955 at Los Angeles. The matter was taken under submission on March 11 and now is ready for decision.

Applicant's Position

Applicant requests that beginning April 15, 1955 an additional offset charge of 2.9 cents per Mcf be added to its rates for firm retail service and to its rate for wholesale service in order to offset the increase of the monthly demand charge from \$1.62 to \$2.00 per Mcf of contracted daily demand and the increase of commodity charge from 16 cents to 18 cents per Mcf of purchased out-of-state gas. Based on El Paso gas deliveries at 100 per cent load factor at the current contract rate of 178,280 Mcf per day at a pressure of 14.73 psi, total annual

^{1/} With regard to the January 1, 1953 increase, the Federal Power Commission, on November 26, 1954, issued its Opinion No. 278 fixing rates of El Paso Natural Gas Company in Docket No. G-2018 and ordered certain refunds to customers of El Paso, including Southern Counties Gas Company of California. Thereafter, on December 13, 1954, El Paso filed an application asking for a stay of Opinion No. 278, and requested a rehearing. On December 22, 1954, the Federal Power Commission granted a stay and rehearing but no date was set therefor. On October 14, 1954, El Paso filed a further application for increased rates, F.P.C. Docket No. G-4769. The El Paso Natural Gas Company has moved, under Section 4 (e) of the Natural Gas Act, to place these rates in effect, subject to refund, on April 15, 1955. Pursuant to the terms of the Natural Gas Act, it is mandatory that this motion be granted.

purchases from El Paso would be 65,072,000 Mcf and the resulting increase in the annual cost of gas would amount to \$2,090,000, or 3.21 cents per Mcf, on a volumetric basis. However, applicant expects to take slightly less gas than this amount in 1955, or 64,729,000 Mcf, at an increase estimated at \$2,083,000.

Under the agreement between the applicant and Southern California Gas Company approved by the Commission in Decision No. 50718, the total cost of all gas purchases by the two companies is adjusted so that the same average price is borne by each. In light of the fact that the contractual purchases by Southern Counties Gas Company of California from El Paso Natural Gas Company are less than its proportionate use thereof, the effect of this agreement is to increase the above-indicated annual increase in the cost of gas to applicant by \$282,000, with a corresponding decrease to Southern California Gas Company. Reflecting this adjustment, the net increase in the cost of purchased gas to applicant, as set forth in the application, is \$2,365,000.

Applicant's basic position is that its present level of earning is not sufficient to absorb the increased cost of out-of-state gas without the offset increase requested in this application.

Earning Position

Applicant presented supplemental testimony and details of its current earning position by Exhibits Nos. 23 and 23-A. The Commission staff analyzed applicant's showing, cross-examined its witnesses, and presented a revised 1955 pro forma estimate of

applicant's operations by Exhibit No. 28. The two estimates for 1955 are set forth below:

| | <u>Applicant's 1955 Pro Forma Estimate Exhibit No. 23</u> | <u>Applicant's 1955 Pro Forma Estimate as Revised by Staff Exhibit No. 28</u> |
|-----------------------------|---|---|
| <u>Operating Revenues</u> | | |
| Gas Sales | \$ 56,339,000 | \$ 56,426,000 |
| Other | 614,000 | 614,000 |
| Total | 56,953,000 | 57,040,000 |
| <u>Operating Expenses</u> | | |
| Production | 27,724,000 | 27,611,000 |
| Transmission | 958,000 | 943,000 |
| Distribution | 3,579,000 | 3,579,000 |
| Customers' Acctg. & Collec. | 2,943,000 | 2,865,000 |
| Sales, Promotion | 1,644,000 | 1,644,000 |
| Administrative & General | 2,637,000 | 2,638,000 |
| Cost Reallocation | 1,187,000 | 1,187,000 |
| Subtotal | 40,872,000 | 40,457,000 |
| Taxes - Ad Valorem | 3,031,000 | 2,900,000 |
| - Payroll | 181,000 | 216,000 |
| - On Income | 4,398,000 | 4,607,000 |
| Total Taxes | 7,610,000 | 7,723,000 |
| Depreciation Annuity & Int. | 2,525,000 | 2,525,000 |
| Total Oper. Exps. | 50,807,000 | 50,715,000 |
| Net Revenue | 6,146,000 | 6,325,000 |
| Rate Base (Depreciated) | 106,405,000 | 106,405,000 |
| Rate of Return | 5.78% | 5.94% |

In making the adjustments to applicant's 1955 pro forma estimate, the staff considered the number of inactive meters estimated by the applicant to be slightly high, based on recent ratios of inactive to active meters, and adjusted the revenue estimate upward by \$87,000. The production expense (cost of gas) was adjusted downward by \$113,000 to eliminate an increase in the cost of 3.2 billion cubic feet of gas from Rincon Field. Applicant's contract for this gas expired. A new contract was entered into by Pacific Lighting Gas Supply Company, at a higher price. It is not clear that applicant might not have had the gas at the same higher price. The \$113,000 represents the estimated difference between the cost to the Supply Company and its charge to the applicant.

Smaller adjustments were made in transmission and customers' accounting expenses. Ad valorem taxes were adjusted downward by \$131,000 by using the latest known tax rate of \$6.30 per hundred dollars of assessed valuation for the 1954-55 fiscal year rather than an estimate of the 1955-56 average tax rate. The state unemployment tax was adjusted upward by \$35,000 to reflect a 10-year average rate of one per cent rather than the current rate of three-tenths of one per cent.

These adjustments required an upward adjustment of \$209,000 in taxes on income, based on the current tax rates of 4 per cent state and .52 per cent federal. The resultant increase of \$179,000 in net revenue raised applicant's estimated rate of return from 5.78 per cent to 5.94 per cent.

Applicant did not contest, particularly, the staff's adjustments, except to point to a probable minimum wage increase in 1955 of \$200,000, due to a 3 per cent offer to the union, that was not included in the above estimates. The applicant did not choose to engage in extensive cross-examination of the staff because the 5.94 per cent rate of return was below the level of 6 per cent heretofore found to be reasonable by the Commission. Applicant's position is that it cannot earn a full 6 per cent return in 1955 and that it is in no position to absorb one dollar of the additional cost of El Paso gas beginning April 15, 1955; therefore it contends its proposed offset rates have been justified.

Rate Increase Proposal

Applicant proposed a 2.9 cents per Mcf increase for all firm service and for wholesale service to San Diego, but did not propose any increase for the interruptible service, Schedules Nos. G-50 and G-55. Its reason for not proposing any increase in

the rates for interruptible service is that the competitive price of fuel oil in its opinion does not permit it. Applicant introduced Exhibit No. 22 to show that currently the Pacific Coast inventory of residual fuel oil is approaching the level which preceded the major distressed oil market of 1949-1950 and the "going price" of residual fuel oil is some 20 to 30 cents or more below the posted price of \$1.85 per barrel. It expects further declines starting this spring and contends that any increase in the interruptible rates might cause an extensive switch in fuels for this class of business.

Rate Spread Discussion

San Diego Gas and Electric Company objected to the proposal to increase its rate by 2.9 cents per Mcf on the basis that this would result in loading that part of the increased cost of gas on San Diego which is incurred on account of applicant's sales to other interruptible customers, including deliveries to steam plants. Instead, San Diego contends that the rate increase should be based on cost-of-service studies wherein the cost of gas from several sources together with transmission costs, underground storage and other applicable changes in cost of gas from principal sources, are accounted for. San Diego contended that the appropriate increase would be 1.88 cents per Mcf based on such cost-of-service principle.

The applicant introduced testimony to show that the cost of competitive fuel oil in the San Diego area is higher than in the Los Angeles area. Accordingly, the applicant alleges that the San Diego Company's interruptible gas rates could stand the proposed increase of 2.9 cents per Mcf. Likewise, a witness for applicant pointed out that under the present offset rate San Diego's electric department pays only 21.15 cents per Mcf for steam plant gas, and that even with the 2.9 cents per Mcf additional offset the rate would be 1.42 cents per Mcf less than the cost of gas to Los Angeles Basin steam plants.

In support of applicant's proposal not to increase the interruptible rates the California Manufacturers Association introduced a cost-of-service study, Exhibit No. 25. By means of this study the association alleges that the general service and wholesale rates are presently below indicated costs to serve and the gas engine, firm industrial and interruptible rates are presently above indicated costs to serve.

The association opposed the proposed uniform increase per Mcf to the firm classes of service and suggested instead that the relative percentages of increases which were prescribed by the Commission in the original proceedings in Application No. 35742 be followed. It suggested the following class increases: general service 5.76 per cent, gas engine service 2.24 per cent, firm industrial service 1.72 per cent and San Diego Gas and Electric Company service 3.66 per cent.

The City of Los Angeles took the position that any rate relief granted the applicant in this proceeding should be only in such amounts as will probably permit applicant to earn a return within a reasonable range of the 6 per cent rate of return found reasonable in Decision No. 50902; and that any such rate relief granted be derived, insofar as competitive fuel oil prices may permit, from the application of additional uniform offset charges to the volumes of gas purchased by all of applicant's customers. It also took the position that the basis for fixing rates for interruptible customers should be essentially the value of the service as determined primarily by competitive fuel costs and it urged that the Commission give due consideration to assessing to the interruptible service as much of the fair share of any increases as may be warranted at this time.

The City pointed out that the Federal Power Commission in its Opinion No. 278^{2/} ordered a reduction in El Paso's demand charge from \$1.62 to \$1.10 per Mcf of contracted daily demand and

^{2/} See footnote 1.

an increase in the commodity charge from 16 cents to 16.94 cents per Mcf. It used these facts as an argument against the cost study of the association and brought out the fact that the findings would be different from those shown in Exhibit 25 if the final rates in Docket No. G-4769, as determined by the Federal Power Commission, vary in a material fashion from the rates as requested by El Paso.

The representative of the California Farm Bureau Federation voiced the opinion that the proposed offset rate and refund plan now before the Commission is fair to both the utility and the customers and merits favorable consideration. However, he held the view that the burden should be spread over all classes of customers with the possible exception of the interruptible service. With respect to interruptible service, he thought there would be more danger to the consumers which he represents if any part of the proposed increase were to be placed on interruptible rates than if no increase is made in such rates.

A customer's representative expressed concern over the possible adverse effect on the firm customers of an increase in interruptible rates under the present oil price situation. He also suggested that cost of service be given consideration in spreading any offset increase.

Refund Plan

By Exhibits Nos. 20 and 20-A, applicant set forth its proposed refund plan in the event refunds are required. Applicant states it proposes to determine the total refund from the difference between the total dollars collected under the offset rates, including refunds received from El Paso, and the total increase in the cost of gas purchased from El Paso not now reflected in base rates, plus the net cost of making refunds. Applicant outlines a

formula to determine a unit refund per Mcf used during the offset period.

Our conclusion on applicant's refund plan is that in general it is reasonable and acceptable but it needs changing because of the revised rate spread being authorized herein. Also, the estimated net cost of any probable refunding should be excluded in the initial calculations. The applicant may submit a plan for equitable disposition of the net balance of the actual cost of refunding not recovered from El Paso and any balance created by applicant's inability to deliver checks and by checks uncashed after one year. Moreover, the refund plan should provide for prorating sales, revenues and gas costs at the beginning and end of the periods involved.

The California Manufacturers Association points out that applicant in effect proposes that, regardless of the amount of refund it may eventually receive from El Paso in respect to gas purchased after April 15, 1955, its interruptible customers shall not participate in that refund. The association states that it is conceivable that the ultimate refund which the Federal Power Commission orders El Paso to make to applicant in respect of gas sold on and after April 15, 1955, will exceed the total of the new offset charges collected by applicant from its firm customers on and after that date. If and to the extent this takes place, the association holds it is only fair and equitable that the interruptible customers should participate ratably with the firm customers in the refund of any such excess. The Commission concludes that the position of the association is reasonable and that the refund plan of applicant should be modified accordingly.

The order will provide that the applicant shall file a refund plan with this Commission, and with each of the parties, within ninety days after the effective date of the Order, modified in accordance with the above. Any party may submit comments with respect to such revised refund plan to the Commission within fifteen days after the receipt thereof.

Conclusions

After considering the evidence of record and giving weight to the contentions of the various parties and objections by customers, it is concluded that applicant has justified its requested revenue increase.

The problem of spreading the needed increase in revenue among the various classes of applicant's customers is a difficult one. The most straightforward and obvious method would be to grant a uniform increase applying to all classes on a volumetric basis. This is the logical method in the absence of convincing evidence against it; and in addition it has a decided advantage in this case arising from the fact that the rates and the relationship between the demand and commodity components for out-of-state gas may be materially altered by the Federal Power Commission in its final decision.

We are informed and aware of the arguments in favor of a substantial differential in the rates charged as between firm and interruptible customers. The interruptible customers are required to be equipped to use alternate fuel at any time that gas is not available to them. As a consequence, they help provide an important and valuable stabilizing effect to the applicant's operations. They provide the demand during the off-peak seasons which enables applicant to contract with out-of-state suppliers for the large volume of gas delivered. There is no question that the firm customers are supplied at lower rates than would otherwise be possible as a result of the existence of the interruptible market.

A further result of the fact that the interruptible customers are prepared to use alternate fuels is that applicant is subject to competition in the sale of gas to these customers; and the interruptible rate must be established at a point which enables applicant to maintain its competitive position with respect to such other fuels, particularly fuel oils. There is some evidence in the record that the fuel oil market is at present importantly affected

by the presence of a surplus, as a result of which fuel oils have been offered to some large consumers at prices substantially below the posted price. In view of this situation, it is unlikely that applicant could increase the price per Mcf of its interruptible customers to the full extent of the increased price it must pay for out-of-state gas without losing an appreciable part of its interruptible market.

Despite these considerations, a careful review of the record is convincing that applicant did not make a showing which would justify the Commission in these proceedings in placing the full burden of the needed revenue increase on the firm customers. It has not been demonstrated that natural gas must compete entirely on a heat unit basis with alternate fuels. Gas is, for many processes, undoubtedly a premium fuel with advantages that would impel its use even at a higher cost per heat unit. It also has the advantage generally of creating less smoke or smog than fuel oils. Moreover, the delivered price of fuel oils may differ considerably from the posted price, depending on a number of elements such as plant location, the quantity demanded, the grade of oil, and the delivery costs. It is quite possible that a system-wide interruptible rate set low enough to make gas competitive on a heat unit basis for customers with barge or pipe-line delivery may be substantially lower than that necessary to make gas competitive with fuel oils for other interruptible customers. Applicant did not provide an industry-by-industry or customer-by-customer survey indicating the delivered costs of fuel oils in its various service areas and the corresponding gas rates which would be necessary to make its product competitive.

This is an offset application, in which applicant met its burden of proof that the requested additional revenue is needed. It did not, however, present the full and detailed showing that is required to justify a substantial redistribution of the burden of its increased costs as between its various classes of customers.

In view of this state of the record, we are not justified in placing the full burden of the increased revenue needs of applicant on the firm customers and leaving the rates to interruptible customers at their present level.

The offset increase of \$2,365,000 of revenue which applicant has proved to be needed does not justify an increase of 2.9 cents per Mcf spread uniformly on all its customers. Such an increase would produce added revenue of \$3,300,000, or some \$935,000 more than the increased cost of purchased gas. Applicant will be authorized to increase its base rates to all classes of customers by 2.5 cents per Mcf. It is recognized that the competitive situation will prevent applicant from increasing its charge to all of its interruptible customers by the full 2.5 cents per Mcf. The rates for some of the interruptible customers may have to be kept at their present levels if applicant is to retain their business. It is to be noted, however, that the authorized increase of 2.5 cents per Mcf applied only to the firm and wholesale customers will produce all of the needed additional revenue except approximately \$308,700; and that this amount would be produced by an average increase of 1.0 cents per Mcf on the interruptible sales. In authorizing a 2.5 cents per Mcf increase on all classes of customers, we therefore leave to applicant a considerable amount of leeway in the adjustment of its rates to interruptible customers in such manner as to accomplish the full increase of revenue which it requires.

It is our intention by this decision to place upon applicant the responsibility for carefully analyzing and reviewing its rates to interruptible customers. This is the area of its operation in which it faces competition and has the best opportunity to exercise and demonstrate the results of sound business judgment and alert

business practices. The maximum increase of 2.5 cents per Mcf to interruptible customers is permissive only. After surveying its interruptible market, applicant is invited to file such rates as will retain this business while securing as much as possible of the needed revenue increase from its interruptible customers. It is not intended, however, that the increased rates to interruptibles should in any event be such as to yield increased total revenues from this source in excess of \$308,700.

The following table sets forth the results of the increases which will be authorized herein as compared with applicant's request.

| <u>Class of Service</u> | <u>Estimated 1955 Sales Mcf</u> | <u>Applicant's Proposed Increase 2.9¢ on Firm and Wholesale</u> | <u>Authorized Increase</u> | |
|--|---|---|--------------------------------|---------------|
| | | | <u>Rate</u> | <u>Amount</u> |
| <u>Firm and Wholesale Services</u> | | | | |
| General Service | 46,305,000 | \$1,343,000 | 2.5¢ | \$1,157,600 |
| Gas Engine | 894,000 | 26,000 | 2.5 | 22,300 |
| Firm Industrial | 3,089,000 | 90,000 | 2.5 | 77,200 |
| Wholesale | 32,535,000 | 944,000 | 2.5 | 813,400 |
| Subtotal Firm & Whs. | 82,823,000 | 2,403,000 | 2.5 | 2,070,500 |
| <u>Interruptible Service</u> | | | | |
| Interruptible Ind. | 15,138,000 | - | | |
| Steam Plant | 15,733,000 | - | | |
| Subtotal Interr. | 30,871,000 | - | 2.5 Max. | 308,700 |
| Total | 113,694,000 | 2,403,000 | | 2,379,200 |

With regard to the request of San Diego for a lesser increase than 2.9 cents per Mcf, it is our conclusion and finding that the supply to San Diego has many of the characteristics of firm service and should stand the 2.5 cent increase during this temporary offset period, notwithstanding the fact that San Diego furnishes certain interruptible service for its own convenience and economy of operation.

The offset rates being authorized herein will be subject to revision when the Federal Power Commission has fixed final rates for El Paso in Docket No. G-4769. Applicant's customers will be protected by a refund plan during the temporary intervening period in the event that applicant collects more offset revenue than the final authorized increase in cost of out-of-state gas during the offset period.

INTERIM ORDER

Southern Counties Gas Company of California having applied to this Commission for an order authorizing increases in rates and charges for natural gas service, public hearing having been held, the matter having been submitted and being ready for decision,

IT IS HEREBY FOUND AS A FACT that the increases in rates and charges authorized herein are justified and that present rates, in so far as they differ from those herein prescribed, for the future are unjust and unreasonable; therefore,

IT IS ORDERED as follows:

1. Applicant is authorized to file in quadruplicate with this Commission after the effective date of this order in conformity with General Order No. 96:

- (a) revised schedules of rates which include additional cost of gas offset rate increases of 2.5 cents per Mcf in base rates for firm and wholesale service and, upon one day's notice to this Commission and to the public, to make said rates effective for service rendered on and after May 10, 1955.

(b) revised or new schedules of interruptible rates containing such portion of a maximum increase of 2.5 cents per Mcf in the base rates compared to existing interruptible schedules as applicant may determine for each such schedule, but not to produce added revenue in excess of a total from this source of \$308,700. Such revised or new schedules shall become effective upon ten days' notice to this Commission and to the public.

2. Applicant shall keep such records of sales to customers during the effective period of this cost of gas offset rate as will enable it to determine readily the total offset charge and the total refund, if any, that may be due to each customer.

3. Applicant shall file a revised refund plan acceptable to this Commission within ninety days after the effective date of this order. Such revised refund plan shall be served on each of the parties in this proceeding within the aforesaid time period and any party may submit comments with respect to such revised refund plan to the Commission within fifteen days after the receipt thereof. The refund plan to be submitted shall reflect the offset rates realized from the order herein and the effective dates of these offset rates. The estimated cost of refunding shall be excluded and sales, revenues, and cost of gas shall be prorated at the beginning and end of the periods involved.

4. Applicant shall determine refunds by the formula contained in the revised refund plan provided for in paragraph 3 above.

5. After determination, refunds shall be made in the manner set forth in the revised refund plan required by ordering paragraph 3 above.

6. Upon the final decision by the Federal Power Commission in Docket No. G-4769, applicant shall file a supplemental application herein containing its proposed permanent rate plan for final determination and authorization by this Commission.

7. Upon final determination of the actual cost of refunding not recovered from El Paso and the amount of any balance created by applicant's inability to deliver checks and by checks uncashed after one year, applicant shall file a plan acceptable to the Commission for the equitable disposition of the resultant net balance.

8. Applicant shall not effect any offset rate charges authorized herein prior to the date increases become effective in its cost of out-of-state gas under Federal Power Commission Docket No. G-4769.

9. Applicant shall file with the Commission monthly reports, within sixty days following the close of each period, setting forth:

- (a) the increase in revenues realized under the offset rates authorized herein, segregated by firm and interruptible classes of service, and
- (b) the increase in cost of out-of-state gas above the rate level in effect immediately prior to April 15, 1955.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 19th day of APRIL, 1955.

E. W. Mitchell
President

Justus Z. Casper

Ray L. Winter

Markus J. Shanley

Commissioners

APPENDIX A

LIST OF APPEARANCES ON SECOND SUPPLEMENTAL APPLICATION

For Applicant: Milford Springer and Frederick G. Dutton.

Interested Parties: City of Los Angeles by Roger Arnebergh, Alan G. Campbell, T. M. Chubb and Robert W. Russell; California Manufacturers Association by George D. Rives of Brobeck, Phleger & Harrison; California Farm Bureau by J. J. Deuel; Monolith Portland Cement Company by Waldo A. Gillette and Norman Elliott of Enright and Elliott; City of Banning by Jesse W. Jacobson; City of Long Beach by Henry D. Jordan; Exchange Orange Products Company and Challenge Cream and Butter Association by W. D. MacKay; Southern California Edison Company by Bruce Renwick, Rollin E. Woodbury and John Bury; City of Anaheim by Preston Turner; County of San Diego by Jean L. Vincenz; City of Pasadena by Clarence A. Winder and Frank L. Kostlan; Hollywood Consumers League by Edwin Goodwin.

Protestant: San Diego Gas & Electric Company by Sherman Chickering of Chickering and Gregory.

For the Commission Staff: Boris H. Lakusta; Charles W. Hors; Theodore Stein.

LIST OF WITNESSES ON SECOND SUPPLEMENTAL APPLICATION

Evidence was presented on behalf of the applicant by: W. J. Herrman, J. Q. Abel, C. L. Dunn, F. M. Foster, Raymond W. Todd, J. A. Millen, George S. Coates.

Evidence was presented on behalf of interested parties by: Homer R. Ross, Edwin Goodwin.

Evidence was presented on behalf of protestant by H. G. Dillin.

Evidence was presented on behalf of the Commission staff by: William W. Eyers, Robert O. Randall, Joseph O. Sordeno.