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Decision No. 83549

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of CALIFORNIA-PACIFIC UTILITIES COMPANY, a California corporation, for authority to increase its rates for electric service in its Needles District.	Application No. 54664 (Filed February 15, 1974)
In the Matter of the Application of CALIFORNIA-PACIFIC UTILITIES COMPANY, a California corporation, for authority to increase its rates for gas service in its Needles District.	Application No. 54665 (Filed February 15, 1974)

INTERIM OPINION

Applicant, a California corporation with its principal place of business at 550 California Street, San Francisco, California, owns and operates public utility electric, gas, water, and telephone systems in various parts of California, Oregon, Nevada, Utah, and Arizona.

Applicant seeks authority to increase its rates for electric and gas service for its Needles District, which is comprised of the town of Needles and the immediate vicinity. Electric power for this district is received from the Bureau of Reclamation and Nevada Power Company; gas is purchased from Pacific Gas and Electric Company.

In addition to requesting general rate relief, applicant filed a petition for interim relief for both departments. This interim decision will dispose of the request for interim relief.

Hearings were held on both applications before Examiner Meaney in Needles on August 13, 14, and 15, 1974. Members of the applicant's staff and the Public Utilities Commission staff testified. The city of Needles appeared as an interested party and presented the testimony of its city manager. Members of the public also appeared and testified. The testimony of public witnesses will be discussed in the decision on final relief in this matter, since such testimony, other than one service complaint which will be the subject of a late-filed exhibit, was primarily directed to the issue of rate design.

Applicant filed a petition for interim relief for both gas and electric rates on July 15, 1974. The petition requests increased electric rates which would provide additional annual revenues of not less than $106,893 and increased gas rates which would provide additional annual gas revenues of not less than $141,652.

Table A-1 attached to the petition shows a decline in company earnings. For the 12-month period ending December 31, 1973, the company-wide net income was $3,599,000, and for the 12-month period ended May 31, 1974, this had dropped to $3,027,000. Much of the recent decrease in net income is due to higher costs of gas and electric energy, and the recent high cost of short-term borrowings.

Kevin O'Conner, the company's financial witness, testified that he considered the times interest earned after taxes an important measure of financial strength or weakness that is used in the financial community as a measure of the company's ability to repay its loans and meet its interest obligations on time. He stated that this is especially important to bond purchasers and people who are rating the financial integrity of the company. This witness sponsored an exhibit (Exhibit 3, page 16-6) which showed that 25 comparable companies had times interest earned of 2.8 for 1971 and 3.0 for 1972. This contrasted with 2.6 during 1972 for California-Pacific. He considered the 25 companies comparable since they had roughly the same capital ratios and the same return on common equity as of December 31, 1972 as California-Pacific.

Table A-3 to the petition for interim relief shows the recent further decline in the times interest earned after taxes and the resultant further inability, based upon the company's debenture indentures to obtain further debt financing. This table shows, based upon funds available for interest as of May 31, 1974, that by August the times interest earned after taxes would be 2.156, and by September, 1.996. At the hearing the witness said he recalculated these estimates based upon funds available for interest as of June 30, 1974 and that such calculation supported the previous projection. This means that if two times coverage is the absolute minimum for determining additional allowable interest expense, as of September there can be no additional debt financing without a waiver from the debenture holders.

This situation is outlined in the petition for interim relief. Various outstanding indentures all provide, among other things, that applicant may not incur any further indebtedness "unless the net earnings of the company for any twelve consecutive calendar months within the fifteen consecutive calendar months immediately preceding the first day of the month in which such indebtedness is to be incurred...shall be at least equal to twice the aggregate amount of the annual interest requirements on all indebtedness for borrowed money outstanding and to be outstanding upon the incurrence of the indebtedness then proposed to be incurred..." Assuming the witness' projection of times interest earned is correct (that is, that as of September 1974, below 2.0), no further indebtedness can be incurred unless the indenture holders are willing to waive this provision.

In this connection, it was explained that the company president is presently touring the country to talk to debenture holders and ask them for such a waiver. The company feels that a major influencing factor in obtaining such waivers will be whether interim relief is granted in this and other similar cases. The company president has not, of course, promised the debenture holders that interim relief would be granted, but has assured them that the company would take steps to obtain interim relief in all of its districts where the rate of return is believed to be unsatisfactory and where immediate relief appears to the company to be essential.

Because of this situation the company has initiated a cost-cutting program and has postponed $2 million of construction during the year 1974. The revised construction budget figure for this year is $12.5 million. In spite of this, and in spite of approximately $4 to $5 million of internally generated funds, the witness stated that the company still needed to raise $2 to $3 million of additional funding from outside sources to meet necessary construction plans for the remainder of the year.

The company has also considered various financing alternatives and has concluded that at present it must rely upon short-term borrowings. The company would not plan on selling a bond issue in 1974, according to the company's witness, unless the interest rates dropped below 9 percent. The company's Exhibit 3 originally showed (page 16-4) that the effective interest rate on bonds and debentures, estimated as of December 31, 1974, would be 6.74 percent. The witness considered this too low since the exhibit included the assumption that the company would be able to issue, during 1974, a "Series U" 30-year bond issue for $5,000,000 at 8.25 percent. At current interest rates, this would of course be impossible.

As to preferred stock, the company witness pointed out that, if issued now, it would cost the company approximately 12 percent, and also that preferred stock issues at present usually have a 10-year nonrefunding provision; thus, such an issue would lock the company into a 12 percent preferred stock for a 10-year period.

According to its financial witness, the company's best method of raising more capital at this time would be the issuance of common stock, since the company is "unfavorably leveraged". The company intended to issue 130,000 shares this year but has postponed such a plan because at present each share would sell for a maximum of about $16. The witness stated that, unless the price were to be about $19 per share, insufficient capital would be raised. Thus, although the company still wishes to issue the 130,000 shares, it must wait until more favorable conditions exist.

Thus, in summary, the company believes that its need for $2 million to $3 million of outside funds must be met through additional short-term borrowings.

The company's witness testified that his calculations established the overall rate of return on rate base for the 12-month period ending June 30, 1974 at slightly less than 8 percent.

Rates of return for the Needles District are low due to the fact that there has been no recent rate relief. Needles electric rates were last increased in 1955. In 1968 and 1969 rate reductions were authorized, and the reductions resulted in rates comparable to those effective prior to 1955, and comparable to those effective during the 1930's. On these rates, the company earned a 3.40 percent rate of return for 1973, and the company estimates a 0.31 percent rate of return for test year 1974.

There have been no gas rate increase applications filed in Needles since 1939. Currently existing rates have produced, for 1973, a negative rate of return of 8.47 percent, and the company estimates a negative 10.31 percent return for test year 1974.

The staff, based primarily upon differences of opinion as to operating revenues and purchased power costs, disagrees with these rate of return estimates for the Needles District for test year 1974. The staff estimates a rate of return of 5.14 percent for the electric department and a negative 0.94 percent rate of return for the gas department, both based on present rates. The detail resulting in these differences will be discussed more fully in the final opinion.

The staff and the city of Needles both oppose interim relief. The city of Needles feels that the company must bear responsibility for its earnings picture in Needles since it delayed so long in asking for relief. Both the city and the staff are of the opinion that since the company received a favorable hearing date, it would be counter-productive to issue an interim decision, since this would delay the final decision.

Neither the city nor the staff presented any testimony specifically concerning the issue of interim relief.

Discussion

While it is true that, particularly regarding the gas department, the company would have been more prudent to seek relief earlier than it did to forestall the current situation, the Commission believes that an emergency has been demonstrated to justify some interim relief, based upon the most conservative estimates of rate of return and operating expenses.

The company's failure to seek rate relief for the gas department since 1939, which allowed it to operate on a negative return (according to the company's own figures) since 1971, has benefited the ratepayers, but should not have gone on for such lengths. We recognize that the company must consider the costs of a regulatory proceeding in a district of this size; nevertheless, applicant and others similarly situated should avoid this much delay in the future.

The Commission does not consider it improper in this proceeding to award interim relief. There are many major issues concerning revenues, operating expenses, depreciation, and rate design which must be resolved. The poor earnings picture in this district, even if the staff's estimates rather than the company's are accepted, justifies some interim increase pending the final resolution of the remaining issues.

It must be remembered preliminarily, when assessing whether the Commission should award interim relief, that it has before it a fully developed record, and full hearings have been held. Thus, this case may be distinguished from some cases denying an interim increase, where the record consisted of pro forma information or untested data (cf. City of Los Angeles (1963) 61 CPUC 217).

We believe that sufficient extraordinary circumstances concerning the capital requirements of this company have been shown so that some interim relief is justified. The Commission has previously held that interim relief may be granted in situations where it is necessary to arrest a utility's downward trend in interest coverage and to enhance its ability to attract its forthcoming capital requirements at reasonable terms. (General Telephone Company (1970) 71 CPUC 657.) In San Diego Gas & Electric Company, Application No. 53945, et al., Decision No. 82279 issued December 18, 1973, the Commission awarded interim relief after public hearings because of serious interest coverage problems which showed that as of 1974, without relief, interest coverage would probably be below 2.0 and, therefore, further financing by way of bonds would not be possible. The present case is based on facts which establish a more serious problem in this regard than was present in the San Diego case.

The Commission is aware that it must consider applicant's overall earnings position as well as that of its Needles District; however, the company has indicated, and the evidence is uncontroverted, that the overall rate of return is less than 8 percent, and the company is pursuing interim increase applications in several other districts with low earnings. Where final disposition of a rate increase application will require some time and where there is an indicated decline in the rate of return, an emergency may exist which will justify the granting of interim relief. (Southern California Gas Company (1952) 51 CPUC 535.) We believe that situation exists here. We have no reason to disregard the company witness' estimate that by September 1974, the times interest earned will be below 2.0 and, therefore, without obtaining a waiver from the debenture holders, the company will be unable to make any more short-term borrowings. The company has initiated a cost-cutting program and has reduced its projected plant additions, but even considering these factors, it is clear from the record that the company will need additional outside capital to meet its necessary commitments and to proceed reasonably with any future financing plans.

We turn now to determining the amount of a reasonable interim increase, the first step of which is to determine the proper rate of return upon which to base interim rates.

The company's witness proposed, for final relief, a 9.3 percent rate of return on rate base which, in his opinion, would produce a return on common equity in the range of 12-1/2 to 13-1/2 percent.

The staff stated that such a 9.3 percent return on rate base would produce a greater return on equity than suggested by the company's witness. The staff rate of return witness recommended a range for rate of return on rate base from 8.65 percent to 8.90 percent, which, according to his determination, would produce a common equity allowance ranging from 11.26 to 11.96 percent.

The testimony of these witnesses need not be discussed in detail for the purpose of this interim order, since the Commission believes it should base interim relief upon the 8.35 percent rate of return found reasonable for the company's Lassen Division (Application No. 53884, Decision No. 82711 dated April 9, 1974, as modified by Decision No. 83089 dated July 2, 1974).

We recognize that the Lassen Division case concerned electric rates only and not gas, and that the rate base for the Lassen Division is approximately $3,800,000 rather than (according to staff figures) a total of $2,470,000 for the Needles electric and gas departments combined. However, more importantly, the company-wide common equity ratio for December 31, 1973, which was used in the Lassen proceedings (35.29 percent) is virtually the same as that estimated by the staff in this present proceeding for December 31, 1974 (35.69 percent).

Of additional importance is the fact that in the Lassen proceeding, the staff estimates for the overall embedded cost of debt and preferred stock, 6.67 percent and 8.05 percent, respectively, adopted by the Commission in that proceeding, are lower than the staff estimates in this proceeding which are 6.88 percent and 8.64 percent.

Thus, for the purposes of interim relief in this proceeding, it is proper to adopt a rate of return found reasonable for virtually the same common equity ratio, at a time when costs of capital were lower than they are now. This 8.35 percent return on rate base is, as stated, lower than the recommendations of either the staff or the company in this proceeding, and, specifically, .30 percent lower than the bottom of the range recommended by the staff in these applications for the Needles Division.

Having determined the rate of return, the next facet of this matter is to set the rates for the electric and gas departments. Again, in keeping with the purpose of interim relief, which is to allow the company to earn sufficient funds to meet the problems of extraordinary circumstances pending final and full relief, the staff results will be accepted for determining interim rate levels.

Regarding the electric department, the company requests an additional $106,893 in gross revenues. Based upon the staff 1974 estimated results of revenues and expenses, and on the staff's calculations of rate base, the rate of return requested which would be achieved by awarding the company $106,900 additional revenues would be 7.91 percent, as more fully shown in the table which follows:

NEEDLES DISTRICT - ELECTRIC DEPARTMENT

Summary of Earnings for Interim Relief
1974 Estimated - Staff Basis

Item	Staff 1974 Estimated[1/]	Interim Relief	1974 Staff with Interim Relief
Operating Revenue	$ 788,400	$106,900[2/]	$ 895,300
Operating Expenses			
Power Purchased	446,500		446,500
Transmission	3,600		3,600
Distribution	48,000		48,000
Customer	28,400	300	28,700
Sales	2,000		2,000
Administrative and General	45,700		45,700
Total Operating Expenses	574,200	300	574,500
Depreciation	65,500		65,500
Taxes			
Other Taxes	74,100	2,100	76,200
State Franchise	(700)	9,400	8,700
Federal Income	(16,100)	45,700	29,600
Total Taxes	57,300	57,200	114,500
Total Revenue Deduction	697,000	57,500	754,500
Net Revenue	91,400	49,400	140,800
Rate Base	1,779,000		1,779,000
Rate of Return	5.14%		7.91%

(Red Figure)

1/ As shown on staff's Report on the Results of Operation, Electric Department, Exhibit No. 6, page 12-2, Table 12-A, column (a).

2/ As requested by the utility petition filed July 15, 1974.

As to the gas department, however, the company has requested not less than $141,652 in interim revenues. Based upon the staff analysis of the gas department, this would produce an amount which would generate a return on rate base in excess of 8.35 percent, and should be adjusted downward to no more than $139,100, which, according to staff results, is sufficient to achieve the 8.35 percent found reasonable for interim relief. The following table sets this out in detail:

NEEDLES DISTRICT - GAS DEPARTMENT

Summary of Earnings for Interim Relief
1974 Estimated - Staff Basis

Item	Staff 1974 Estimated 1/	Interim Relief	1974 Staff with Interim Relief
Operating Revenue	$187,000	$139,100	$326,100
Operating Expenses			
Purchased Gas	95,400		95,400
Distribution	38,000		38,000
Customer	19,600	600	20,200
Sales	800		800
Administrative and General	22,400		22,400
Total Operating Expenses	176,200	600	176,800
Depreciation	31,500		31,500
Taxes			
Other Taxes	36,300	2,800	39,100
State Franchise	(8,100)	12,200	4,100
Federal Income	(42,400)	59,300	16,900
Total Taxes	(14,200)	74,300	60,100
Total Revenue Deduction	193,500	74,900	268,400
Net Revenue	(6,500)	64,200	57,700
Rate Base	691,400		691,400
Rate of Return	(0.94)%		8.35%

(Red Figure)

1/ As shown on staff's Report on the Results of Operation, Gas Department, Exhibit No. 8, page 11-2, Table 11-A, column (a).

Since the Commission has reserved issues of rate design for the final decision, this rate relief will be spread to each customer group on the basis of the energy consumed by that group. This will be applied as an interim increase to each customer's bill on a uniform cents per unit of energy consumed, pending final decision of these applications.

For electric customers, the additional charge is 0.246¢ per kilowatt-hour, which is determined from dividing the $106,900 by 43,414,900 kilowatt-hours.

For gas customers, the additional charge is 10.46¢ per therm, which results from dividing $139,100 by 1,329,800 therms.

The interim relief awarded herein will be sufficient to meet the company's needs as to times interest coverage for the Needles District, pending final relief, since the rates found reasonable herein will produce a times interest coverage of 2.20 for the electric department and 2.21 for the gas department, based upon staff results and 1974 estimated costs of financing.

Findings

1. Applicant is in need of additional revenues in both its gas and electric departments, and is in need of interim relief in this proceeding in an amount sufficient to assist it in obtaining necessary financing pending the final decision in these matters.

2. The amount of additional annual revenue requested for the electric department in the petition for interim rate relief in the amount of $106,893 is reasonable, and will produce a rate of return on rate base of 7.91 percent, and a return on common equity of 9.19 percent.

3. The amount of additional annual revenues proposed in the petition for interim rate relief for the gas department in the amount of $141,652 is excessive, and should be adjusted to $139,100 so as not to exceed an 8.35 percent rate of return, which was authorized by Decision No. 82711 dated April 9, 1974, as modified by Decision No. 83089 dated July 2, 1974 in Application No. 53884. Such relief for the gas department will produce a return on common equity of 10.42 percent.

4. The total additional revenue found reasonable in Findings 2 and 3 will produce a combined return on rate base for the Needles District of 8.04 percent and a combined return on equity for the district of 9.55 percent.

5. It is reasonable, for the purpose of determining the amount of interim relief, to find that the staff's estimates of operating revenues, expenses, including taxes and depreciation, the rate base, and the rate of return for the test year 1974 are reasonable.

6. Interim rate relief granted herein for the electric department should be applied to each customer's bill by adding an additional charge of 0.246¢ per kilowatt-hour.

7. The interim rate relief granted for the gas department should be applied as an interim increase in the form of an additional charge of 10.46¢ per therm.

8. The increases in rates and charges authorized by this decision are, for interim purposes, just and reasonable, and the present rates and charges, insofar as they differ from those prescribed by this decision, are, for the future, unjust and unreasonable.

<u>Conclusion</u>

The petition for interim relief should be granted to the extent set forth in the order which follows.

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INTERIM ORDER

IT IS ORDERED that:

California-Pacific Utilities Company is authorized to file with this Commission on or after the effective date of this order, in conformity with General Order No. 96-A, revised tariff schedules for its Needles District, to become effective five days after the date of filing, with rates increased as follows:

A. For the electric department: tariff schedules with the rates increased from present levels by 0.246¢ per kilowatt-hour.

b. For the gas department: tariff schedules with the rates increased from present levels by 10.46¢ per therm.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 8th day of OCTOBER, 1974.

President

Commissioners