

Decision No. 86498

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of

SOUTHWEST GAS CORPORATION

For Authority to Change Rules and
Service in San Bernardino County,
California.

Application No. 55837
(Filed July 28, 1975)

Darrell Lincoln Clark, Attorney
at Law, for applicant.
Leonard E. Ellis, for Mark Fore
Builders, protestant.
James T. Quinn, Attorney at Law,
Donald L. King, and I. B. Nigao,
for the Commission staff.

O P I N I O N

Southwest Gas Corporation (SW) seeks authority pursuant to Section 491 of the Public Utilities Code to revise its gas tariff Rules 13, 15, and 16 in its San Bernardino County District (SBCD) to require nonrefundable contributions by customers of all gas main extensions and new service lines in order to shift from it to the new customers requiring service the costs of the facilities necessary to provide gas service to such new customers. SW estimates an increase of 600 customers during 1976 at a cost of \$181,000 for new service lines and \$217,000 for additions to main lines for a total of \$398,000, less customer advances of \$152,000, for a net expenditure of \$246,000.

After notice public hearings were held in Victorville on December 18, 1975 and in Los Angeles on February 18, 1976. The matter was submitted upon the filing of concurrent briefs in the form of letters to the examiner on or before May 10, 1976.

Exhibit 1, Notices of Hearings; Exhibit 2, newspaper clipping; Exhibit 3, the direct testimony of Marvin R. Shaw; Exhibit 4, Application No. 55837 with Exhibits A, B, and C attached thereto; Exhibit 5, qualifications of Charles H. McCrea; Exhibit 6, testimony of Charles H. McCrea; Exhibit 7, SW's present Rules 13, 15, and 16; Exhibit 8, statement of staff position; Exhibit 9, qualifications and testimony of staff utilities engineer Donald L. King; Exhibit 10, qualifications of Terry R. Mowery; and Exhibit 11, the Utilities Division staff report, were received in evidence.

Three members of the public were present, of which two made statements and one testified. One stated that if the effect of the rule change was to increase rates, it amounted to a subsidy which should be borne by the government and not by the ratepayers. Another person, who owns 65 units consisting of apartment buildings, duplexes, and single-family residences in the area, inquired as to whether the rule change would affect maintenance or replacement of existing facilities, and he was assured that it would not.

The person who offered testimony was a building contractor in the area. He stated that the proposed rule change would render many parcels of land in that area worthless. The average cost of a lot for a single-family residence in Hesperia is \$1,500 and it might cost as much as \$1,850 for a 1,000-foot extension which would do great harm to the construction and real estate business in the Hesperia Valley. He also stated that he cannot understand why gas extensions cost \$2.80 per lineal-foot while water extensions cost only 75 cents per lineal-foot.

SW's rate administrator; its vice president for administration who is also its general counsel and a member of its board of directors; and the division manager of its southern California division testified for SW. An auditor assigned to the Finance and Accounts Division and a senior utilities engineer testified for the Commission staff.

SW is a corporation organized and existing under the laws of the State of California, and is engaged in the business of distributing and selling natural gas in certain portions of San Bernardino County and Placer County, California, as a public utility subject to the jurisdiction of the Commission. It is also engaged in the intrastate transmission, sale, and distribution of natural gas as a public utility in certain portions of the States of Nevada and Arizona, and is a natural gas company within the meaning of the Natural Gas Act and as such is subject to the jurisdiction of the Federal Power Commission with respect to the interstate transmission facilities and sales of natural gas for resale in its northern Nevada system.

SW contends that its difficulty in raising adequate capital would require it to discontinue accepting new customers unless its request for a change in its rules as set forth in its application is granted. It further contends that it must pay a larger percentage for debt than it is permitted to earn on its rate base so that every additional dollar of investment for new customer service causes a reduction in profit. It contends that its last rate increase as set forth in Decision No. 84603 dated July 1, 1975 purported to provide an annual return of 9.20 percent on rate base, but its income has been less and its expense and cost of debt greater than anticipated so that its rate of return has been less than 9.20 percent.

SW contends that its cost of debt exceeds the rate of return it is permitted to earn on the cost of installing new main extensions and service lines resulting in a loss on each occasion where it is required to have a new customer and make such installations.

SW's rate administrator referred to Exhibit C, a part of Exhibit 4 in evidence, and stated that Decision No. 84603 purported to grant SW a rate of return of 9.20 percent on rate base of \$13,012,100, but that Column (f) of that exhibit shows the amounts for the 12 months ended May 31, 1975, after being adjusted to annualize the sales and purchase rates at the July 1, 1975 rate level which includes the rate relief granted in Decision No. 84603, reflect a rate of return of 7.29 percent, or 1.91 percent less than that which was purportedly authorized by Decision No. 84603. He testified that the primary reason that SW has not been able to earn the return authorized by the Commission for SBCD is because of a drop in gross revenues due to a reduction in the sale of gas during the period involved by reason of a conservation program.

He testified that if the rule change being sought had been in effect for the 12-month period ending May 31, 1975 or during the calendar year 1976 it would not have caused a significant effect upon SW's rate of return.

SW's executive vice president for administration testified that the purpose of filing this application was to obtain relief from the pressure of making uneconomic investments in utility plant in SW's SBCD. He stated that in the SBCD there is no capacity limitation problem and the only capital expenditures of any great consequences are for main and service connections to reach new customers.

He stated that the problem of unavailability of capital would be solved by requiring new customers to contribute the cost of the facilities needed to serve them.

He stated that the price that SW was required to pay for the new increments of capital that it sold or arranged for in 1975 is indicative of the scarcity of capital and that a rate of return of 12.37 percent would be needed to support this incremental capital structure merely to pay the prescribed debt interest and preference stock dividends and maintain the current rate on common stock with no provision for returned earnings. He stated that for every \$1,000 of new capital invested in its SBCD, the company would experience a deficit of \$31.70 annually on the incremental costs of the capital invested if it should earn a rate of return of 9.20 percent, the last rate of return allowed by the Commission, and for every \$1,000 of additional capital invested, the company would experience a deficit of \$50.80 annually from its rate of return on May 31, 1975. He stated that accordingly, each new customer has now become a liability instead of an asset.

He testified that he was familiar with the fact that the Internal Revenue Service intended to issue its Ruling No. 75-557 to be effective February 1, 1976, but was unable to state whether or not the effect of this would require contributions in aid of construction to be subject to federal income tax.

He testified that SW has made an effort to obtain relief similar to that sought in this application in its Placer County, California, service area where a moratorium on new sewer connections has had the effect of curtailing new construction, thereby imposing a de facto moratorium on nearly all new gas connections so that the amount of new investment needed for that service area is minimal.

He testified that SW declared a moratorium on connection of all new customers in its Nevada service areas as it was faced with capacity limitations and inability to raise sufficient funds to build a new compressor station on its northern Nevada transmission system. The Nevada Public Service Commission denied the moratorium application, but granted approximately \$2,000,000 in additional general rate relief during the period that the moratorium application was pending, and this has temporarily solved the company's problem in raising new capital in that area.

He testified that California does not carry its fair share of the burden and that in Nevada the rule is as follows:

For main extension, an "allowable investment" formula is used. For residential customers, the allowable investment is six times the difference between the cost of gas and the annual revenue estimated to be realized as a result of the extension. For commercial customers, the allowable investment is four times this difference. For industrial customers, there is no allowable investment formula.

For service extensions, the allowable investment formula also is used, with the allowable investment being four times the difference between the cost of gas and the estimated revenue for both residential and commercial customers. There is no allowable investment for industrial customers. If no main extension is required, or the required main extension does not use up all of the allowable investment for main extensions, the excess may be applied as a credit against the allowable investment in service.

He stated that in Arizona the rule is as follows:

For main extensions, the company will invest the smaller of two times the estimated annual revenue or \$500 to reach a residential or commercial customer. For an industrial or gas engine customer, the company will invest one and one-half times the difference between the estimated revenues and the cost of gas. For service extensions, the company will run 100 feet inside the customer's property line.

He stated that the Arizona Commission has granted SW substantially what it has requested in recent general rate increase applications, and relief has been forthcoming in six or fewer months from the date the application is filed. Since Arizona is a so-called fair value state, the last allowed rate of return is meaningless, but the rate of return allowed translated into a 16 percent return on common equity.

He stated that Nevada is the most important jurisdiction to the company inasmuch as Nevada jurisdictional rates produce approximately 72 percent of the company's revenues. The Nevada Commission last granted a rate of return of 9.34 percent which translated into a 14.2 percent return on common equity. The Nevada Commission must act within six months after the date the application is filed or the rates proposed by the applicant become effective by operation of law. Further, the capital structure used by the Nevada Commission is that which actually is in effect ninety days after the date the application is filed. He stated that expensive new increments of SW's capital structure are reflected in Arizona, Nevada, and Federal Power Commission rates relatively soon after they are actually experienced. Unfortunately, he stated, that this is

not the case in California and it is for this reason that SW believes that it cannot afford to continue to make capital investments in California.

He stated that historically a new customer was an asset to the system, however, in recent years the incremental cost of even the company's most senior debt securities has not only exceeded the embedded cost of debt by a huge margin, but has exceeded the allowed rate of return as well. Under these circumstances each added customer increases the attrition in the company's rate of return and has become a liability rather than an asset.

He stated that in April 1975 SW sold an additional 500,000 shares of common stock to the public through underwriters and netted about \$3,675,000 and in November 1975 sold 400,000 shares of preferred stock which netted it approximately \$7,500,000. The proceeds of these sales were used to reimburse SW's treasury for funds expended on new utility plant. Short-term borrowing, which has been continuously outstanding since April 1973, has been reduced from \$14,000,000 in April of 1975 to \$8,000,000 as of December 18, 1975.

In accordance with authority granted by Decision No. 85621 dated March 23, 1976, SW sold an additional \$12,000,000 aggregate par value of its promissory notes in April 1976, consisting of \$1,025,000 principal amount of 9 percent Series A due April 1, 1982 and \$10,975,000 principal amount of 10 percent Series B due April 1, 1988. A portion of the net proceeds was used to repay short-term indebtedness of \$10,000,000 and the remainder will be applied to capital improvements planned for 1976.

SW's Southern California division manager testified that in SBCE he anticipated 600 new customers in 1976. The total costs for new service lines to provide service for these new customers would be approximately \$181,000 and the cost of

new main extensions to serve such customers \$217,000 or a total of \$398,000, less customer advances of \$152,000, or a net amount of \$246,000. He stated that there has been a general decline in new customers during the last few years and that there were 1,500 new customers in 1973 and 900 in 1975.

Exhibit 8, the statement of the Finance and Accounts Division of the Commission, did not support or oppose SW's application, but urged that if its requested relief is granted, that it be for a limited period in order that the Commission may review the extension rules of all gas utilities through an OII in the foreseeable future.

The auditor assigned to the Finance and Accounts Division of the Commission testified that it is his opinion and the position of the staff that by reason of the activity of the Internal Revenue Service that contributions in aid of construction which would result in the requested amendment of the rules by SW would be subject to federal income tax.

A senior utilities engineer of the Commission stated the staff's position set forth in Exhibit 9 that this application be held in abeyance until an investigation into the appropriateness of the present main and service extension rules of all gas utilities within California can be initiated. The Utilities Division staff report (Exhibit 11) in Attachment 1 thereto sets forth the financial effect on SW of a typical general service customer addition and shows that the costs incurred by the utility are essentially offset by the additional revenue generated under the present rates. Exhibit 11 sets forth on page 2 that "...there is no justification for changing the present extension rules."

Discussion

A public utility must meet all reasonable demands for extension of service within its dedicated service area in accordance with its lawfully filed tariffs. (Calif. Elect. Power Co. (1948) 48 CPUC 183; Engel v Henry (1962) 59 CPUC 457.) It is the duty of gas utilities to install at their own expense a service connection of normal size to the property line or curblin of property abutting upon the public street in which the main is laid for consumers desiring to purchase gas. (City and County of San Francisco v Pacific Gas and Elec. Co. (1917) 14 CRC 233; W. W. Ward (1925) 27 CRC 269, 272.)

As a general rule, it is the duty of a utility in this State to install at its own expense such extensions to its mains as may be necessary to serve the inhabitants of any community which it is serving (Dooley v Peoples Water Co. (1913) 3 CRC 948; Pacific Gas and Elec. Co. v Great Western Power Co. (1912) 1 CRC 203), unless the Commission finds that it would be unfair to have the utility make the extension, whereupon it may impress terms upon consumers as conditions precedent to requiring the utility to make extensions. (Northern Cal Power Co. (1912) 1 CRC 315, 326.) The general practice of the Commission has always been to require all water, gas, electric, or telephone utilities to install at their own expense a service connection to the property line or curblin of property abutting upon a public street or highway. (W. W. Ward (1925) 27 CRC 269, 272.)

Each case of an asserted exception to the general rule of the duty of a utility to make extensions at its own expense must be clearly proved before the Commission will authorize a deviation from the general rule; but while it is the general rule that it is the duty of a utility holding itself out as being willing to serve a certain territory to incur at its own expense the necessary capital expenses and thereafter to serve the applicant at the published rates, there may be cases in which the expenditure necessary to serve would be so large or in which the other conditions would be such as to make it unreasonable, both from the point of view of the company and of its other subscribers, to demand that the necessary extension shall be made entirely at the cost of the utility. Unless an exceptional case is presented, the Commission will adhere to the general principle to the effect that it is the duty of a public utility to build at its own expense all extensions which are necessary to serve persons residing in territory which the company, either by direct assertion or by necessary implication, holds itself out as ready to serve. (Stewart v Great Western Power Co. (1913) 3 CRC 1160, 1165.) If improvements in the service offered are required, and adequate financing is available, a utility should be ordered to make such improvements even if the utility has in the past relied primarily on internally generated funds and existing long-term debt may have to be refinanced at current interest rates. (Park Water Co. (1968) 68 CPUC 672.)

The contention of SW that by reason of the reduction of gross revenues as the result of the decline in the sale of gas in SBCD it has not been able to earn a rate of return of 9.20 percent on rate base as authorized by the Commission, and the statement of SW's executive vice president for administration to the effect that California does not carry its fair share of the burden of the operation of SW, and his explanation as to what the rules are in Nevada and Arizona and the results of SW's operation in Nevada and Arizona, and his statement that extensive new increments of SW's capital structure are reflected in Arizona, Nevada, and Federal Power Commission rates relatively soon after they are actually experienced, do not provide a basis for the rule change requested by SW and are relevant only insofar as a reduction in gross revenues may have caused a limitation of SW's financial ability to provide new extension and main lines for new customers.

A public utility has the right to earn a reasonable return and in determining what that return is to be the cost of debt is taken into consideration. The Utilities Division, Gas Branch report (Exhibit 11, Attachment 1) shows that when all factors are taken into consideration, including income taxes, a typical customer addition expenditure will not show a loss but will show a profit. Each added customer, therefore, does not increase the attrition in the company's rate of return.

The issuance by the Internal Revenue Service of Revenue Ruling 75-557 appears to require that contributions, including connection fees, will be subject to the payment of federal income tax at the time such contributions are received.

In SW's application which was filed July 28, 1975, SW stated that on February 24, 1975 its board of directors, because of the extreme difficulty SW was encountering in attempting to raise capital and because of its inability to raise adequate amounts of capital, adopted resolutions instructing the management to seek authority from the regulatory commissions in California, Nevada, and Arizona to cease taking on new customers on any terms which would require SW to spend money for the construction of utility facilities. Since February 1975, the financial condition of SW as regards the obtaining of capital has substantially improved. In April 1975 it sold 500,000 shares of common stock to the public through underwriters and netted approximately \$3,675,000; in November 1975 it sold 400,000 shares of preferred stock from which it received the sum of \$7,500,000; short-term borrowing has been reduced from \$14,000,000 in April of 1975 to \$8,000,000 as of December 18, 1975; and in April 1976 it sold \$12,000,000 aggregate principal amount of promissory notes.

SW's financial condition has improved and it has the financial ability to provide mains and extensions for new customers. The cost incurred by SW of a typical general service customer addition is essentially offset by the additional revenue generated under the present rates. Internal Revenue Service Revenue Ruling 75-557 will require that capital which might be generated by the requested rule changes would be subject to federal income tax so that only a portion of the capital would be available to SW for construction of mains and extensions. Such a rule change would tend to curtail the construction and real estate business in Hesperia Valley and the effect on SW's finances would be minimal.

Findings

1. SW seeks authority to revise its gas tariff Rules 13, 15, and 16 in SBCD to require nonrefundable contributions by customers of all gas main extensions and new service lines in order to shift from it to the new customers requiring service the costs of the facilities necessary to provide gas service to such new customers.

2. SW estimates an increase of 600 customers during 1976 at a cost of \$181,000 for new service lines and \$217,000 for additions to main lines for a total of \$398,000, less customer advances of \$152,000, for a net expenditure of \$246,000 during 1976.

3. The payments required to be paid in aid of construction by reason of the requested rule changes will be subject to federal income tax which will require the new customers to pay the entire additional cost of providing gas service but will provide only a portion of their contributions for such purpose.

4. The cost incurred by SW by the addition of a typical general service customer is essentially offset by the additional revenue generated under the present rates.

5. The effect of the rule changes on SW's finances would be minimal to SW, but would curtail and be harmful to the construction and real estate business in SBCD.

6. SW is financially able to provide main and service extensions for new customers.

7. The advantages to SW of granting the requested rule change are minimal and far outweighed by the disadvantages which would result to prospective customers and the area served by SW.

8. It is the duty of SW to install at its expense the additional mains and service lines which might be necessary in order for it to service new customers in the future, and it is not unfair or unreasonable to require it to do so.

9. Under the circumstances presented by the evidence in this case, it is not reasonable to require SW's new customers to make nonrefundable contributions for gas main extensions and new service lines in order to shift from SW to the new customers requiring service the cost of the facilities necessary to provide gas service to such new customers.

The Commission concludes that the authority sought by SW to revise its gas tariff Rules 13, 15, and 16 in SBCD should be denied.

O R D E R

IT IS ORDERED that the authority sought by Southwest Gas Corporation to revise its gas tariff Rules 13, 15, and 16 in its San Bernardino County District to require nonrefundable contributions by customers of all gas main extensions and new

service lines in order to shift from it to the new customers requiring service the costs of the facilities necessary to provide gas service to such new customers is denied.

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

Dated at San Francisco, California,
this 13th day of OCTOBER, 1976.

[Signature] President
William S. Squire
Leroy L. Sturgeon
Hon.
Robert D. [Signature]
Commissioners