ORIGINAL

Decision No. 47546

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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| In the Matter of the Application of CALIFORNIA WATER SERVICE COMPANY, a corporation, for an order authorizing it to increase rates charged for water service in the City of Stockton and vicinity. | Application No. 32881 |

McCutchen, Thomas, Matthew, Griffiths & Greene, by Robert Minge Brown, for applicant; City of Stockton, protestant, by Bill Dozier, City Attorney; John Power, C. G. Ferguson and John Donovan for the Commission staff.

O P I N I O N

California Water Service Company, by this application filed November 8, 1951, seeks authority to increase rates and charges for water service rendered by it in the City of Stockton and vicinity, San Joaquin County.

Public hearings in the matter were held before Examiner Emerson on May 15 and 16, 1952 at Stockton. Except for the city representative no person came forward to register any objection to an increase in water rates. No person indicated any dissatisfaction with the service being rendered by the utility.

Rates, Present and Proposed

The rates now in force in applicant's Stockton District were made effective on April 1, 1950 as authorized by the Commisson's Decision No. 43880 and Decision No. 43992 in Application No. 30271. Metered consumers comprise about 99.8% of the total consumers and use approximately 95.4% of the total water produced. In 1951 applicant served 27,301 metered connections, 49 flat rate services and 1,128 fire hydrants.

Present and proposed rates are compared in the following tabulation. Historically but one rate was effective for the entire year. Applicant, however, in an attempt to equalize consumers' water bills voluntarily reduced the summertime rate. Although applicant's witness on rate structures testified that a service charge type of rate was preferred, applicant did not make a specific proposal regarding such a rate form. Rather, the present rate form was to be continued.

## General Metered Service

| Quantity Rates: | Winter Rate "A" Present Rates | Winter Rate "A" Proposed Rates | Summer Rate "B" Present Rates | Summer Rate "B" Proposed Rates |
|---|---|---|---|---|
| | Per Meter per Month | | | |
| First 500 cu. ft., or less..... | $1.05 | $1.25 | $1.05 | $1.25 |
| Next 2,000 cu. ft., per 100 cu.ft. | .18 | .20 | .12 | .14 |
| Next 3,500 cu. ft., per 100 cu.ft. | .13 | .12 | .10 | .12 |
| Next 54,000 cu. ft., per 100 cu.ft. | .07 | .085 | .07 | .085 |
| Over 60,000 cu. ft., per 100 cu.ft. | .05 | .07 | .05 | .07 |

Rate "A" shall apply to bills rendered in the months of January, February, March, April, November, and December for meter reading periods immediately preceding the billing dates.

Rate "B" shall apply to bills rendered in the months of May, June, July, August, September, and October for meter reading periods immediately preceding the billing dates.

| Minimum Charge: | Per Meter per Month Present Rates | Proposed Rates |
|---|---|---|
| For 5/8-inch meter .............. | $ 1.05 | $ 1.25 |
| For 3/4-inch meter .............. | 1.75 | 1.80 |
| For 1-inch meter .............. | 2.75 | 2.90 |
| For 1-1/2-inch meter .............. | 5.00 | 5.75 |
| For 2-inch meter .............. | 7.50 | 8.00 |
| For 3-inch meter .............. | 13.50 | 13.50 |
| For 4-inch meter .............. | 19.00 | 19.00 |
| For 6-inch meter .............. | 30.00 | 32.00 |
| For 8-inch meter .............. | 45.00 | 47.00 |
| For 10-inch meter .............. | - | 65.00 |

The Minimum Charge will entitle the consumer to the quantity of water which that monthly minimum charge will purchase at the Quantity Rates.

On the average, a typical residential consumer would experience an increase of 18% or about 40 cents per month if applicant's rate proposal were authorized.

The present schedule for municipal fire hydrant service embraces a single rate of $1 per hydrant per month, applicable to all water service rendered to fire hydrants owned by the city. The company proposes to continue this rate in effect for all public fire hydrants connected to its distribution mains located within the city limits.

Another schedule applies to all water service rendered to fire hydrants attached to the company's distribution mains for public fire protection in three fire districts located outside of the Stockton city limits. This schedule consists of monthly charges varying from $0.75 to $3.50 per hydrant, depending upon the size and type of hydrant, the size of main to which it is attached, and whether the hydrant is owned by the fire district or by the company. The company proposes no change in this schedule.

The presently filed rate schedule for private fire protection service includes rates for service through 4-inch, 6-inch, and 8-inch connections. The company now proposes a schedule for this service, revised to include rates for additional sizes of connections.

The System and Its Growth

Stockton District of applicant is one of 21 operating districts. All of its water is supplied from 37 company-owned wells, ranging in depth from 192 feet to 1,140 feet and in casing size from 10-inch to 20-inch diameter. Water is processed through a treatment plant and placed in a 1,830,000-gallon concrete reservoir from which it is delivered by means of booster pumps into the transmission and distribution mains. Pressures are maintained and water provided for peak consumption periods and emergencies by means of seven storage tanks of an aggregate capacity of three million gallons. At the end of 1951 the transmission and distribution system consisted of about 1,586,356 feet of pipe, 72% of which is 4 inches or larger in diameter.

In the six postwar years lengths of mains have been extended by 51%. Water production has increased by 54%, reaching an amount of over 5½ billion gallons in 1951. Customer growth has exceeded 62% since 1945.

Since 1949, the year of the last rate proceeding involving this district, applicant has installed gross additions of more than $960,000. Water production has increased by about 4,500 gallons per minute. Thirty new residential subdivisions have been served. Approximately 160,000 feet of main have been laid and 3,760 services connected in the past two years. In all such construction applicant has been faced with ever-increasing costs of materials and labor, a cost spiral experienced by other industries as well as by individuals.

During the year 1952 an estimated 1,700 new consumers will be added to the system requiring, together with certain increased usage by present consumers, the development of two new wells, three new pumping stations, two chlorinators, an additional 250,000-gallon storage tank and other miscellaneous categories of reinforcements to the system. Such additions will require an estimated gross capital outlay of more than $463,000.

During the next three-year period applicant will be involved in a $200,000 project of quality improvement as an attempt to overcome discoloration and odor of water from certain of the deeper wells. While such water is not harmful in any way, it has been the source of consumer complaints and needs some betterment. The present chemical process of treatment appears to have reached the limits of its capabilities. Applicant will seal off certain deep wells at higher levels and will therefore have to drill new wells to replace the flow to be sealed off.

Summary of Presentations

The tabulation below is a summary of the presentations respecting results of operations as made by applicant and the Commission staff. The components thereof are discussed in succeeding paragraphs.

| | Present Rates | | Proposed Rates | |
|---|---|---|---|---|
| Adjusted Year 1951 | Applicant | CPUC Staff | Applicant | CPUC Staff |
| Net Revenue | $ 210,022 | $ 202,032 | $ 285,643 | $ 277,561 |
| Rate Base (deprec.) | 4,461,444 | 4,451,000 | 4,461,444 | 4,451,000 |
| Rate of Return | 4.7% | 4.54% | 6.4% | 6.24% |
| Estimated Year 1952 | | | | |
| Net Revenue | 210,702 | 215,847 | 291,009 | 296,318 |
| Rate Base (deprec.) | 4,860,056 | 4,868,000 | 4,860,056 | 4,868,000 |
| Rate of Return | 4.3% | 4.43% | 6.0% | 6.09% |

Rate Base

In developing a rate base on which applicant may be entitled to earn a return, applicant used as a starting point the same fixed capital and substantially the same methods heretofore established or followed by the Commission's staff of engineers. Depreciated rate bases were developed from the weighted average undepreciated rate bases by deducting the adjusted depreciation reserve on a 4½% sinking fund basis as of the beginning of the period. In this latter connection, applicant by letter agreement with the staff, dated March 20, 1952, adopted the 4½% sinking fund remaining life method of depreciation accounting and correspondingly altered its books of account thereto as of January 1, 1952.

The City of Stockton did not develop a rate base but instead indicated that its position is that applicant should be allowed a return on applicant's investment as represented solely by its capitalization. The city further urged that the allowable rate of return exactly equal the cost of money.

For the year 1951 applicant derived a depreciated rate base of $4,461,444 while the staff derived a corresponding base of $4,451,000. The depreciated rate bases of applicant and staff, for the estimated year 1952, are $4,860,000 and $4,868,000, respectively. The differences are so minor, in view of the known expansion needs clearly set forth in the record herein, that acceptance of the higher bases is entirely warranted. We shall, therefore, adopt them for the purposes of this rate proceeding.

Operating Revenues and Expenses

As in its development of rate base applicant, in the main, adopted Commission staff procedures in adjusting its results of past operations and in estimating most of its future operating expenses. There is, therefore, no substantial disagreement between the results of operations as presented by applicant and the staff.

For the adjusted year 1951 and the estimated year 1952, on a modified sinking fund basis in which 4½% interest on the depreciation reserve is included as an operating expense, the respective presentations for the Stockton District are summarized as follows:

| Adjusted | Operating Revenues | | Operating Expenses | |
|---|---|---|---|---|
| Year 1951 | Present Rates | Proposed Rates | Present Rates | Proposed Rates |
| Applicant | $912,165 | $1,077,084 | $702,143 | $791,441 |
| Staff | 912,165 | 1,077,084 | 710,133 | 799,523 |

| Estimated | Operating Revenues | | Operating Expenses | |
|---|---|---|---|---|
| Year 1952 | Present Rates | Proposed Rates | Present Rates | Proposed Rates |
| Applicant | $968,000 | $1,143,207 | $757,298 | $852,198 |
| Staff | 968,750 | 1,144,452 | 752,903 | 848,134 |

The differences apparent above are well within the limits of accuracy inherent in estimating. We shall adopt $968,500 and $1,144,000 as being reasonable estimates of 1952 revenues at present and proposed rates, respectively. For the purposes of this proceeding we shall adopt as reasonable estimates of operating expenses for 1951 adjusted, $710,000 at present rates and $799,000 at proposed rates, and for 1952, $755,000 and $850,000 at present and proposed rates, respectively.

Net Revenues and Rate of Return

The above-adopted revenues, expenses and rate bases indicate rates of return as follows:

| Item | Adjusted Year 1951. | | Estimated Year 1952. | |
|---|---|---|---|---|
| | Present Rates | Proposed Rates | Present Rates | Proposed Rates |
| Operating Revenues | $912,165 | $1,077,084 | $968,500 | $1,144,000 |
| Operating Expenses | 710,000 | 799,000 | 755,000 | 850,000 |
| Net Revenues | 202,165 | 278,084 | 213,500 | 294,000 |
| Rate Bases (Deprec.) | 4,461,444 | 4,461,444 | 4,868,000 | 4,868,000 |
| Rates of Return | 4.53% | 6.23% | 4.38% | 6.04% |

It is apparent, from the above tabulation, that applicant is faced with a declining rate of return. Any increased rates cannot and will not be in effect during the entire year 1952. From the record in this proceeding it is also apparent that because of the company's continuing program of expansion and improvement in the Stockton District the rate of return which it could realize during the first full year of operations under the proposed rates will be somewhat less than that shown above and would probably not exceed 5-3/4% on a depreciated rate base.

Financing of Properties

The company has financed its net investment in the properties located in the Stockton District, as well as those located in the other 20 districts in which it operates, primarily through the issue of first mortgage bonds, shares of preferred and common stocks and through the use of retained earnings from operations. As shown in Exhibit 18, its capital structure at the close of 1951 was as follows:

| | | Amount | Per Cent of Total |
|---|---|---|---|
| First mortgage bonds due 1975 - | | | |
| Series C, 3-1/4's | $17,822,000 | | |
| Series D, 3-5/8's | 3,000,000 | | |
| Total first mortgage bonds | | $20,822,000 | 55.8% |
| Serial notes | | 240,000 | .6 |
| Preferred stock - | | | |
| Series C, 4.4% | 3,475,000 | | |
| Series D, 5.3% | 1,522,375 | | |
| Series E, 5.28% | 964,400 | | |
| Series F, 5.36% | 1,622,925 | | |
| Total preferred stock | | 7,584,700 | 20.3 |
| Equity capital - | | | |
| Common stock | 6,523,000 | | |
| Surplus | 2,200,020 | | |
| Total equity capital | | 8,723,020 | 23.3 |
| Total | | 37,369,720 | 100.0 |

During June, 1952, the company sold 50,000 shares of its common stock ($1,250,000 par value) to net it $28 per share before allowance for expenses of issue.

The record in this proceeding contains a considerable amount of evidence indicating, among other things, the company's interest and preferred stock dividend requirements, the earnings and dividends on common stock and the experienced trends, the terms under which the company has disposed of its securities, comparative statistics of other utilities, earnings-price ratios and calculations of the cost of equity capital.

The testimony and exhibits show the average effective interest rate associated with the securities outstanding on December 31, 1951, to be 3.08% on bonds, 4.78% on preferred stock and 3.52% as the average on bonds, preferred stock and a small issue of serial notes. It appears that prior to 1951 the company issued $17,822,000 of 3-1/4% bonds on an average basis of 2.98%, that in September, 1951, it issued $3,000,000 of 3-5/8% bonds on a 3.69% basis and that no issues have been made since that date. As to the preferred stock, it appears that several issues have been made on bases ranging from a low of 4.19% in 1945 to a high of 5.31% in October, 1950, the date of the latest offering.

With reference to the common stock the record shows that since 1942 the company has paid annual dividends of $2, being at the rate of 8% of the par value. During the period from 1946[1] to 1951, inclusive, the annual earnings per share averaged $2.64, the book value per share averaged $33, and the earnings on book value averaged 8.05%.

Return on Investment

A witness for the company indicated that in his opinion a return of 6% was necessary to enable the company to continue to attract the new capital required to finance its construction program. A witness called on behalf of the City of Stockton urged a return of 5.2% based, for the most part, on the use of earnings-price ratios applied to outstanding securities which had been allocated on a percentage basis to the various districts in which the company operates. There is no evidence in this proceeding to show that applicant has acquired or constructed the properties located in any district other than through the use of common funds provided by the corporation through the issue and sale of its securities and through the use of its retained earnings. Delete

The conclusion as to what constitutes a reasonable rate of return must take into consideration numerous factors, including, among other things, prevailing interest levels and other economic conditions, construction requirements, and the amounts of securities

1/ Prior to 1946 all the outstanding shares of common stock were held by General Water, Gas and Electric Company.

presently outstanding as well as the amounts needed for future issue. Statements showing effective interest rates on outstanding bonds and preferred stock are useful in indicating the company's past experience, its interest and dividend requirements, and the trend of the costs associated with such securities. Calculations setting forth earnings-price ratios and yields give additional background financial information. Such figures, however, are influenced by general market conditions and merely reflect the investors' appraisal of the market value of the stock and the prices at which outstanding shares of stock are being traded rather than the cost of the physical property or the amount the company is required to pay with respect to capital already committed to the enterprise.

The determination by the Commission of a proper rate of return must represent the exercise of judgment, taking into consideration all the circumstances surrounding each particular case. If this Commission were to adopt the methods urged upon it by the city's witness it would necessarily follow that rates would be changed at every instance when the company's capitalization ratios changed or the cost of money altered. We see no merit in such method. We are concerned that the rates authorized will be reasonable from the standpoint of the customers and at the same time that they will be sufficient to afford the [utility an opportunity to earn a reasonable return on the capital reasonably employed by it so as to maintain its credit and attract capital sufficient to discharge its public duty in meeting the reasonable demands for service.] The record shows the extent to which applicant has been compelled to extend its plant during the postwar years and the estimated expenditures with which it still is faced.

Rewritten

It is only fair that the customers should pay such amounts as will enable the company to sell securities in the amount necessary to finance the additional facilities which will be needed to provide them with the service they demand.

The records of the Commission show that applicant has acquired the systems it operates and has issued all its securities under authorization granted by the Commission and, under the circumstances and considering that our regulatory action in fixing rates is directly related to the reported investment in plant, it appears that the book figures as recorded should be considered. Delete Exhibit 18 shows that at the end of 1951 the investment in equity capital amounted to $33.69 a share but that the market values of the common stock since 1947 have been considerably lower than the book figures. Information filed with the Commission shows the most recent sale of common stock by the company, in June of this year, was at $28 a share for subsequent reoffering to the public at $29.25. This indicates that investors have been and are unwilling to risk their funds under the same terms as those which prevailed for prior investors who have invested equity capital and that the earnings of the company have not been sufficient to maintain the financial integrity of the enterprise.

In March of 1950 the Commission fixed rates designed to yield the company a return in its Stockton Division equivalent to 5.5% on an undepreciated rate base. The equivalent return on a depreciated rate base would have been between 5.6% and 5.7%. The record now before the Commission shows that since that time the company has been faced with increasing costs in disposing of its securities, that, in general, interest rates have risen and that, as matter of fact, the company did not earn the return allowed in the 1950 decision owing to a downward trend in earnings.

Actual earnings in 1951 were equivalent to 4.52% applied to an undepreciated rate base and may decline to 4.44% in 1952 under present rates.

Conclusion

It is apparent from the evidence that the present rates will yield inadequate income from future service rendered in Stockton. The record likewise indicates and we hereby find that the rate of return of 5-3/4%, which applicant will receive from its proposed schedules of increased rates, is reasonable. The requested rates are reasonable and will be authorized.

Re-rewritten

O R D E R

California Water Service Company having applied to this Commission for an order authorizing increases and charges for water service rendered in Stockton and vicinity, San Joaquin County, a public hearing thereon having been held and the matter having been submitted for decision,

IT IS HEREBY FOUND AS A FACT that the increases in rates and charges authorized herein are justified and that the existing rates, in so far as they differ therefrom, are unjust and unreasonable, therefore,

IT IS HEREBY ORDERED that applicant is authorized to file in quadruplicate with this Commission the schedule of rates set forth in Table 2 of Exhibit No. 2 in this proceeding, in conformance with General Order No. 96, and, after not less than five (5) days' notice to the Commission and to the public to make said rates effective for service rendered on and after September 1, 1952.

The effective date of this order shall be twenty (20) days after the date hereof.

Dated at San Francisco, California, this 5th day of August, 1952.

President.

Commissioners.