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ORIGINAL

Decision No. 63539

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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 Oroville district.	Application No. 43397 (Filed May 15, 1961)

McCutchen, Doyle, Brown & Enersen, by A. Crawford Greene, Jr., for applicant.
Thermalito Irrigation District, by David A. Minasian; City of Oroville, by Carl O. Ohmer; Berkeley Olive Association, by Peter Frandsen; protestants.
Table Mountain Irrigation District, by A. L. Chaffin, interested party.
Cyril M. Saroyan and Robert W. Beardslee, for the Commission staff.

O P I N I O N

Public hearing in this matter was held before Commissioner George G. Grover and Examiner F. Everett Emerson on October 4, 5 and 6, 1961, at Oroville. Written closing statements were filed and the matter was submitted as of October 26, 1961.

This application is one of three concurrent filings[1/] and the record herein has been incorporated by reference into the other two proceedings because applicant's showing respecting its over-all operations was presented during the course of this proceeding.

Applicant seeks authority to increase its rates for water service in its Oroville district by amounts sufficient to yield a rate of return for that district of 6.64 percent in 1962.[2/] On the basis of its estimate of 1961 operations, its proposal would

1/ Application No. 43395 (Bakersfield), Application No. 43396 (East Los Angeles) and Application No. 43397 (Oroville).

2/ According to applicant, the proposed rates were designed to yield 6.64% in 1962; applicant claims, however, that inflation would reduce such return to 6.18% in 1963 and to an even lower percentage in 1964.

produce an increase of approximately $52,000 in gross revenues. It proposes to obtain such gross increase by increasing charges for treated water by approximately 17 percent and by increasing charges for raw water by approximately 32 percent.

Applicant operates water systems in 17 separate districts. Its general office is in San Jose. It has a central billing office in Stockton and meter shops in Stockton and East Los Angeles. It becomes necessary, therefore, to allocate a fair share of the costs and expenses of these over-all functions and services to each of the operating districts. While the Commission staff and applicant are in substantial agreement as to the methods and procedures of allocation, the staff has challenged the propriety and reasonableness of both the manner of handling and the amounts involved in applicant's estimates of (1) administrative and general salaries; (2) the tax effect of involuntary conversions; and (3) employees' pensions and benefits.

In its estimate of administrative and general salaries for the years 1961 and 1962, the staff has included amounts which are $15,900 and $36,900, respectively, below those which applicant claims to be necessary. The staff-allowed amounts are based upon the premise that the existing executive payroll should not be increased beyond its 1962 level. As justification for such assumption, the staff directs attention to the facts that since 1954 applicant has sold five of its operating systems and that applicant's executive officers, upon retirement, either have been replaced from within the organization or have had their functions redistributed to others. Applicant claims that any reduction in executive salaries is of a temporary nature and, as in the case of other salaries, executive salary trends have been and must continue to be upward. In view of

the evidence on this subject, we are of the opinion that reliance should be placed upon the estimates as they now pertain to the test year 1962 and not upon conjectures as to what may transpire in subsequent years. We find that the staff estimate of $275,200 is a fair and reasonable level of administrative and general payroll during the test year 1962.

So-called "involuntary conversions" occur when a utility, such as applicant, sells its properties in the face of threat and imminence of condemnation by a public agency and acquires replacement properties in an amount equal to the proceeds received from the "involuntary" sale. Applicant has experienced such sales in five operating districts. The United States Internal Revenue Code, by Section 1033, under such circumstances permits an election to be made whereby the taxpayer may escape immediate recognition of a taxable gain and instead spread the tax consequences over the service life of the depreciable replacement property purchased with the proceeds of the involuntary sale.[3/] Applicant has made such election for four of its five sales. Election with respect to the fifth and latest sale, made during 1961, had not yet been made at the time of the hearing herein. Under the terms of the revenue code, the tax basis of the replacement property is its cost less the amount of the gain not recognized. This adjusted basis results in lower future annual depreciation charges allowable for tax purposes, with consequent increases in the amount of future income tax expense based on ordinary income at the corporate rate. The effect, in essence, is that instead of applicant's paying a capital gain tax of 25 percent at the time of sale, applicant's future customers, for an indeterminate period in the future, would be called upon, through rates, to

3/ The California Revenue and Taxation Code has comparable provisions.

provide for applicant's corporate income tax of 52 percent on the difference in depreciation charges. Another way of stating the situation is that instead of payment by the owners of the property of the tax on the capital gain, the burden of the payment would fall upon applicant's customers through future taxes on applicant's income. Such result, in our opinion, would be unfair to applicant's customers. Although applicant's election pursuant to Section 1033 has altered the superficial appearance of the tax, as well as the time of its payment and even its amount, the tax nevertheless is one occasioned by a profitable transfer of property. It should not be charged to operating expense for ratemaking purposes.

It is true that the amount of the tax liability (whether paid directly on the capital gain or pursuant to the election allowed by Section 1033) is somewhat greater by reason of applicant's earlier use of liberalized depreciation for federal income tax purposes. It is also true that such use of liberalized depreciation has reduced applicant's operating expenses and made possible the establishment of lower rates for applicant's customers. Even so, we would not be justified in shifting the tax burden to the ratepayers. Involuntary conversions are exceptional, and the risk of their occurrence depends on the location, type, and size of each utility. A more appropriate place to consider the possible consequences of liberalized depreciation is in connection with rate of return and we have done so.

In this proceeding, applicant has used so-called "actual" tax payments as part of its current and estimated operating expenses and has thereby included in operating expenses the above-discussed tax burden resulting from its election respecting involuntary conversions. The Commission staff has excluded it. Applicant's

capital gains from such sales (amounting to more than $4,000,000) have become part of applicant's earned surplus or surplus reserves and are so recorded. We believe that, for ratemaking purposes, the costs associated therewith should not be divorced therefrom and should not become a part of the operating expenses chargeable to the ratepayers. In view of the evidence, the Commission finds that the exclusion made by the staff is proper and provides a fair and reasonable solution of the problem. The staff method will be adopted for ratemaking purposes in this proceeding.

Applicant maintains both funded and unfunded pension and welfare plans. It has established a reserve for the purpose of providing for its estimated liability under retirement contracts with its officers. The reserve, originally established by crediting thereto an amount equal to 10 percent of the profit from the sale of utility properties, has been further increased by charges to operating expenses and reduced in an amount equal to payments made to retired officers. The balance in this reserve had reached $382,000 by mid-1961. The credits to the reserve, resulting from charges to operating expenses, have been at the rate of $20,000 per year. The charges to such reserve, in order to meet the obligations applicant has assumed with the four retirement contracts in force with retired officers of the company, total $36,000 annually. Such amount will normally increase as additional officers retire. Applicant is charging the yearly amount to the operating expenses of the general office. The staff of the Commission urges that this charge be totally disallowed, chiefly on the grounds that the plan is unfunded, that it is not contributory, that it has not been submitted to the stockholders for their approval, that officers who have already retired will in effect receive increased

compensation for past services, and that some retired officers receive more than others. We do not concur in all of these objections. Thus, the Commission in the past has not insisted that all retirement plans be contributory; especially in view of the substantial reserve set up by applicant from its own funds, it is not fatal that the plan is not funded; neither do we consider, in this rate proceeding, that stockholders might raise objections to the contracts authorized by the board of directors. Certain of the staff's criticisms, however, are pertinent. We note that the retirement payments do not really constitute a "plan" at all; each officer is dealt with on an individual basis, and the contracts of some officers still do not contain retirement provisions. Moreover, benefits for some officers were not authorized in final form until at or near the time of retirement, so that their allowances to some extent resemble bonuses for services already performed. Although applicant is entitled to a certain number of days of consultation from each retired officer each year, the payments cannot be justified on that ground alone, especially since the work of most of the officers involved is now being performed by others. We do not here question the right of applicant to make retirement payments, nor do we now instruct applicant that a particular plan should be adopted. In determining to what extent these payments should be borne by the ratepayers, however, we have taken the foregoing matters into consideration.

Even so, we cannot adopt the staff recommendation that the payments be entirely excluded for ratemaking purposes. One of the principal objectives of such a retirement program is to attract talented executive personnel--for the benefit of ratepayers as well as stockholders. We have no doubt that the payments in question are

being made nor do we doubt that applicant's policy in this respect does make employment more attractive to prospective officers. At least a portion of these payments should be recognized in this proceeding. The payments to retired officers now total $36,000 annually. In the circumstances, we find that $20,000 is a reasonable amount for test year purposes; that amount will be allowed herein.

With respect to the earnings of applicant's Oroville operations, after adjusting the estimates of applicant and the staff to reflect the above-stated conclusions regarding applicant's over-all operations, the evidence may be summarized as shown in the following tabulation:

SUMMARY OF EARNINGS
OROVILLE DISTRICT OPERATIONS
TEST YEAR 1962

Under Existing Rates

Item	Applicant	CPUC Staff
Operating Revenues	$289,100	$290,800
Operating Expenses	246,916	246,388
Net Revenue	42,184	44,412
Rate Base (depreciated)	975,700	971,900
Rate of Return	4.32%	4.57%

Under Applicant's Proposed Rates

Item	Applicant	CPUC Staff
Operating Revenues	$341,600	$343,600
Operating Expenses	275,516	275,188
Net Revenue	66,084	68,412
Rate Base (depreciated)	975,700	971,900
Rate of Return	6.76%	7.04%

The evidence demonstrates, as the above tabulation indicates, that applicant is in need of and is entitled to increased revenues in its Oroville district and the Commission so finds. In

the light of the evidence, the Commission finds that a rate of return, based upon the estimated and test year 1962, of approximately 6.35 percent on a depreciated rate base of $971,900 is fair and reasonable for this system's operations. Rates will be authorized which should produce such result and provide applicant with increased revenues amounting to $43,000 on an annual basis.

Thermalito Irrigation District, Table Mountain Irrigation District and Berkeley Olive Association are three (of approximately 12) customers who take delivery of raw water from applicant at separate points along the Powers Canal under applicant's rate schedule for irrigation service. All three object to applicant's proposal to increase the existing irrigation rate of 20½ cents per miner's inch per day to a new rate of 27 cents. Table Mountain and Berkeley make use of the water almost wholly for irrigation. The characteristics of the usage by Thermalito, however, have changed considerably in recent years. What was once primarily an irrigation service has increasingly become a domestic service as lands have been subdivided into homesites.

It appears from the evidence that water deliveries under the existing irrigation rate schedule are of the order of 1,536 millions of gallons for the year 1961 and are estimated to decline by about 18 millions of gallons during the year 1962. Such amounts are approximately 55 percent of the total amount of water to be used by applicant's entire system in each of these years. Irrigation service customers pay an average of only 1.3 cents per thousand gallons while all other metered customers pay an average of 27.3 cents per thousand gallons, or 21 times as much. When costs are examined, the evidence is clear that the cost of providing irrigation water service averages about 1.8 cents per thousand gallons sold and

that, as a result, the revenues which applicant receives under the present irrigation rate, fail to meet costs by about 1/2 cent per thousand gallons. The Commission finds that such disparity is unfair to applicant's other customers, that the continuation of applicant's present rate would constitute an unreasonable discrimination between classes of customers, and that the irrigation service rate schedule which applicant has proposed is fair and reasonable. We conclude that it should be authorized.

As heretofore recited[3/] Thermalito receives utility service from applicant by contract. Such contract, in paragraph 5 thereof, sets forth the price at which water is sold to Thermalito. Since January 1, 1955, the specified price has been identical with that set forth in applicant's regularly filed tariffs. It is appropriate at this time to modify said paragraph 5 in such manner as will recognize such fact and thereby obviate the necessity of modifying the contract each time a change in rate or price may be found to be justified by this Commission.

The evidence shows that applicant's existing and proposed residential flat rate service schedules are cumbersome and require continuing inspections of premises. They should be modified. We find that it is fair and reasonable to bill flat rate charges on a lot-size basis and the schedule to be authorized herein will be so classified.

In view of the evidence, the more important elements of which are hereinabove discussed, the Commission finds and concludes that the increases in rates and charges authorized herein are justified and that existing rates and charges, insofar as they differ therefrom, for the future are unjust and unreasonable.

3/ See Decision No. 50844, issued December 7, 1954, in Application No. 34458 (53 CPUC 671-679).

O R D E R

Based upon the evidence and the foregoing discussion, findings and conclusions,

IT IS ORDERED that California Water Service Company is authorized to file in quadruplicate with this Commission, on or after the effective date of this order and in conformity with the provisions of General Order No. 96-A, the schedules of rates and charges set forth in Appendix A attached to this order and, upon not less than ten days' notice to the public and to this Commission, to make said schedules effective for service rendered on and after May 1, 1962.

IT IS FURTHER ORDERED that that certain contract entered into on April 25, 1923 by Thermalito Irrigation District and Pacific Gas and Electric Company, as modified by this Commission's Decision No. 50844, is hereby further modified by adding to paragraph 5 thereof the following:

> "On and after May 1, 1962, the price at which water shall be sold and delivered to, and purchased and paid for by, the District hereunder shall be that rate set forth in the regularly filed tariffs of California Water Service Company applicable to the District."

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

Dated at San Francisco, California, this 5th day of April, 1962.

I dissent. I do not approve of the treatment of pollution abatement by this decision.
Everett C. Case
President

President

E. Lynn Fox

George G. Grover

Frederick B. Holoboff

Commissioners

I concur but take exception to the inclusion in operating expenses of amounts represented by "retirement contracts" with utility officers. The utility has not sustained its burden of proving that any such amounts should reasonably be charged to the ratepayer. "The plan" is discriminatory in that it fails to encompass all employees. Although a reserve was set aside from a portion of profits from the sale of utility properties, the company has not in effect relied on this reserve in payment for the retirement contracts, but is, in effect, attempting to pass the entire costs on to the ratepayer. In the absence of any definitive proof that such amount in practice is reasonable, the item should be entirely disallowed for ratemaking purposes.

While the dollar amount involved is small, if this novel principle were to be widely applied, the impact would be considerable on the ratepayers.

Peter E. Mitchell, Commissioner

Schedule No. OR-1

Oroville Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Oroville and vicinity, Butte County. (T)

RATES

	Per Meter Per Month	
Quantity Rate:		
For all water delivered per 100 cu.ft.	$ 0.14	(I)
Service Charge:		
For 5/8 x 3/4-inch meter	$ 2.90	
For 3/4-inch meter	3.20	
For 1-inch meter	4.35	
For 1½-inch meter	6.10	
For 2-inch meter	7.80	
For 3-inch meter	14.50	
For 4-inch meter	20.00	
For 6-inch meter	33.00	
For 8-inch meter	49.00	
For 10-inch meter	60.00	(I)

The Service Charge is a readiness-to-serve charge applicable to all metered service and to which is to be added the monthly charge computed at the Quantity Rate.

Schedule No. OR-2R

Oroville Tariff Area

RESIDENTIAL FLAT RATE SERVICE

APPLICABILITY

Applicable to all flat rate residential water service. (T)

TERRITORY

Oroville and vicinity, Butte County. (T)

RATES

	Per Service Connection Per Month	
1. For a single-family residential unit, including premises having the following area:		
6,000 sq.ft. or less	$ 6.00	(I)
From 6,001 to 10,000 sq.ft.	6.70	
From 10,001 to 16,000 sq.ft.	8.00	
From 16,001 to 25,000 sq.ft.	10.00	
a. For each additional single-family residential unit on the same premises and served from the same service connection	3.50	(I)

SPECIAL CONDITIONS

1. The above flat rates apply to service connections not larger than one inch in diameter. (N)

2. All service not covered by the above classification will be furnished only on a metered basis. (N)

3. Meters shall be installed if either the utility or customer so chooses for above classification, in which event service thereafter shall be furnished on the basis of Schedule No. OR-1, General Metered Service. (T)

Schedule No. OR-2UL (T)

Oroville Tariff Area

LIMITED FLAT RATE SERVICE

APPLICABILITY

Applicable to all flat rate water service furnished to customers taking untreated water directly from Powers Canal. (T) (T)

TERRITORY

Oroville and vicinity, Butte County. (T)

RATES

	Per Month	
Slaughter House Meat Co.	$19.25	(I)
Ray Heberle	2.65	|
William Caron	3.95	(I)

SPECIAL CONDITION

Service under this schedule is limited to those service connections through which service was being furnished as of January 1, 1955.

Schedule No. OR-3M (T)

Oroville Tariff Area

IRRIGATION SERVICE

APPLICABILITY

Applicable to service of untreated water from Powers Canal to irrigation districts and to irrigation or mining ditches, for uses including but not limited to the irrigation of vineyards, orchards and pasture lands. (T) | (T)

TERRITORY

Lands located along the Powers Canal, between Coal Canyon Power House and Cherokee Reservoir, north of the City of Oroville, Butte County. (T) | (T)

RATE

	Per Miner's Inch Day	
For all water delivered	$0.27	(I)

SPECIAL CONDITION

A miner's inch day is defined as the quantity of water equal to 1/40 of a cubic foot per second flowing continuously for a period of 24 hours.

(D)