YPO*

Decision No. 63706

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 Gas Rates under Section 454 of the Public Utilities Code.

Application No. 43670
(Filed August 9, 1961)

First Amendment Filed
October 6, 1961

(Appearances are listed in Appendix A)

O P I N I O N

Nature of Proceeding

Pacific Lighting Gas Supply Company 1/ by the above-entitled application as amended requests authority under Section 454 of the Public Utilities Code to increase its gas rates to yield additional annual gross revenues of $5,114,000 based on operations estimated for the year 1962. The requested increase approximates 5.8 percent, based on applicant's estimate of operating revenues for the test year 1962 at present rates in the amount of $88,000,000, and is equivalent to 2.72 cents per thousand cubic feet (Mcf) of gas sales of 188.011 billion cubic feet for 1962 as estimated by applicant.

Corporate Relationship

Applicant is a subsidiary of Pacific Lighting Corporation and operates properties located principally in the counties of Fresno, Kings, Kern, San Luis Obispo, Santa Barbara, Ventura, Orange, Los Angeles and San Bernardino. Pacific Lighting Corporation, a holding

1/ Applicant is a California corporation engaged in the business of purchasing, compressing, transporting, storing, and exchanging natural gas and selling it to Southern California Gas Company and to Southern Counties Gas Company of California for resale.

company, owns all of the outstanding capital stock of applicant as well as all of the common capital stock of Southern California Gas Company and all of the outstanding capital stock of Southern Counties Gas Company and of Pacific Natural Gas Exploration Company.

Public Hearing

After due notice, public hearing was held before Commissioner George G. Grover and Examiner William W. Dunlop in Los Angeles on October 25, 26 and 27, 1961 and in San Francisco on November 20, 21, 22 and December 11 and 12, 1961. A total of 33 exhibits were filed, and testimony was presented by nine witnesses. Oral argument was presented on January 4, 1962, on which date all members of the Commission were in attendance.

Motion for interim rate relief in the amount of $4,509,000 was made by applicant at the hearing of October 27, 1961 and such motion was renewed by applicant on January 4, 1962.

The entire matter was submitted for decision at the conclusion of oral argument on January 4, 1962, subject to the receipt of a brief filed by the Department of Defense and other executive agencies of the United States of America and applicant's reply thereto, which reply was filed on January 18, 1962. The matter is now ready for decision.

Applicant's Position

Applicant refers to its most recent rate proceeding, Application No. 41277. By interim order, Decision No. 59429, dated December 21, 1959, the Commission authorized increases in applicant's rates in the amount of $3,570,000 effective January 12, 1960 and by Decision No. 60428, dated July 26, 1960, authorized a further increase in rates in the amount of $12,026,000 effective upon the commencement of deliveries of gas to applicant by Transwestern

Pipeline Company. Such increases were estimated to result in a rate of return of 6.5 percent on a depreciated rate base for test year 1960 operating conditions. Applicant represents that for the year 1960 it realized a rate of return of 7.06 percent on a depreciated rate base and estimates that its rate of return will decline to 6.40 percent for the year 1961 and will further decline to 3.61 percent for the year 1962 at present rate levels.

The substantial decline in rate of return estimated by applicant for 1962 is attributed by applicant largely to an increase in the cost of California produced gas under the terms of applicant's so-called long-term gas purchase contracts with California producers. Applicant attributes approximately $4,000,000, or 78 percent, of its claimed gross revenue deficiency to increases in cost and in volume of gas. Other major items listed by applicant as contributing to its need for rate relief include: (1) an increase in rate base primarily brought about by its proposed construction of a 16-inch natural gas transmission pipeline extending from Gaviota to Goleta,[2/] (2) an increase in taxes, (3) a requested increase in rate of return to 6.6 percent, (4) an increase in depreciation expense and (5) an increase in administrative and other costs of doing business resulting from normal growth of operations.

Positions of Other Parties

The City of Los Angeles opposed the application primarily on two grounds. First, Los Angeles claims that the alleged long-term contracts are nothing more than letters of intent, so that applicant is not legally bound to pay or to continue to pay according to the

2/ This project was the subject of Application No. 43622 for a certificate of public convenience and necessity. Decision No. 63414, therein was issued March 16, 1962.

border price formula for California produced gas on and after January 1, 1962. Second, Los Angeles claims that applicant has failed to show that the border price formula results in a reasonable price for California produced gas. In addition Los Angeles opposed applicant's request for an increase in rate of return to 6.6 percent.

The City of San Diego urged that the price for California produced gas under the so-called long-term contracts is not reasonable; that such contracts are not reasonable; and that applicant has failed to establish and prove that it is entitled to a rate increase.

The California Farm Bureau Federation expressed approval of the gas purchase prices estimated by applicant to be paid in the test year 1962 for California produced gas, although not supporting applicant's request for a rate of return higher than 6.5 percent.

The California Manufacturers Association (CMA) expressed the view that the Commission should not disallow applicant's claimed cost of California produced gas as provided in the so-called long-term contracts. CMA did urge, however, that applicant's rates for sales to the two distributing companies should be based on the cost incurred in serving the distributing companies, computed by methods used by CMA in Exhibit 27. CMA represents that for test year 1962, based upon a 6.6 percent rate of return and upon applicant's estimates of expenses and rate base, the average annual fixed cost per Mcf of peak day demand is $19.13 and the average variable cost per Mcf sold is 33.32 cents.

Southern California Edison Company, the largest customer of the distributing companies to which applicant sells its gas, took no position on the cost of California gas which should be allowed for rate-making purposes in this proceeding, but did assert that gas utilities have no vested right to all gas produced in Southern

California. Edison also stated that the Edison - Richfield gas purchase contracts involve a commitment on the part of the producer for substantial quantities of gas on an assured annual basis, whereas applicant's so-called long-term gas purchase contracts for California produced gas in general do not involve any obligation for the delivery of specific volumes of gas by the producers.

The Department of Defense and other executive agencies of the United States of America urged that a rate of return substantially below 6.5 percent is fair and reasonable for applicant. With respect to cost of gas, the United States urged that this Commission is bound to allow as justifiable expense only that part of the purchase price which is found to be reasonable.

The Commission staff urged the Commission to deny the applicant's request in its entirety. The staff contended that there are two basic deficiencies in applicant's showing: First, that applicant's failure to place into the record as evidence certain alleged long-term gas purchase contracts is a fatal defect in that applicant's justification for increased rates depends, in large part, upon the existence of and its claimed obligations under such alleged contracts. Second, that even if the existence of and applicant's claimed obligations under the alleged contracts are assumed, the prices, terms and obligations thereunder are contrary to the public interest for the purpose of setting fair and reasonable rates. The Commission staff also took exception to a number of items of cost estimated by applicant for test year 1962. These items are discussed in more detail later in this opinion. Finally, the staff criticized the cost incurrence study sponsored by CMA and urged that it not be adopted. The staff claimed that the CMA study would be unfair to firm customers because it does not recognize that for all normal occasions the coordinated system of the Pacific Lighting group serves all customers, both firm and interruptible.

Earning Position

The following tabulation summarizes the evidence respecting applicant's rate of return on an average depreciated rate base, realized in the recent past and estimated for the years 1961 and, 1962:

	Rate of Return		
	Applicant	CPUC Staff	City of Los Angeles
Year 1959	6.43%	Not Shown	6.46%
Year 1960	7.06	Not Shown	7.10
12 Mo. Ending Aug. 31, 1961	Not Shown	Not Shown	7.39
Year 1961 Estimated at Present Rates	6.40	Not Shown	Not Shown
Year 1962 Estimated			
at Present Rates	3.61	7.02%	Not Shown
at Proposed Rates	6.60	10.05	Not Shown

The estimates for the test year 1962 at present rates as developed by applicant and by the Commission staff are compared in more detail in the following tabulation, which also shows the adopted results used herein to test the level of applicant's earning position at its present rates:

SUMMARY OF EARNINGS - ESTIMATED TEST YEAR 1962

AT APPLICANT'S PRESENT RATES

	Applicant Ex. 6	CPUC Staff Ex. 20	Adopted Results At Present Rates
Operating Revenues:			
Sales for Resale	$86,357,000		
Miscellaneous Gas Revenue	1,643,000		
Total Operating Revenue	88,000,000	$88,000,000	$88,000,000
Operating Expenses:			
Cost of Gas	72,899,000	67,805,000	69,080,000
Storage Expenses	1,393,000	1,370,000	1,375,000
Transmission Expenses	2,785,000	2,754,000	2,760,000
Administrative & General Expenses	1,812,000	1,722,000	1,722,000
Depreciation Expense	2,152,000	1,990,000	1,990,000
Taxes - Other Than Income	2,501,000	2,391,000	2,423,000
- Income	1,655,000	4,620,000	3,930,000
Total Operating Expenses	85,197,000	82,652,000	83,280,000
Net Revenue	2,803,000	5,348,000	4,720,000
Rate Base (Wt. Avg. Depreciated)	77,581,000	76,213,000	76,251,000
Rate of Return	3.61%	7.02%	6.2%

Revenues

The revenue estimates of applicant and the staff are the same. Both estimates reflect commodity sales of 188.011 billion cubic feet (M^3cf) at a commodity charge of 31.5 cents per thousand cubic feet (Mcf) and a maximum contract demand of 1,534 million cubic feet (M^2cf) per day at a demand charge of $1.474 per Mcf of maximum contract demand per month. Most of the miscellaneous gas revenue represents charges made to oil companies for exchange of gas incident to gas purchase contracts.

We adopt as reasonable for purposes of this decision the amount of $88,000,000 for revenues for the estimated test year 1962 at applicant's present rates.

Cost of Gas

Cost of gas is a principal issue in this proceeding. Applicant's estimate of the cost of gas exceeds the Commission staff's estimate by $5,094,000. A comparison of the two estimates follows:

Item	Millions of Cubic Feet	Applicant's Estimate Rate ¢ Per Mcf	Applicant's Estimate Amount	CPUC Staff Estimate Rate ¢ Per Mcf	CPUC Staff Estimate Amount
Purchases					
Transwestern	99,645	43.09¢	$42,935,000	42.00¢	$41,850,900
California Producers	88,777	34.27	30,424,000	29.69	26,357,100
Total Purchases	188,422	38.93	73,359,000	36.20	68,208,000
Free Fuel	730	-	-	-	-
Storage Withdrawal	20,797	39.37	8,189,000	36.05	7,487,700
Total for Sales & Co. Use	209,949	38.84	81,548,000	36.05	75,695,700
Deduct					
Storage Injection	20,069	39.47	7,921,000	35.97	7,218,600
Company Use	1,869	38.97	728,000	35.97	672,300
Total Deductions	21,938	39.42	8,649,000	35.97	7,890,900
Sales	188,011	38.77	72,899,000	36.06	67,804,800
Rounded	-	-	72,899,000	-	67,805,000

The staff's estimate reflects the same volumes of gas from the several sources as estimated by applicant, but the staff used unit prices different from those used by applicant.

Applicant and the two distributing companies, sometimes referred to herein as the Pacific Lighting System, have three principal sources of gas supply: El Paso Natural Gas Company, Transwestern Pipeline Company and California producers. El Paso furnishes about two-thirds of the gas supply for the Pacific Lighting System, directly to the two distributing companies from out-of-state sources. Applicant buys no gas from El Paso but is the sole purchaser of gas for the system from Transwestern Pipeline Company, another out-of-state supplier. Applicant also purchases gas from California producers, as do the two distributing companies.

Applicant purchases gas from Transwestern under the terms of tariffs filed by Transwestern with the Federal Power Commission (FPC). In accordance with such tariffs, applicant has available from Transwestern in the test year 99,645,000 Mcf of gas at a price of 43.09 cents per Mcf, an additional 9,855,000 Mcf of gas at a price of 31 cents per Mcf and an additional 16,425,000 Mcf at a price of 24 cents per Mcf, if the first two volumes, totaling 109,500,000 Mcf, are taken.

Gas is purchased by applicant and its two distributing companies from California producers under various agreements. Such agreements basically are of two types: so-called long-term and other than long-term. Most of the agreements do not provide for any specific quantity of gas to be delivered by a producer to applicant during the test year. A large portion of the California source gas that is purchased by applicant is produced in association with oil or other hydrocarbons.

For the test year 1962 applicant estimates that some 83 percent of the California source gas which it will purchase will be purchased under the so-called long-term contracts. The price paid for gas purchased under such long-term contracts was 27 cents per Mcf in 1960, and 29 cents per Mcf in 1961. Effective January 1, 1962 such long-term contracts provide for payments to be determined by a border price formula based on the January 1 weighted average price of out-of-state gas purchased by applicant or its affiliates at the California-Arizona border, using 100 percent load factor and 14.73 pounds per square inch absolute pressure, at 60 degrees Fahrenheit temperature. Based upon such border price formula, applicant computed a cost of 34.47 cents per Mcf to be paid in the test year for

California source gas to be purchased under the so-called long-term contracts. For the balance of the California source gas (14,842,000 Mcf) applicant computed an average price in the test year of 31.31 cents per Mcf.

Gas supply is coordinated for the Pacific Lighting System based on systemwide gas balances. Applicant used a different gas balance in its first amendment to the application from that used in the original application. (This difference is shown on Exhibit 21.) In its original application applicant estimated it would purchase 109,500,000 Mcf of gas from Transwestern for $45,990,000 (99,645,000 Mcf at 43.09 cents per Mcf and 9,855,000 Mcf at 31 cents per Mcf) and 70,549,000 Mcf from California sources for $24,260,000, or an average price of 34.39 cents per Mcf. In its first amendment, applicant reduced its estimated purchases from Transwestern by 9,855,000 Mcf at a unit price of 31 cents and increased its estimated purchases from California sources by 18,228,000 Mcf at an average unit price of 33.82 cents.

Applicant states that it has been the considered policy of the management of the Pacific Lighting System to favor gas purchases from California producers whenever this could reasonably be done. By giving preference to California producers and by increasing estimated purchases from California sources in the test year, applicant estimates it will be unable to avail itself of 9,855,000 Mcf of 31-cent gas and 16,425,000 Mcf of 24-cent gas from Transwestern and that the Pacific Lighting System will be unable to take 3,839,000 Mcf of 24-cent gas from El Paso. Furthermore, applicant has refused offers made by Transwestern for additional volumes of gas at prices considerably below the average border price estimated by applicant for 1962.

The staff maintains that for rate-making purposes out-of-state gas should be taken at the maximum contractual volumes and that this Commission should allow applicant only 29 cents per Mcf rather than 34.47 cents per Mcf for California produced gas purchased under the so-called long-term contracts. The record reveals that if applicant and its affiliates were to take all contractually available out-of-state gas first, and then fill the remaining requirements with California produced gas, the system would save $2,505,000 per year on gas purchases, assuming applicant's 34.47-cent price under the so-called long-term California contracts, and would save $6,590,000 per year, assuming the staff's 29-cent price for such California gas.

It appears from the record that beginning in 1959 applicant embarked upon a program of putting under long-term contract all available Southern California gas in an effort to prevent interruptible customers from obtaining independent supplies of gas. This program has had the effect of forcing the price of California produced gas upward.

As justification for this program, applicant argues that competition for California produced gas naturally tends to raise the price to the level of the price for the alternative supply, namely, gas produced outside California; the long-term contracts, it is claimed, merely recognize that, to obtain California produced gas, applicant must be willing to pay the substantial equivalent of the border price. Wholly aside from its theoretical character, this argument ignores the elements other than price which are involved in applicant's gas purchasing program. Indeed, applicant conceded that short-term California gas is available at less than the border price. At the same time, the long-term contracts do not assure a gas supply comparable to those originating outside California. Not only are the interstate supplies subject to regulation by the Federal Power Commission, but they also involve commitments for delivery of fixed quantities and are based on dedicated reserves of established size. In contrast, the reserves associated with the long-term California contracts have not been made known, and, with certain minor exceptions, the producers are not committed to deliver definite amounts of gas. In addition, much of the California gas is produced in connection with oil, and the producers may thus be in a position to control the rate of gas production in a way that will benefit themselves as producers of oil, a competing fuel.

Applicant also contends that even a relatively high price for California produced gas is justified in order that the Pacific Lighting System may retain its large interruptible users; it is claimed that if such users are able to purchase their gas directly from California producers, the load-balancing which they provide for the system will be lost. Again the argument is theoretical. Although applicant's witness was questioned concerning the cost of the additional equipment, lines and storage which it was claimed would be required if these interruptible customers were lost, no such cost showing was introduced. Moreover, the largest of these customers (Edison) has already taken steps to acquire an out-of-state supply; although Edison's plan is not yet certificated, it is clear that outbidding Edison for California produced gas has not succeeded, by itself, in holding Edison as a customer.

On this record we find that the long-term contracts and applicant's policy of favoring California produced gas, even when volumes of lower priced out-of-state gas are available, combine to increase the estimated cost of applicant's gas in the test year.

We further find as follows:

1. It was imprudent and not consistent with the public interest for applicant to undertake to bind itself to pay a price for gas beginning January 1, 1962 which jumped from 29 cents per Mcf to 34.47 cents per Mcf, or by 5.47 cents per Mcf, without any demonstrated increases in the producers' cost of producing the gas and without any other reasonable economic justification.

2. It was imprudent and not consistent with the public interest for applicant to tie the price of California produced gas to a formula precluding applicant from effectively bargaining with California producers in the future as conditions and circumstances change.

3. The border price formula is unreasonable in that it yields a price for California produced gas based on out-of-state gas prices which have not been found reasonable by the Federal Power Commission.

4. The border price formula is unreasonable in that, should out-of-state gas prices be reduced, no reduction in price for California gas would result until the following calendar year, and no refund for excessive prices meanwhile charged would ever be made.

5. The plan of tying the price of California produced gas to the border price of El Paso and Transwestern gas is unreasonable in that such price can be, and is, increased by El Paso's and Transwestern's rate filings with the Federal Power Commission, without any economic justification for the resultant increase in price of California produced gas.

6. It was imprudent and not consistent with the public interest for applicant to have undertaken to bind itself to take casing-head gas under the border price formula,where applicant has no control over the rate of production of such casing-head gas and where deliverability quantities depend to a large extent upon the market for oil and other liquid hydrocarbons, including fuel oil which competes with gas.

7. The border price formula for California produced gas is unreasonable in that such price changes as would occur thereunder would not be within the control of either applicant or this Commission but would be the result of tariffs filed in another jurisdiction by corporations operating in other states, based on factors and conditions prevailing in other states, and applicable to gas produced in a state other than California.

8. The type of long-term contract in common usage in the gas industry, unlike applicant's contracts, contains specific prices and generally provides for periodic price renegotiation.

9. Applicant's price of 34.47 cents per Mcf for California produced gas is substantially higher than producers receive in Texas or the United States as a whole for gas sold in interstate commerce.

10. Applicant has not sustained its burden of proof with respect to the alleged reasonableness of its claimed cost of gas for rate-fixing purposes for the test year 1962.

11. For rate-fixing purposes, any amount in excess of $69,080,000 for cost of gas for test year 1962 would be unreasonable. Such amount reflects 99,645,000 Mcf of gas from Transwestern at an average price of 43.09 cents per Mcf, 9,855,000 Mcf of gas from Transwestern at an average price of 31 cents per Mcf, 16,425,000 Mcf of gas from Transwestern at an average price of 24 cents per Mcf and 62,497,000 Mcf of gas from California or other sources at an average price of 31.31 cents per Mcf,[3/] with appropriate adjustments for free fuel, storage injection and withdrawal, and gas for company use.

3/ We do not here approve 31.31 cents per Mcf as the lowest reasonable cost of gas from such California and other sources. We do find, however, that any greater price would be unreasonable for rate-fixing purposes herein.

Before leaving this subject we again place applicant on notice that it has the burden of proof as to the reasonableness of the cost of gas and that such burden is a continuing responsibility. In fairness to all concerned, including consumers, the producers and applicant, we place applicant on notice that in future rate proceedings California gas producer costs may be one of the considerations in determining fair and just gas cost allowances for rate-fixing purposes.

Storage and Transmission Expenses

The staff's estimates of storage and transmission expenses are $23,000 and $31,000, respectively, lower than applicant's estimates. These differences are related entirely to the lower cost of gas used by the staff as compared with the applicant. Consistent with the cost of gas used herein, we find reasonable $1,375,000 for storage expense and $2,760,000 for transmission expense for test year 1962.

Administrative and General Expenses

Applicant's estimate for administrative and general expenses is $90,000 higher than that of the staff. Some $71,000 of this difference results from the staff's estimate of a transfer credit to reflect capitalization of certain overhead costs related primarily to a change in estimated completion date of construction projects including the Gaviota-Goleta pipeline project. This $71,000 difference was not challenged by applicant.

Approximately $16,000 of the difference relates to expenses for property insurance and injuries and damages. The staff's estimate reflects the trend in actual charges for property insurance and injuries and damages and also reflects uninsured losses chargeable to these accounts, but eliminates additional amounts included by applicant in the form of accruals to its insurance reserve. The staff's allowances for these items are in accord with past Commission policy and we find them to be reasonable.

The staff's estimate also excludes $7,000 of political expenditures and some $2,000 of dues and donations in accordance with past Commission policy which we find to be reasonable. On the other hand the staff's estimate includes $6,000 of expenses associated with a move of construction headquarters, which was not included in applicant's estimate for 1962.

On this record we adopt as reasonable an amount of $1,722,000 for administrative and general expenses for test year 1962 at applicant's present rate levels.

Depreciation Expense

The staff's depreciation expense estimate is $162,000 lower than applicant's estimate. Some $144,000 of this difference results from the staff's use of a 35-year life for the desert pipeline compared with a 27-year life used by applicant for this facility. The remaining $18,000 difference results from the staff's use of applicant's latest construction program for 1962. In its prior rate proceeding in 1960, both the applicant and the staff used a 35-year life for the desert pipeline facility and applicant's gas rates were fixed at that time reflecting a 35-year life for such facility. Applicant has used a life of 40 years for other transmission pipelines on its system. Applicant's showing is not convincing that a 27-year life for the desert pipeline should be used for rate-making purposes at this time.

In view of the evidence we adopt as reasonable an amount of $1,990,000 for depreciation expense in the test year.

Taxes Other Than Income

Estimates of taxes, other than income, presented by the staff are $110,000 below applicant's estimates. This difference results primarily from a difference in estimates for ad valorem taxes. Applicant reflected in its estimate for 1962 an increase of 18 cents per $100 of assessed valuation over its latest known over-all tax rate of $6.38 per $100 of assessed valuation, whereas the staff used the latest known assessment ratio and tax rates.

Applicant points out that its over-all tax rate has increased from $4.86 in 1953 to $6.33 in 1961, an average increase of 19 cents per year. The record reveals, however, the following over-all tax rates and assessment ratios applicable to applicant's operations for the last three years:

	1959	1960	1961
Assessment Ratio 4/	42.30%	41.18%	42.50%
Over-all Tax Rate	$6.38	$6.40	$6.38

This record indicates stabilization of applicant's ad valorem tax rates in recent years. The latest known rates and assessment ratios will be used herein for developing reasonable ad valorem tax allowances in a test year for rate-fixing purposes.

Applicant claims that the staff's estimate of ad valorem taxes is understated by $29,000, even assuming the use of the latest known tax rates and assessment ratios and the staff's cost of gas, because the staff incorrectly computed the amount of current asset gas in storage. Consistent with the cost of gas used herein and the allowance for current asset gas in storage hereinafter found reasonable, we find an amount of $2,423,000 for taxes other than income to be reasonable for the purposes of this proceeding.

4/ Ratio of tax base to book cost.

Income Taxes

Applicant has calculated and paid its income taxes on a straight-line depreciation basis in all years, but filed a claim for and received a tax refund based on liberalized depreciation for years 1954 and 1955 in the total amount of $73,169.86. The record shows that applicant does not intend to claim liberalized depreciation in the future. In developing federal income taxes for the test year 1962 both applicant and the staff have reduced by $7,000 the computed amount to reflect the write-off of the refund.

While the principal difference between the estimates of income taxes presented by applicant and the staff results from a difference in the respective estimates for expenses as heretofore indicated, applicant takes exception to an adjustment of $56,000 made by the staff relating to a consolidated income tax credit. It appears this is the first time the staff has made such an adjustment in computing applicant's income taxes. Applicant urges that the tax loss that accrues to the parent company, Pacific Lighting Corporation, a nonutility holding company, should not be allocated to the public utility subsidiaries because no part of the expenses of the parent company are allocated to the subsidiaries. Allowable income taxes for the purposes of this proceeding will reflect applicant's position. However, we place applicant and its affiliates on notice that in any future rate proceeding they will be expected to furnish complete detail regarding the deductions in their consolidated tax return which are not reflected in the hypothetical income tax calculation made on a separate return basis.

After giving effect to the revenues and expenses being adopted herein, we compute and adopt an income tax amount of $3,930,000 for the purposes of this decision for test year 1962 at applicant's present rate levels. Such computation reflects a 5.5 percent State income tax rate and a 52 percent Federal income tax rate.

Rate Base

The components of the weighted average depreciated rate base for test year 1962 as developed by the applicant and by the staff are compared below:

WEIGHTED AVERAGE DEPRECIATED RATE BASE
Test Year 1962 Estimated

Item	Applicant	CPUC Staff	Adopted
Weighted Average Gas Plant	$86,703,000	$85,874,000	$85,874,000
Deduction for Depreciation and Amortization	14,265,000	13,942,000	13,942,000
Weighted Average Net Gas Plant	72,438,000	71,932,000	71,932,000
Current Asset Gas in Storage	4,338,000	3,701,000	4,200,000
Working Capital:			
Weighted Average Materials and supplies	580,000	580,000	-
Working Cash Allowance	225,000	-	-
Subtotal Working Capital	805,000	580,000	150,000
Deduction for Unamortized Tax Reserve	-	-	31,000
Weighted Average Depreciated Rate Base	77,581,000	76,213,000	76,251,000

The staff's estimate of weighted average gas plant is $829,000 lower than applicant's estimate. This difference was not challenged by applicant since it resulted from the staff's use of applicant's latest construction program for 1962 which reflected a later completion date for certain projects, including the Gaviota-Goleta pipeline, than used in applicant's estimate. We adopt as reasonable the staff's estimate for this item.

Applicant's weighted average deduction for depreciation estimated for 1962 is $323,000 higher than estimated by the staff. The use by the staff of applicant's latest construction program and changes in the actual program for 1961 account for $49,000 of the difference while the use by the staff of a 35-year life for the desert pipeline accounts for the remaining difference of $274,000. We find the staff's estimate to be reasonable for this item.

The staff's estimate of current asset gas in storage is $637,000 lower than applicant's estimate. Applicant claims that the staff's estimate does not give effect to the greater volume estimated by applicant in its first amendment to be in storage at the beginning of 1962 and further claims that the staff used a short-cut method which seriously understates the inventory balance at the end of several months during the test year. In Exhibit 33 applicant computed $4,298,000 as the weighted average of current asset gas in storage for the test year 1962 using the Commission staff's estimated gas prices. Such amount is about $40,000 less than applicant's estimate of $4,338,000 using its estimated gas prices for 1962. It is significant, however, that applicant's estimate of current asset gas in storage as of October 31, 1961 shown in Exhibit 16 is $7,151,000 compared with the actual balance of $6,602,207, or about $549,000 less than applicant's estimate for that date. In view of the entire record and consistent with the price of gas used herein, we find an amount of $4,200,000 to be reasonable for current asset gas in storage to be included in rate base for test year 1962.

There is no difference in the respective estimates for materials and supplies in the amount of $580,000. With respect to working cash, applicant has included in its rate base an allowance of $225,000 which it claims is the approximate average of daily bank balances that are currently required by applicant. In its 1960 rate proceeding applicant urged that a working cash allowance of $300,000 be adopted. The staff states that an allowance for working cash is included in rate base in order that investors may be compensated for monies which they have supplied over and above the investment in tangible and intangible property in order to enable the utility to operate economically and efficiently; that the working cash allowance is a judgment amount based upon an analysis of certain balance sheet accounts and upon a detailed study of relative lags in the collection of revenues and the payments of expenses; and that the short collection time for revenues from its two affiliated customers and the accruals of monies for income taxes produce sufficiently large quantities of money so that applicant's stockholders do not need to supply any additional money for working cash.

In this connection the staff developed in Exhibit 22 a gross working cash requirement of $735,000, which was offset by $1,499,000 resulting from an excess of credits received over credits extended, showing that on the average applicant had on hand $764,000 not supplied by stockholders. However, based on the rate of return used in this decision, the corresponding excess of credits received over credits extended would be $1,212,000 at the staff's cost of gas and $1,140,000 at the applicant's cost of gas. The average on hand not supplied by stockholders would thus be $477,000 at the staff's cost of gas and $413,000 at the applicant's cost of gas. The $580,000 needed for materials and supplies exceeds these amounts by $103,000 and $167,000, respectively.

While in its Exhibit 20 the staff has used a zero working cash allowance based upon its working cash study (Exhibit 22), nevertheless staff counsel in oral argument urged that the Commission deny applicant's request for a working cash allowance, and also that the Commission give careful consideration to the use, for rate-making purposes, of a single figure for working capital which would include both materials and supplies and working cash and that there be deducted therefrom the average amount of working cash applicant has on hand not supplied by investors.

In our opinion it is equitable both to applicant's stockholders and to the ratepayers to deduct from rate base the average amount of working cash applicant has on hand not supplied by stockholders. Consistent with the revenues, expenses and rate of return herein found reasonable for test year 1962, we adopt as reasonable working capital in the amount of $150,000 for the test year rate base.

Neither the applicant nor the staff deducted from rate base the unamortized tax reserve resulting from a refund based on liberalized depreciation for the years 1954 and 1955 previously mentioned. Consistent with Commission policy in this regard, which we find to be reasonable, the estimated unamortized tax reserve of $31,000 will be deducted from rate base.

We adopt as reasonable a rate base for test year 1962 of $76,251,000.

Rate of Return

Applicant's request for rate relief is based upon a rate of return of 6.6 percent on its depreciated rate base estimated for test year 1962. While applicant asserts that a 6.6 percent rate of return is not commensurate with the risks associated with the functions performed by applicant, nevertheless applicant states it has limited its request to a 6.6 percent rate of return solely for the purpose of expediting the proceeding and without waiving its right to request hereafter a higher rate of return.

Applicant points out that in its last rate proceeding, Application No. 41277, the Commission in Decision No. 60428, dated July 26, 1960, found a rate of return of 6.5 percent to be just and reasonable and that the 6.6 percent rate of return which it seeks herein is equal to that allowed by this Commission in the most recent rate proceedings involving applicant's affiliated companies, Southern California Gas Company (Decision No. 60615) and Southern Counties Gas Company of California (Decision No. 60614), decided in August 1960.

In support of its position, applicant computed in Exhibit 14 a 6.67 percent average rate of return on a depreciated historical cost rate base it claims was allowed in 28 decisions involving natural gas distributing utilities by some 19 state regulatory bodies during the period November 1959 through May 1961. Applicant asserts that its business is subject to greater potential risks than the usual gas distributing utility. A similar analysis was presented by applicant in its last rate proceeding (Application No. 41277) indicating a 6.89 percent average rate of return allowed selected natural gas distributing utilities by regulatory bodies during the period September 1957 to May 1960. Thus, on applicant's own showing there has been a decline in allowed average rate of return of .22 percentage points between the two periods.

Applicant's witness testified that in his opinion a utility that has not elected to take liberalized depreciation for income tax purposes has less risk than one making such an election. (See California Water Service Co., Decision No. 63530, dated April 5, 1962, in Application No. 43397.) On this record applicant has stated its intention not to elect to take liberalized depreciation for income tax purposes for the future.

A witness for the City of Los Angeles pointed to a number of differences between applicant and the utilities listed in applicant's Exhibit 14, including size, annual revenue, capital structure, bond ratings, type of operation and corporate affiliation, all of which he considered significant as to relative risks of operations. This witness showed in Exhibit 25 that the median rate of return of the 28 decisions used by applicant in Exhibit 14 was 6.55 percent; that 14 of the cases allowed rates of return of 6.5 percent or less; and that the allowed rates of return computed by applicant on a depreciated historical cost rate base ranged from a low of 5.90 percent to a high of 8.36 percent. Exhibit 25 also reveals that the yield of both debt and equity capital had decreased since applicant was last authorized a rate of return of 6.5 percent in 1960.

The witness for Los Angeles in Exhibit 25 also compared the financial results of applicant with results for 11 major natural gas distribution utility subsidiaries. Specific items compared included (a) percent earned on common stock equity; (b) common stock equity in percent of total capital; (c) interest coverage; (d) common stock dividends; and (e) payout ratios. Based upon his analyses and studies, the witness for the City of Los Angeles concluded that if any adjustment at all is now to be made in the 6.5 percent rate of return last allowed applicant, such adjustment would more appropriately be a downward one, rather than upward as sought by applicant.

In closing argument staff counsel urged that the Commission should very seriously consider lowering the 6.5 percent rate of return last found reasonable for applicant. The representative of the California Farm Bureau Federation saw no reason to increase the rate of return over the 6.5 percent last authorized. The Department of Defense and other executive agencies of the United States of America urged in their closing brief that applicant be allowed a rate of return substantially less than either the 6.6 percent requested or the 6.5 percent previously allowed so as to reflect adequately the reduced risks of applicant's operations.

We find that a rate of return of 6.2 percent will be fair, adequate and reasonable for this applicant for test year 1962 under all of the circumstances set forth in the record herein.

On this record the Commission finds that for test year 1962 applicant's present rates will yield to applicant a rate of return of approximately 6.2 percent on a depreciated rate base of $76,251,000, after allowing for reasonable operating expenses, depreciation and taxes. We find such rate of return, rate base and over-all results to be fair and reasonable.

We find that applicant's request for an increase in rates is not justified and conclude that it should be denied in its entirety. Applicant's motion for interim rate relief likewise should be denied.

ORDER

Based on the evidence and the findings thereon as hereinabove set forth,

IT IS ORDERED that the application of Pacific Lighting Gas Supply Company for an increase in rates and its motion for interim rate relief are denied.

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

Dated at San Francisco, California, this 14th day of May, 1962.

Everett C. McKeage
President

George G. Grover

Frederick B. Holoboff
Commissioners

I dissent; will file details later
C. Lyn Fox

McKEAGE, President, specially concurring:

I concur in the end result of this decision with the qualification that I withhold my approval of the Commission's action in not requiring the gas purchase contracts, involved herein, to be made of record in this proceeding.

These contracts do not constitute confidential matter. This proceeding is the public's business, and the public is entitled to know the parties to and the contents of said contracts. The public pays the bill.

It is true that in prior proceedings the Commission has not required gas purchase contracts of the nature here involved to be made of record. However, it is never too late to correct an erroneous view; never too late to start doing things the right way. This being a rate proceeding, it presents a frame of reference which all the more demands full public disclosure of these gas purchase contracts.

In my judgment, the public interest requires a full disclosure on the record of these contracts.

McKEAGE

APPENDIX A

LIST OF APPEARANCES

FOR APPLICANT

O. C. Sattinger, J. R. Elliott, and R. D. Twomey, Jr.

FOR INTERESTED PARTIES

Harry P. Letton, Jr. and John Ormasa, for Southern California Gas Company; Milford Springer and Robert M. Olson, Jr., for Southern Counties Gas Company of California; Rollin E. Woodbury, J. F. Nail and William E. Marx, for Southern California Edison Company; Chickering & Gregory by Richard B. Morris, for San Diego Gas & Electric Company; Roger Arnebergh, Arthur Karma, Robert W. Russell and Manuel Kroman, for the City of Los Angeles; Alfred H. Driscoll and Oliver C. Jessen, for the Department of Water and Power, City of Los Angeles; Robert S. Teaze and Stanley M. Lanham, for the City of San Diego; Harold Gold, Reuben Lozner and Clyde F. Caroll, for the Department of Defense and Other Executive Agencies of the United States of America; Robert N. Lowry, Brobeck, Phleger and Harrison, Gordon E. Davis and William W. Eyers, for California Manufacturers Association; Donald J. Carman and Richard Edsall, by Richard Edsall, for California Electric Power Company; Jack O. Sanders and Eldridge W. Sinclair, for H. Zinder and Associates, Inc.; O'Melveny & Myers, by Lauren M. Wright and Donn B. Miller, for Riverside Cement Company, Division of American Cement Company; Henry E. Jordan, Bureau of Franchises & Public Utilities, City of Long Beach; Gerald Desmond, by Edward T. Bennett, for the City of Long Beach; William L. Knecht, for California Farm Bureau Federation.

FOR THE COMMISSION STAFF

Franklin G. Campbell and Colin Garrity.

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 Gas Rates under Section 454 of the Public Utilities Code.	Application No. 43670 (Filed August 9, 1961) First Amendment Filed October 6, 1961

DISSENTING OPINION

of

COMMISSIONER C. LYN FOX

I dissent:

In my opinion the majority decision errs in three vital particulars:

(1) In refusing to allow for rate-making purposes the price applicant actually pays for gas produced within California, when such price was determined by bona fide arm's length bargaining, free from any taint of collusion or other improper dealings.

(2) In deducting from applicant's rate base an alleged "negative working cash."

(3) In reducing applicant's rate of return when no evidence whatsoever was presented to support a reduction in the rate of return, either by the Commission's staff or by any interested party or protestant in this proceeding.

Cost of Gas

The majority finds $69,080,000 for the test year 1962 to be a reasonable allowance for cost of gas. This total is calculated as follows:

(1) Transwestern supply:

(a) 99,645,000 Mcf at 43.09 cents per Mcf--------	$42,937,000
(b) 9,855,000 Mcf at 31 cents per Mcf-----------	3,055,000
(c) 16,425,000 Mcf at 24 cents per Mcf-----------	3,942,000
(2) California or other sources:	
62,497,000 Mcf at 31.31 cents per Mcf-------	19,568,000
	$69,502,000 (1)

(1) The figure of $69,080,000 is reached after certain adjustments for free fuel, storage, injection and withdrawal and gas for company use.

Applicant's estimates for cost of gas included 99,645,000 Mcf at 43.09 cents per Mcf of Transwestern gas, 88,777,000 Mcf of California source gas at 34.27 cents per Mcf for a total of $73,359,000.(2)

Thus, there is sharp disagreement with applicant, first, as to the amounts of gas to be taken from Transwestern and California sources respectively and, secondly, as to the cost of California gas.

The cost of California gas is the crucial factor here. It appears undisputed that some 83 per cent of California source gas will be purchased under binding "long-term" contracts during 1962 at a cost of 34.47 cents per Mcf as computed by a border price formula. However, the majority finds that it was "imprudent and not consistent with the public interest" for applicant to bind itself to pay such 34.47 cents per Mcf "without any demonstrated increases in the producers' cost of producing the gas and without any other reasonable economic justification" and that the use of border price formula was also imprudent, not consistent with the public interest and unreasonable. Then, somewhat mysteriously, the majority concludes that a price of 31.31 cents per Mcf for California source gas would not be unreasonable.

I believe that the majority position is erroneous and without any foundation or factual support in the record and is an

(2) Adjusted to $72,899,000 after similar adjustments as in footnote (1), supra.

unwarranted and unlawful substitution and imposition of judgment in a matter properly the concern and responsibility of applicant's management.

Since the judgment of applicant's management with respect to gas purchases is under attack, I believe it is necessary to summarize the background of applicant's current purchasing policy for California gas.

Prior to World War II, California sources of gas were adequate to meet applicant's requirements. At this time, a buyer's market for gas existed and producers were willing to enter into 20-year contracts at low prices in order to be assured of an outlet for their gas. Gas in Southern California was and is almost entirely associated with oil and legal prohibitions have existed since 1931 against dissipation of gas produced in conjunction with oil. However, with a decline in discovery of additional gas supplies in California and the phenomenal growth experienced in California in the 1940s, applicant was forced to look to out-of-state gas in order to be assured of adequate supplies required for its operations. Subsequently, applicant has looked primarily to out-of-state sources of supply and currently with its affiliates, receives more than 75 per cent of their total supply annually from such sources. From 1947-1957 there was a greater potential market than there were volumes of gas available. Applicant was able to buy and use all California gas plus all the gas applicant was able to contract for and get certificated by the Federal Power Commission.(3)

These circumstances resulted in a change of attitude by the producers, who demanded higher charges for their gas, which was no longer a surplus commodity. They also sought only short-term contracts in order to take advantage of any increases in the price of gas. Thus, the price of California source gas had risen from 6 cents per Mcf in 1941 to about 22 cents in 1957.

The growth in California coincidentally produced a substantial increase in demand for gas to supply applicant's industrial customers, including Southern California Edison Company. The importance of interruptible customers to a gas utility's economical and efficient operation has long been recognized by this Commission. Recently, in D. 62260 in C. 5924, dated July 11, 1961, we said:

> "During the off-peak periods of firm demands and generally throughout the summertime, because of the high load-factor deliveries from out-of-state, large quantities of gas are available for non-firm usage. A gas utility may effect economies, and thus provide firm service at lower rates, by selling gas during off-peak periods for industrial consumption on an interruptible basis. The interruptible class of customers is thus an important class, both from the standpoint of the utility and from the standpoint of the firm customers."

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(3) Applicant's witness Jacobs testified:
"There was not a time during that period of years as I recall it now when we were taking less than 100 per cent capacity on our out-of-state supplies." (RT 672)

In addition to growing demands and declining supplies, another condition of great significance to applicant's gas purchasing policies occurred in the 1950s when certain of applicant's interruptible customers began to seek independent California gas supplies. In 1955, applicant lost important supplies of California gas to the City of Long Beach as a result of its offering the producer a better price for his gas than applicant was then paying. In the 1956-57 period, Edison and the Richfield Oil Corporation entered into an agreement whereby Richfield dedicated 500 billion cubic feet of natural gas for delivery and sale to Edison. The price was in excess of that then currently offered by applicant and included a border price formula provision.(4)

At the same time applicant was advised by various California producers from whom it was purchasing gas that they had been approached regarding future deliveries of gas.(5)

The effect of the foregoing involved not only loss of both valuable interruptible customers, and important sources of California supply, but by creating a competitive demand, served to force the price of California gas upwards and introduced the border price concept.

(4) In 1957, the average price paid for out-of-state gas actually delivered at all points along the borders of California was 24.3 cents per Mcf.

(5) Applicant's witness Todd testified that in 1956 Edison offered certain owners of gas producing properties some 24 cents per Mcf, a price 4 cents higher than that then offered by applicant.

Applicant, as a regulated public utility, is required by law to render its services at just and reasonable charges and must furnish such adequate, efficient, just and reasonable service and facilities as are necessary to promote the safety, health, comfort and convenience of the public. (Section 451, Pub. Util. C.; Richardson v. Railroad Commission (1923) 191 Cal. 716, 720; Allen v. Railroad Commission (1918) 179 Cal. 68, 88.) In the discharge of this public obligation, applicant must stand ready to meet all the demands of its firm customers in the most efficient and economical manner. Thus, in the face of continually rising requirements and the competitive and economic conditions heretofore described, applicant had the duty and responsibility, as it always has, of obtaining the necessary gas to supply its requirements. This period was a time of grave concern to the gas utilities of this State, this Commission, as well as other organizations and governmental entities representing the consumers and public.(6) Applicant sought additional out-of-state supplies to meet these increasing demands in projects which this Commission finally certificated after extended proceedings.(7) New supplies were sought by the Pacific Gas

(6) See, for example, in D.61261 in A. 40588, dated December 28, 1960, the "Rock Springs" proceeding, the concern of the City of Los Angeles, the Air Pollution Control District of Los Angeles County and others over the securing of adequate gas supplies to meet increased industrial uses of gas as a means of alleviating the severe air pollution problem in the Los Angeles Basin.

(7) See D.57419 in A.40022, dated September 30, 1958, authorizing the initial Transwestern - applicant project involving 300 Mcfd of out-of-state gas; and D.62117 in A.40588 dated June 6, 1961, and D. 61261 in A. 40588, dated December 28, 1960, the "Rock Springs" project involving El Paso Natural Gas Company and applicant's affiliates.

and Electric Company from as distant a source as Canada.(8)

In the matter of its California source supply, the policy of applicant was consistently to take gas produced in Southern California in preference to out-of-state gas. Applicant's management in 1957 determined to continue this policy and also that the best interest of the public would be served by negotiating the so-called "long-term" contract with California gas producers. This policy would not only provide against the loss of California supplies, but also against the loss of interruptible customers, which, as we have seen, play a significant part in load equation permitting the most economical disposition of gas to all gas customers, firm and interruptible. The first "long-term" contracts were negotiated in 1957 and executed in 1958, conditioned upon this Commission's approval. In D.57598 in A.40079, dated November 10, 1958, a rate increase application of this applicant, this Commission expressed its concern with increasing gas costs, both inside and outside the State and applicant was directed to resist unwarranted increases in field prices. Subsequently, applicant filed Application No. 41004 requesting an order finding (1) that, in negotiating the "long-term" contracts, applicant has been diligent to protect the welfare of its customers and that the "long-term" contracts are in the public interest and (2) that the price provisions represent the lowest reasonable prices for which applicant's needs for an adequate supply

(8) In D.60564, in A.40738, dated August 16, 1960, this Commission authorized the California portion of the 1,400 mile pipeline from Canada.

of California source gas can be satisfied. On motion of the Commission staff, we dismissed the application in D.58677, dated June 29, 1959, upon the grounds that no jurisdiction existed to approve or disapprove the contracts involved. But, although we felt that the law precluded a decision in this matter, we stated:

> "We are not unmindful of the objective sought by the applicant, and we hasten to offer the thought that applicant is to be commended for what it is here attempting to do." D.58677, page 4.

Based upon this language, applicant could and did reasonably infer that this Commission sympathized with its "long-term" contract policy. At that time and presented with the form of the "long-term" contract, we did not suggest or infer any criticism of these contracts or the underlying policy.

Thereafter applicant decided to continue the policy of negotiating "long-term" contracts. The considered judgment of applicant's management, in view of the competitive and supply factors, was that no alternative method of securing necessary California source gas existed and that periodic short-term renegotiations of prices was incompatible with the availability of gas to the consumer at fair and reasonable prices. The majority of the contracts became effective July 1, 1959.

It is also relevant to note that in D.57598 in A.40079, dated November 10, 1958, and D.60428 in A.41277, dated July 26, 1960, applicant's most recent rate cases, this Commission adopted applicant's figures as to cost of California gas. Significantly, the 1960 case included gas purchased under "long-term" contracts. The specific contracts were then made available to the Commission staff on a confidential basis, yet no objection to the form or underlying policy was made.

Subsequent to the events heretofore described, important changes occurred in the over-all gas supply matter, which I believe have profoundly influenced the decision in this proceeding, but which were reasonably unforeseeable and unforeseen by either applicant or this Commission. First, commencing in 1960, there has been a considerable development of offshore gas in Southern California. Most of the producers involved had previously entered into "long-term" contracts with applicant and their offshore gas was automatically covered by those contracts.[(9)] Secondly, recent winters have been warmer than normal, thus reducing applicant's annual sales. Third, there have been excess supplies of fuel oil which have competed with gas for industrial energy needs. In view of those factors and the advent of Transwestern gas at the rate of 300 M^2cfd, the result has been to place applicant in a position of temporary oversupply. However, even in retrospect, it must be conceded that available supply and requirements can hardly be expected to conform precisely at all times, where new sources of gas, and particularly

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(9) The State of California is vitally interested in these offshore developments, having received some $65,000,000 under its offshore leases. Based upon a 20 per cent royalty, California would receive some 7 cents per Mcf of the approximately 35 cents per Mcf which applicant would pay for this gas as proposed in this proceeding.

out-of-state gas, must be secured periodically in large increments and temperature and other economic conditions are beyond applicant's control.

In addition to the foregoing, the price of El Paso gas, by virtue of a series of rate filings with the Federal Power Commission, has risen sharply and unexpectedly in the amount of some 9 cents per Mcf since the institution of applicant's "long-term" contract policy. This, of course, has raised the cost in the "long-term" contracts under the border price formula provisions.

The majority, without the necessity of exercising any foresight into these very technical and unpredictable factors, can now confidently assert that based upon present conditions, applicant's cost of California gas is unwarranted and too high, and that applicant should take less California gas and more Transwestern. But even taking advantage of the majority's hindsight position, I must disagree with the opinion. The taking of Transwestern increments at 31 cents per Mcf and 24 cents per Mcf is accomplished at the expense of taking less California gas. This not only overlooks applicant's contractual obligations, but unrealistically assumes that the available but unpurchased gas would remain in the ground. For, assuming that applicant could somehow be released from its existing contractual obligations, the record demonstrates convincingly that such gas, 95 per cent of which is produced in association with oil, will be produced as the oil is produced; that the gas cannot by law be dissipated; and that it will therefore seek a market and most likely among applicant's present customers. Such losses to the extent of the

Transwestern increments would mean that applicant would in fact not be acquiring any increment.

I am convinced, therefore, and I believe the record overwhelmingly demonstrates that applicant's management, the competence of which is unchallenged, has acted prudently and in the public interest under the circumstances there existing in pursuing its "long-term" contract policy. To now challenge that action, even assuming this Commission's authority to substitute its judgment in this matter, is wholly without support in the record and an unconscionable example of "second guessing tantamount to confiscation."

I must also dissent to the specific findings with respect to the "long-term" contracts appearing on pages 12 and 13 of the majority opinion. The record demonstrates that such contracts have three basic provisions. First, terms of 20 to 35 years are utilized for the purpose of securing the supplies of gas essential to applicant's service to the public. Also, the longer the term, the less competitive factors will influence the price. The second basic feature is a stabilized price geared to the regulated border price. The third is the right to purchase all gas produced in the Southern California area, whether it had been discovered at the time of the contract or not, again assuring a continuing supply.

Finding 1, page 13. Applicant has presented considerable and uncontradicted testimony to the effect that competitive conditions and producer demands have resulted in the adoption of the border price formula. The Edison-Richfield transaction and border price provision included therein amply support applicant's contentions. During the period of negotiations of the "long-term" contracts, applicant's competitors were offering significantly higher prices than applicant for California gas. In 1957 the average border price was some 24.3 cents per Mcf, 26.9 cents in 1958 and 25 cents in 1959. The price paid under the "long-term" contracts was 27 cents in 1960 and 29 cents in 1961. The jump to 34.47 cents in 1962 was the result of unforeseeable rate fixings by El Paso Natural Gas Company before the Federal Power Commission, an eventuality unforeseeable and uncontrollable by applicant. These competitive conditions and the Edison-Richfield transaction appear ample economic justification for the border price formula.

Producers in this State are not regulated by this Commission. (Richfield Oil Corp. v. Public Util. Com. (1960) 64 C.2d 419.) Hence, producer cost data is unavailable to this Commission and applicant testified that such data was unavailable to itself. Furthermore, there is no basis in this record for assuming that traditional regulated utility standards and formulae are applicable to oil and gas producers. In fact, the Federal Power Commission experience since the famous Phillips decision imposing wellhead regulation points to a contrary conclusion.(10) Applicant testified that the California producers themselves thought in terms of value of service, beginning with the border price, rather than in terms of

(10) Phillips Petroleum Co. v. Wisconsin (1954) 347 U.S. 672.

utility cost of service concepts. The majority of this Commission and its staff may desire field regulation or theorize about unascertained producer cost of service data, but the record is without contradiction that applicant acted prudently and obtained the best price it could under the conditions existing at the time of the negotiating of the "long-term" contracts.

Finding 2. The border price formula provides a relatively stable price for substantial periods of time which will be unaffected by local competitive conditions. Prices will not be subjected to periodic renegotiation along vague value concept lines. The formula is based upon the weighted average of the Federal Power Commission established tariff rates at the California border for gas committed only to applicant and its affiliates and assumes a 100 per cent load factor.

Finding 4. This presents only one side of the coin and is an example of the majority citing but one provision in order to justify its position with respect to the entire contracts. The border price is computed on January 1 each year based upon the then effective price. The formula price then remains the same throughout the year regardless of increases as well as decreases for out-of-state gas.

Finding 6. The record is clear that some 95 per cent of the gas produced in Southern California has been associated with oil. The "long-term" contracts include provisions that all gas available for sale will be available to applicant whether these supplies are presently known or discovered in the future. Substantial amounts of gas are in production (as witnessed by the amounts applicant estimates to receive in the test year). There is no wellhead regulation, hence specific reserve data is unavailable. Faced with the reality of the production of this gas, I cannot believe that applicant acted imprudently in deciding to secure as much of these supplies as possible in an effort not only to satisfy its own growing needs, but to forestall that gas from seeking a market among applicant's customers.

Findings 3, 5, 7 and 8. A significant element of the "long-term" contracts is relative price stability. The price is set according to the rates established by the Federal Power Commission for out-of-state gas sales to applicant and its affiliates only and not to prices negotiated by or established for other companies over which applicant has no control. Before arriving at a price standard, applicant considered various indices. These were generally inapplicable. Periodic price renegotiation was deemed inadvisable because of the local competitive situation which could easily force prices upward rapidly. Furthermore, producers were thinking in terms of border prices. Therefore, I do not believe that it was imprudent or unreasonable for applicant to utilize prices established by the Federal regulatory agency most cognizant of natural gas problems.

Finding 9. The 34.47 cents per Mcf price which applicant is paying should be considered in the circumstances of the particular contracts and not with reference to sales occurring elsewhere. Applicant has testified that local competitive conditions have forced the price of California gas upwards, but there is no evidence in the record concerning the circumstances surrounding sales of natural gas elsewhere in this country, or otherwise indicating the relevancy or materiality of sales in Texas or elsewhere in the United States to sales under the "long-term" contracts.

In a more comparable situation and for comparative purposes, I must point out that the 34.47 cents price is substantially less than the proposed price per Mcf in the so-called PEMEX project.(11) Over a 20-year period the price to Edison will average some 40.42 cents per Mcf at the California-Mexico border and 45 cents per Mcf at the Edison load center at a 100% load factor.

Finding 10. In view of the uncontradicted testimony concerning the competitive situation existing during the 1950s in Southern California, the uncontradicted testimony that the "long-term" contract negotiations were carried on in good faith and at arm's length, and the other evidence before this Commission, this finding is completely without foundation or any support in this record.

Finding 11. In the light of my foregoing comments, I would reject this finding and adopt applicant's cost of gas figures without modification.

(11) A.43931 and A.43932, now pending before this Commission.

It is also interesting to note that while the majority opinion rejects applicant's 34.47 cent price as unsupported in the record, it adopts a figure of 31.31 cents per Mcf. The opinion does not enlighten the reader as to the basis for this figure nor does any readily appear. The Commission staff recommended a price of 29 cents per Mcf for California gas purchased under the "long-term" contracts on the theory that this was the price last accepted for rate-fixing purposes by this Commission.(12) The only recommendation for the 29 cent figure apparently is that it is lower than 34.47. However, even the majority recognizes the irrationality and confiscatory nature of such a figure. But, why do they then select 31.31? Is there any cost of service data or other producer cost figures to support this figure? No. The majority finds that any price greater than 31.31 would be unreasonable. Upon what basis is 31.32 unreasonable, but 31.31 not unreasonable? I must admit my inability to decipher any basis for the selection of this figure, nor in fact does any basis appear in the record. It appears that faced with an unreasonable staff recommendation and unwilling to realistically accept applicant's figure, the majority has arbitrarily settled upon a compromise which is notable only for the absence of any rational foundation.

I also believe that Finding 11 on page 14 of the majority opinion is erroneous as a matter of law for the following reason.

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(12) In D.60248, supra.

The evidence is entirely uncontradicted that the "long-term" contracts were negotiated at arm's length.(13) The evidence is similarly uncontradicted that a competitive situation for securing gas has existed in Southern California. Nor does the majority suggest or the record in any way indicate that applicant's officers acted in bad faith or negligently or wastefully.

To the extent that utilities secure materials and services necessary to their business through contracts made by arm's length bargaining in the open market, the contract price is ordinarily accepted as the proper cost to the utility. (Pac. Tel. & Tel. Co. v. Public Utilities Com. (1950) 34 C.2d 822, 826). It is also a settled principle of regulatory law that a public utilities commission, under the guise of establishing a fair rate for its services, may not usurp the function of the utility's management and substitute its judgment for that of the directors of the corporation as to the propriety of contracts entered into by the utility; nor can it ignore items charged by the utility as

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(13) For example, applicant's witness testified: "These negotiations were continuous and protracted and the final result represents arm's-length bargaining in earnest." (RT 327) Under cross-examination, staff witness Doran was asked: "Q. Well, now Mr. Doran, is there any question in your mind but that the Gas Company bargained with these producers to the maximum of its ability?
A. I am not questioning or have not questioned the ability of Pacific Lighting's management.
However, I have stated certain conclusions with respect to Pacific Lighting's long'term contracts which I do believe should be taken into account for rate fixing.
Q. Well, has any information come to your attention that would disprove my statement that the Gas Company officials bargained on these contracts to the best of their ability?
A. I have no information that they did not." (RT 1354)

operating expenses in the absence of a showing of an abuse of discretion in that regard by the officers of the utility. (United Fuel Gas Co. v. Railroad Commission, 278 U.S. 300, 320, 73 L.ed. 390, 401; Missouri Ex. Rel. S.W. Bell T. Co. v. Public Serv. Com., 262 U.S. 276, 288, 67 L.ed. 981, 985; State Public Utilities Commission ex rel. Springfield v. Springfield Gas & E. Co., 291 Ill. 209, 234, P.U.R. 1920 C, 640, 125 N.E. 891.) Recently, a United States Circuit Court of Appeals said as to expenses: "If properly incurred, they must be allowed as part of the composition of the rates. Otherwise, the so-called allowance of a return upon the investment, being an amount over and above expenses, would be a farce." (Mississippi Fuel Corp. v. Federal Power Commission 163 Fed. 2d 433, 437.)

Public utility commissions have power to prevent a utility from passing on to the ratepayers unreasonable costs for materials and services. However, the decisions of the Supreme Courts of this State and of the United States, including those cited above, are clear that expenses incurred by a utility through contracts for materials necessary to their business and negotiated at arm's length bargaining must be accepted by the regulatory commission for rate fixing purposes.

Exceptions to this principle merely underscore the validity of the general proposition. One exception is the disallowance of excessive payments under contracts between affiliated corporations for the purpose of fixing rates. (Dayton

P. & L. Co. v. Public Utilities Commission 292 U.S. 290, 295, 78 L.ed. 1267, 1273, Pac. Tel. & Tel. Co. v. Public Utilities Com., supra, 34 C.2d at 826.)

In the Dayton Power & Light case, the court stated that where an affiliation was shown, the burden of proof was on the buyer to show that the price was no higher "than would fairly be payable in a regulated business by a buyer unrelated to the seller and dealing at arm's length." (292 U.S. at 308, 78 L.ed at 1279.) The court in the Pacific Tel. & Tel. case recognized that arm's length bargaining provides "safeguards" assuring fair and reasonable costs.

Other exceptions may include situations involving "bad faith" (Missouri Ex Rel. S.W. Bell T. Co. v. Public Serv. Com., supra, 262 U.S. at 288, 67 L.ed at 985); or waste or negligence which "must be established by evidence......" (West Ohio Gas Co. v. Public Utilities Com. 294, U.S. 63, 68, 79 L.ed. 761, 767).

Under the foregoing authorities, the fact of arm's length bargaining raises a presumption of fairness and reasonableness which can only be rebutted by something over and above a substitution of judgment such as the majority would erroneously here impose. The disallowance of applicant's claimed cost of gas expense thus is patently unlawful. "A rate order which does not provide for proper allowable expenses, taxes, depreciation and return is unfair, unreasonable and confiscatory . . . obvious basic premise."(13)

(13) Mississippi Fuel Corp. v. Federal Power Commission, supra, 163 F. 2d at 451.

Working Capital

I must dissent also to the majority's working capital figure in principle, as to its development in this proceeding, and as to the staff section which evoked the theory and prepared and presented the studies on this issue. In this proceeding the Finance and Accounts Division of the Commission was by-passed utterly and the preparation and presentation of working capital data presented by the Utilities Division, apparently to support the philosophy and theories of this staff section. This usurpation of the functions of other staff divisions is a characteristic of the Utilities Division and, in my opinion, unconscionable. For this reason alone I reject all testimony and slide rule manipulation presented on this issue in this case.

However, because of the weight apparently accorded by the majority to this engineer-produced data on a financial matter, I will discuss the merits of the question. This Commission has uniformly treated the allowance for materials and supplies and the allowance for working cash separately, including the last rate case of this applicant. (D. 60428 in A. 41277, dated July 26, 1960.) In fairness to the parties in this proceeding and those who may be similarly affected in future proceedings, this Commission should clearly set forth the basis for adopting a "negative" working cash and deducting it from the materials and supplies allowance.

The Commission engineering staff, following its past procedure, developed a zero working cash allowance. This allowance is entirely a judgment amount based upon a study of certain balance sheet items and relative lags in the collection of revenues and payment of expenses. The staff has utilized the figure developed to allegedly show that an applicant has not in fact supplied monies for needed working cash as claimed. There has never been a suggestion that such figure is factually sound and, if negative, be deducted from the rate base. In D. 62446 in A. 42887, dated August 22, 1961, this Commission recognized the principle underlying the working cash allowance heretofore followed and recognized the judgment nature of the figure by noting that "(a) witness for the staff also developed through alternate methods working cash allowances ranging from something less than 0 up to $744,000." To utilize admittedly judgment figures developed for one purpose and apply them to a new concept of rate making entirely without foundation in this record is unconscionable.

I must also dissent to the disallowance of any working cash allowance for the reasons enunciated in my dissent in D.60428, the last rate proceeding of this applicant. I incorporate that dissent here and point out additionally that the lag and lead study fails to recognize the fact that the amounts collected by the applicant represent, in part, the profit element to which applicant is entitled and also the depreciation accruals which merely repay applicant for the consumption of its properties. Furthermore, I do not believe it is a sound policy to compel applicant to invest amounts set aside for taxes in items of materials and supplies.

The engineering staff offered no oral or written evidence in support of a combined working cash and materials and supplies allowance. It seems to me that a prejudicial inconsistency arises thereby. In utilizing the engineering staff figures, the majority is using lag and lead computations developed for working cash only and not for materials and supplies, which undoubtedly include items that must be held for many months.

Rate of Return

The finding that the allowed rate of return of 6.2 per cent will be fair, adequate and reasonable is without any foundation in this record. The only evidence on rate of return was presented by applicant and the City of Los Angeles which the majority opinion summarizes. The evidence of the City of Los Angeles was presented to support a recommendation that no increase over the present 6.5 per cent be authorized. The evidence and testimony of these parties in no way supports a rate of return as low as 6.2 per cent and, on the other hand, clearly point to at least a retention of the 6.5 per cent rate of return.

In view of the record in this proceeding and the matters of which this Commission may take official notice, my conclusions are:

1. This Commission has no lawful authority to fix the wellhead price of natural gas, nor to compel gas producers to provide cost studies on the production of such gas.
2. During the period the contracts between applicant and the California gas producers were under negotiation, this Commission and its staff were kept fully informed as to price and other pertinent features of said contracts. This Commission and staff now are fully cognizant of the content of the contracts to which they now object.
3. Not once, to my knowledge, during the period cited in paragraph 2 above, did the Commission or any member of the Commission staff, object to the price under discussion nor to any other pertinent features of said contracts. On the contrary applicant was led to believe such contracts had the unofficial approval of the Commission and staff in D. 58677 in A. 41004, dated June 29, 1959.

4. During the period said contracts were being negotiated, applicant was faced with a genuine probability that gas producers would sell their gas directly to large industrial consumers, thus depriving applicant of large portions of its important interruptible market, to the ultimate disadvantage of California householders.
5. Said contracts were negotiated at arm's length bargaining, absent the slightest hint of collusion or other improper dealings.
6. The majority's treatment of working capital is unrealistic and improper.
7. The evidence clearly supports at least continuance of applicant's presently authorized rate of return of 6.5 per cent.
8. The evidence is clear that applicant has met its burden of proof in demonstrating that it is entitled to a substantial portion of the increase sought.

I am mindful that findings of fact by this Commission ordinarily are conclusive and not subject to review. But findings which are unsupported by any competent evidence cannot sustain an order. (Cal. Water & Tel. Co. v. Pub. Util. Com. (1959) 51 C.2d 478, 494; Southern Pac. Co. v. R.R. Commission (1939) 13 C.2d 125.) For the reasons heretofore discussed, I believe that the majority opinion is untenable and erroneous as a matter of law in that the findings to which I dissent are unsupported by any competent evidence and in that the disallowance of applicant's claimed cost of California gas amounts to an unlawful and confiscatory substitution of judgment in a matter properly within the purview of applicant's managerial discretion.

C. Lyn Fox
Commissioner

Los Angeles, California
May 16, 1962.