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ORIGINAL

Decision No. 84603

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of SOUTHWEST GAS CORPORATION for authority to increase natural gas rates in San Bernardino County, California.	Application No. 54807 (Filed April 16, 1974)

Darrell Lincoln Clark, Attorney at Law, for Southwest Gas Corporation, applicant.
Col. Frank J. Dorsey, Attorney at Law, for the Executive Agencies of the United States, interested party.
Janice S. Kerr, Attorney at Law, E. J. Texeira, and K. K. Chew, for the Commission staff.

INTERIM OPINION

Southwest Gas Corporation (SW) seeks authority to increase its rates and charges for natural gas service in its San Bernardino County District (SBCD) approximately $727,000 (9.85 percent) annually over rates which became effective April 2, 1974. In addition, on April 22, 1974, SW petitioned for interim emergency rate relief alleging that it was facing a financial emergency and that unless existing rates were changed prior to the normal hearing schedule, SW would suffer irreparable harm.

SW, a California corporation, renders public utility natural gas service in certain portions of San Bernardino and Placer Counties, California. It is also engaged in the intrastate transmission, sale, and distribution of natural gas as a public utility in portions of Nevada and Arizona, and is subject to the jurisdiction of the Federal Power Commission with respect to interstate transmission and sales of natural gas for resale on its northern Nevada system.

SBCD serves approximately 23 percent of SW's total customers, and includes service areas in and around the cities of Barstow and Victorville and the community of Big Bear, all in San Bernardino County.

After notice, public hearings were held on the matter before Examiner Johnson on June 27 and 28, 1974 in Victorville and the interim portion of the matter was submitted on the filing of briefs which were received. Decision No. 83458, dated September 17, 1974 authorized an interim increase of $260,900 Additional hearings on the general rate increase were held before Examiner Johnson on October 16, 17, and 18, 1974 in Victorville, and on October 23 and 24, 1974 in Los Angeles. Testimony on the general rate increase was presented on behalf of SW by its executive vice president and general counsel, a vice president, its assistant controller, its tax manager, its rate engineer, and an employee from its rates and special studies department. SW also presented rebuttal testimony by its vice president and controller, its assistant controller, its Southern California division manager, and a vice president of Dean Witter and Company. The Commission staff presented testimony on the general rate increase through a financial examiner and two engineers. Testimony was presented on behalf of the Executive Agencies of the United States by the facilities maintenance officer at the Marine Corps Depot at Barstow and by an electrical engineer assigned to the civil engineering squadron of George Air Force Base. SW filed its opening brief on December 9, 1974, answering briefs were filed by the Commission staff and the Executive Agencies of the United States on January 8, 1975, and the matter was submitted on receipt of SW's reply brief filed January 21, 1975.

Rate of Return

The net revenue a utility will be authorized to earn is set forth in Commission decisions as an adopted reasonable rate of return. This net revenue, or return, provides the funds for the payment of interest on the utility's long-term debt, dividends on preferred stock, and return on common equity.

Testimony relating to the factors for the proper determination of the required rate of return was presented on behalf of SW by its vice president and controller, and a vice president of Dean Witter and Company, and on behalf of the Commission staff by one of its financial examiners.

SW's vice president and controller testified that in his opinion most common equity purchase decisions are guided by experts who look at an industry first and then to the companies within that industry to select one in which to make an equity investment. Consequently, his recommended return on equity largely evolved from comparisons to other companies whose size and circumstances were, in his opinion, similar to SW. He testified about his selection of ten natural gas companies having both transmission and distribution facilities and operating revenues within $20,000,000 of SW's 1972 operating revenues. Of these ten utilities, this witness eliminated from comparison with SW, three companies who received a significant portion of their net income from non-regulated activities and two who were subsidiaries of much larger utilities. He then compared SW's operations with the remaining five utilities with respect to times interest coverage, common equity capital ratio, return on average common equity capital, common dividend payout ratio, return on average total capital, potential gas curtailment risk, and tax accounting procedures.

This witness' comparative tabulations set forth in his Exhibit 4 indicated that SW's interest coverage has been less than the averages of the comparative companies; that the trend of SW's return on equity was declining as contrasted to the upward trend of comparative companies; that SW's rates of return on historic dollars should have increased during an inflationary period, whereas they actually declined; and that SW's return on average total capital was lower than comparable companies. He further testified that the mean and median 1973 return on average common equity capital for the group was 13.65 and 13.90 percent, respectively, and that since SW competes with this group in the financial markets he believes the absolute floor for a reasonable return on average common equity for SW to be within this range of 13.65 to 13.90 percent.

He further testified that SW's percentage send out to residential customers is less than one-half of the average of the five comparison utilities resulting in a higher curtailment risk for SW than the other five companies. In addition he noted that four of the five comparison companies normalized investment tax credits as contrasted to SW's procedure of flowing through such tax deferrals to the ratepayer. Flow through results in less funds from operations being available to SW than for those four companies utilizing income tax normalization. In his opinion these two factors necessitate SW's having a higher return on equity than the five comparison utilities to permit it to successfully compete with them on the financial market. In his judgment the proper level of such higher return on equity for SW is 16 percent.

Based on the assumption that SW would issue $5,000,000 of first mortgage bonds at 9.50 percent interest during 1974, the proportion of debt and preferred stock in SW's capital structure as of December 31, 1974 would aggregate 71.16 percent, bearing a related imbedded cost of 7.36 percent. With such a senior capital ratio it would be necessary for SW to earn a 9.85 percent rate of return to yield a return on common equity of 16 percent as shown in

Chapter 8 of Exhibit 3. Such a return would provide a times interest coverage of 2.40 times for long-term debt and a combined coverage factor for all interest and preferred stock dividends of 1.88. This witness also testified that the indenture requirements and the certificate of determination of preferences covering the issuance of shares of preferred stock are such that the only possibility available to SW is the issuance of common equity securities at substantially below book value.

The Commission staff's financial examiner testified that the earnings allowance for common equity is necessarily a judgment figure based on many factors, such as trends in interest rates, coverage for senior securities, capital requirements, sources of financing, earnings comparisons, and governmental efforts to curb inflation. The staff report on the cost of capital and recommended rate of return included 11 tables pertaining to interest rates, capital structure, financing, and five-year earnings summaries comparing SW with ten combination gas and electric utilities and ten gas companies. Comparative data relating to returns on average net plant investment in the year 1973 are also presented for each of these groups of utilities. The staff witness further testified, however, that comparative data constitutes only one test in arriving at a rate of return recommendation, that each company experiences business and financial risks which are similar to SW's but some may experience substandard or excessive earnings at any given time, and that it is important to recognize differences among comparison companies with regard to types of service, customer mix, economic environment, etc. The witness assumed that during 1975 SW would issue $6,000,000 of bonds at a cost of 10 percent and that $6,000,000 of short-term bank loans bearing a 9 percent interest rate would be outstanding at the end of 1975. He also assumed that an additional $3,000,000 of preferred stock would be sold at a cost of 10-1/4 percent and that $3,000,000 would be obtained from the sale of common stock in 1975. Based on the staff witness' projections, SW's common equity ratio at the end of 1975 would be 31.28 percent and the ratios of senior capital would include 54.18 percent for long-term debt at an imbedded cost of 7.39 percent, 5.76 percent in bank loans at 9 percent, and 8.78 percent represented by preferred stock at an imbedded cost of 6.62 percent. The staff's recommended allowance for common equity is a range of 12.15 to 13.11 percent, which would require a rate of return between 8.90 and 9.20 percent using the capital ratios and related costs developed by the witness. Such a return would provide long-term debt times interest coverage ranging from 2.23 and 2.30 times after income taxes and a combined coverage factor for all interest and preferred stock dividends between 1.74 and 1.80 after income taxes. It was the witness' opinion that his recommended range for rate of return would result in fair rates for SW's customers and allow a reasonable return to present and prospective investors in SW's common stock.

According to this witness' testimony one of the factors contributing to the decline in SW's times interest coverage was the continued maintenance of debt ratios above 60 percent during a period in which new debt was issued at interest rates substantially in excess of the imbedded costs of debt. His recommended capital structure would, in his opinion, strengthen SW's coverage position. Under cross-examination he stated that probably the spread between debt and preferred stock for this utility would be about one percent rather than one-quarter percent used in his exhibit; that if SW were unable to issue $6,000,000 of bonds because of indenture limitations it could, instead, issue $3,000,000 of bonds and $3,000,000 of preferred stock provided it first issued common stock to improve the coverages to comply with the requirements under SW's certificate of preferences; and that by the time that the bonds are issued the interest rate will probably have dropped from the then current high value to approximately the 10 percent rate set forth in his exhibit.

A vice president and manager of the Corporate Finance Department of the Southern Division of Dean Witter and Company presented rebuttal testimony on behalf of SW stating his opinion that SW would have to pay a minimum of 13 percent interest for debt and 14 percent for preferred stock. He further testified that he did not foresee any lowering of interest rates because of the continued high demands for financing.

Recent utility bond issues support the validity of the staff's estimates and we will, therefore, adopt a debt cost of 10 percent and a preferred stock cost of 11 percent.

As previously stated SW's vice president and comptroller testified that under present conditions the only possibility available to SW was the issuance of common equity securities at a price substantially below book value. According to the staff's financial examiner's testimony such issues would be desirable from the point of view of increasing interest coverage by decreasing the relative percentage of long-term debt. In this regard, the Commission takes official notice of the sale of 500,000 shares of common stock by SW on April 2, 1975 for an aggregate sum of $3,725,000 in accordance with authorization granted by Decision No. 84242 dated March 25, 1975. Based on these observations and related testimony previously discussed we will adopt a capital structure reflecting the sale during 1975 of $3,000,000 of bonds at 10 percent interest, $3,000,000 of preferred stock at a cost of 11 percent, $6,000,000 of common stock, and a year-end balance of bank loans outstanding of $6,000,000 at nine percent interest.

As previously stated, it is SW's position that 1973 mean and median return or average common equity experienced by the five comparison utilities should be increased for SW to compensate the investors for the added risk associated with possible relatively greater curtailment and flow-through accounting. The record clearly shows that any curtailment risk that exists relates to sales not subject to this Commission's jurisdiction. Clearly, the allowance of such a factor in the determination of the return to be allowed SW would be contrary to this Commission's long-established policy of exercising our jurisdiction over only those portions of a utility's operations within our jurisdictional limits. Flow-through accounting procedures are imputed by this Commission to provide that the tax savings derived by the utility's selection of available options be realized by the ratepayers. The allowed return on common equity takes into consideration, among other things, risks such as the use of flow-through tax accounting.

The 13.65 mean and 13.90 median return on average common equity earned in 1973 by the five utilities set forth in SW's comparison tabulations were the second highest recorded during the five-year comparison period. For these five companies the mean return on average common equity ranged from a low of 12.74 percent to a high of 15.83 percent and the median return ranged from a low of 11.81 percent to a high of 15.99 percent. This relatively wide year-to-year fluctuation of return on common equity would tend to invalidate the utilization of a single year as a basis for establishing the return on equity advocated by SW.

The staff tabulations indicate that the average earnings rate on common equity for the five-year period 1969-1973 is 12.21 percent for the selected ten gas utilities and 12.62 for the ten combination gas and electric utilities. It will be noted that both these figures are within the staff recommended range of 12.15 to 13.11 percent as is SW's last authorized return on equity of 12.57 percent. While the return on common equity is admittedly only one factor considered by the staff's financial examiner in arriving at his recommended rate of return, it does tend to confirm the reasonableness of his recommended range. There appears to be nothing in the record to adequately support a rate of return that would result in a return on equity outside the staff recommended range. Consequently, we will adopt as reasonable a rate of return of 9.20 percent which applied to the previously adopted capital structure and cost components results in the following:

Component	Capital Ratio	Cost Factors	Weighted Cost
Long-Term Debt	51.30	7.24	3.71
Bank Loans	5.76	9.00	.52
Preferred Stock	8.78	6.87	.60
Common Equity	34.16	12.79	4.37
	100.00		9.20

This return on common equity of 12.79 percent will provide a times interest coverage of 2.48 for long-term debt and a combined coverage factor for all interest and preferred stock dividends of 1.90 times.

Results of Operation

The following tabulation compares the estimated summary of earnings for the test year 1975 under present and proposed rates as estimated by SW and by the Commission staff together with the adopted summary of earnings at present rates for the test year 1975. At the hearing, SW submitted Exhibit 24 setting forth a comparison of operating and maintenance expenses for various periods of time. The stated purpose of this exhibit was to show that the staff's estimated expenses for the test year 1975 are below the expense levels being experienced by SW at that time. In its brief the staff alleges that this exhibit tends to support rather than refute the staff's estimates. SW's position, set forth in its reply brief, is that Exhibit 24 should be disregarded by this Commission because it was sponsored only for the limited purpose of showing that the staff's estimates for the 1975 test year are unreasonably low.

SUMMARY OF EARNINGS
(Estimated Year 1975)

Acct. No.	Item	Southwest Estimated: Present Rates 1/	Southwest Estimated: Company Proposed Rates	Staff Estimated: Present Rates 1/	Staff Estimated: Company Proposed Rates	Adopted Results 1/
		(Dollars in Thousands)				
	Operating Revenues	$ 7,383.9	$ 8,110.9	$ 7,400.4	$ 8,129.9 2/	$ 7,400.4
	Operating Expenses					
807	Purchased Gas	3,577.3	3,577.3	3,579.0	3,579.0	3,579.0
	Transmission	4.2	4.2	4.2	4.2	4.1
	Distribution					
880	Other Expenses	53.2	53.2	32.6	32.6	32.2
887	Maint. Mains	107.7	107.7	79.3	79.3	93.7
892	Maint. Services	108.4	108.4	86.0	86.0	93.3
893	Maint. Meters	28.8	28.8	18.0	18.0	26.1
	Other Distribution	512.3	512.3	473.9	473.9	468.4
	Total Tr. & Dist.	814.6	814.6	694.0	694.0	717.8
	Wage Adjustment	-	-	(36.2)	(36.2)	-
	Total T & D	814.6	814.6	657.8	657.8	717.8
	Customer Accounts	458.7	465.1	460.9	464.0	477.9
	Sales Expense	124.0	124.0	67.8	67.8	75.3
	Total O&M	4,974.6	4,981.0	4,765.5	4,768.6	4,850.0
	Admin. & Gen.					
920	Salaries	188.9	188.9	180.0	180.0	177.1
925	Injuries & Damages	37.0	37.0	32.7	32.7	33.7
	Other A&G	115.9	115.9	115.9	115.9	115.8
	Total A&G	341.8	341.8	328.6	328.6	326.6
	Wage Adjustment	-	-	(14.0)	(14.0)	-
	Total A&G	341.8	341.8	314.6	314.6	326.6
	Taxes Other Than Income	529.7	537.0	494.3	501.6	494.3
	Income Taxes 3/	119.1	494.8	261.6	640.5	209.7
	Depreciation	473.8	473.8	472.6	472.6	472.6
	Total Oper. Exp.	6,439.0	6,828.5	6,303.6	6,697.9	6,353.2
	Net Operating Revenue	944.9	1,282.5	1,091.8	1,432.0	1,047.2
	Depreciated Rate Base	13,019.8	13,019.8	12,996.0	12,996.0	13,012.1
	Rate of Return	7.26%	9.85%	8.40%	11.02%	8.05%

1/ At rates placed into effect April 2, 1974.

2/ $8,127,400 at staff proposed rates at 100 percent requested increase level.

3/ Recomputed to reflect changes made at hearings.

However, at transcript page 480 the following exchange occurred between SW's witness and staff counsel:

"Q Are they different projections?

"A Yes, they are.

"Q Which is correct?

"A I have definitely used more later data in twelve-months ending August 31, 1974; moreover, the data produces better results.

"Q Are you changing your estimates?

"A I think so.

Your estimates should be better as time goes on."

Obviously this exchange constitutes more than ample justification for full utilization of the material set forth in Exhibit 24.

Revenue

The Commission staff's estimate of revenues exceeded SW's estimate by $16,500 at rates in effect April 2, 1974 and $19,000 at SW's proposed rates due to the inclusion by the staff, based on later data, of the new Big Bear Hospital. The staff's estimate will be adopted.

Operation and Maintenance Expense

The staff's estimated unaccounted-for gas was developed by trending 12 months moving totals from July 1973 through June 1974. The derived amount was added to the above adopted gas sales amount and the purchased gas cost was computed in accordance with Pacific Gas and Electric Company's (PG&E) rates in effect on April 2, 1974. The staff estimate will be adopted.

For the other operation and maintenance expenses the staff's estimates were, in general, prepared by trending separately labor and non-labor expenses after deducting payroll taxes from the non-labor expenses. An estimate for 1975 payroll taxes was then added to the 1975 projection. SW's estimates were based on recorded year 1973 data updated for known changes in 1974 and 1975. Both sets of estimates by accounts reflect a nine percent wage increase for each of the years 1974 and 1975. The Commission staff, however, excluded the 1975 anticipated increase from the 1975 estimated year results by lump sum adjustments totaling $75,200, by groups of accounts. In its opening brief SW included a copy of a letter dated December 2, 1974 to all of SW's employees announcing a seven percent wage increase effective January 1, 1975. This seven percent wage increase will be included in our adopted results.

Transmission and Distribution Expenses

The Commission staff's estimate for transmission and distribution expenses for the 1975 test year was $657,800 as compared to SW's original estimate of $814,600 set forth in Exhibit 3 and its revised estimate of $750,300 set forth in Exhibit 24. Of the original $156,800 differential $36,200 reflects the staff's deletion of the 1975 estimated nine percent wage increase. The 1975 test year adopted seven percent wage increase will decrease the original differential by $28,200 to $128,600.

The staff's 1975 test year estimates are less than SW's estimates by $28,400 for Account 887, Maintenance of Mains, and $22,400 for Account 892, Maintenance of Services. SW alleges that the staff's estimates did not include sufficient monies to provide for additional cathodic protection and control expenses required by the Department of Transportation. The staff's witness testified that the expenses necessitated by those requirements were historically reflected for the years 1971 through 1973 and that, therefore, an average of those recorded amounts increased to reflect wage adjustments would result in a proper and reasonable estimate. SW's method utilized the latest recorded data and added allowances for wage increases and additional employees. For Accounts Nos. 887 and 892, SW's Exhibit 24 revised downward the allowance for new employees from $37,362 to $9,568 for the year 1974 and from $9,047 to $6,355 for the test year 1975. SW's witness testified that the new employees' allowances included in Exhibit 24 were employees committed for hiring late in 1974. Inasmuch as the staff's estimates for Accounts Nos. 887 and 892 were prepared in a manner similar to SW's estimates, we will adopt the latest recorded data of record, adjusted for experienced 1974 wage increases and committed additional employees and including a seven percent wage increase for 1975, to yield a 1975 test year figure of $93,700 for Account No. 887, Maintenance of Mains, and $93,300 for Account No. 892, Maintenance of Services.

The staff's 1975 test year estimate for Account No. 893, Maintenance of Meters and House Regulators, was $18,000 as compared to SW's original estimate of $28,800 and updated estimate of $48,600. The record shows that the staff's estimate was based on a normal meter testing program, whereas SW's updated estimate was based on make-up testing of 3,400 meters during the 12-months period ended August 31, 1974 at a cost of $48,377 or $14.23 a meter. Exhibit 23 indicates that SW had in service as of December 31, 1973 1,485 meters that were nine years old, 2,734 eight-year-olds, 1,858 seven-year-olds, 1,662 six-year-olds, and 1,442 five-year-olds, an average of 1,836. Assuming a ten-year testing program for all meters we will adopt this figure as an appropriate average for the 1975 test year. The application of the recorded $14.23 cost per meter test to the 1,836 average number of meters to be tested yields our adopted 1975 test year amount of $26,100 for this account.

Also discussed in detail on the record was Account No. 880, Other Distribution Operating Expenses. The staff's estimate for this account was $32,600 as compared to SW's original estimate of

$53,200 and revised estimate of $34,100. The staff witness testified that his estimate was a trended figure based on a continuous historical pattern. We will adopt the staff estimate adjusted to $32,200 to reflect a seven percent rather than nine percent wage adjustment.

The staff's estimate of the total of the other distribution expenses for the test year 1975, adjusted for the seven percent test year wage increase, is $468,400 as compared to SW's original estimate of $512,300 and revised estimate of $478,500. The staff's estimate will be adopted to yield a total adopted transmission and distribution expense of $717,800 for test year 1975.

Customers' Accounts Expense

The customers' accounts expense estimated by the Commission staff was $460,900 excluding any wage adjustment, as compared to SW's original estimate of $458,700 and its revised estimate of $439,900. The staff's estimate was derived from trending unit costs per customer. Such a method is consistent with past practices and the staff estimate adjusted to $477,900 to reflect the seven percent wage increase will be adopted.

Sales Expense

The sales expense estimated by the Commission staff for test year 1975 was $67,800 as compared to SW's original estimate of $124,000 and its revised estimate of $115,100.

The record shows that SW's estimated 1975 test year sales expense is $4.38 per customer as compared to Southern California Edison Company's (Edison) sales expense of $2.66 per customer, PG&E's sales expense of $1.01 per customer, and Cal Pacific's sales expense of $0.15 per customer. The staff engineer's 1975 sales expense estimate is $2.39 per customer. He testified that such an amount was quite comparable with Edison's per customer sales expense authorized by Decision No. 81919 dated September 25, 1973.

He admitted under cross-examination that he had erroneously reversed his institutional and service expenses in making his computations and that he had not done so the sales expense might very well have computed to be $110,298. He maintained, however, that such erroneous calculations did not invalidate the reasonableness of his estimates and that the comparability with Edison's authorized sales expense was the true test of reasonableness.

SW's witness testified that his sales expense estimate was based on recorded data updated to reflect known changes and estimated test-year increased expenses. He admitted under cross-examination that our ratemaking adjustments to sales expenses set forth in Decision No. 82417 were excluded from the current estimates. He stated that of the $104,411 recorded sales expense for the 12 months ended December 31, 1973, only $10,574 pertained to promoting increased consumption but gave no breakdown of the residue of his estimated sales expense.

Section 796 of the Public Utilities Code, effective May 1, 1974 provides that this Commission shall disallow, for ratemaking purposes, all expenses for advertising which encourages increased consumption. It is obvious, therefore, that we are mandated to eliminate for ratemaking purposes, at the very least, the $10,574 admittedly used for promotional purposes. However, such an adjustment might well be insufficient. Southern California Edison Company is essentially a one-product utility as is SW and would assumably have comparable conservation orientated expenses. It is, therefore, not unreasonable to allow SW the same per customer expense permitted Edison. On this basis we will adopt $2.66 per customer for 28,314 average customers or $75,300 for 1975 test year sales expense.

Administrative and General Expenses

The Commission staff after careful review accepted SW's estimated 1975 test year expenses except for Account 920, Administrative and General Salaries, and Account 925, Injuries and Damages.

The staff's estimate of Account 920, Administrative and General Salaries, was $180,000 as compared to SW's estimate of $188,900. The difference in these two estimates derives from the application of different four-factor percentages to the estimated 1975 total general office salaries. The records show that the recorded four-factor percentages for Southern California was 17.50 percent for 1970, 16.86 percent for 1971, 16.21 percent for 1972, and 16.07 percent for 1973. The staff witness projected this recorded data on the slope of the first significant change and derived a 1975 test year four-factor percentage of 15.77 percent. SW's witness testified that he used the recorded 1973 four-factor percentage of 16.07 percent for his 1974 and 1975 calculations. The staff method appears reasonable and the staff estimate, adjusted for the seven percent wage increase, will be adopted for this account.

The staff's estimate for Account 925, Injuries and Damages, was related to the number of employees working at a given time whereas SW's estimate reflects the relationship of the amount of insurance premiums to gross revenue. The staff engineer applied the 1973 recorded ratio of injuries and damages to administration and general salaries of 0.032 to estimated 1975 administrative and general salaries adjusted to reflect the actual number of SW employees to derive his incremental addition to 1973 recorded injuries and damages of $4,608, which added to the $27,926 recorded 1973 expense resulted in his 1975 estimate of $32,700. He further testified that when the staff financial examiner furnished him the actual computed amount for the seven-month period ended July 31, 1974, he extrapolated this amount on a 12-months basis to derive an estimated expense of $33,700, only $1,000 different than his original estimate. This latter figure appears reasonable and will be adopted.

Taxes

The Commission staff's ad valorem tax estimate for the 1975 test year is $420,000 as contrasted to SW's original estimate of $455,400. Based on later data, SW revised this estimate downward to $426,143 reflecting the actual assessment ratio of 30.6 percent and an estimated tax rate of 11.3 percent. The staff estimate, based on the latest known assessment ratio and tax rate, will be adopted.

The company's estimate of $26,800 for Job Development Investment Tax Credit on a flow-through basis was accepted by the staff for the income tax computations. Subsequent to submittal of this matter, the Tax Reduction Act of 1975 was signed into law by the President on March 29, 1975. We will take official notice of this Act and include the $7,000 tax saving resulting from the increased surtax exemption and the reduction in tax rate for the first $50,000 of taxable income. Both the staff and Southwest used liberalized depreciation on a flow-through basis in computing income taxes and this method will be adopted for this proceeding.

Rate Base

Rate base consists of utility plant plus working capital minus depreciation reserve and advances for construction. Most of the difference in staff's and SW's estimated plant and depreciation reserve derive from the application of different four-factor percentages. As previously discussed the staff projected recorded percentages from the point of first significant change to derive the 1975 test-year factor and SW used the 1973 recorded factor for both the estimated years 1974 and 1975. The staff's estimate of $17,621,900 for utility plant and $4,223,700 for depreciation reserve will be adopted.

Both the staff and SW estimated average advances for construction of $1,141,100. This figure will be adopted.

Working capital consists of materials and supplies, allocated prepayments, and working cash. The differences in the staff's and SW's estimates of materials and supplies and allocated prepayments are due to the staff's access to more recent data than that included in the application. The staff's estimates of $182,900 for materials and supplies and $22,800 for allocated prepayments will be adopted.

SW's 1975 test year estimated working cash requirement is approximately $582,600 and equals the sum of one-sixth of the estimated operating and maintenance expense, excluding uncollectibles, and one-twelfth the estimated purchased gas costs. The staff's 1975 test year estimated working cash requirement is $533,200 and equals the sum of one-sixth of the estimated operating and maintenance and administrative and general expenses, excluding payroll taxes and uncollectibles, and one-twelfth of estimated purchased gas costs. We will adopt the staff method using previously discussed adopted 1975 test year expenses to yield a working cash requirement of $549,300.

Neither the Commission staff nor SW included compensating balances required by SW's lender in their estimates of working cash for 1975. This practice is in keeping with the simplified method of computing working cash used by both the staff and SW.

The total adopted rate base thus derived is $13,012,100.

<u>Rates</u>

In the comparison tabulations submitted into evidence by the Commission staff and SW, the revenues computed at present rates reflect rates authorized by this Commission's Decision No. 82417 dated February 5, 1974 in Application No. 53727 increased by a uniform .134 cents per therm, effective April 2, 1974, to offset the increased cost of gas purchased from Pacific Gas and Electric Company (PG&E). These revenues do not include subsequent offsets nor the interim increase granted by Decision No. 83458. SW's proposed rates reflect minor changes in the rate blocking and, within the confines of these blocking changes, a uniform cents per therm increase for all rate schedules. In addition, SW proposed the elimination of interruptible Schedule G-51, the elimination of two months of the effective period for the air conditioning discount, and a purchased gas adjustment clause.

The staff prepared recommended rates for 100 and 50 percent of the requested increase. At the 100 percent level the recommended rates reflect the discontinuation of any air conditioning discount, the elimination of the seventh rate block proposed by SW for the G-1 schedule, and a uniform increase of $0.01199 per therm for all G-1 schedules and $0.01361 per therm for all other schedules. The 50 percent level recommended rates reflect similar changes except the uniform increase for the G-1 schedules is $0.00505 per therm and for all other schedules is $0.0068 per therm. The stated objective of the proposed rate changes was to effect conservation of natural gas.

Both the effectiveness of the proposals and the equity of the resultant rates were hotly contested by the Executive Agencies of the United States (Agencies) through extensive cross-examination of the staff witness and the testimony of the facilities maintenance officer of the Marine Corps Depot at Barstow and an electrical engineer assigned by the civil engineering squadron of George Air Force Base. Under cross-examination the staff witness admitted that the staff's proposed rates will increase the costs to the two miltary installations approximately $60,000 over the rates proposed by SW and reduce the rates proposed by SW for other G-1 customers by this same approximate amount. Further cross-examination of the staff witness also indicated that he was unfamiliar with the operations of the military bases, did not know whether they were master-metered for gas service, and did not know the number of family dwellings receiving gas at either base, the manner and cost of distribution of gas on the military bases, governmental budgetary constraints placed on the bases, conservation measures already effected, and whether or not the families on the military bases paid for the gas they consumed. The facilities maintenance officer at Barstow testified that on the Marine Corps Base there are 427 family housing units furnished natural gas for heating, hot water heating, and cooking and 461 other structures heated by five central heating plants of which four burn natural gas as a primary fuel; that numerous steps had been taken to conserve natural gas with the result that the gas consumption for the fiscal year 1974 was less than for the fiscal year 1973 by 26.5 percent for the firm schedule, by 13.8 percent for the interruptible schedule, and by 18.5 percent overall; that a consulting firm reviewed the base operations and established conservation goals that were within five percent of the conservation actually achieved; and that very little additional conservation could be achieved without actually shutting down portions of the base. An electrical engineer assigned to the civil engineering squadron of George Air Force Base testified that at this military installation there are 137,756 linear feet of gas distribution main costing $624,000; that there are 1,641 family housing units on the base furnished free gas service; that George Air Force Base initiated a conservation program seeking to reduce the consumption of gas by 15 percent; and that significant reductions in usage were achieved as a result of this conservation program. In its brief on this matter, Agencies stated that in this time of serious need for conservation, rates should be designed to mitigate the adverse results of conservation on recovery of fixed costs by having a large portion of any granted increase in the minimum and initial blocks as was done in Decision No. 82417.

Because gas is provided at no charge to the housing units on the military bases it is doubtful that an increase in the tail block of the General Service Schedule G-1 as proposed by the staff would effect any conservation beyond that already achieved on these military bases. In addition, purchased gas offset increases are generally, and justifiably so, applied on a uniform increase per therm basis. In this instant proceeding the authorization of a uniform increase per therm, coupled with continuing offset increases, might result in undue burden on the large user with little control over his total consumption. Consequently, the rates authorized by this decision will instead provide in part a uniform percent increase to all rate schedules.

The elimination of the rate block for all consumption over 52,000 therms as proposed by the staff would place all consumption over 1,000 therms a month on one rate block. The effect of such a rate structure on the military installations, the only customers consuming over 52,000 therms per month, would be to increase their costs approximately $60,000 over the rates proposed by SW and charge the military the same rate per therm at the point of delivery into the military's distribution systems as other customers pay at their individual meters. Consequently, the operating and maintenance costs associated with the military's distribution system, are added to its cost of providing gas service to the military housing units with little or no benefit to be derived from such added costs. Under these circumstances, the military would be able to economize by abandoning the distribution system and having SW serve the housing units directly which, in the long run, would probably be unsatisfactory for both SW and the military. We will retain the rate block for all consumption over 52,000 therms per month.

SW proposes the abolition of Schedule G-51, Interruptible Service. At the time of filing the application there were no customers on this schedule. However, at this time the new Big Bear Hospital is receiving service on this schedule. In spite of this SW recommends abolition of the schedule with Big Bear Hospital being placed on the firm schedule. The staff proposes continuation of the interruptible schedule on the basis that at the time service was requested, SW was holding itself out to provide interruptible service. Schedule G-51 will be continued.

SW proposes that the air conditioning discount now applicable during the months of May through October be made applicable instead for the months of June through September, whereas the staff recommends the abolition of the air conditioning discount. Both proposals are directed at effecting conservation. The staff's proposal will be adopted and the air conditioning discount will be eliminated.

Purchased Gas Adjustment Clause

Southwest requested a purchased gas adjustment clause (PGA) alleging that tracking procedures have been inadequate to permit recovery of cost of gas increases. On the last day of hearing, Southwest withdrew its proposed purchased gas adjustment tariff.

The staff recommends that Southwest be authorized a PGA, subject to the following conditions:

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 PGA shall be filed with the California Public Utilities Commission 30 days before the proposed effective date.

d. No change in rates under the PGA clause will become effective without Commission approval.

e. Each rate schedule shall be changed to reflect changes in the PGA.

f. Results of Operation Reports be filed by April 15 of each year providing estimated operations for the ensuing year and recorded and adjusted operations for the prior year.

g. Offset increases should be authorized only to the extent that the last authorized rate of return is not exceeded.

h. Any refund and rate reduction from a supplier with interest added to refunds shall be returned to utility customers.

The staff-recommended PGA was similar to the PGA granted Southern California Gas Company in Decision No. 83160. The staff took the position that purchased gas adjustment clauses be similar for the various gas utilities as this would help to assure expeditious regulation.

Southwest in its reply brief stated that they would support the staff-proposed PGA if the notice period was 25 days instead of 30 days. This would enable Southwest to avoid absorbing increases in cost of gas proposed by Pacific Gas and Electric Company (PG&E) if PG&E had a PGA clause with a 30-day notice period. This modification will be adopted in this proceeding.

Findings

1. Southwest Gas Corporation is in need of additional revenues for its San Bernardino County District, but the proposed rates set forth in the application are excessive.

2. The adopted estimates previously discussed herein of operating revenues, operating expenses, and rate base for the test year 1975 reasonably indicate the results of SW's operations in its San Bernardino County District in the near future.

3. A rate of return of 9.20 percent on the adopted rate base of $13,012,100 is reasonable. Such rate of return will provide a return on equity of approximately 12.79 percent, a times interest coverage of approximately 2.48 for long-term debt, and a combined coverage factor for all interest and preferred stock dividends of 1.90 times.

4. The elimination of the rate block for consumption over 52,000 therms per month would place an unreasonable burden on the military installations of record and should not be approved.

5. Schedule G-51, Interruptible Service, should continue in effect.

6. To assist in the conservation of gas, the air conditioning discount should be eliminated.

7. The increases in rates and charges authorized herein are reasonable; and the present rates and charges, insofar as they differ from those prescribed by this decision, are for the future unjust and unreasonable.

8. The authorized increase in rates is expected to provide increased revenues of approximately $320,800 over the rates in effect April 2, 1974 in SW's San Bernardino County District for the full test year 1975. This compares to the requested increase of approximately $727,000 and the Commission staff recommended increase of $174,800 excluding the seven percent wage increases or $233,300

including the seven percent wage increase. The staff recommendation is based on a rate of return of 9.05 percent, the midpoint of the staff recommended range of rate of return.

9. The frequency of gas rate increases by the suppliers of Southwest justify authorization of a PGA procedure. The conditions proposed by the staff are reasonable, except that Southwest should be authorized a 25-day notice period.

Conclusions of Law

1. The Tax Reduction Act of 1975 has made changes in the applicability of the investment credit to utilities under our jurisdiction. Pending a determination of the effect of these changes we will make our order in this proceeding an interim order subject to refund. This will permit us to act promptly upon a determination of the effect of these changes on the ratepayers of Southwest Gas Corporation.

2. The Commission concludes that the application should be granted to the extent set forth in the order which follows.

INTERIM ORDER

IT IS ORDERED that:

1. After the effective date of this order, Southwest Gas Corporation is authorized to file the revised rate schedules attached to this order as Appendix A and concurrently to cancel and withdraw the presently effective schedules. Such filing shall comply with General Order No. 96-A and shall be subject to refund. The effective date of the revised schedules shall be four days after the date of filing. The revised schedules shall apply only to service rendered on and after the effective date thereof.

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2. Southwest Gas Corporation is authorized to file a revised Preliminary Statement providing for a purchased gas adjustment clause in its tariffs, which incorporates the criteria set forth in this opinion. Such filing shall comply with General Order No. 96-A. The effective date of the revised tariff schedule shall be four days after the date of filing and shall apply only to service rendered on and after the effective date thereof.

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

Dated at San Francisco, California, this 1st day of JULY, 1975.

President

William Symons Jr.

Vernon L. Sturgeon

Robert Batinovich

Commissioners

I concur and will file a concurrence

ROBERT BATINOVICH
Commissioner

Commissioner Leonard Ross, being necessarily absent, did not participate in the disposition of this proceeding.

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APPENDIX A
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Southwest Gas Corporation
Southern California Districts

Tariff schedules include tracking increases totaling 4.194 ¢/therm from April 2, 1974 to April 2, 1975 as authorized by the Commission.

Description		Per Meter Per Month Rate A	Per Meter Per Month Rate H
GENERAL NATURAL GAS SERVICE			
Rates		G-1	
First	2 therms or less		
	October-May, Inclusive	$3.750	$4.820
	June-September, Inclusive	3.750	1.170
Next	30 therms, per therm	.18509	.20859
Next	72 therms, per therm	.17424	.18645
Next	414 therms, per therm	.16546	.17195
Next	518 therms, per therm	.16112	.16317
Next	2,073 therms, per therm	.15427	.15747
Next	7,256 therms, per therm	.14629	.15256
Next	41,464 therms, per therm	.13829	.14115
Over	51,829 therms, per therm	.13293	.13555
Rates		G-2	
First	2 therms or less		
	October-May, Inclusive	$4.030	$5.210
	June-September, Inclusive	4.030	1.230
Next	30 therms, per therm	.20026	.22685
Next	72 therms, per therm	.18793	.20174
Next	414 therms, per therm	.17801	.18532
Next	518 therms, per therm	.17310	.17550
Next	2,073 therms, per therm	.16534	.16899
Next	7,256 therms, per therm	.15633	.16340
Next	41,464 therms, per therm	.14731	.15051
Over	51,829 therms, per therm	.14126	.14423

Description	Per Lamp Per Month
STREET AND OUTDOOR LIGHTING NATURAL GAS SERVICE	
Rates	G-15
1.99 cu. ft./hr. or less	$1.93
2.00 - 2.49 cu. ft. /hr.	2.91
2.50 - 2.99 cu. ft. /hr.	3.33
3.00 - 3.99 cu. ft. /hr.	4.01
4.00 - 4.99 cu. ft. /hr.	4.73
5.00 - 7.49 cu. ft. /hr.	6.41

GAS ENGINE NATURAL GAS SERVICE

Rates	Per Meter Per Month	
	G-45	G-46
First 1,037 therms, per therm	.14946	.16004
Next 3,110 therms, per therm	.14049	.15029
Over 4,147 therms, per therm	.13503	.14415

INTERRUPTIBLE NATURAL GAS SERVICE

Rates	Per Meter Per Month	
	G-50	G-51
First 10,930 therms, per therm	$.13260	$.14022
Next 98,370 therms, per therm	.12571	.13311
Next 109,300 therms, per therm	.12366	.13072
Next 327,900 therms, per therm	.12047	.12707
Over 546,500 therms, per therm	.11887	.12525

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COMMISSIONER BATINOVICH, Concurring in part and
Dissenting in part:

I concur in the award of interim relief.

I dissent from the denial of the simple rate restructure recommended by Staff.

The only customers to be affected by the proposal are the military installations in the service territory. The location and maintenance of military bases is a matter of national policy and planning, so the true costs of maintaining the installations should be borne nationally, rather than by the local ratepayers. I distinguish the military from ordinary commercial and industrial customers, whose location in the service territory is founded on economic, rather than strategic, grounds. A change in defense policy could leave the service territory with far more plant than required, and it is only equitable to require the federal government, not the local ratepayers, to pay for that portion of the utility plant that serves military installations.

Dated: July 1, 1975
San Francisco, California

Respectfully submitted,

Robert Batinovich

Robert Batinovich, Commissioner