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Decision No. 84006

**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 gas service in its South Tahoe  
Division.

Application No. 54803  
(Filed April 12, 1974)

Bradley Bunnin, Attorney at Law, for applicant.  
Peter Arth, Jr., Attorney at Law, and Edmund  
Texeira, for the Commission staff.

O P I N I O N

Applicant is a corporation duly organized and existing under the laws of the State of California. Applicant owns and operates public utility electric, gas, water, and telephone systems in various parts of California; electric, gas, and telephone systems in Oregon; electric, gas, water, and telephone systems in Nevada; and electric systems in Utah and Arizona. Applicant is also engaged in the nonutility sale of liquefied petroleum gas in Oregon. Applicant's principal place of business is located at 550 California Street, San Francisco, California.

According to the application, except for a tracking increase that became effective May 18, 1972 in the amount of .00065¢/therm, there have been no changes in gas rates for the South Tahoe Division since 1967. On December 1, 1967 a rate reduction was authorized by the Commission. Decision No. 79348 dated April 18, 1972 authorized tracking of purchased gas costs through, but not beyond, December 31, 1972.

The application was made necessary by the increased cost of gas purchased from Southwest Gas Corporation and to provide for the additional revenues necessary to permit a rate of return of 9.3 percent on average depreciated rate base.

For the estimated year 1974 the increased cost of purchased gas as a result of increases that became effective on January 22, 1974 and April 1, 1974 is \$272,900. Based on the estimated year 1974 after application of the \$272,900 cost of gas increase, the rate of return drops from 7.42 percent to a negative amount. The revenue requirement needed to track this increase is \$277,123.

The total revenue increase requested in the application is \$391,184. This amount includes the revenue requirement needed to recover the increased cost of purchased gas as well as an additional amount necessary to achieve a return of 9.3 percent. Applicant's proposed rates are based on a rate of return of 9.3 percent (approximately 13.0 percent return on equity) which it claims is required to attract new capital needed for supplying the service that must be supplied and to permit it to maintain its credit and financial integrity.

As the staff was not prepared to proceed with a full rate case showing prior to October 1974, applicant requested a hearing for an offset increase and authority to track increases through the last six months of 1974.<sup>1/</sup>

Public hearing on the offset was held before Examiner Gillanders at South Tahoe on June 25 and 26, 1974. Applicant had published, mailed, and posted notice of the hearings in accordance with this Commission's Rules of Practice and Procedure. Three members of the public attended the hearing but did not participate.

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<sup>1/</sup> Applicant is requesting, for the future, a "Purchased Gas Adjustment Clause".

Testimony on behalf of applicant was presented by its rate and valuation engineer. Testimony on behalf of the Commission staff was presented by an engineer.

Applicant and the staff stipulated that, for the purpose of the offset proceeding only, Exhibit 8 could be used for setting interim rates. The examiner accepted the stipulation with the understanding that the staff, when it presented its showing in the full rate case, would present a results of operation study fully developed and complete within itself. Exhibit 8 showed that to offset the increases in costs of gas after June 30, 1974 an increase of 2.730¢/therm would be required.

By Decision No. 83097 dated July 2, 1974 applicant was authorized to add 2.730¢/therm to each of its tariff schedules and it was also authorized to track any changes in cost of gas which might occur between the effective date of that decision and December 31, 1974. The increase amounted to \$332,500 on an annual basis.

Further public hearing was scheduled on the application for October 8 and 9, 1974 at South Tahoe.

Hearing was held before Examiner Gillanders as ordered. No members of the public attended. Testimony on behalf of applicant was presented by seven witnesses. A complete 12-chapter results of operation study and accompanying testimony on behalf of the Commission staff were presented by three witnesses. The matter was submitted on November 7, 1974 upon receipt of late-filed Exhibits 18 and 19.

#### Present Operations

The South Tahoe Division provides gas service in the city of South Lake Tahoe and adjacent territory in El Dorado County. The utility also provides at the customer's request and expense the maintenance or replacement of parts of gas-fired heating equipment and related facilities that are located on customer's property.

At the end of year 1973, the utility was furnishing gas service to about 6,000 customers through approximately 101 miles of distribution mains ranging from 2 inch to 8 inch in diameter. A summary of operations as presented by applicant and staff is set forth below:

1974 Estimated at Present Rates (7/5/74)

Item	Staff	Utility	Utility Exceeds Staff	
			Amount	Ratio
Operating Revenue	\$2,080,300	\$1,862,201	\$(218,099)	(10.5)%
<u>Operating Expenses</u>				
Purchased Gas Cost	1,376,000	1,255,427	(120,573)	(8.8)
Distribution	77,100	83,200	6,100	7.9
Customer Accounts	81,050	80,771	(279)	(.3)
Sales	950	2,250	1,300	136.8
Admin. & Gen.	82,000	89,000	7,000	8.5
Total Oper. Exp.	1,617,100	1,510,648	(106,452)	(6.6)
Depreciation	93,600	94,266	666	.7
<u>Taxes</u>				
Other Than Income	73,600	72,529	(1,071)	(1.5)
California State				
Franchise	12,800	3,100	(9,700)	(75.8)
Federal Income	36,900	-	(36,900)	(100.0)
Total Taxes	123,300	75,629	(47,671)	(38.7)
Total Oper. Deductions	1,834,000	1,680,543	(153,457)	(8.4)
Net Revenue	246,300	181,658	(64,642)	(26.2)
Average Rate Base	2,809,100	2,833,700	24,600	.9
Rate of Return	8.77%	6.41%	(2.36)%	-
(Inverse Item)				

1974 Estimated at Proposed Rates

Item	Staff	Utility	Utility Exceeds Staff	
			Amount	Ratio
Operating Revenue	\$2,168,200	\$2,016,023	\$(152,177)	(7.0)%
<u>Operating Expenses</u>				
Purchased Gas Cost	1,376,000	1,255,427	(120,573)	(8.8)
Distribution	77,100	83,200	6,100	7.9
Customer Accounts	81,450	81,571	121	.1
Sales	950	2,250	1,300	136.8
Admin. & Gen.	82,000	89,000	7,000	8.5
Total Oper. Exp.	1,617,500	1,511,448	(106,052)	(6.6)
Depreciation	93,600	94,266	666	.7
<u>Taxes</u>				
Other Than Income	74,500	74,073	(427)	(.6)
California State				
Franchise	20,600	16,700	(3,900)	(18.9)
Federal Income	74,700	56,000	(18,700)	(25.0)
Total Taxes	169,800	146,773	(23,027)	(13.6)
Total Oper. Deductions	1,880,900	1,752,487	(128,413)	(6.8)
Net Revenue	287,300	263,536	(23,764)	(8.3)
Average Rate Base	2,809,100	2,833,700	24,600	.9
Rate of Return	10.23%	9.30%	(.93)%	-
(Inverse Item)				

Rate of Return

After making the customary studies<sup>2/</sup> involved in rate of return determinations, it was the opinion of one of applicant's assistant treasurers that the rates proposed by applicant would result in a rate of return of 9.30 percent on the South Tahoe Division rate base.

<sup>2/</sup> Exhibit 11 contains 13 tables in support of the rate of return requested by applicant.

He testified that many factors are considered in arriving at his recommended rate of return, but the three tests which are used generally are derived from decisions of the United States Supreme Court. They include a comparison of the earnings of this company with the earnings of comparable companies with comparable risks, a consideration of whether the rates are sufficiently high to enable the company to continue to attract capital that is needed for supplying the utility service that it is obligated to supply, and whether they are sufficient to permit the company to maintain its credit and financial integrity.

In the final analysis, according to the witness, the selection of what is a fair and reasonable rate of return, however, is a subjective opinion; it is not a mathematically precise exercise. It is not a factual matter that is capable of being proven as is the number of vehicles the company uses. That is why expert opinion evidence is required on the issue of a fair and reasonable rate of return.

Some of the many factors considered by the witness in arriving at his subjective opinion include things, such as the characteristics of the locality served by the company, the size of the company in comparison to other utilities, the capital structure of the company, the financial history and earnings experience that the company has had, the requirement that the company pay reasonable dividends to its common stockholders, the future debt and equity needs of the company, the internally supplied funds the company is able to generate, the trend of long-term interest rates, the trend of interest coverage, the fact that the embedded cost of debt in the company will continue to rise even though current interest rates are lower than their peaks, the degree of anticipated inflation, the possibility of an economic downturn nationally or locally, and the level of applicant's rates as compared to the level of other rates.

Another important factor is the anticipated regular increases which can be expected in the costs that the company pays for the gas or electricity which it purchases from other sources and the policy of the regulatory body in authorizing or not authorizing the tracking or the passing through to customers of those increased costs. Such increases can be reasonably anticipated on the basis of the increasing fuel and construction costs that these suppliers are experiencing.

At the end of his testimony he was asked the following questions:

- "Q - What, then, is your specific recommendation as to the rate of return on common equity that California-Pacific Utilities Company should be allowed to earn?
- "A - California-Pacific Utilities Company should be allowed to earn 15% on its common equity.
- "Q - Based on the adjusted capitalization of California-Pacific Utilities Company as of December 31, 1973, what would be the rate of return required on total invested capital, or equivalently, on total rate base, given a 15% rate of return on common equity?
- "A - Table A, Line 8, Column G, indicates that California-Pacific Utilities Company would require a 10% rate of return on its utility investment based on my testimony supporting a 15% rate of return on common equity. It is my opinion that a 10% allowed rate of return on the Company's investment is necessary if the Company is to maintain investor confidence in its financial integrity and preserve its ability to attract capital.
- "Q - You are requesting a 10% rate of return on the Company's investment. However, the Company's proposed rates are based on a 9.3% rate of return. How do you reconcile this difference?

"A - In the period elapsed since the Company's application for increased rates was prepared, additional significant considerations in determining an appropriate rate of return has been brought to my attention. Such considerations, as I have brought forth in this testimony and which I could not foresee during the preparation of the Company's application, lead me now to request a higher rate of return on the Company's utility investment.

"However, the Company has been unable to refile the application for increased rates based on a higher requested rate of return due to the more urgent need to prepare applications for increased rates in other service territories of the Company."

The Commission's rate of return expert prepared a study consisting of text (Exhibit 17) and 14 tables (Exhibit 16). Based upon his study it was his judgment that a range for rate of return of 8.65 percent to 8.90 percent was applicable to the rate base to be determined for the South Tahoe Division of applicant. Within this rate of return range, according to the witness, the allowance for common equity is 11.26 percent to 11.96 percent. He testified that an 8.65 percent rate of return would be reasonable and would cover fixed charges for senior securities and allow earnings for common equity sufficient to increase retained earnings moderately after payment of a suitable dividend.

The earnings allowance for common equity, according to the witness, is necessarily a judgment based on many factors, such as trends in interest rates and coverage for senior securities, capital structure and related costs, capital requirements and sources of financing, earnings comparisons, and governmental efforts to curb inflation. He recognized that applicant is engaged in a regulated business which affects the public interest and that it is required to provide satisfactory service to its customers at reasonable rates. Moreover, it was his opinion that the earnings



allowance for common equity produced by his rate of return recommendation would result in fair rates for the applicant's customers and would provide a reasonable return to present and prospective investors in the applicant's common stock.

In Decision No. 83642 dated October 22, 1974 in Application No. 54223 regarding applicant's Weaverville Electric Division, we found a rate of return on rate base of 8.89 percent and a resulting return on common equity of 12.35 percent to be reasonable. Here, we likewise conclude that a 12.35 percent return on common equity is adequate and reasonable.

#### Gas Loss and Sales Expense

At the October 8 hearing, applicant stipulated that the staff's estimated operating revenue figures for 1974 could be used for ratemaking purposes. However, applicant took exception to the staff's estimate of lost gas and to the staff's adjustment to Account 916, Miscellaneous Sales Expense.

The following table shows gas requirements for 1974 estimated according to staff and applicant:

Item	Staff	Utility	Utility Exceeds Staff Amount	Ratio
(In Therms)				
Sales	13,238,140	11,747,174	(1,490,966)	(11.3)%
Company Use	-	-	-	-
Total Accounted for	13,238,140	11,747,174	(1,490,966)	(11.3)
Losses Therms	763,066	899,154	136,088	17.8
% of Requirements	5.45%	7.11%	1.66%	-
Total Requirements	14,001,206	12,646,300	(1,354,906)	(9.7)
(Inverse Item)				

According to the staff engineer, he accepted the recorded losses for 1973 of 5.45 percent as representative of the test year 1974. Applicant presented Exhibits 9 and 10 and associated testimony to show that its estimate of 7.11 percent should be adopted.

The Commission by Decision No. 78348 dated February 22, 1971 in Application No. 52415 authorized the South Tahoe Gas Company to transfer its business and assets and related rights to applicant. This transfer became effective March 2, 1971, and the South Tahoe Gas Company became the South Tahoe Division of applicant.

According to applicants' witness it did not receive the operating records of South Tahoe Gas Company which is the reason Exhibits 9 and 10 show only 3 years results. With only three years experience to guide us and taking into consideration applicant's testimony regarding its use of nontemperature compensating meters, the staff's use of applicants' recorded gas loss is reasonable.

According to applicant, Account 916, Miscellaneous Sales Expenses, consists of expenses of the South Tahoe Division personnel related to business promotional activities. Expenses of this nature amounting to \$1,300 were not considered appropriate for ratemaking purposes and were deleted in the staff's estimate. The staff's decision engendered a tremendous amount of controversy culminating in a request by the examiner for details to be provided by applicant by means of a late-filed exhibit (No. 18). Exhibit 18 shows two employees attended a total of 133 meetings of service clubs at an average cost of \$6.87 per meeting. The cost includes meals, drinks, fines, and other charges. Exhibit 18 shows an expenditure of \$232 for "Guests Dined" and expense of the local manager.

The Uniform System of Accounts prescribed by this Commission for gas utilities shows the following:

"913 Advertising expenses.

"This account shall include the cost of labor materials used and expenses incurred in advertising designed to promote or retain the use of utility service, except advertising the sale of merchandise by the utility.

"ITEMS

"Labor:

- "1. Direct supervision of department.
- "2. Preparing advertising material for newspapers, periodicals, billboards, etc., and preparing and conducting motion pictures, radio and television programs.
- "3. Preparing booklets, bulletins, etc., used in direct mail advertising.
- "4. Preparing window and other displays.
- "5. Clerical and stenographic work.
- "6. Investigating advertising agencies and media and conducting negotiations in connection with the placement and subject matter of sales advertising.

"Materials and expenses:

- "7. Advertising in newspapers, periodicals, billboards, radio, etc., for sales promotion purposes, but not including institutional or goodwill advertising includible in account 930, Miscellaneous General Expenses. ✓
- "8. Materials and services given as prizes or otherwise in connection with canning, or cooking contests, bazaars, etc., in order to publicize and promote the use of utility services.
- "9. Fees and expenses of advertising agencies and commercial artists.
- "10. Novelties for general distribution.
- "11. Postage on direct mail advertising.
- "12. Premiums distributed generally, such as recipe books, etc., when not offered as inducement to purchase appliances.
- "13. Printing booklets, dodgers, bulletins, etc.
- "14. Supplies and expenses in preparing advertising material.
- "15. Office supplies and expenses.

"Note A: The cost of advertisements which set forth the value or advantages of utility service without reference to specific appliances, or, if reference is made to appliances, invites the reader to purchase appliances from his dealer, or refer to appliances not carried for sale by the utility, shall be considered sales promotion advertising and charged to this account. However, advertisements which are limited to specific makes of appliances sold by the utility and prices, terms, etc., thereof, without referring to the value or advantages of utility service, shall be considered as merchandise advertising and the cost shall be charged to Costs and Expenses of Merchandising, Jobbing and Contract Work, accounts 416 or 915, as appropriate.

"Note B: Advertisements which substantially mention or refer to the value or advantages of utility service, together with specific reference to makes of appliances sold by the utility and the price, terms, etc., thereof, and designed for the joint purpose of increasing the use of utility service and the sales of appliances, shall be considered as a combination advertisement and the costs shall be distributed between this account and accounts 416 or 915, as appropriate, on the basis of space, time, or other proportional factors.

"Note C: Exclude from this account and charge to account 930, Miscellaneous General Expenses, the cost of publication of stockholder reports, dividend notices, bond redemption notices, financial statements, and other notices of a general corporate character. Exclude also all institutional or goodwill advertising. (See account 930, Miscellaneous General Expenses.)"

A perusal of Account 913 fails to show that charges of the kind shown on Exhibit 18 could or should be included in the account. The staff's adjustment is not only proper<sup>3/</sup> but indicates that by following the standard 12-chapter format for

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<sup>3/</sup> The correct rule, according to the California Supreme Court is "...to exclude from operating expenses for rate-fixing purposes all amounts claimed for dues, donations and contributions..." (Pacific Tel. & Tel. v PUC (1965) 62 Cal 2d 634, 669.)

staff results of operations reports such improper ratemaking expenses will be discovered.<sup>4/</sup>

Based on our resolution of the two controverted expense issues and a rate of return on rate base of 9.04 percent resulting in a 12.35 percent return on common equity, applicant is entitled to a revenue increase of \$16,350.

Rate Spread

Applicant proposes to maintain the existing block structure for tariff Schedule G-224 and to make small price adjustments to the included blocks. It proposes to replace the existing block structure for interruptible service under Schedule G-244 with a uniform rate of \$0.115 per therm. The minimum charge per month, accumulative annually for interruptible service, is requested to be increased from \$190 to \$304.

The staff also proposes to maintain the existing block structure for Schedule G-224 but recommends major changes in the pricing of the blocks. The staff proposes to increase the rates to large users by decreasing the differential in prices between the existing block structures. Sufficient differential in rates still exists so as to provide lower rates to the large user to reflect the lower cost of providing such service. The staff recommends increasing the minimum charge to assign the cost of service more fairly to all users.

Acceptance of applicant's proposal of a uniform rate of \$0.115 per therm for service under interruptible Schedule G-244 in place of the existing block structure was recommended by the staff. The \$0.115 rate includes the cost of gas plus an allowance for the other elements of the cost of service. The biggest user of this schedule is the South Tahoe sewage disposal plant. Small

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<sup>4/</sup> In three recent proceedings involving applicant, such adjustment was not proposed by any division of the staff.

users include a hospital, two schools, and two laundries. The staff also recommends approval of applicant's proposed increase to the minimum monthly service charge.

Applicant's authorization to track cost of gas increases granted in Decision No. 83097 expires on December 31, 1974. According to the staff, increased energy demands and the cost of developing new gas supplies have substantially increased the frequency of gas increases to California gas utilities. These conditions are likely to continue into the near future. Therefore, the staff considers it appropriate to recommend a purchase gas adjustment clause (P.G.A.). The staff would recommend the following restrictions be included in the P.G.A.:

- (a) All rate schedules would be increased or decreased by an adjustment factor on a cents-per-therm basis.
- (b) The utility will use advice letter procedures in order to file revised tariff schedules.
- (c) Each P.G.A. shall be filed with the California Public Utilities Commission 30 days before the proposed effective date.

#### Findings

1. Applicant is in need of additional revenues, but the proposed rates set forth in the application are excessive.
2. The staff's estimates of operating revenues, expenses, including taxes, depreciation, and rate base for the test year 1974 are reasonable.
3. A rate of return of 9.04 percent on the adopted rate base and return on common equity of 12.35 percent for the future is reasonable. Rates should be increased by approximately \$16,350.
4. The increases in rates and charges authorized herein are justified, the rates and charges authorized herein are reasonable, and the present rates and charges, insofar as they differ from those prescribed herein, are for the future unjust and unreasonable.

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5. The increase authorized in this proceeding should be apportioned between blocks in accordance with the staff recommended rate design.

6. Applicant should be authorized to file the staff's recommended Purchased Gas Adjustment Clause.

Conclusion

The application should be granted to the extent set forth in the order which follows.

O R D E R

IT IS ORDERED that after the effective date of this order applicant is authorized to file the revised rate schedule attached to this order as Appendix A, and the Purchased Gas Adjustment Clause attached to this order as Appendix B. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedule shall be five days after the date of filing. The revised schedule

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shall apply only to service rendered on and after the effective date of the revised schedule.

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

Dated at San Francisco, California, this 21<sup>st</sup> day of JANUARY, 1975.

Theron L. Litzinger  
President  
William L. Litzinger  
[Signature]  
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Commissioners



## APPENDIX A

California-Pacific Utilities Company  
South Tahoe Division

Tariff schedules include tracking rate changes totaling 3.233¢/therm from July 5, 1974 through January 1, 1975 as authorized by the Commission.

<u>Description</u>	<u>Per Meter Per Month</u>
<u>GENERAL NATURAL GAS SERVICE</u>	
<u>Rates</u>	<u>G-224</u>
First 2 therms or less .....	\$2.61902
Next 18 therms, per therm .....	.21851
Next 66 therms, per therm .....	.18851
Next 774 therms, per therm .....	.17851
Over 860 therms, per therm .....	.16351

INTERRUPTIBLE NATURAL GAS SERVICE

	<u>G-244</u>
All usage per therm .....	\$ .12865

Minimum Charge

\$275 per month accumulative annually.

APPENDIX B

California-Pacific Utilities Company  
South Tahoe Division

PRELIMINARY STATEMENT

5. Purchased Gas Adjustment Clause (South Tahoe Division)

Each filed rate schedule and contract in the South Tahoe Division subject to the jurisdiction of the California Public Utilities Commission shall include a Purchased Gas Adjustment (PGA) of \_\_\_\_\_ cents per therm to reflect a change from the base rates of \_\_\_\_\_ in the cost of gas purchased from Southwest Gas Corporation. The PGA will become effective after Commission authorization for service on and after the effective date of the change in cost of gas, but not less than 30 days after the date of filing. A PGA increase will be authorized only to the extent that the last authorized rate of return (for any of utility's California operations) is not exceeded.

Results of operations reports for the South Tahoe Division shall be filed by April 15 of each year. Such reports will set forth estimated operations for the current year and recorded and adjusted operations for the prior year.