

COMMENTS BY DISCUSSANTS ON NATHAN PAVEN'S SPEECH ON THE  
CONSUMER STAKE IN PUBLIC UTILITY RATE REGULATIONS BEFORE  
THE COUNCIL ON CONSUMER INFORMATION IN CALIFORNIA  
APRIL 21, 1965

The Moderator. Thank you very much Mr. Paven for a most thoughtful and challenging address that I think really digs deeply in the problems that we face in the utility rate regulation areas. I will now introduce the discussants and will ask each of them to take five or seven minutes to comment on Mr. Paven's speech. They are to comment on his general analysis of the breakdown in the utility regulations as he sees it, or on the suggestions he has for remedies, or on both aspects of his talk.

Immediately on my left is Commissioner George G. Grover of the California Public Utilities Commission. He is one of those rarities in the United States, both as an individual and as member of a commission which is not the weak, inefficient, understaffed and timid regulatory agency but, to the best of my knowledge as a consumer, tends to be strong, efficient, well-staffed and always courageous.

His courage was most recently and dramatically exemplified by the telephone rate decision which earned the P U C no gratitude in the California press; I believe every California newspaper wrote an editorial attacking the rate reduction which was of enormous benefit to the public.

Mr. Grover is one of the commissioners who led the fight for the telephone rate reduction and has been one of the commissioners who has fought hard for the public interest.

On my right is Richard Tuttle. His title is Chief Counsel of the Public Utilities Commission. He has the staff that does all the work in these rate cases and he is the man who last month was in Sacramento before the Supreme Court arguing the telephone rate cases in the face of what might finally be called vigorous attacks from the telephone company.

Finally, on my right is a gentleman from Washington, D. C., who represents a different phase of the public utility area. He heads the Electric Consumers' Information Committee, which is concerned with supplying the necessary information to rural co-ops, farm groups and other groups that have a direct stake in public utility regulations.

THREE DISCUSSANTS TO COMMENT  
IN ORDER

I have asked each of the three discussants to comment in the order in which I have introduced them and then we will give Mr. Paven a chance to take his crack at whatever they might say. We will begin with Commr. Grover.

COMMR. GROVER. There are two newspapers out of the hundreds that I saw that were for us. The first was in Yreka and the other was in Pasadena, one of the places that I wouldn't have expected support.

I know if any one of you were to be appointed to the California commission you would think that things would

change. Yet, echoing Mr. Paven's remark that the moderator picked up about the weak, inefficient, understaffed and timid regulatory agency, I must say that if you were appointed tomorrow morning you would find you were just as weak as I am.

That is due to the law. As inefficient as it is, we think it is a better-than-average mechanism, but still it is the mechanism of the law as it is. You would be just as understaffed, in spite of the fact that we have one of the largest staffs in the country. Since we are the largest state, relatively we do have a large staff.

But we don't have near enough people to do what we need to do and you would find that the only difference it would make is that you would be "courageous" where the present commissioners, perhaps, are timid. You would find that the problems are the same problems which the present commission has. You would find that we need and ought to have a better way of solving them than we have. And the telephone problem is a good example. It is a problem I will mention a little later in handling the rate adjustments.

#### PRIVATE ENTERPRISE IS HERE TO STAY

But the thing I like about Mr. Paven's remarks is that while he is critical of regulations he is sophisticated about it. Those of you who were at the Consumers' Association Conference last December, where I spoke, will remember I used the word "sophistication" as the key in doing anything about regulation.

You are not going to abolish regulation and you are not going to abolish private enterprise in the utility system. All you can do is make it a little better. And you can only make it better if you know what is going on; you have to have your facts and you have to know what the legal requirements are.

This telephone case before the Supreme Court is not a political case. It is a question of the law concerned with regulating the telephone company; you have to know that law and you have to apply it. It requires knowledge, not just a lashing out at high rates, not just a lashing out at a monopoly. It requires expertise and sophistication.

Take this analysis of the NRUCA here, the three points Mr. Paven mentioned. Let me take the second and third first. The second one is the rate base, the plant depreciates and, I believe, the original cost of the plant. The California commission has done that for years and years, and has followed that principle. The third point concerns the amounts classified as deferred taxes from accelerated depreciation and invested credit. The California commission has been the leader in seeing that those tax credits go through profit as savings. That is an accounting technique — as the profits rise you cut the

profits down because the firms don't get to take this profit and put it in reserve and pretend it isn't a profit.

#### NO REVOLUTIONS IN REGULATIONS

We have been a leader in this technique. It is only on that first point, whether 6% is a fair and reasonable rate of return, that you could argue with the California commission. Yet, we are in with all the other commissions in this denunciation. I might add here that when I walked in the door I got a lot of figures from somebody called the Free University Program on Electric Utilities.

Now I am sure these people are well meaning but in terms of doing anything for the consumers in the present political combat, there is no revolution going on about public utility regulations. You go up to Sacramento and you can build a bonfire for yourself but you won't find any legislators up there tending a bonfire because there is no heat on them from home for doing anything about public utility regulation. Rates may not be right, but you aren't going to revolutionize it.

I would say that this Free University paper here is just unsophisticated. If I were a strictly regulated utility president, I would attack regulators. I would say it was a farce. Just as this paper does. The only help for rates to get them in line with these city rates that are quoted here is just to support sophisticated regulation.

#### YOU PAY THE TAXES IN PUBLIC OWNERSHIP

How about public ownership? Public ownership is tax free. You pay a utility's taxes. The utility doesn't pay the taxes. They brag about the fact they contribute to the taxes. They do that in their ads and that is a joke, as Mr. Paven says, because in the end you pay the taxes; that goes into the rate approved for the utility.

You can't compare Glendale and Southern California Edison, bearing in mind that the Glendale rate payers are not paying taxes that Southern California Edison is paying. Glendale decides to build a new steam plant. It borrows the money via municipal bonds. No tax on municipal bonds. It gets 3% money, and all that sort of thing, where Southern California Edison has to pay higher charges as we found out this year.

I don't know whether Southern California Edison is doing better or not from reading this paper because it is an unsophisticated attack.

Now when you come down to private versus public ownership, what are you going to do about it?

I don't know what these people want when they hand me this paper. Do they want to abolish regulation? Do they want to have all power nationalized? Is that what they want?

They say that when the public takes over Southern California Edison the power will be cheaper, taxes aside and all these other things aside. They think it will be cheaper when they take over because of some notions that have prevailed for generations about condemnation. There are fantastic prices they would have to pay. Then they can't get these low rates they thought they could get because they have to pay back this money they paid to the utilities when taking over — money above what the utilities were making when they owned it.

I didn't get support from this quarter when the Monterey condensation case was argued. I was a dissenter in that case. I was for capitalization of earnings.

#### REGULATIONS NOT EASY TO COMPREHEND

So, I would like to repeat my theme about sophistication. That is the thing I like most of all about Mr. Paven's paper. He has been in this business and he is not just lashing out. He is talking about a specific regulatory problem.

Now here is one phrase — "unfortunately the mechanics of rate regulation do not lend themselves to easy comprehension" — and that's the key. True, they don't render themselves to easy comprehension. We have to know what we are talking about before we can criticize rate regulation.

There is one aspect of his technique, of his approach, that he has suggested: the conference technique, and the year by year sliding scale adjustment. I would like to emphasize it. It was an addition to his paper.

I got an advance copy, that is why I didn't quote what he said — the addition that mentioned the abolishing of this method in 1955, I think it was in the District of Columbia. He put his finger right on the key to it. They withdrew their consent. Why did they, in 1955, withdraw their consent? Because it was great when prices were going up, adjust them every year, you know. Prices are going up, the new cost comes in, grab it on a sliding scale. Isn't this delightful? We get our money tomorrow for an increased cost experience today.

#### RATES GOING DOWN AROUND THE NATION

What is happening throughout the nation on rates today? They are going down. Now this isn't because the utilities are great people. I do think many of our utilities are providing us with good services, and they are dedicated people and are struggling within their private enterprise limits to do a good job. I am not criticizing them, although there are good and bad. But because of economic forces, prices in the utility field are going down. Since they are going down profits of utility com-

panies are going up. I have some figures, and they may be right and they may be wrong.

The point I am going to make is not that the figures are right. I am going to give you the changes because the figures for January 1964 are on the same basis as the figures for January 1965. I am going to give you the changes which delete any distortion which may exist from our particular way of computing them.

Here is a big water company, up .5% in one year on the rate of return. A water and telephone company up .57%. Incidentally, it is a tiny telephone company compared with the big ones, but it is one of the larger independents.

General Telephone of California up .04%. Now that is practically the same, but remember it had a terrific strike, one of the biggest utility strikes in California history this past year. Still, it is up a shade.

Here is the Pacific Lighting System, the largest gas distribution system in the world, up .6% in rate of return.

Pacific Tel. and Tel. just about even.

Southern California Edison Company up .18% and I want to mention that because we went after them on the conference method and we got several million dollars out of them. Rather than go to a rate case, they were willing to admit it. Still, as against a year ago and after this reduction they are up .18%.

Those are companies — not the telephone company — but the gas and electric companies, that have agreed to give the recent tax deductions to the public in the form of reduced rates. You remember the taxes went down from 52 to 50 to 48% this year. The telephone industry has still not given us a dime back and yet the gas and electric companies have agreed to those reductions.

#### NATION'S PROSPERITY BOOSTING PROFITS

Yet, the profits are still going up. There are some basic reasons for that. The biggest reason for that is prosperity. Everybody is getting utility services and the sky-rocketing is just impossible to believe until you look at the figures. Wages are going up, but wage expense per telephone is going down because of a number of reasons.

Automation. You don't have all the operators you used to have. The machine does the work and remember, when there is a dollar put into expense in the utility industry this is a sophisticated thought. When a dollar goes into expense for an operator's wages the phone company gets from the rate payer, under our system of rate regulation, a dollar to offset that expense. But when a

dollar goes into dial machinery, that is investment. They get \$1.06, up to now \$1.063. Whatever it is, they get the profits. So, by converting from people to machines they are not only saving expense but they are also putting more of their money into investment on which they make a profit.

There is automation in those huge power plants. They have them on a triple cycle now. It is not perpetual motion, but they have got automation to the place where in spite of construction costs being higher, in spite of wage costs being higher, the cost of producing a unit of electricity is lower in the modern plants than it was 10 years ago.

Automation, technology, reducing the cost of electricity services. Any reduction in the rates? Well, if we are fast enough we can do it.

Finally, there is another major reason. This is taxation. Taxes are reduced. That is terrific expense, 2% in one year, 2% in the next year. Accelerated depreciation, another form of it. They revised depreciation. You have heard of guide lines. All they did is say your taxes are less. Instead of having, for example, 25 years depreciation, it is, say, 30 years now, and you get larger credits each year against your taxes.

With all these forces and others working, profits are going up. The problem in regulation today is the mechanics of reduction. This sliding rate system worked fine for the company when it wanted fast increases. Right after the war inflation sent everything to a new high and, quite legitimately, utility rates were building up.

Now because of these economic forces we have turned a corner and they are going down and the company doesn't want annual reductions. We are in this battle before the Supreme Court with the telephone company to see if this thing that we started back in 1962 can be automatic. I mean that because we signed a formal investigation order in 1962 we want to push the new rates back to 1962.

#### PAVEN'S METHOD DOES HAVE LOT OF PROMISE

But if we have to wait for years and years, as we do in these complicated cases, and there is no way of doing it fast, then the economics of rising profits are just going to defeat us. We will fall easily behind and that is why Mr. Paven's method, it seems to me, does suggest a lot of promise.

I do want to say a word about the conference method because the California commission has recently filed a suit in the Ninth Circuit against the Federal Communications Commission because they have never used anything else but the conference method. Now we use it and we got some money out of Edison this past year, as I mentioned, by the conference method.

But by itself the method just can't work. You have to bring it out into a full blown hearing once in a while. The AT & T has never been put into that position and I must say that in spite of the fact it can work on a year to year basis in between, our official view, and I must say a vigorous one, is that you can't sit in a locked room, and that is what it was, a locked room, with the AT & T, the biggest economic enterprise in the world, and expect them to agree every year to what they ought to agree to.

So, on this business of sophistication there are all kinds of ways of doing things. You can be dedicated in spirit as much as you want, but unless you know the details and appreciate the procedural problems you just can't get anywhere and that is the promise I see in the suggestions that Mr. Paven has made.

THE MODERATOR. Thank you very much Mr. Commissioner. We will turn next to Mr. Tuttle for his comments on Mr. Paven's address.

MR. TUTTLE. I will say first that with respect to the particular processes that are used, whether it is an annual review or some other method, the mechanics and the legal theory and approach are *all* important. But it seems to me that more significant than the mechanics you use is the outlook of the people who are implementing the machine.

To put it more specifically, if the five California commissioners were appointed by Ronald Reagan, if they were appointed by Archie Brown, instead of Pat Brown, to use a local example, they would have had different approaches in a rate case.

And regardless of what mechanics you use, it does seem to me that if you place a greater emphasis on the type of regulatory approach you use you might be leading yourself into a blind alley. Because no matter what you do, you may have people who honestly and earnestly believe that the important thing is, for example in California, to maintain a high-flow of Eastern capital into the state. And we have had commissioners, very able men of outstanding educational attainment and character who felt that this was the prime reason for the regulatory commission in California.

Well, if that type of person is your regulator it really doesn't make much difference whether you decide the rate of return every year.

## VIEWS OF REGULATOR ARE VERY IMPORTANT

We are talking about how much money a utility should make. The basic approach of the regulator and his view of economics are going to be awfully important no matter what mechanical process is used. I am not saying the process, the administrative approach that is used here, is unimportant. It certainly is important, but no process is going to make up for individuals whose heart is in the place where the one who makes the judgment thinks it should be.

The discussion of both the commissioner and the major address was devoted mainly to the economic aspects of regulation. It does seem to me the consumer interest in what the regulatory body does extends, and properly should extend, beyond the question of whether the service is being provided adequately at the lowest reasonable cost. There are factors in regulation, increasingly in modern times with the wealth of our society, that play a role in regulatory judgments beyond supplying services at the minimum price for adequate services.

The most obvious example of all this today is the question of undergrounding utilities. The cheapest, the quickest, the safest way to provide power is by overhead lines and yet, the interest of society as a whole may well lie in the direction of paying somewhat more for your electricity and enjoy the other advantages of an installation underground.

Now it is true that you might make an economic case for underground utilities. Noting the cost of installation, you might make a perfectly valid projection of things involving environment, mental illness, the property tax base, elimination of other things that downgrade a community by unnecessarily ugly utilities. But I really don't think the case for underground is primarily one for economic benefit.

### WHO WILL PAY FOR THESE ADVANTAGES?

So, I would suggest that this is one of the types of non-economic considerations a modern regulatory commission has before it and it is one of the types of interests consumer groups might have in mind, aside from the question whether they could get 75 cents off their electric bills.

This is a difficult, sticky question and one of the other problems that we have on this is the question of who pays for it and in what area it is to be installed. There are many fine people who have no difficulty in seeing that a small community of people in a very high income

bracket should enjoy the esthetic benefits of an underground utility at the expense of the electric bill of the people elsewhere whose ability to pay some one's else part is somewhat limited. But the question of the underground, nevertheless, is a policy consideration to be resolved on a plane other than a purely economic issues.

Another type of question that is before a regulatory agency, and was the type of case that we recently had, involved the type of expenditure by a utility which relates to its economic, political and social influence, its dominance as an institution in the community. Sometimes it costs more in a rate case to disprove and disallow one of these expenditures than the amount of money that is being disallowed.

In arguing the case that I refer to, the point was made by the utility that the disallowance of contributions by the utility of \$160,000 a year amounted to only two cents a year for the consumer and therefore it was ridiculous for the commission in a rate case of this magnitude to quibble over this amount, which actually was a contribution to educational and charitable purposes. And in this consideration when the commission disallows this type of expenditure this is a policy determination.

I was not one of the commissioners that signed the decision and I can't speak for things that are not in the decision. But it seems to me this disallowance has in it the idea that there are some kinds of expenditures which a utility makes to buy popularity, to buy social acceptability, to buy political influence.

These expenditures should be paid by the shareholders of the utilities. These are the ones who are benefitting by the good will which is being purchased by this money.

The point I make is the cost accounting just in our agency, the staff work, the engineering work, the legal work involved in putting together a rate case and the time that is spent in Sacramento. The time spent in putting that together exceeded any benefit. I mean the rate payer and the taxpayer paid more to support the commission when it was working on this disallowance and would have been ahead of the game if it hadn't been disallowed.

But the point is that there were policy considerations that prompted the commission in such circumstances to make rate adjustments not based upon monetary considerations but on social and political philosophy.