

ALEX
DOCNJ
HD
9685
.U7
P83
1934

**ARGUMENT OF THOMAS N.
MCCARTER AT THE OPENING OF
THE COMPANY'S CASE ON THE
PETITION FOR REDUCTION IN
ELECTRIC RATES BEFORE THE
BOARD OF PUBLIC UTILITY
COMMISSIONERS OF NEW JERSEY**

ALEX
DOCNJ
HD
9685
U7
P83
1934

ARGUMENT OF
THOMAS N. McCARTER

President of Public Service Corporation of New Jersey
and Public Service Electric and Gas Company

At the Opening of the Company's
Case on the Petition for Reduction
in Electric Rates before the Board
of Public Utility Commissioners of
New Jersey

June 26, 1934

Compliments of
Thomas N. McCarter

ARGUMENT OF
THOMAS N. McCARTER

President of Public Service Corporation of New Jersey
and Public Service Electric and Gas Company

At the Opening of the Company's Case on the Petition for Reduction in Electric Rates before the Board of Public Utility Commissioners of New Jersey.

MAY IT PLEASE THE BOARD:

After ten months of floundering by self-constituted tribunes of the people, who, with the aid of an irresponsible and radical theorist, have consumed much valuable time in proclaiming the wickedness of an industry of which they know little or nothing, the proponents of this case have finally rested. The ultimate disposition of the matter is, as I see it, of such momentous consequence to the people of the State, and to the electric industry thereof, that it is fitting that I, who am primarily charged with the responsibility of leadership of this industry in the State, should fully and frankly discuss the issues involved, and point out the line of proof that will be produced to sustain the Company's case.

We are living in a day that is surcharged with hysteria. One form that it takes is an attack upon the Light and Power industry, and the fundamental reason seems to be because it has been reasonably prosperous. Whatever is good should be destroyed! The fad of the day is to imprint upon the brow of success the scarlet letter of sin. When will the American people learn that hysteria, carried to the point of threatened destruction through radical action, does not pay? No one objects to proper regulation of public utilities. All the enlightened utilities of the country have not only acquiesced in but cooperated with it. But over-regulation and persecution has brought the whole railroad industry of this country to the brink of disaster and destroyed its credit. Over-regulation, together with certain other economic factors, has already destroyed the electric railway industry as a going concern. Are these things in the public interest? And now the appetite of the radical is not satisfied, and if he has his way the Light and Power industry is listed for the same kind of treatment.

Let us consider what it is all about. The business carried on by this industry is really of four different kinds:

1. Service to the domestic consumer; that is to say, the ordinary householder. And this is the class of business concerning which the politicians become active because in this way they appeal to a large number of voters.
2. What are known as commercial customers, such as storekeepers and places of business generally, who have to be placed in a separate class so far as rates are concerned because of the vast amount of plant they require to be kept in readiness to serve them, of which they make use, generally speaking, only a very small portion of the electric day, and only during a portion of the year.
3. Public or Municipal lighting. This is served at moderate rates.
4. The Power business. This is largely, if not altogether, a competitive business, involving varying uses of current in substantial quantities for long hours, constituting a class of customers who by reason of the quantity and hours of their use are entitled to rates competitive with those rates they would have to pay if they made use of other forms of power.

This brief outline of the business is, I think, sufficient to demonstrate that rate-making is a science by itself. We employ a corps of competent rate engineers whose entire time is devoted to the proper adjustment of these problems. The aim of our Company has always been, and will continue to be, to so adjust rates that each class of business shall pay the fair cost of serving it.

As above stated, the public excitement is all about the first class—the Domestic Consumer. Now we have some 690,000 Domestic Consumers, and the average bill paid by this whole class of customers per month is—What do you think?—\$2.80 per-month! Less than 10c per-day; less than the average smoker pays for a package of cigarettes or a cigar; less than the price of a large loaf of bread; less than half the price of one ticket to the movies; about half the price of one gallon of gasoline, or a quart of oil. One would think from the shouting that goes on about it that the public were being mulcted out of a large portion of their income by a grasping monopoly, and that the payments made constituted a very substantial part of the family budget. Let us look at the facts.

Reliable statistics show that the average family budget, upon a percentage basis, is as follows:

Food	33%
Housing	20%
Clothing	12%
Coal	3.33%
Electricity and Gas.....	1.67%
Sundries	30%
Total	100%

and as between gas and electricity, a further subdivision may be made of electricity—1%; and gas $\frac{2}{3}$ of 1%. Thus this problem which affects 1% of the domestic budget is exaggerated in importance beyond all reason. Surely this agitation is much ado about very little. It is nothing but artificially stimulated buncombe.

Under our system of rate-making an attempt is made to apportion the cost of serving Domestic customers as equitably as possible, but this desideratum is by no means attained because our records demonstrate that 10% of our Domestic customers pay us no return whatever upon the investment cost of serving them with the rates as they are at present; and one-third of our customers do not pay us as much as 6% upon the investment cost involved in serving them. It is because of these facts that Domestic customers in the higher brackets of use pay a much lower price for their consumption over and above a small quantity. The explanation of the facts set forth in this paragraph is that there are certain fixed costs connected with the supplying of service to every customer, large or small, and it logically follows that the smaller the use the greater is the cost per kilowatt of service by the Company to the customer.

The whole principle of regulation rests upon the theory that, because of the peculiar nature of the business, operating utilities shall always be limited to a fair return upon the value of the property devoted to the public use. They are not like the ordinary industrial concerns that are unlimited as to profit, and in good times can lay up proper surpluses with which to meet depressions like the present. Conversely the principle is just as deep-rooted that, as they are limited in earnings in good times, so they shall be protected in earnings in poor times.

For the last twelve years or more, the Board and the Company have negotiated and reasoned together on the question of rates, with the results—so far as I know—satisfactory to both, and to the people of the State. As a consequence thereof, the following rate reductions have been put into effect from December 1922 to January 1933, inclusive—a period of a little over ten years:

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
ELECTRIC DEPARTMENT

Rate Reductions,
December 1922 to January 1933, inclusive.

Date of Rate Reduction		Estimated Annual Reduction in Revenue
December	1922.....	\$1,600,000.00
May	1924.....	1,500,000.00
March	1926.....	10,731.00
January	1927.....	1,000,000.00
June	1928.....	8,640.00
January	1929.....	1,250,000.00
January	1930.....	1,300,000.00
February	1931.....	50,000.00
June	1931.....	136,000.00
January	1932.....	600,000.00
January	1933.....	1,755,400.00
Total.....		\$9,210,771.00

In November 1924 the Company increased its Street Lighting Burning Hour Schedule 145 hours 30 minutes, without increasing the rates for Municipal Street Lighting, Private Street Lighting, and Floodlighting.

On January 1, 1928, the Company again increased its Street Lighting Burning Hour Schedule 2 hours 50 minutes, without any increase in rates.

From the foregoing, it appears that over a period of ten years, as a result of this policy, the rates have been reduced approximately a million dollars per-year. This means that from a cumulative standpoint, during this period of time, the customers of Public Service have paid something like \$50,000,000. less for their electric service than they would have paid had the rates of 1922 still remained in existence, without including the amount saved by customers on the increased use in the years succeeding the rate reductions.

But the point is made that there has been no reduction since January 1933. This in one sense is true. In another sense it is far from true. All departments of Public Service have gone along

one hundred per cent. with the President in his Recovery Program. All are operating under the N.R.A. In the Electric and Gas Departments a 6-day week of 8-hours has been reduced to a 5-day week of 8-hours, a decrease of from 48-hours per-week to 40-hours per-week without diminution of pay. The Federal Government has imposed upon all corporations substantial increases in taxation, and a special tax of 3% upon the bills of the Domestic and Commercial Customers of light and power companies. This item alone in the case of Public Service involves an annual cost of \$1,250,000, and the combined increase in cost of these various items is well above \$2,000,000. This has all been done without any increase in rate or revenue and is tantamount to the largest reduction that has been made in any one year in the period of years covered by the foregoing table. While we are on the subject of taxation I desire to submit herewith the taxes that have been paid by the Electric Department of Public Service Electric and Gas Company for the past eleven years:

PUBLIC SERVICE ELECTRIC AND GAS COMPANY
ELECTRIC DEPARTMENT

Taxes included in Operating Revenue Deductions

	Amount	Increase over Preceding Year
1923	\$3,172,885.78	\$
1924	3,255,835.68	82,949.90
1925	4,068,991.54	813,155.86
1926	5,060,730.26	991,738.72
1927	5,635,785.14	575,054.88
1928	6,749,477.23	1,113,692.09
1929	8,113,813.71	1,364,336.48
1930	8,268,395.43	154,581.72
1931	9,524,192.02	1,255,796.59
1932	10,506,859.73	982,667.71
1933	10,559,146.92	52,287.19
Increase 1933 over 1923.....		\$7,386,261.14

Thus it appears that in a period of eleven years, the taxes of the Electric Department alone have increased from \$3,172,885.78 to \$10,559,146.92—an increase for 1933 over 1923 of \$7,386,261.14. And now the taxes that have been paid by Public Service Corporation and all of its subsidiary companies during the same period of time:

PUBLIC SERVICE CORPORATION OF NEW JERSEY AND SUBSIDIARY COMPANIES

Operating and Non-Operating Taxes included in Consolidated Statement of Operations

	Amount	Increase over Preceding Year
1923	\$8,555,133.74	\$
1924	8,816,309.79	261,176.05
1925	10,186,632.95	1,370,323.16
1926	11,542,293.30	1,355,660.35
1927	12,188,056.31	645,763.01
1928	13,618,959.60	1,430,903.29
1929	15,458,564.64	1,839,605.04
1930	15,439,179.73	*19,384.91
1931	16,953,176.77	1,513,997.04
1932	17,918,196.15	965,019.38
1933	17,785,065.51	*133,130.64
Increase 1933 over 1923.....		<u>\$9,229,931.77</u>

* Decrease.

The total of these taxes paid during the eleven year period is \$148,461,568.49, which is a vast contribution for any one interest to have made within such a period of time toward the cost of government. It would appear to be of doubtful wisdom for the State, through any agency, to do anything that would endanger the future payment by this interest of such fair and reasonable taxes as may be assessed against it. In my opinion, the foregoing taxes are not fair and reasonable.

Now what is the duty of the Board in a case like the present? It is as defined by the statute creating the Board, "to fix, after hearing, just and reasonable rates". A just and reasonable rate is one that under all the circumstances of the case, is fair to the public and to the investors in the enterprise. It should take into account and make allowance for every element of an existing situation. It is not a rate whittled down to as low a point as possible that will withstand the scrutiny of confiscation that would be applied to it by the Federal courts—which latter yardstick is the only concern of the Federal court. The highest court of this State—The Court of Errors and Appeals—has twice gone on record in the famous Passaic Gas Case, in defining the yardstick which the Board should use in arriving at a just and reasonable rate.

And that yardstick is eight per cent. upon the fair value of the property devoted to the public use, arrived at by the application of proper methods, which have all been defined both by the Federal court and the courts of this State, and which include a proper allowance for going value—placed in the Passaic Gas Case at 30% of the physical value, after deducting observed but not theoretical depreciation. The highest court of this State has never deviated from that position, and it is and should be the law of the land until changed in a lawful manner.

It is the fashion of the theorists to belittle and decry substantial allowances for going value, because the individual items thereof cannot be defined with the same precision as can more tangible property. Going value of a successful enterprise is just as truly a factor of value as the bricks, the mortar, and the electrical machinery that go into a power house. Various elements enter into it, such as the cost of establishing the business; the value of the business built up over a long period of years; consolidation value; and franchise value, if any, is to be allowed.

A year or so ago when this case started, the attitude of the Board was that it desired to expedite the disposition of the matter as rapidly as possible. To cooperate with this desire of the Board, it was impractical to make an inventory of the property, as would be the most thorough way of finding its true value, within the time then supposed to be available. Had we had any idea that the case of the proponents would have dragged on all this time, we would have taken advantage of the long period to have had such an inventory made. But in the absence of it, we have done the best that we could. We have employed perhaps the best known firm in this country in this kind of business. I refer to Ford, Bacon & Davis of New York. And we have employed in certain features of the work, the well-known and experienced Professor Henry C. Anderson of the University of Michigan.

Messrs. Ford, Bacon & Davis, who start just where Major Barry, the Board's engineer started, take the value of the property as found fifteen or more years ago—add to it the actual expenditures from that day to this—and apply thereto the trend of prices existing at the present time to the actual costs. Professor Anderson, who has carefully examined the property, will show the

amount of accrued depreciation of the property, which will be deducted from the base rate otherwise found by Messrs. Ford, Bacon & Davis, and the result—something in excess of \$400,000,000—will be found to be the proper rate making base for this wonderful property. Commissions have a careless way of deducting from the rate base the entire depreciation reserve that may have been accumulated by a company for use in the future. There is no warrant in law for this. That fund, so accumulated, is, of course, not available for dividends, and must be held to take care of future depreciation or obsolescence, but as thus qualified it belongs to the company and is an asset. All the authorities hold that only actual observed depreciation to the property is rightly deductible from the rate base.

In connection with the proper rate base for this property, I am informed that much criticism has been made by the proponents of this proceeding of the fact that the Company in the past has acquired a larger amount of real estate than is now actually used for home office purposes, and for future power station sites. My answer to this is that had the Directors not thus acted they would have been woefully negligent of their duties. When these transactions took place, the Electric end of our business was compounding at the rate of 20% per-year, with every indication of an indefinite continuance of this tremendous growth. So too the Gas property was making very substantial gains. The depression of the last few years was not anticipated. We proceeded from the real estate standpoint—from a home office standpoint, in exactly the same manner that all wise life insurance companies have done, viz., to anticipate for a reasonable future the office space requirements we would need. I have never yet heard of the Insurance Commissioner of New Jersey, or any other state, throw out such investments by life insurance companies as improper assets.

So too with power station sites. Properly located power station sites for the future are few and far between, and it would have been an act of folly not to have protected the people of this State by the acquisition of such sites while they were still available. When recovery comes and this Company again gets under full steam, the wisdom of the Directors in taking time by the forelock will be abundantly vindicated. Some of the property thus acquired

was originally taken in the name of the Corporation, or one of its holding companies, but in the final disposition it was all for the benefit of the Electric and Gas Company. I understand that it has remained for the gentlemen of the opposition to criticize certain of the purchases because they were properties that were owned in whole or part by my brother, now deceased, and myself. I have only to say with reference to this that in each case the purchases were made upon the recommendation of specially appointed committees of the Board of Directors, upon definite real estate appraisals by independent authorities, followed by affirmative action of the Board of Directors, in which neither my brother nor I took the slightest part. So far as I know, this is the first time that any one in this community has ever sought to asperse the integrity of the family name which I bear.

Now the net earnings of the property for the year ending May 31, 1934, which are naturally the latest figures available, are approximately \$27,300,000. It is a simple mathematical calculation to figure out what the percentage of earnings is on the rate base as above outlined. But this is not all. The annual figures just referred to only include the 3% electricity tax assessed by the Government for a portion of the 12-months period. Nor do they reflect the fact that during this last Spring we have restored to the employees of the Company one-third of the 15% wage cut to which they had previously been subjected, and to which modification they were in all conscience entitled. When these adjustments are made, the earnings for the 12-months period will be found to approximate \$26,000,000.

Because of the limited time that I have had for the preparation of this opening, I do not name these figures with absolute accuracy, but they are substantially accurate and are on the safe side. Nor do these figures take into account the already existing and further anticipated rise in the cost of all commodities used by the Company, both for construction purposes and operating expenses. Coal and oil prices, not to mention the general commodities, are now far in excess of the prices that we are paying for them under our existing contracts.

But some one will say "these contracts have a year or more to run." And so they have. But are the investors in this great enter-

prise to be held down to the absolute limit of present-day costs in the face of an existing situation as at present. Are they to receive no benefit from the action of the management that was wise and far-sighted enough to make these contracts? Is every dollar of this advantage to be taken from them and given to the public? Is there to be no incentive or reward for good management? If the same contracts were made today, at prevailing prices, the increased cost of operating in the Electric and Gas Company for fuel alone would involve a large additional expense, and it is the best judgment of our Purchasing Department that by the time these contracts expire, prices will have risen still further very substantially.

Notwithstanding what has been said, the claim is vociferously made that Public Service rates suffer by comparison with rates in certain other cities which are mentioned. Making rates by comparison is a very dangerous experiment and utterly unscientific. Before we can make any proper comparison we have to know a great variety of things. Some cities have water power. New Jersey has none. We have to know the availability of coal supply and the freight rates paid thereon. We have to make a thorough-going comparison of taxes paid by one company and by another in different states. In New Jersey the taxation cost per K.W.H. of electricity generated is now higher than the cost of generating the same unit.

Some companies with apparent low rates serve one compact municipality. We serve over two hundred municipalities stretching from the largest city in the State to small hamlets, with lines running over one hundred miles in length. Our rate is a state-wide rate—a principle countenanced and approved by the Board of Public Utility Commissioners many years ago. Our situation cannot be compared with service rendered to one compact municipality. It is also true that there are quite a number of situations in the country that have been driven into unconscionable and unscientific low base rates as a result of just such agitation as the one before us. Thereafter the attempt is made to use these unjust rates as a yardstick with which to compare rates of other companies. Two wrongs never made a right! Our rates, however, are lower than those of any other company operating within the State.

All that I have said to date, except in so far as I have referred to the vast increase in taxes paid by all departments of the Corporation, has related to the Electric business of the Corporation alone, as though there were no complicating factors of any kind whatever. Every intelligent citizen of this State knows that that is not the fact. The business of the Corporation consists of the three great branches of the utility business: The electric business; the gas business, and the local transportation business. I have been speaking of the electric business. I will not stop to discuss the gas business. It is not earning a full fair return upon the value of its property devoted to the public use, but it is a reasonably successful going concern. Not so with the local transportation business. For the thirty-one years of its life, the Corporation has borne with this burden. A proper system of local transportation is absolutely essential to the welfare of the people of this State despite the changed habits of the people and the tremendous activity of the automobile industry, and the use of motor cars. It is the business of this unit of our activities to serve all the people of all the territory within which we operate. Not merely lines on Broad Street, Newark, but lines in outlying territory; the bitter with the sweet—and to maintain a proper continuity of a local transportation system.

This arm of the business has always been difficult, troublesome and lacking in financial stability. Fifteen years or more ago, a situation already bad was aggravated by the appearance of the jitney car and later the jitney bus, upon the better thoroughfares of the cities of the State. The continuity of the whole transportation system was threatened and a condition of chaos in it appeared likely. With not only the knowledge but with the direct approval of the then Board, the Coordinated Transport commenced to acquire the rights of these jitney buses, in many cases, at large cost—the then Board distinctly saying they believed it to be necessary for the Coordinated Transport to do this in order that the continuity of the local transportation system of the State should be maintained.

Simultaneously therewith and thereafter, there was much disturbance over transportation fares upon this system, until finally the Company made an application for a ten-cent fare—the lesser

and different fares theretofore tried out having proven inadequate. Once again at the direction and written request of the Board, a return was made to the five-cent fare, splitting however the old existing zones into a city and a suburban zone. The Board was of the opinion that it was distinctly to the interest of the people of the State that the five-cent fare, now almost an anachronism elsewhere, should be preserved. The Company went along. And from that day to this there has been not a legal but a moral understanding with the Board that all these facts would be recognized from time to time in the adjustment of our electric rates, known to be the most profitable end of the Corporation's business.

The burden with the changing habits of the people has been very severe, until now we have in our Coordinated Transport system \$80,000,000 of actual cash invested, upon which we are receiving no return whatever and in addition thereto, last year lost nearly \$1,000,000 in operating. Therefore, the Corporation is carrying the Transport burden at an expense to it on a 6% basis of from \$5,000,000 to \$6,000,000 per year. The radical theorist says however "all this is just too bad" and has nothing to do with the amount that should be allowed by way of return upon the electric property—which he would hold down to the proverbial pound of flesh. Notwithstanding all this, we are not asking for any increase in rates. We simply do ask that our electric rates be not interfered with until they show an earning upon a proper valuation, with all elements included, in excess of the 8% already determined by the courts as just and reasonable. When they do show such an earning, we will be glad to voluntarily reduce them to that point.

It must also be remembered that there is looming up for consideration by the next Congress, the problem of social insurance both as to unemployment and old age pensions. The President has definitely announced this as part of his policy, and that the expense thereof should be borne by employer and employee contributions to a fund which should be paid into an arm of the Government at Washington for distribution, instead of raising the funds therefor by general taxation. In the case of the railroads, pension legislation has already been passed which, if I am correctly informed, will add 4% to the railroad payroll. This, of course, will be substantially increased if unemployment is also

covered. This policy, if carried out, is a complete innovation in American industrial life. In any consideration of the rate problem it must be considered and cannot be ignored. In my opinion, to meet all the factors herein discussed, many companies will be required to apply for an increase over existing rates in order that they may properly function.

Utilities are not like ordinary commercial concerns. We cannot pass on additional costs to our customers, as is so generally done in industrial and mercantile life, except at the end of a long-drawn-out rate case. Even certain newspapers which have so virulently attacked us have been compelled to meet their problems by an increase of 50% in the sale price of their product. I do not criticize this. On the contrary, I have no doubt that their action was within every principle of sound economics. I do not pretend to understand their problems, but perhaps I know quite as much of their difficulties as they know of ours. We have no Magic Wand or Alladin's Lamp by means of which monies will gush forth. All our revenues come from our customers. We have met the problems of the depression as they have come along:

1. We have reduced Common dividends 17%.
2. We have reduced senior salaries 25%; other salaries and wages a net 10%.
3. We have made the reductions in rates that have been above set forth.

Our aim has always been and will continue to be to strike a fair balance between the various classes of consumers, the employees and the investors.

Should there be imposed at this time a further substantial rate reduction, it is manifest that it can only be met by another reduction in the common dividend or a further reduction in wages, or both. I do not believe either would be in the public interest. Nor have I heard any one, however radical, recommend them.

There seems to be an impression abroad that somehow, some way, such a reduction could be made and the present status quo maintained. As shown in the array of figures in the earlier part of this opening, the domestic consumer, who is the main solicitude of the radical and the politician, is the one least entitled to any decrease in rates, if such a decrease could be made with propriety,



and it was there also demonstrated that the matter is largely de minimis.

New Jersey is one of the original thirteen states. Its people have always been conservative and lawabiding. I indulge the hope that this commonwealth will never join that array of sovereignties that now find it fashionable to repudiate obligations. Nor that it will ever deny proper justice to either personal or property rights. Is it wise in a time of stress like the present to depart from our traditions and run after the false gods of radicalism and injustice?

Some years ago the Supreme Court of the United States expressed itself on this subject as follows:

"Our social system rests largely upon the sanctity of private property, and that State or community which seeks to invade it will soon discover the error in the disaster which follows. The slight gain to the consumer, which he would obtain from a reduction in the rates charged by public service corporations, is as nothing compared with his share in the ruin which would be brought about by denying to private property its just reward, thus unsettling values and destroying confidence."

It would be a sorry day for the people of the more thickly populated sections of this State, served by the various interests of this Corporation, if its operating units were so hampered for political or other reasons, as not to be able to go forward with the construction that will be required with the return of a better day.

The misdeeds or mismanagement of those connected with large holding companies in other parts of the country, which have properly created resentment, have nothing to do with this case. Mistakes of judgment we may have made, as unfortunately take place in all human activity. Otherwise I have nothing to apologize for in the thirty-one years of my stewardship.

I appeal to this Board, when the evidence is all in, to decide this case upon an economic and not a political basis, and to do justice to the people of the State, to the vast number of security holders of this enterprise, of whom there are nearly 100,000 stockholders of the parent Corporation, exclusive of all bondholders and underlying security holders—and to keep this great enterprise, to which it has been my privilege to devote my life, in a position to function at all times for the best welfare of the people of the State.

GOVERNMENT PUBLICATIONS
ALEXANDER LIBRARY
RUTGERS UNIVERSITY
NEW BRUNSWICK, N.J.