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Decision No. 90649 AUG 14 1979

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of CP NATIONAL CORPORATION, a California corporation, for authority to increase its rates for gas service in its South Tahoe Division.	Application No. 57822 (Filed January 20, 1978)

Orrick, Herrington, Rowley & Sutcliffe, by Robert J. Gloistein, Attorney at Law, for applicant.
Sara S. Myers, Attorney at Law, and Bertram Patrick, P.E., for the Commission staff.

O P I N I O N

By this application, CP National Corporation (applicant) seeks to increase gas rates in its South Tahoe Division to produce additional annual gross revenues of $584,200 for an average increase of 10.7 percent over the revenues produced by the authorized rate levels now in effect, based on 1979 operations. In addition, applicant seeks to establish separate rates for test year 1980 which would be applicable until revised by a new showing of revenues, expenses, and rate base that would be applicable beyond that time.

Public hearing was held before Administrative Law Judge Gillanders in South Lake Tahoe on November 28, 1978, and the matter was submitted upon receipt of late-filed exhibits on February 15, 1979. Copies of the application had been served and notice of hearing had been published and posted in accordance with this Commission's Rules of Practice and Procedure.

Oral testimony on behalf of applicant was presented by a rate engineer. The Commission staff presentation was made by an engineer. A representative of the South Tahoe Public Utility District testified regarding cost of natural gas versus fuel oil.

General Information

Applicant is a corporation duly organized and existing under the laws of the State of California. It owns and operates public utility electric, gas, water, and telephone systems in California; electric, gas, and telephone systems in Oregon; electric, gas water, and telephone systems in Nevada; and electric systems in Utah and Arizona.

Its principal place of business is located in San Francisco, California.

South Tahoe Gas Department

Organization. The South Tahoe Division is under the supervision of a division manager who has under his employ 23 people, 21 of whom are employed permanently.

The business office of the South Tahoe Division is located at South Lake Tahoe, California.

Territory Served. The South Tahoe Division provides gas service in South Lake Tahoe and adjacent territory in El Dorado County. The population of South Lake Tahoe is estimated to be 21,000.

Source of Gas. Applicant purchases its gas requirements for the South Tahoe Division from Southwest Gas Corporation on Rate Schedule PGA-1. The gas purchased from Southwest Gas Corporation is received at South Lake Tahoe, California, where it enters applicant's distribution system.

Results of Operation

During the course of hearings in this proceeding, the disputed issues between applicant and the staff were narrowed to (1) rate of return; (2) appropriate allowance for the cost of Stanford Research Institute's (SRI) management audit; and (3) appropriate allowance for the capitalized cost of applicant's customer information services system. Applicant's witnesses and witnesses for the Commission staff analyzed and estimated applicant's operating results for test year 1979.

At the conclusion of the hearing, applicant stated that, after a review of the staff showing which was based on later data, it was prepared to agree with the staff's estimate, except for rate of return and management audit, in order to expedite decision. To this end, a late-filed exhibit, jointly sponsored by applicant and the Commission staff, was filed showing an agreed summary of earnings at present rates. This exhibit also reflects reduced ad valorem property taxes due to the passage of Proposition 13, the new federal income tax rate of 46 percent, and a reduction in the working-cash allowance.

Applicant hired SRI to conduct a management audit of its general office and top level management. SRI conducted its audit at a cost of $110,000 and submitted a report which covered applicant's strengths and weaknesses and proposed solutions to problems and changes in organization and business. The report also focused on problems with data systems, management practices and training, the need for development of a public relations program, and the role of the Board of Directors. Applicant considers the cost of the SRI study to be a proper charge to its ratepayers. Thus, it allocates the cost among its operating divisions. The staff recommends that the entire cost of the study be charged to the stockholders because the ratepayers have already paid for competent management in the rates charged and should not have to pay for correcting deficiencies, corporate acquisitions and divestments and profitability improvement which, according to the staff, are clearly for the benefit of the stockholders. We agree with the staff and will adopt the staff's disallowance of the cost of the SRI study.

In Decision No. 90597, issued in OII No. 14, we found the expense for the management audit conducted for CP National by the Institute of Management Research should be disallowed when setting rates for CP National's district. However, we directed CP National to develop an improved training program for its customer relations personnel and to provide better supervision over such personnel. We recognized the net revenue requirement for this undertaking to be $38,000 annually for CP National's total California operations. Accordingly, we will include $8,100 expense in the adopted test year to fund this activity (allocated to this CP National district by the four-factor methodology).

The following table sets forth the jointly sponsored summary of earnings at rates in effect on January 1, 1978 for test year 1979, the amount of additional revenue required to raise applicant's rate of return to that recommended by the Commission staff and the additional revenue required to raise applicant's rate of return to that recommended by applicant.

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SOUTH TAHOE GAS DISTRICT
(Estimated Year 1979)
Based on December 31, 1977 Purchased Gas Cost

	At Present Rates	STAFF Rate of Return at 9.50% Adjustment	Results	UTILITY Rate of Return at 11.03% And SRI Adjustment of $1,194 Adjustment	Results
	(Dollars In Thousands)				
Operating Revenue					
Basic Rates	$1,113.4	$443.2	$1,556.6	$141.0	$1,697.6
Energy Rates	4,319.0	-	4,319.0	-	4,319.0
Miscellaneous	11.6	-	11.6	-	11.6
Total Oper. Revenues	5,444.0	443.2	5,887.2	141.0	6,028.2
Operating Expenses					
Production	4,256.5	-	4,256.5	-	4,256.5
Distribution	180.2	-	180.2	-	180.2
Customer Service & Information	2.9	-	2.9	-	2.9
Sales	5.5	-	5.5	-	5.5
Customer Acs. With or Without Uncollec.	204.0	-	204.0	-	204.0
Uncollectibles	21.8	1.8	23.6	0.6	24.2
Administrative and General	390.8	4.6	395.4	2.7	398.1
CIS Amortization	29.9	-	29.9	-	29.9
Subtotal	5,091.6	6.4	5,098.0	3.3	5,101.3
Book Depreciation	179.2	-	179.2	-	179.2
Taxes other than Income	80.6	-	80.6	-	80.6
State Corporation Franchise Tax	(13.2)	39.3	26.1	12.4	38.5
Federal Income Tax	(99.8)	182.8	83.0	57.6	140.6
Total Oper. Expense	5,238.4	228.5	5,466.9	73.3	5,540.2
Net Oper. Revenues	205.6	214.7	420.3	67.7	488.0
Rate Base	4,423.9	-	4,423.9	-	4,423.9
Rate of Return	4.65%	-	9.50%	-	11.03%

(Red Figure)

The staff's original analysis of the results of operation showed rates of return as follows:

RATE OF RETURN

Item	Estimated Year 1978: Present Rates	Estimated Year 1978: Proposed Rates	Test Year 1979: Present Rates	Test Year 1979: Proposed Rates
Staff	3.71%	11.97	3.75%	13.44
Utility	(0.06)	10.72	(2.03)	11.03

(Red Figure)

To estimate attrition the staff adjusted the estimated 1978 ad valorem tax as if the Jarvis-Gann initiative was in effect for the full calendar year, then calculated rate of return for the years 1978 and 1979 on the assumption that (1) 1978 proposed rates were in effect for both 1978 and 1979 and (2) 1979 proposed rates were in effect for both 1978 and 1979. The results are as follows:

RATE OF RETURN

	Estimated Year 1978	Test Year 1979
At 1978 proposed rates	12.12%	12.25%
At 1979 proposed rates	13.33	13.44

As the above returns indicated that there is no attrition in rate of return and that increased revenues for 1979 would be sufficient to offset estimated increase in expenses and rate base without causing reduction in rate of return, the staff recommended that no allowance for attrition be made in rate of return allowed.

Rate of Return

Any rate of return determination necessarily requires the weighing of a number of economic intangibles which are difficult to measure by statistical comparisons. It devolves upon the judgment of the Commission, after weighing the evidence presented by all of the experts, to determine and set a fair and reasonable rate of return. (Pac. Tel. & Tel. Co. (1968) 69 CPUC 53.) It was the testimony of applicant's rate of return witness that an 11.03 percent rate of return on rate base or approximately 16 percent rate of return on common stock equity is needed to enable applicant to sell its shares at a price which would not be punitively dilutive to the present stockholders and destructive to the market for applicant's common stock.

The staff's financial witness recommended a rate of return of 9.50 percent on rate base, or approximately 12.21 percent return on common stock equity. We have considered the arguments advanced by applicant and staff and adopt as reasonable a rate of return of 9.50 percent on rate base. Such a rate of return will provide a return on equity of approximately 12.21 percent, an after-tax interest coverage of 2.53 times, and a combined coverage of 2.00 times. This return on capital is adequate to attract capital at a reasonable cost and to maintain the credit of applicant.

Rate Design

Applicant and staff (with some minor differences) have proposed a new rate design for residential gas rates which will aid in reducing the effects of declining sales on revenue, promote conservation and not disadvantage the ratepayers. (See Appendix A which illustrates the adopted sales quantities per class of customers.)

Simply stated, applicant's revenue requirement if divided into two components are: One, the energy rate revenue consisting of the cost of purchased energy and related uncollectibles and franchise fees; the other, the basic rate revenue consisting of revenue required for a return on rate base and all other expenses. For applicant, which purchases its total energy requirement, the former component generally represents two-thirds of the total revenue requirement. Both applicant and the staff recommend that this component be collected subject to adjustment through a balancing account.

Applicant and staff differ slightly with respect to the collection of basic rate revenue. First, applicant proposes higher monthly service charges than the staff. It is apparent that even the higher proposed charge does not cover the fixed costs of service, and, in any event, the amount adopted will be reflected in an adjustment to the commodity rate in order to produce the needed revenue requirement.

For residential sales, applicant proposed that the commodity charge portion of the basic revenue be collected by a uniform price through the lifeline usage. The staff recommended that the commodity charge portion of the basic rate be spread on an inverted basis over three blocks. For nonresidential sales, the basic rate is spread uniformly over all sales. We will adopt the staff's basic rate design for residential and commercial sales.

For the energy rate portion of the commodity rate, the applicant recommended a lifeline rate and a nonlifeline rate for residential service and the staff recommended that energy costs be spread on an inverted basis. We will adopt the applicant's proposal and establish a lifeline energy rate and a uniform nonlifeline rate for all other sales. The energy rate revenue shown on the adopted sales table consists of the adopted cost of gas at January 1, 1978 rates plus the difference between the current gas costs contained in Advice Letter No. 132-G and authorized by Resolution No. G-2269. This difference (purchased gas adjustment) amounts to $1,230,100 based on the adopted test year; the resultant energy revenue to be allocated in rate design is $5,549,100.

The staff's proposed rate design provides rates designed to encourage conservation by providing an economic incentive for customers to achieve conservation.

According to the witness for the South Tahoe Public Utility District, the district uses approximately 10 million cubic feet of natural gas per month for the incineration of sludge, the recalciting of lime which is used in the treatment process, for regeneration of activated carbon, and for steam production. The witness was concerned that if the price of natural gas increased above the cost of No. 2 fuel oil, then the district would have to investigate the possible use of No. 2 fuel oil in its incinerator. To date the district has made no studies of the cost of burning fuel oil nor has it made studies regarding air pollution standards. The witness asked the Commission to consider the fact that any increased costs of energy to the district are passed on to the district's customers.

According to the staff, the sewer district's usage is 4 percent of the totals and is the only industrial customer on the system. The staff has estimated an annual increase in applicant's total sales of 5 percent. If applicant lost the sewer district as a customer, it would represent less than one year's growth.

We do not wish to disturb the air quality of the Tahoe Basin and will set the applicant's industrial rate no higher than the current equivalent cost per therm of No. 2 fuel oil in South Tahoe.[1/]

Findings of Fact

1. Applicant is in need of additional revenues, but the proposed rates set forth in the application are excessive.

2. Increased gas rates for residential customers will provide an economic signal for customers to achieve conservation.

3. If the commodity charge for gas is priced higher for higher quantities of usage, customers will have an incentive to reduce use to obtain a lower commodity rate.

4. Pricing gas for industrial use at $.0610 (the equivalent current price for No. 2 fuel oil) will provide industrial users with an economic signal of the true cost of energy and give incentive to review energy use requirements and possible conservation measures.

5. The estimates, previously discussed herein, of operating expense and rate base for the test year 1979 reasonably reflect the estimated results of applicant's operations for the future.

6. A rate of return of 9.50 percent on the adopted rate base for the year 1979 will produce a return on common equity of approximately 12.21 percent. Such rate of return requires an increase in gross revenues of $443,200 which amount is reasonable.

7. The apportionment of the authorized revenue increase to the various customer groups as previously described is reasonable.

1/ The adopted industrial rate of $0.3610 per therm is equivalent to the current current price of No. 2 fuel oil in South Tahoe.

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

The Commission concludes that the application should be granted to the extent set forth in the order which follows which should be effective the date of signature because there is an immediate need for the rate increase authorized.

O R D E R

IT IS ORDERED that after the effective date of this order, CP National Corporation is authorized to file the revised rate schedule attached to this order as Appendix B, and concurrently to withdraw and cancel its presently effective schedules. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedule shall be five days after the date of filing. The revised schedule shall apply only to service rendered on and after the effective date thereof.

The effective date of this order is the date hereof.

Dated AUG 14 1979, at San Francisco, California.

President

Commissioners

Commissioner Richard D. Gravelle, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

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CP NATIONAL

South Tahoe Division Gas Service
Adopted Sales
(Estimated Year 1979)

Based on April 1, 1979 Purchased Gas Cost

Classification (Schedule No.)	Volume (Mth)	Basic Revenue		Energy Revenue 1/		Total Revenue	
		$/th	M$	$/th	M$	$/th	M$
Residential (211,223,224)							
Customer Charge (1,000's)	116.8	2.20	257.0	-	-	2.20	257.0
Tier I (Lifeline)	7,748.9	.06118	474.1	.28022	2,171.4	.3414	2,645.5
Tier II	3,040.0	.07228	219.7	.31132	946.4	.3836	1,166.1
Tier III	1,215.7	.10323	125.5	.31132	378.5	.41455	504.0
Employee Discount			(0.8)		(2.5)		(3.3)
Total Residential	12,004.6		1,075.5		3,493.8		4,569.3
Non-Residential							
Commercial (221)							
Customer Charge (1,000's)	9.25	2.20	20.4	-	-	2.20	20.4
Commodity Charge	5,871.9	.07228	424.4	.31132	1,828.0	.3836	2,252.5
Industrial (244)	730.6	.04968	36.3	.31132	227.5	.3610	263.7
Total Sales	18,607.1		1,556.6		5,549.3		7,105.9
Schedule 223 Lifeline Discount	67.0						
Total Volume	18,674.1						

1/ Energy revenue includes PGA after January 1, 1978 and prior to April 16, 1979 based on adopted purchases.

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APPENDIX B

CP National, South Tahoe Division -- Gas

I. Applicant's rates and charges are changed to the level or extent set forth this appendix.

				Per Meter Per Month
Customer Charge (All schedules except GT-244)			....	$2.20
Commodity Charge				
Schedule GT-211 and GST-223 (Residential)				
	Basic & Summer	Winter		
First	26	166	Therms, per therm	.34140
Next	100	166	" " "	.38360
Over	126	232	" " "	.41455
Schedule GMT-224 (Residential)				
	Basic & Summer	Winter		
First	21	105	Therms, per therm	.34140
Next	81	105	" " "	.38360
Over	102	210	" " "	.41455
Schedule GT-221 (Commercial)				
All deliveries, per therm			....	.3836
Schedule GT-244 (Industrial)				
All deliveries, per therm			....	.3610
Minimum Charge: $342 annually				

II. Applicant's tariff schedules are revised to the extent that they shall show the entire commodity rate in effect. The Purchased Gas Adjustment Clause section shall be revised to reflect the energy rates authorized and note that they are included in the authorized commodity rates above.