Cs.5413 - JD

ORIGINAL

Decision No. 48485

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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| In the Matter of the Investigation on the Commission's own motion into the reasonableness of the rates, rules and regulations, charges, classifications, practices, or any of them, of DEL ESTE WATER COMPANY, operating a public utility water system in Stanislaus County. | Case No. 5413 |

E. Ronald Foster, for the Commission's staff
Robert Minge Brown, of McCutchen, Thomas, Matthew, Griffiths & Greene, for Del Este Water Co.

O P I N I O N

Nature of Proceeding

This is an investigation on the Commission's own motion the purpose of which, as stated in the order, is

> "to determine whether the rates, rules, regulations, charges, classifications, practices, or any of them, of Del Este Water Company, a corporation, are unjust, unreasonable, discriminatory, or preferential in any particular and to determine the just, reasonable, sufficient and proper rates, rules, regulations, charges, classifications, practices, or any of them, of said Del Este Water Company, a corporation, and to fix the same by order". (See Pub. Util. Code, Secs. 728, 729)

Origin of Investigation

By Decision No. 45848, in Application No. 31810, the Commission authorized the company, whose headquarters are in Modesto, to increase its rates for metered and flat-rate service throughout its seven operating districts. The rates became effective July 15, 1951. As of December 31, 1952, about 10 per cent of the company's 6,932 consumers, including all of the 355 patrons on the Salida system (6 miles northwest of Modesto) and 19 industrial users,(1) were served on a metered basis and the rest under flat rates. The Salida consumers complained that the practice of metering some services while serving others under flat rates was discriminatory. The Commission, in its decision, concluded that, while no unjust discrimination had been shown, the record indicated that the company might be receiving an excessive rate of return on its investment.(2) This investigation followed.

Public Hearing

A public hearing was held, after due notice, before Examiner Gregory at Modesto on February 17, 1953.

Results of Operation

a. The Salida Case

The studies introduced by the staff and by the company in the Salida complaint case, based on periods of a year preceding and following the increase in rates effective in July, 1951, exhibited significant variations in several particulars; viz., revenues, expenses, net income, deductions from fixed capital and treatment of taxes and depreciation. The staff, in that case, estimated a systemwide rate of return of 9.65 per cent for the 12 months following the rate increase, using a depreciated rate base, as of December 31, 1951, of $659,260 and net operating revenues of $63,590. The company, using a depreciated rate base of $666,675 and net income of $51,145, estimated its rate of return for the same period at 7.7 per cent. For the year August 1, 1952, through July 31, 1953, the company, using a depreciated rate base of $743,123, and estimated net income of $49,844, concluded it

(1) The company, prior to the hearing in the instant case, had reported to the Commission's staff a total of 27 industrial metered services, but corrected the number to 19 at the hearing. Revenue and other data included in the staff report in evidence are based on the erroneous larger figure.

(2) Dec. 47720, Sept. 16, 1952, Case 5357.

would receive a 6.7 per cent rate of return.

Upon analysis of the differences in the two studies, it was found that the staff had taken into consideration, while the company had not, in their respective determinations of the rate base as of December 31, 1951, a transaction approved early in 1951 by the Commission (Dec. 45208, Jan. 3, 1951, Appl. 31986), whereby the company had been authorized to issue 150 additional shares of stock, priced at $50,000, in exchange for $9,981.10 in cash and cancellation of $40,018.90 in indebtedness under Account No. 28A, Consumers' Advances for Construction, which had the effect of reducing the amount in that account from $141,022.48 to $101,003.58. The difference of $41,774 between the staff's and the company's determination of the undepreciated rate base at the end of 1951 appears to have been due, to a large extent, to the different treatment accorded that transaction. In other words, if the deduction of the $40,018.90 for consumers' advances is eliminated from the rate base, the estimated rates of return for the year preceding the rate increase are almost the same; i.e., 5.21 per cent for the staff and 5.26 per cent for the company.

The cumulative effect, in the year following the rate increase, of the varying treatment accorded consumers advances and tax and depreciation expense by the staff and the company, together with the company's allowance, in the rate base, in 1952 of $6,175 more than the staff for materials and supplies, resulted in a staff estimate of net revenue amounting to $12,445 higher than that of the company. The combination of larger net revenue with a smaller rate base chiefly accounts for the high rate of return for 1952 determined by the staff for the entire Del Este system in the Salida proceeding.

b. The Present Investigation Case

The record in the present investigation includes a study by the Commission's staff on the basis of recorded and adjusted results for 1951 and 1952 and estimates for 1953 and by an engineer retained by the company on the basis of recorded figures for the years 1950, 1951 and 1952 and estimated results for 1953. A summary of the main features of those studies, for the years 1952 and 1953, appears in the tabulation below.

| | Staff | | Company | |
|---|---|---|---|---|
| | 1952 Adjusted | 1953 Estimated | 1952 Recorded | 1953 Estimated |
| Operating Revenues | $ 245,043 | $ 266,721 | $ 245,006 | $ 262,200 |
| Operating Expenses Excluding Taxes and Depr. | 127,910 | 145,680 | 126,537 | 141,070 |
| Depreciation Expense | 31,071 | 34,485 | 31,071 | 34,485 |
| Taxes | 39,110 | 38,860 | 39,759 | 40,073 |
| Total Operating Expenses | 198,091 | 219,025 | 198,490[a] | 216,677[a] |
| Net Revenue | 46,952 | 47,696 | 46,516 | 45,523 |
| Depreciated Rate Bases | 700,250 | 755,040 | 760,906 | 811,215 |
| Rate of Return | 6.70% | 6.32%[b] | 6.1% | 5.6% |

a Includes uncollectibles separately stated in Table VII of company's study, Exhibit No. 2, page 11.

b 6.16% if 19 instead of 27 industrial consumers used. (See footnote 1)

Differences Between Staff and Company Results

Although the statistics for 1951 are not included in the above tabulation, the staff study in evidence indicates a net revenue of $49,551 for that year, assuming present rates to have been in effect during the whole year, and a rate of return of 7.66 per cent on an average depreciated rate base of $646,740. The company's study for the same year, using recorded revenues, shows a net revenue of $43,619 and a rate of return of 6.3 per cent on a depreciated rate base of $689,076.

While the results obtained by the staff and by the company for the years 1951, 1952 and 1953 differ, in greater or lesser degree depending upon the item under consideration, the trend of the rate of return shown by both is downward. The principal point of divergence in the two studies lies in the treatment accorded the item of deduction from fixed capital of Consumers' Advances for Construction, as indicated in the following table. The company added the difference to its rate base for the years shown.

Deduction from Fixed Capital of Consumers' Advances

| | 1951 | 1952 | 1953 |
|---|---|---|---|
| Staff | $ 101,935 | $ 107,607 | $ 126,744 |
| Company | 49,451 | 46,221 | 66,061 |
| | $ 52,484 | $ 61,386 | $ 60,683 |

The company, in support of it's method of handling the item, argues that consideration should be given, and was given by it, to the refunds committed in the application of its extension rule for subdivisions, which provides that refunds shall be made on the basis of 35 per cent of the revenue derived from the extension over a period of 10 years. It urges, therefore, that the rate base should include the amount currently shown in the consumer advances account which the company ultimately is obligated to refund by reason of presently connected customers. The company contends, in substance, that the rule handicaps it during periods of rapid expansion by burdening it with repayment obligations that, under an operating ratio of more than 80 per cent as shown by this record, require funds in excess of its net income. The company states that its financial position could be improved considerably if a more "realistic" rule were adopted; for example, a rule permitting refund of 15 per cent of subdivision revenue over a period of 20 years.

The staff, by way of answer to the company's contention on this point, takes the position that the full amount of unrefunded consumers' advances should be deducted from fixed capital, since the company does not pay interest on the unrefunded amounts. Although obligated to pay certain amounts in the future, the company is not required to advance funds of its own to make such refunds until due. The staff cites a number of Commission decisions in support of its argument.(3)

The position taken by the staff, to the effect that consumers' advances in aid of construction, being available to the company without interest, should be treated as a proper deduction in determining the rate base, in our opinion accords with past expressions of the Commission on this subject. Accordingly, the staff's treatment of that item will be adopted as reasonable for the purpose of this proceeding. The company, of course, may initiate appropriate action, if it should so desire, for the purpose of amending its rule respecting repayment of advances made by subdividers for extension of water service by the company.

Had the company deducted consumers' advances in the same manner as that pursued by the staff, the rates of return estimated by it for 1952 and 1953 of 6.1 per cent and 5.6 per cent would be increased to 6.7 per cent and 6.1 per cent for the two years, respectively, which are practically identical with the rates of return calculated by the staff for those years.

The company estimated revenues, expenses and net income for 1953 at somewhat lower amounts than did the staff. The

(3) Southern California Gas Co., et al., 32 CRC 379, 382; Southern Counties Gas Co., 32 CRC 477, 478; Southern Counties Gas Co., 45 CRC 537, 546; San Gabriel Valley Water Co., 47 Cal PUC 434, 442. See also Bayshore Park, Inc. v. Calif. Water Service Co., 44 CRC 74, for discussion of subdivision extension rule.

difference is largely attributable to the fact that the company employed a factor of 420 and the staff 570 additional consumers during the year.

Company's Financial Position and Requirements

Del Este Water Company began operations as a public utility in 1938. As of December 31, 1952, its balance sheet shows capital stock - $85,000, funded debt - $400,000 and notes payable - $40,000. Assets and liabilities are listed at $1,130,149. Donated capital and customers' advances represent less than 15 per cent of the total capital investment. Although the company appears to have been confronted with serious financial burdens it seems to have kept pace with expansions and to have rendered good service.

In 1951 the pressure of high costs, the need for additional personnel and the need for a return which would attract new capital impelled the company to obtain an increase in rates, from a minimum charge of $1.50 per month for a 5/8 x 3/4 inch meter, allowing 2,000 cubic feet of water at the rate of $0.075 per 100 cubic feet, to a minimum of $2.00 per month, allowing 1,000 cubic feet of water at the rate of $0.20 per 100 cubic feet. Flat rates were increased from $1.50 per month, for residences of five rooms or less occupied by a single family, to $2.70 per month for a 3/4-inch connection. The new rates, which were somewhat lower than those proposed by the company, were designed to produce system gross revenues of $209,800, net revenue of $41,000 and a return of slightly over six per cent on a depreciated rate base of $673,000 for a normal 12-month period in 1951. While the studies made by the staff and by the company in the present case tend to bear out the estimates developed in the 1951 rate proceeding, the trend of the rate of return is definitely downward. The average drop from 1950 to 1953 is 0.9 per cent per year, on the basis of the company's estimates but including the deductions for consumers' advances made by the staff. The downward trend of the rate of return, which was sharp in 1952, may be levelling off.

The company estimated that it would have a net income in 1953, after taxes and depreciation, of $45,523. It plans capital additions during the year amounting to about $40,000. Its charges on income during the same period will amount to approximately $44,500. They include: interest on funded debt, $16,000; interest on bank loans, $2,500; payment on principal of funded debt, $12,000; refunds to subdividers, about $14,000. Only one dividend has been paid to stockholders, amounting to $2,500 in 1950. Additional capital of about $100,000 is needed by the company in order to make it eligible for further long term financing from insurance companies.

Conclusions

We conclude, on the basis of the record made in this proceeding, that Del Este Water Company is not earning an excessive return on its investment in property used in the public service and that, in consequence, the investigation should be dismissed.

ORDER

Public hearing having been held in the instant proceeding, the matter having been submitted for decision, the Commission now being fully advised and basing its decision upon the findings and conclusions contained in the foregoing opinion, IT IS ORDERED that the investigation herein be and it hereby is dismissed.

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

Dated at San Francisco, California, this 14th day of April, 1953.

R. I. [illegible]
President

Justus F. Craemer

Harold P. Hulo

Kenneth Potter

Peter E. Mitchell

Commissioners