

Decision No. 84617

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of
SAN DIEGO GAS & ELECTRIC COMPANY for
authority to increase its rates and
charges for electric service to offset
the effects of increased labor costs.

} Application No. 55403
(Filed December 20, 1974)

In the Matter of the Application of
SAN DIEGO GAS & ELECTRIC COMPANY for
authority to increase its rates and
charges for natural gas service to
offset the effects of increased labor
costs.

} Application No. 55404
(Filed December 20, 1974)

In the Matter of the Application of
SAN DIEGO GAS & ELECTRIC COMPANY for
authority to increase its rates and
charges for steam service to offset
the effects of increased labor costs.

} Application No. 55405
(Filed December 20, 1974)

(Appearances listed in Appendix A)

O P I N I O N

By the above entitled applications San Diego Gas & Electric Company (SDG&E) seeks to increase its rates to offset the effects of increased labor costs. At prehearing conference held March 19, 1975, at Los Angeles, California, the three matters were consolidated for hearings. Four days of public hearings were held from April 14 through May 8, 1975 at La Mesa, California, before Commissioner William Symons and Examiner Charles Mattson. On May 1, 1975 counsel for the Commission staff filed a motion to dismiss the applications. On May 8, 1975 the matter was submitted subject to the filing of written response to the staff motion. Applicant's answer to the staff motion was received May 15, 1975.

Applicant's Request

The applications request rate increases to offset wage increases incurred by applicant on December 1, 1974 and March 1, 1975. The gross revenue increases requested are \$2,823,100 (electric department), \$1,276,300 (gas department), and \$15,700 (steam department) for a total increase of \$4,115,100. The annual revenue increase, based on test year 1974 sales and revenues from Decision No. 83675, would be approximately one percent for the electric department and 1.3 percent for the gas department.

The applications rely upon the results of operations adopted by Decision No. 83675 dated October 29, 1974 in Applications No. 53945, No. 53946, and No. 53970. The applications allege that SDG&E is experiencing employee wage expenses in excess of those reflected in Decision No. 83675 and that unless the increase wage expense is offset, as requested in the applications, SDG&E's earnings will not approach the 8.75 percent rate of return authorized in that decision.

Applicant's Evidence

Federal wage guidelines were eliminated in 1974. Under the terms of an existing union contract SDG&E's employees commenced renegotiations for wage increases. The contract was for a three-year period and was to terminate February 28, 1976. Prior to renegotiations, the contract provided for a six percent wage increase to become effective March 1, 1975. As a result of renegotiations concluded on November 6, 1974 the SDG&E union employees obtained a six percent wage increase effective December 1, 1974 in addition to the March 1, 1975 six percent increase. In accordance with long standing practice SDG&E granted the same wage increases to nonunion employees as the union employees.

The witness on behalf of the applicant reviewed the experience of SDG&E for the nine months ending September 30, 1974 and determined that 58.7 percent of the labor costs were charged to expenses, and that the balance of the labor cost was capitalized,

i.e. was construction labor. The 58.7 percent was applied to the total wage increase. The total increase was obtained by a computer print-out of wages paid employees just prior to the December 1, 1974 increase. The witness testified that the number of company employees as of November was below the average of the year 1973. As a result of the calculation, the company computed the increase wage expense, as reflected in operating and maintenance expenses, as \$3,827,000. As set forth in Exhibit No. 1, page 6, the increase wage expense is increased by the uncollectibles and franchise fees attributable to additional revenues to recover increased expense. In addition, the increase in interdepartmental gas rates are alternately collected from electrical department customers, with the result that the total proposed rate increase is \$4,115,100. The witness testified that the increased wage expense attributable to union employees is approximately \$2,100,000. The balance of the increase wage expense would be attributable increased wages of nonunion employees.

The Staff's Evidence

The staff presented two witnesses. One witness made independent estimates relative to the wage increases granted by SDG&E as a result of renegotiation of the union contract. This witness concluded that the basic estimated payroll increase of \$6,519,600 of SDG&E was reasonable. However, to develop the ratio of expense payroll the staff witness utilized the five-year average of the last five years recorded and to distribute payroll expense to the three utility departments the staff utilized the same five-year recorded average basis. The staff witness concluded that estimated at the increase revenue requirement for the departments would be \$2,576,400 (electric department), \$1,207,200 (gas department), and \$13,300 (steam department). The total revenue increase required under the staff estimates would be \$3,796,900. The staff witness stated that if the Commission decides an offset is warranted, rates should be increased by applying an approximately constant percentage to all rates but the revenue increase should reflect the staff's lesser expense payroll dollars.

A second staff witness testified regarding the effect of the Tax Reduction Act of 1975. The Tax Reduction Act of 1975 provides for additional and higher percentages of investment tax credit. Applying the 1975 investment credit to the SDG&E budgeted plan additions for the year 1975 resulted in credits in excess of the 1971 Act credits used in the computation of taxes in the adopted results of operations in Decision No. 83675. The additional investment credits resulted in a tax savings effect which more than offset the staff estimated gross revenue increase required by the wage increases. The staff witness recommended that the rate increase be denied.

Evidence by the City of San Diego

The city of San Diego appeared as an interested party, and presented evidence and testimony in opposition to the proposed rate increases. The basic objections of the city of San Diego was that the wage increases were expense increases incurring largely outside the 1974 test year relied upon by SDG&E. There was no showing that sales growth experienced by SDG&E in the posted 1974 period would not more than offset the increased labor expenses. The witness on behalf of the city of San Diego witness also contended that the fuel clause allowances in the present rates resulted in over-compensation to San Diego Gas & Electric Company.

The Staff Motion

A staff motion, filed May 1, 1975, requested that the Commission dismiss the applications on the grounds that the applicant has failed to put in a prima facie case in support of the applications. The staff questions whether a wage offset proceeding would ever be appropriate, arguing that the adjustment of rates to reflect a change in a specific definable element of expense, independent of changes that may have occurred to other elements in the company's operations, require that the specific element of the cost of service should reflect a sudden and significant change. The staff argues that applicant has failed to show that the wage increases were either sudden or substantial.

In addition the staff urges that the motion should be granted since the increased wage expense is primarily a 1975 event. Applicant's showing makes no allowance for sales growth forecast for 1975. The exhibits relied upon to establish the increased revenue requirement set forth substantial Federal income tax expense, although the applicant maintains that it will have no Federal income tax liability in 1975. As a result of this contention applicant urges that it is inappropriate to reflect 1975 Federal income tax reductions in the results of operations relied upon by applicant.

The applicant's answer to the staff's motion to dismiss the applications urges that the staff's motion is inappropriate since it is not consistent with the provisions of Rule 56. However, Rule 56 is applicable only to a motion to dismiss based upon the pleadings or any matter occurring before the first day of hearing. It does not establish a restriction upon the right to move to dismiss an application based upon the evidence developed at hearings.

Applicant, by answer to the motion, argues that its applications for offset relief are indistinguishable from offset rate relief requested and granted Southern California Gas Company (SoCal) in Application No. 55117. In that matter wage increases were offset by rate increases authorized by Decision No. 83881, dated December 17, 1974. Applicant argues that its evidence establishes that the wage increases incurred as a result of contract negotiations were both sudden and substantial. Moreover, SDG&E argues that its evidence in these rate offset proceedings falls within the definitions set forth in Decision No. 83127 dated July 9, 1974 in Application No. 54616 (PG&E).

Discussion

In its answer to the staff's motion to dismiss the applications SDG&E urges that it is entitled to a prompt determination of its request on the merits. SDG&E claims that the Commission has, on a number of occasions, granted offsets for wage increases and that it would be inequitable not to recognize an offset increased wages for SDG&E.

We agree with the basic contention of SDG&E that it would be inequitable to dismiss the applications without making a determination on the merits. We will for purposes of this decision treat the staff motion as a request that the applications be denied based upon the record in this case. A basic contention presented by the staff motion is that the Commission should not authorize rate increases on the showing that applicant has made in these matters. In order to evaluate that contention, it is necessary to once again review the nature of an offset proceeding.

It is important to recognize that this Commission has had before it a variety of factual showings in differing offset situations.

Both the staff and SDG&E have referred to our recent Decision No. 83127 dated July 9, 1974 in Application No. 54616 of PG&E. In that Decision we stated:

"Absent any major changes in price level, taxes, or technology, rates prescribed after a general rate case may be appropriate for many years. Occasionally, a specific element of the cost of service can undergo a sudden and significant change. The adjustment of rates to reflect the effect of a change in specific definable elements, independent of the changes that may have occurred to other elements, is known as an offset, and a rate proceeding involving such a change is known as an offset proceeding. The offset procedure has an obvious advantage from a time standpoint, but, in order to be valid, a relatively recent adopted cost of service, or results of operations as it is known in California, must be available as a foundation upon which to base the offset."

Underlying the rationale in the above decision, wherein we required a recently adopted cost of service as a foundation upon which to base the offset, is a problem that pervades all offset proceedings. The PG&E decision quoted above involved increasing cost of gas supply, a substantial item of expense to a gas distributing company. This is perhaps one of the most easily understood offset situations: the customers cannot reasonably expect a gas

distributing company to be able to sell gas at a constant price when that same distributing company is compelled to pay substantially higher prices for the gas that it purchases for distribution and sale. The addition of incremental expense increases to the gas rates of the ultimate customers, based upon and equal to the increased cost of gas to the distributing company, is a relatively simple concept. Moreover, the additional revenue received from customers by the sale of gas should be offset by increased gas costs incurred by the utility in order to obtain the gas sold to customers. In short, expenses and revenues for a PGA should be approximately the same over a period of time.

The application of the concept of an offset proceeding to meet increased employee wage rates presents problems which differ from those found with the PGA procedure. Post test period adjustments for increased wage and salary rates have always been a questionable basis for increasing rates for utility service. A decade ago we found that for a large utility wage increases were more than offset by increasing revenues and wage saving technological improvements, although the rates remained relatively stable.

Pacific Tel. & Tel. Co. v. CPUC, 62 C. 2d 634; 44 Cal. Rptr. 1, 401 p. 2d 353 (1965).

In reviewing cases in which the offset procedure has been used to offset increased wage cost, even the decisions applicant relies upon discuss the shortcomings of the offset procedure.

In California Trucking Association, Decision No. 76353, 70 Cal PUC 277 (1969) we noted:

"(1) In view of the overall lack of particularity and definitiveness involved in a cost offset rate adjustment, it is evident that such method for updating minimum rates was never designed nor intended to replace or be accepted as a completely satisfactory alternative for thorough full-scale studies. It should also be clear that any cost offset method of rate making, premised upon the theory that a percentage increase (decrease) in

rates should be the same as experienced in the supporting costs, assumes an economic margin for error which, the facts of record permitting, may be reasonable to accept for relatively short periods of time.

When the original cost and rate studies have been updated over the years by successive offset adjustments, the resulting cost and rate information tends to become vulnerable to an attack upon its continued competency to represent actual for-hire carrier operating experience. At this time, full scale cost and rate presentations are imperative to a thorough evaluation of the reasonableness of existing minimum rates. While it may be argued that the cost offset adjustments in minimum rates have been consistently found to be a just, reasonable and expeditious method for enabling the carriers to recover significant increases in their wage and allied payroll costs, the obvious limitations of this offset procedure should not be overlooked." (70 Cal PUC at 279-80).

The evidence relied upon in offset procedures involving increased wage costs may vary as to the particular utility operation concerned. In Greyhound Lines, Inc. Decision No. 76455 dated November 18, 1969 (70 Cal PUC 429) we noted that labor costs and fringe benefits accounted for 60 percent of Greyhound's operating expenses. Moreover, although Greyhound sought an "offset" increase in fares and express revenues in that case the decision sets forth adjusted estimated results of operations for year ending February 28, 1971 whereas the previous test year operating results for Greyhound were based on year-ending June 30, 1970 results in Decision No. 75939. In fact the rate increases authorized in the Greyhound Lines decision were based upon estimated operating results for a future year. The evidence relied upon in the Greyhound Lines case differs substantially from the evidence presented by applicant.

Tax Reduction Act of 1975

The staff presented evidence that the Tax Reduction Act of 1975 (Public Law 94-12) would provide for additional investment credits for public utilities. The staff witness estimated that as

a result of increases in investment credit available to SDG&E in the Tax Reduction Act of 1975, SDG&E's tax savings would more than offset the estimated gross revenue increases due to the wage adjustment in the three applications. The staff recommended that the rate increase be denied.

The company presented a rebuttal witness on the effect of the increase in investment credit available to SDG&E under the new Federal statutes. Applicant pointed out that the staff witness assumed that the utility would elect an option to flow through the tax savings resulting from the increased investment credit. However, the Federal legislation provides that the public utility may make an election to normalize the benefits of the increased investment credit, as opposed to flowing through the tax savings. The applicant's rebuttal witness testified that the 1975 legislation provides that if a utility elects to normalize and the Commission flows through the benefit in establishing rates, the utility will forever lose the benefits of the increased investment credit. The thrust of applicant's rebuttal evidence was that the staff reliance on the Federal Tax Reduction Act of 1975 was improper, since it assumed a flow through of increased investment credit at a time when SDG&E had not exercised its option to either normalize or flow through such increased investment credit.

Conclusions

For purposes of reaching our conclusions in this matter, we treat the staff motion to dismiss as a staff recommendation that the request for rate increases be denied. The answer to the staff's motion sets forth a basic claim by SDG&E that its wage offset requirements set forth in the three applications is essentially the same as the wage offset request of Southern California Gas Company (SoCal) granted by Commission Decision No. 83881 dated July 17, 1974.

In the absence of any evidence of current operating results, we cannot determine if SDG&E will obtain excess revenues at the proposed rate levels. SDG&E relies upon the adopted results of operations from Decision No. 83675 dated October 29, 1974 in Application No. 53945.

The decision relied upon by SDG&E relates to the Phase I determinations for this utility. Our Phase II determination recognizes that substantial rate increases will be required because of the reduced sales volumes in 1974, reduced volumes that we reasonably anticipate will continue into the near future. We do not and cannot accept the applicant's position that the wage rate changes should be reflected as one expense change to be offset without an examination of other changes that may occur in 1975. As the staff motion states, applicant's showing makes no allowance for sales growth forecast for 1975. It wholly ignores the efforts of the applicant company to cut controllable expenses, as evidenced by a freeze on hiring of new employees. Moreover, it would translate union negotiated increases and nonunion wage increases directly into further charges to ratepayers without regard for the question of whether the nonunion increases were appropriate under the 1974-75 economic conditions.

We should be prepared to recognize by offset rate relief a change in a specific element of the cost of service when such element undergoes a sudden and significant change. An offset proceeding may become necessary. Under the circumstances presented by applicant, we cannot make the necessary findings in this regard. The request will be denied.

Findings

1. Applicant San Diego Gas & Electric Company (SDG&E) requests gross revenue increases in the total amount of \$4,115,100 to offset increased wage expense.

2. SDG&E's requested annual revenue increase is less than 1.5 percent of the base sales and revenues relied upon. SDG&E relies upon the sales and revenues adopted for test year 1974 by Decision No. 83675.

3. The evidence presented does not establish a sudden and significant change in one element of the cost of service which should be offset without regard to other changes in revenues and expenses.


O R D E R


IT IS ORDERED that the application be, and hereby is, denied.


The effective date of this order is the date hereof.

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

*I dissent. I would have
granted the request
William Lyons, Jr.*


President


Commissioners


Commissioners

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

APPENDIX A

LIST OF APPEARANCES

Applicants: Chickering & Gregory, by Sherman Chickering, C. Hayden Ames, Allan Thompson, David Lawson, III; Gordon Pearce, Attorneys at Law, and John H. Woy, for San Diego Gas & Electric Company.

Interested Parties: John W. Witt, City Attorney, by William S. Shaffran and Ronald L. Johnson, Attorneys at Law; Manley W. Edwards, for the City of San Diego; Brobeck, Phleger & Harrison, by Thomas G. Wood and Gordon E. Davis, Attorneys at Law, for California Manufacturers Association; William Knecht and William Edwards, Attorneys at Law, for California Farm Bureau Federation.

Commission Staff: Elinore C. Morgan and Patrick J. Power, Attorneys at Law, John E. Johnson and John Gibbons.