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Decision No. 55903

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of PACIFIC LIGHTING GAS SUPPLY COMPANY for a general increase in the gas rates under Section 454 of the Public Utilities Code.)	Application No. 38957

(Appearances and witnesses are listed in Appendix A.)

O P I N I O N

Applicant's Request

Pacific Lighting Gas Supply Company, a California corporation, engaged in the business of purchasing, compressing, transporting, storing, exchanging and selling natural gas for resale to Southern Counties Gas Company of California, hereinafter referred to as Counties and to Southern California Gas Company, hereinafter referred to as Cal, filed the above-entitled application on April 1, 1957 and filed amendments thereto on April 23, 1957 and July 19, 1957, finally seeking authority to increase rates to yield additional gross revenue of $3,771,000, approximately a 15.4 per cent increase at the estimated 1958 level of business. To obtain this increase in gross revenue, applicant proposes that the commodity charge be set at 29 cents per Mcf and the additional monthly charge to Cal be set at $396,675 and to Counties at $248,325.

Public Hearing

After due notice three days of public hearing were held on this application on May 6, 1957 in San Francisco, and on July 24, and 25, 1957 in Los Angeles before Commissioner Matthew J. Dooley and Examiner Manley W. Edwards. Applicant presented seven exhibits and testimony by four witnesses in support of its application. The Commission staff made an independent study of applicant's operations for the purpose of developing a full record to aid the Commission in deciding this matter, presented five exhibits by five witnesses and cross-examined applicant's witnesses. The California Manufacturers Association presented five exhibits by one witness with reference to a cost analysis it had prepared. The matter was submitted on summary statements or on briefs on or before September 3, 1957, and now is ready for decision.

Accelerated Depreciation

The question of whether or not the applicant would elect to take accelerated depreciation for income tax purposes in 1958 was discussed at the hearings. The staff in its study had computed results on both the straight-line basis and the accelerated depreciation basis using the "flow through" method. Applicant's witness stated: "management considers that it would be imprudent to elect to take accelerated depreciation if gas rates are fixed on a flow-through method." The determination by the Commission of the treatment to be accorded accelerated depreciation for rate-making purposes was raised in Applications Nos. 38372 and 38382 of Southern California Edison Company but the Commission deferred making any decision in respect thereto.

Pending decision on this question, the straight-line tax depreciation method will be used and the adopted income tax figures will be adjusted to account for any differences in net revenue that may be shown. Should applicant avail itself of accelerated depreciation prior to Commission determination of the pending cases requesting normalization of income taxes and the creation of a deferred tax reserve, the Commission will promptly move to adjust the rates hereinafter authorized as the circumstances may require.

Recent Rate Increase

In view of the fact that as recently as January 29, 1957 applicant was granted a rate increase (Decision No. 54465, Application No. 37553), a motion was made that the transcripts and exhibits in Application No. 37553 be incorporated by reference in this record. Applicant stated that the present testimony of its witnesses is largely supplemental to that given in the prior rate case and that it would be of advantage to incorporate by reference the prior record. Such motion was granted by the presiding Commissioner.

By Decision No. 54465 applicant was granted an increase of $5,150,000, approximately a 27 per cent increase on the estimated year 1957 revenues of $19,198,000 at the former rate levels. That decision was based upon a large increase in capital in service because of the Montebello Gas Storage Project (then estimated to cost $10,399,000), an increase in cost of gas, a decrease in volume of gas to be sold in 1957 and an increase in allowable rate of return from 6.0 to 6.5 per cent.

Applicant's Present Position

Applicant requests this supplemental rate relief because it computes that its estimated earnings in 1958 will fall considerably below what it considers is a reasonable rate of return. It lists the following specific reasons for this request:

1. As of February 28, 1957, approximately 6.5 billion cubic feet of gas had been injected in the Montebello Gas Storage Project, additional property in the vicinity had been acquired and the estimated capital expenditure had been raised to $14,050,000 for this project;

2. Further increase in cost of gas purchased from California producers;

3. Accelerated completion of a major transmission pipeline, 83 miles in length, extending from the San Joaquin Valley to the Los Angeles

Basin (the completion date now is scheduled for July 1958, instead of November 1958) and enlargement of the diameter of the pipeline from 30 to 34 inches.

Earning Position

Applicant represents that its earnings, expressed in rate of return, show the following trend:

Year 1955 Recorded	5.47%
Year 1956 Recorded	4.05
Year 1957 Estimated	5.36
Year 1958 Estimated	3.35

The staff study showed a somewhat similar down trend of earnings, but at a higher level. By a late-filed exhibit the staff showed the following rates of return for 1958 under the assumptions listed below:

1. No pipeline in 1958 .... 4.61%
2. 30-inch pipeline in November 1958 4.74
3. 34-inch pipeline in November 1958 4.78
4. 34-inch pipeline in July 1958 3.82

The two studies for the estimated year 1958 may be compared in more detail in the manner shown below:

Estimated 1958 Results of Operation
at Present Rate Levels

	Applicant's Exh.No.2 and Exh.A 2d Amd.	Staff's Late-filed Exhibit Superseding Exhibit No. 7
Operating Revenues	$24,468,000	$24,480,000
Operating Expenses		
Production (Cost of Gas)	15,311,000	15,263,000
Transmission	2,785,000	2,740,000
Administrative and General	924,000	871,000
Depreciation (Str.-line basis)	1,019,000	1,004,000
Taxes		
Other than Income	1,206,000	1,051,000
Income	1,585,000	1,717,000
Total Expenses	22,830,000	22,646,000
Net Revenue	1,638,000	1,834,000
Rate Base	48,891,000	47,984,000
Rate of Return	3.35%	3.82%

There is very little difference in the estimates of gross revenue, the staff's being $12,000 higher. We will adopt $24,480,000 as reasonable under present rate levels. While the staff's estimate indicates need for a substantial further increase, nevertheless, the applicant took exception to the level of certain expense and rate base items used by the staff.

Production Expenses

Applicant points out that the net difference between its estimate and the staff's, in production expenses, is $48,000, which was not, at the time of filing of applicant's brief, covered by a firm contract or offer, but was applicant's estimate of the increase in cost of gas. The applicant represents that, with constant gas negotiations in progress, it is an impossibility to have all gas covered by contracts or offers at one moment, that only approximately 1.4 per cent of the gas to be purchased in 1958 is not covered by firm contracts or offers and that this added amount is a realistic appraisal of the cost of gas to be purchased. Since such a small amount remains uncovered, we find applicant's position is reasonable and we will adopt an amount of $15,311,000, as reasonable, for production expenses for 1958.

Transmission Expenses

Applicant did not contest, particularly, the lower transmission estimate of the staff and an amount of $2,740,000 will be adopted, as reasonable.

Wage Increase

Applicant represents that the staff's expense estimate is approximately $49,000 low because it did not allow for an estimated 4 per cent wage increase anticipated to be effective April 1, 1958. The staff's estimate is based on Commission policy not to speculate as to future wage rate increases, and is adopted.

Administrative and General Expense

Applicant states that the staff disallowed all of the estimated accruals under the insurance account which exceed estimated charges for premiums, losses and expenses and that the staff gave no consideration to the adequacy of the self-insurance reserves; however, applicant now has sizeable insurance reserves and interest thereon should, in the Commission's opinion, provide for reasonable growth in the reserve. Applicant represents that no part of the accruals to the reserves has been contributed by the rate payer and that it is unrealistic to deny accumulation of the reserve because of failure to show interest on the reserve. The Commission has reconsidered this matter and still is of the opinion that to the extent the insurance reserves are invested in plant and earning a return, the reserves should be built up by reasonable interest accumulations.

The staff deleted a portion of the dues, donations and contributions consistent with Commission policy.

We will adopt, as reasonable, the staff's administrative and general expense estimate of $871,000.

Depreciation Expenses

Applicant did not contest, particularly, the lower depreciation estimate of the staff and an amount of $1,004,000 will be adopted as reasonable.

Taxes, Other than Income

Applicant states that $120,000 of the difference of $155,000 in taxes other than income results from the failure of the staff to apply the experienced annual increase in ad valorem tax assessment ratio and the experienced annual increase in tax rates. The staff's position was in accord with Commission policy not to speculate on future tax increases because, with the expanding tax base, these rates may, at any time, turn downward. We will adopt, as reasonable, the staff's estimated taxes other than income.

Rate Base

The items used by the applicant and the staff in computing the 1958 rate base are summarized below:

	Applicant	Staff
Plant (12-31-56)		
Intangible Plant	$ 85,883	$ 85,883
Storage Plant		
East Whittier	1,902,038	1,902,038
La Goleta	11,543,786	11,543,786
Montebello	7,994,571	7,994,571
Transmission Plant		
Pipelines, 423 miles	12,094,175	12,094,175
Compressor and Regulator Facilities	8,007,212	8,007,212
Structures and Land	478,052	478,052
General	794,267	794,267
Total Recorded Plant (12-31-56)	42,899,984	42,899,984
Operative Construction Work in Progress, 12-31-56	380,000	380,000
Estimated Total Net Additions, 1957	5,497,016	4,844,016
Subtotal, 12-31-57	48,777,000	48,124,000
Estimated Weighted Average Additions, 1958	8,363,000	8,637,000
Total Weighted Average Gas Plant, 1958	57,140,000	56,761,000
Working Capital		
Working Cash	300,000	0
Current Asset Gas in Storage	2,068,000	1,826,000
Material and Supplies	625,000	625,000
Undepreciated Rate Base	60,133,000	59,212,000
Deduction for Depreciation	11,242,000	11,228,000
Depreciated Rate Base	48,891,000	47,984,000

Applicant states that an additional 40 days, compared with previous estimates, will be required to complete injection of cushion gas in Montebello and therefore, it does not disagree with the lower estimate of rate base used by the staff, except for the item of working cash. In expanding and developing its facilities and in meeting its monthly payments to producers of gas, applicant states it requires substantial sums of current operating funds and represents that the staff's disallowance fails to recognize the advantages of time discounts and purchases at low prices. The staff stated that a detailed study showed that the average amount of working cash available as a result of collect[illegible] revenues in advance of paying expenses and taxes exceeded the gros[illegible]quirement indicated by the balance sheet accounts. The Commission is fully cognizant of the fact that no business enterprise can operate successfully without an adequate supply of working cash; and in the case of a utility when such working cash is provided by the investors it should be included in the rate base. The present applicant, however, serves only two affiliated customers; an allowance for working cash is provided in the rate bases for these two customers; they are prompt in their payments to this applicant; and it is unnecessary, therefore, for the investors to provide this applicant with working cash. We will adopt, as reasonable, the staff's estimate of rate base for 1958 of $47,984,000. Such rate base contemplates completion of the 34-inch pipeline in July 1958. The larger pipeline was authorized by Decision No. 55752 under Application No. 38407, First Supplemental, dated October 28, 1957.

Adopted Operating Results

The adopted operating results which the Commission will use for the test year 1958, using present rates, for determining the validity of this application and which hereby are found reasonable for the purposes of this decision follow:

Test Year 1958
Adopted Operating Results

Operating Revenues	$24,480,000
Operating Expenses	
Production (Cost of Gas)	15,311,000
Transmission	2,740,000
Administrative and General	871,000
Depreciation (Str.-line Basis)	1,004,000
Taxes	
Other than Income	1,051,000
Income	1,691,000
Total Expenses	22,668,000
Net Revenue	1,812,000
Rate Base	47,984,000
Rate of Return	3.78%

Rate of Return

Applicant seeks a rate of return of 6.9 per cent on its depreciated rate base and computes such request by adding one half of one per cent to the average rate of return of 6.4 per cent computed by it for 33 gas distributing utilities in the United States. Such average return was computed from all available reported decisions since March 1955 of state regulatory bodies, converted to a rate of return on average depreciated original cost, as shown in Exhibit F of its application. The added one half per cent is to reflect the claimed additional risks inherent in applicant's operation compared to a regular gas distributing utility.

Applicant refers to the rate of return of 6.5 per cent which it was granted by Decision No. 54465 and states that the risks are of the same character today, although the magnitude has significantly increased with the addition to capital of the Montebello underground storage project. Applicant also refers to the inflationary trend of 1956 and 1957 and states that it cannot depend indefinitely upon equity financing from the parent company. If the Commission disallows the estimated increases in wages and taxes which applicant estimates for 1958, applicant seeks an additional one half per cent (or a total of 7.4 per cent) in rate of return to correct for the effect of what it calls "regulatory lag."

The City of Los Angeles takes the position that a rate of return of no more than 6.5 per cent should be authorized, that the contention for a 7.4 per cent rate of return should be rejected as being without proper foundation or justification and beyond the range of reasonableness, and that the assertedly greater risks are largely hypothetical and conjectural and are fully offset by the applicant's very real and unique position in having a firm market for all the gas it can supply and in being affiliated with the largest retail distributors of natural gas in the country.

Applicant has indicated that its capital base is expanding so fast that it will have to ask for a further rate increase in 1959 in order to maintain its earning position. Since we are predicating our findings herein on a test year for a full year in the future, and applicant plans another rate case next year, we find no reason to make an extra allowance for a down trend in rate of return or for "regulatory lag." Recently, the Commission has rendered rate decisions affecting applicant's two customers. A rate of return of 6.5 per cent was authorized for Counties[1] and of 6.75 per cent for Cal.[2] While the cost of money generally has increased since January, 1957, the Commission takes notice of the fact that the Federal Reserve Banks in November, 1957 lowered the discount rate from 3.5 to 3.0 per cent, and that bond interest rates thereafter, generally started falling. The cost of money outlook is sufficiently improved, in the Commission's opinion, so that no increase in the 6.5 per cent rate of return formerly allowed this applicant is justifiable at this time.

The net annual earnings herein found reasonable are $1,307,000 in excess of those calculated to accrue under present rates for 1958. To achieve such net increase at present income tax rates an over-all increase in gross revenues of approximately $2,840,000 will be required for the year starting January 1, 1958.

Rate Spread

To obtain the proposed increase applicant suggests raising the commodity charge from 26.5 cents per Mcf to 29.0 cents per Mcf and the additional monthly charge from $233,500 to $248,325 for Counties and from $233,500 to $396,675 for Cal. The California

1 Decision No. 55579, Application No. 38211, dated September 17, 1957.
2 Decision No. 55642, Application No. 38787, dated October 1, 1957.

Manufacturers Association took the position that, although none of the rates here involved apply to gas service provided directly to its members, such rates become an important part of the total cost of gas to the two distributing companies which are reflected in their rates to its members. Based on its cost studies (Exhibits Nos. 11 to 15 inclusive), the Association represents that for 1958 applicant's costs should be spread so that the commodity rate is 24.25 cents per Mcf and the monthly charge to Counties is $363,450 and to Cal is $577,320.

The City of Los Angeles did not agree with a rate spread on the basis of the Association's cost study, instead it took the position that cost to serve is not an appropriate issue in this rate spread and that the applicant should be given a reasonable measure of latitude in managerial judgment in the matter of the determination of fixed charges to its two customers.

The City of Los Angeles requested a reconciliation of applicant's 1958 estimated sales of 66,524,000 Mcf with the sales of 73,089,800 Mcf as shown in Case No. 5924, the Commission's gas investigation. On July 29, 1957 a witness for applicant[3] clarified this matter as a transfer of gas from 1958 to 1959 by utilization of storage for smog abatement and stated that approximately 67 million Mcf is the correct 1958 figure.

In deciding as to the rate spread, consideration has been given to the contentions of the various parties with regard to the relationship between the monthly charges and the commodity charge.[4] We find that a reasonable balance between these charges will result

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3 Transcript, page 268, Case No. 5924.

4 The estimated 1958 peak-day supply to Counties is 354,600 Mcf and to Cal is 563,900 Mcf.

from a commodity rate of 27.5 cents per Mcf and monthly charges at $250,200 for Counties and $398,000 for Cal.

Findings and Conclusions

The increase in rates to be authorized herein will, in the considered judgment of the Commission, provide such additional gross revenue as should enable applicant to meet its expenses of operation, and to afford it the opportunity to earn a fair and just return upon its depreciated rate base hereinbefore found reasonable starting in 1958.

After carefully considering all factors pertinent to this proceeding it is our finding and conclusion that an order should be issued authorizing increased rates in the over-all amount of approximately $2,840,000 (REW) ~~$3,100,000~~ in the manner hereinbefore outlined effective for service furnished on and after January 1, 1958. Accordingly, the Commission finds and concludes that the increases in rates and charges authorized herein are justified, and that the existing rates, in so far as they differ therefrom, are for the future unjust and unreasonable.

ORDER

The Pacific Lighting Gas Supply Company having applied to this Commission for an order authorizing increases in rates and charges for gas service, public hearing having been held, the matter having been submitted and being ready for decision; therefore,

IT IS HEREBY ORDERED that applicant is authorized to file in quadruplicate with this Commission after the effective date of this order, in conformity with the Commission's General Order No. 96, revised tariff Schedules Nos. G-60 and G-61 for Resale Natural Gas Service with monthly charges of $398,000 and $250,200, respectively, a commodity rate of 27.5 cents per Mcf and a rate of not less than

27.5 cents per Mcf for emergency gas, and upon not less than one days' notice to the Commission and to the public, to make said rates effective for service furnished on and after January 1, 1958.

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

Dated at San Francisco, California, this 5th day of December, 1957.

President

Commissioners

APPENDIX A

LIST OF APPEARANCES

For Applicant: O. C. Sattinger and J. R. Elliott.

Interested Parties: Roger Arnebergh, Alan G. Campbell, T. M. Chubb and P. A. Erickson, for City of Los Angeles; J. J. Deuel and Bert Buzzini, for California Farm Bureau Federation; Brobeck, Phleger & Harrison by George D. Rives, for California Manufacturers Association; John H. Lauten, for City of Glendale; Chickering & Gregory by John MacMeeken and C. Hayden Ames, for San Diego Gas & Electric Company; Milford Springer and J. R. Rensch, for Southern Counties Gas Company of California; T. J. Reynolds and Harry P. Letton, Jr., for Southern California Gas Company; Enright & Elliott by Norman Elliott, and Waldo A. Gillette, for Monolith Portland Cement Company; Henry E. Jordan, for City of Long Beach.

Commission Staff: Harold J. McCarthy, Carol T. Coffey and Theodore Stein.

LIST OF WITNESSES

Evidence was presented on behalf of the applicant by: W. D. Morningstar, Raymond W. Todd, C. E. Pearman, Keith McKinney.

Evidence was presented on behalf of the California Manufacturers Association by Edwin Fleischmann.

Evidence was presented on behalf of the Commission staff by: Richard Entwistle, Louis Mendonsa, James M. McCraney, Greville L. Way, Robert Hamilton.