

ORIGINALDecision No. 64256

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of SUBURBAN WATER SYSTEMS, a cor-)
poration, for authority to)
increase its rates for water)
service.)

Application No. 43241
Filed March 17, 1961
Amendment Filed December 4, 1961

Investigation on the Commission's)
own motion into the operations,)
rules, regulations, contracts and)
practices of SUBURBAN WATER)
SYSTEMS, a corporation.)

Case No. 6323
Filed July 28, 1959

Arthur D. Guy, Jr., and C. H. Deitz, for
Suburban Water Systems, applicant in
Application No. 43241 and respondent
in Case No. 6323.

Harry C. Williams, for the City of West
Covina; Mrs. Marie L. Edwards, for
Valley Council of Home Owners Associa-
tion; Wanda Hendricks, for San Jose
Hills Home Improvement Association;
Albert Gearing, for San Jose Associa-
tion, Inc.; William Emmens, Joe Ramirez
and Meno Wilhelms, for City of Santa Fe
Springs; Mrs. Nancy Baranger, for Santa
Fe Springs Chamber of Commerce; and
Harry H. Johnson, for Sungold Hills
Community, Inc., protestants in Appli-
cation No. 43241.

Hugh N. Orr, William V. Caveney, John R.
Gillanders and Richard R. Entwistle, for
the Commission staff.

O P I N I O NHearing

This application was heard before Commissioner Peter E. Mitchell and Examiner William W. Dunlop in West Covina on July 26, 1961, and in Whittier on July 27 and 28, 1961. Thereafter, adjourned hearings¹ were held before Examiner William W. Dunlop in Los Angeles

¹ Case No. 6323 was consolidated for hearing with the above-entitled application (No. 43241) on November 1, 1961.

on September 13, 14, 15, 20, 21, 22, November 1, 2, 3, December 18, 19, 20, 1961 and January 17 and 18, 1962. Applicant and the Commission staff filed opening briefs on March 12, 1962 and closing briefs on April 23, 1962.

Copies of the application and the notice of hearing were served in accordance with the Commission's procedural rules. The protestants are the City of West Covina, Valley Council of Home Owners Association, San Jose Hills Home Improvement Association, San Jose Association, Inc., City of Santa Fe Springs, Santa Fe Springs Chamber of Commerce and Sungold Hills Community, Inc.

The City of West Covina, at the hearing on July 26, 1961, took the position that the requested rates were excessive and that special review should be made of factors used by Suburban in normalizing revenues and expenses, Suburban's depreciation rates, Suburban's transactions with companies which appear to be intimately related to Suburban and Suburban's stock exchange arrangements in place of pay-back agreements with some subdividers.

Petition for Examiner's Proposed Report

On November 24, 1961, Suburban Water Systems filed a petition requesting the Commission to direct that a proposed report be prepared and issued by the presiding officer. The Commission has considered this request and is of the opinion that no useful purpose would be served by the issuance of an examiner's proposed report herein. Accordingly, the request is denied.

Applicant's Request

Suburban Water Systems seeks authorization to increase its rates for water service pursuant to Section 454 of the Public Utilities Code and, by amendment, seeks authorization to include in its utility plant accounts an amount for water rights at an estimated current value rather than at cost as prescribed by the uniform system

of accounts for water utilities (Class A). Applicant estimates that the rates which it seeks to have made effective will increase its annual revenues by approximately \$730,000, or by 32 percent, based on its revenue estimate of \$2,424,500 for 1961 at present rates.

With respect to rates, applicant seeks authority to establish two rate zones to replace the present seven rate schedules applicable on its system. Minimum rates of \$2.40 a month for 600 cubic feet of water are requested for Zone A (lower elevations) and \$2.70 for Zone B (higher elevations). Based on a monthly usage of 2,000 cubic feet of water, present and applicant's requested charges for water service are as follows:

<u>Area</u>	<u>Charge per Month for 2,000 Cu.Ft. of Water</u>		<u>Percentage Increase</u>
	<u>Present</u>	<u>Requested</u>	
<u>Zone A</u>			
La Puente - South Covina	\$3.30	\$5.51	66.9%
West Covina	4.00	5.51	37.7
Glendora	4.30	5.51	28.0
Rivera	4.30	5.51	28.1
Whittier, except 600 ft.pressure zone	4.82	5.51	14.3
<u>Zone B</u>			
Covina Knolls	5.00	6.51	30.2
Eighlands (Covina-West Covina Area)	5.00	6.51	30.2
Whittier, 600 ft.pressure Zone ..	4.82	6.51	35.0

Applicant's Operations

Applicant is engaged in the business of furnishing water service for domestic, industrial and fire protection service from four geographically separated systems. Three of the systems are in the upper San Gabriel Valley and one is in the Central Basin in and around Whittier. In total the applicant serves approximately 44,540 customers. The four systems are known as Glendora, Covina Knolls San Jose Hills and Whittier-Rivera.

The Glendora system serves approximately 2,050 customers in an area lying between the cities of Azusa and Glendora. The Covina

Knolls system serves some 310 customers in an area lying northeast of the City of West Covina. The largest system as measured by the number of customers served is the San Jose Hills system, which serves about 23,270 customers in the cities of West Covina, La Puente and Industry and intermediate unincorporated area. The Whittier-Rivera system serves approximately 18,910 customers in areas southeast of the City of Whittier and in the cities of Santa Fe Springs and Pico Rivera and adjacent territory.

Water supplies for the four systems are obtained primarily from applicant's wells supplemented with water purchased from various sources including so-called mutual water companies. Storage reservoirs are located in the several service areas. There are four pressure zones in the San Jose Hills system and six major pressure zones in the Whittier-Rivera system.

Officers and Corporate Relationships

As of December 31, 1960, Suburban's officers were: Camille A. Garnier, president; E. S. Galster, June G. White,² J. C. Luthin, and W. Hannon, vice presidents; C. H. Deitz, secretary-treasurer; Marian Feneck and A. D. Guy, Jr., assistant secretaries. Directors were: Camille A. Garnier, June G. White, C. H. Deitz, E. S. Galster, R. T. Gardner, P. R. Jackson and R. S. Carvey.

During various periods of its history Suburban has utilized the services of associated companies³ and persons primarily in connection with the construction or installation of plant or for the purchase of other assets. These associated companies and persons include Garnier Construction Company, Garnier Utility Service Company.

² Sister of Camille A. Garnier.

³ "Associated companies" means companies or persons that, directly or indirectly, through one or more intermediaries, control, or are controlled by, or are under common control with Suburban.

Whittier Utility Supply Company, Garnier Machinery and Equipment Company, San Jose Ranch Company, Valinda Engineering Company, Pacific Utility Service Company (a division of Valinda Engineering Company), South Covina Water Service, Water Suppliers Mobile Communications, California Pacific Finance Company, Cal-Fin Company, Garnier Pipeline Construction Company, Southwest Water Company, Utility Service Company and Camille A. Garnier. So-called mutual water companies controlled by Suburban include Hollenbeck Street Water Company, La Grande Source Water Company, La Puente Co-Operative Water Company, Temple Avenue Mutual Water Company and Valencia Water Company. Suburban also owns stock in several other so-called mutual water companies that do a substantial business with Suburban, including California Domestic - La Habra Water Company, Covina Irrigating Company and Murphy Ranch Mutual Water Company. Other entities that are associated with Suburban that function principally as holders of associated company stocks include Garnier Enterprises, Inc. and Garnier Trust. The extent of ownership and office held by Camille A. Garnier, June White, Constance Garnier⁴ and C. H. Deitz in a number of the associated companies as of September 9, 1958 and as of June 20, 1961 are as set forth on Table 1-K of Exhibit 13.

For an understanding of the interassociated transactions that are included in the history of Suburban Water Systems as revealed by this record, particularly by Exhibits 10 and 13, a brief summary of the function, operation, ownership and control of a number of the associated companies is appropriate.

Garnier Construction Company was organized in 1937 as a partnership of the Garnier family. Since November 1, 1955 it has

⁴ Mother of Camille A. Garnier.

been a corporation with its stock held by San Jose Ranch Company. This company has constructed and installed the major portion of pipelines, pumping stations, reservoirs and other large facilities of Suburban on a cost-plus basis prior to 1957 and on a unit price contract basis and on a cost-plus basis since 1957, as indicated by Table 1-B of Exhibit 13. It used materials purchased from Whittier Utility Supply Company and rented machinery and equipment from Garnier Machinery and Equipment Company generally prior to April 1956 when such companies were active. It conducts its operations from rented premises owned by San Jose Ranch, which also provided office, warehouse and yard space on a rental basis to other associates. In the three-year period, 1958 through 1960, some 73 percent of its total sales to Suburban have been billed under the unit price schedule. In addition to its construction business, this company has provided engineering and administrative services and has sold material direct to Suburban and to its other associates. On March 29, 1960 the unit price contract was assigned, with Suburban's consent, from Garnier Construction Company to Garnier Pipeline Construction Company, a new corporation, which performed work for Suburban under the extended contract until December 31, 1960. Sales of Garnier Construction Company for the years 1955 through the first nine months of 1960, as shown in Table 1-A of Exhibit 13, were directed primarily to its associated public utilities, associated mutuals, or associated utility operating and supply companies.

Garnier Pipeline Construction Company was incorporated in March 1960. It is owned 87½ percent by Valinda Engineering Company and 12½ percent by Mr. William Long. This company's sales to Suburban in 1960 amounted to \$497,638 or 67.8 percent of its total sales in that year (Exhibit 13, Table 1-C). This company held the unit price contract with Suburban from March 29, 1960 to

December 31, 1960. Such unit price contract was awarded by Suburban to J. E. Young Pipeline Construction Company on January 25, 1961. On February 3, 1961, J. E. Young Pipeline Construction Company and Garnier Pipeline Construction Company were issued joint construction license No. 198276 (Exhibit 13, Table 1-B).

Utility Service Company was formerly known as Garnier Utility Service Company and was jointly owned by Camille Garnier and his sister Mrs. June White. From its incorporation in 1952 until it became generally inactive insofar as direct sales to Suburban in 1956, it performed work relating to the installation of services and meters and certain related functions. Materials were purchased from Whittier Supply Company; construction machinery and other equipment were rented from Garnier Machinery and Equipment Company; and its accounting and administrative functions and operating premises were provided by other associates. Work was performed under contract on a cost-plus basis with markups to cover material handling, supervision and overhead, engineering and profit similar to those used by Garnier Construction Company. Garnier Utility Service Company had no investment in fixed capital, the bulk of its assets consisted of accounts receivable and work in progress. In 1955 sales of Garnier Utility Service Company to Suburban amounted to \$158,969 or 88.8 percent of Garnier Utility's total sales for that year (Exhibit 13, Table 1-D). Sometime subsequent to 1956 Utility Service Company began providing management, accounting, maintenance, operating and construction services for so-called mutual water companies and public utilities. Its customers included so-called mutual water companies controlled by Suburban and whose expenses are reflected in the cost of water purchased by Suburban from said mutuals. In 1960 its functions were taken over by Pacific Utility

Service Company, a division of Valinda Engineering Company. Utility Service Company is now owned 100 percent by Mrs. White.

Pacific Utility Service Company is a division of Valinda Engineering Company and as such is owned 85 percent by Camille A. Garnier, 5 percent by C. H. Deitz and 10 percent by other parties. This company has continued the services formerly offered by Utility Service Company. Its sales for 1960 to Suburban amounted to \$24,775 (Exhibit 13, Table 1-E).

Whittier Utility Supply Company, a corporation, whose stock is held by Camille A. Garnier and his sister, Mrs. June White, operated in the period between 1949 and 1956. During that period it sold the bulk of materials and supplies used by its associated companies in construction and operations. It had no investment in buildings or equipment and rented its warehouse and office facilities from San Jose Ranch. Accounting, administrative and other functions were provided by Garnier Construction Company. Approximately 98.4 percent of its sales during its active period were to its operating associates. During the years 1955 and 1956 the bulk of material sold by the supply company was to Garnier Construction Company, which in turn in those same years had the bulk of its sales to Suburban (Exhibit 13, Tables 1-F and 1-A).

Garnier Machinery and Equipment Company was incorporated and commenced operations about the middle of 1952. The stock of this corporation is owned one third each by Camille Garnier, Mrs. June White and Garnier Enterprises. This company has been inactive since March 1956. Its principal activity was the renting of construction machinery and automotive equipment on a serviced basis to several of its associates. It had no clerical, accounting or administrative employees, and purchased services of this nature from other

associates, particularly Garnier Construction Company and Garnier Utility Service Company. For the years 1955 and 1956 the bulk of its sales were to Garnier Construction Company and to Suburban (Exhibit 13, Table 1-H).

San Jose Ranch Company is a partnership of the Garnier Trust and Garnier Enterprises, Inc., and holds a portion of Suburban's stock. It owns and rents to its various associates, including Suburban, the office building, land and other premises used by these companies in their operations, and derives its principal revenues from this service. Rentals are charged on the basis of floor space occupied and are designed to yield gross revenues sufficient to meet estimated operating costs. In addition, San Jose Ranch owns and operates a well and pumping plant several miles distant from its ranch property and sells water to Suburban for use in its San Jose Hills System and to several other parties, including the City of West Covina.

Valinda Engineering Company, incorporated November 5, 1953, was organized to perform the engineering functions formerly provided by Garnier Construction Company. Originally it was owned one half each by Camille Garnier and Mrs. June White. It is now owned 85 percent by Camille Garnier, 5 percent by C. H. Deitz and 10 percent by others. Prior to April 1956, substantially all revenue of this company was derived from sales of its services to its associates, including Suburban. Since April 1956, it has not been doing any work for Suburban but it has been retained by others, including so-called mutual water companies controlled by Suburban. Of its total sales for the years 1955 and 1956, 66.5 percent and 64.8 percent, respectively, was to Suburban (Exhibit 13, Table 1-J).

South Covina Water Service is a partnership composed of Camille A. Garnier and his three minor children. It owns and operates pumping facilities and transmission mains used in producing and selling water primarily to the San Jose District of Suburban Water Systems and to others, including South Hills Country Club. It also holds stock in Suburban. It owns no other property, has no other source of revenues, and does not use any of the water produced for its own domestic purposes or for irrigation of its lands.

Water Suppliers Mobile Communications Service was incorporated August 5, 1950, and is wholly owned by the various associates utilizing its radio service, such ownership taking the form of membership shares in the ratio of the radio units used. Costs of operation of central transmitting and receiving facilities are assessed to members in the same manner, it being operated on a nonprofit basis. Personnel requirements for dispatching, clerical, accounting and administration are furnished by Garnier Construction Company.

California Pacific Finance Company was incorporated in 1950. All of its stock is held by Camille Garnier, Mrs. June White and C. H. Deitz. According to its management it serves the purpose of establishing a market for the securities of its associated companies. It has appeared as a vendor to Suburban of a portion of Suburban's investment in stocks of so-called mutual water companies and of certain land and a well.

Garnier Trust was formed in 1937 by Mrs. Constance Garnier for the purpose of enabling her to transfer to herself, as trustee,

real estate properties for the benefit of Camille Garnier and Mrs. June White, her son and daughter, and at the same time enabling the trustee to continue to control and operate these properties during her lifetime. In 1951 Constance Garnier withdrew her one third of the trust and formed the Garnier Enterprises. Garnier Trust holds two thirds ownership in San Jose Ranch.

Garnier Enterprises is owned one tenth each by Camille Garnier, his wife and three minor children, his mother, his sister and his brother-in-law and their two children. This company is a partnership. It is a partner in the ownership of the San Jose Ranch and in addition, owns one third of the Garnier Machinery and Equipment Company.

Cal-Fin Company is a wholly owned subsidiary of Suburban Water Systems. Its principal functions are to purchase land for the utility, to repurchase from subdividers Suburban's stock and to trade such stock for that of so-called mutual water companies.

Staff Accounting Adjustments

A financial examiner of the Commission's Finance and Accounts Division testified that, based upon his investigation, Suburban's balance sheet book figures as of December 31, 1960 could not be relied upon as representative of Suburban's financial condition on that date. Accordingly, he developed in Chapter 4 of Exhibit 10 an adjusted balance sheet at December 31, 1960 as follows:

Adjusted Balance Sheet
(December 31, 1960)

Item	Balance Per Books 12-31-60	CPUC Staff Accounting Adjustments	Adjusted Balance 12-31-60
<u>Assets and Other Debits</u>			
Utility Plant:			
Intangible plant	\$ 471,585	\$ -	\$ 471,585
Utility plant in service	15,148,461	(450,480) ^a	14,697,981
Construction work in progress	526,753	-	526,753
	16,146,799	(450,480)	15,696,319
Less reserve for depreciation or amortization	2,238,562	(810) ^b	2,237,752
	13,908,237	(449,670)	13,458,567
Investment & fund accounts	507,310	(102,816) ^c	404,494
Current & accrued assets	1,007,379	5,761 ^d	1,013,140
Deferred debits	248,945	-	248,945
Total assets & other debits	15,671,871	(546,725)	15,125,146
<u>Liabilities and Other Credits</u>			
Capital stock	4,071,929	-	4,071,929
Long-term debt	6,745,931	-	6,745,931
Current & accrued liabilities	785,869	-	785,869
Deferred credits	1,998,577	-	1,998,577
Reserves	25,747	-	25,747
Contributions in aid of construction ..	461,010	197,090 ^e	658,100
Surplus:			
Capital surplus	999,505	(652,901) ^f	346,604
Earned surplus	583,303	(90,914) ^g	492,389
	1,582,808	(743,815)	838,993
Total liabilities & other credits ...	15,671,871	(546,725)	15,125,146

(Red Figure)

a. Elimination of water rights in excess of cost	\$(444,000)
Removal of Valencia Water Co. line costs charged in error ..	(5,629)
Reduction of facilities acquired from Temple Avenue Mutual Water Co. to original investment	(851)
Total	(450,480)
b. Valencia Water Co. line	(338)
Temple Ave. Mutual Water Co. facilities	(472)
Total	(810)
c. Reduction relating to acquisition of 5,414 shares of Murphy Ranch Mutual Water Company stock from Sun Gold for 5 cents on the dollar	(102,816)
d. Unrecorded amounts for water "loaned" to Southwest Water Co.	4,618
La Puente Cooperative Water Co.	940
Valencia Water Co.	203
Total	5,761
e. Discounts on exchange of Series A Preferred stock for outstanding refund contracts	208,875
Applicable amortization	(11,785)
Total	197,090
f. Appraisal value of water rights	(444,000)
Capital surplus arising from acquisition of assets of Temple Ave. Mutual Water Co.	(26)
Discount on exchange of Series A preferred stock for outstanding refund contracts	(208,875)
Total	(652,901)
g. Reduction in investment in Murphy Mutual Water Co. stock	(102,816)
Valencia Water Co. line	(5,291)
Temple Ave. Mutual Water Co. assets	(353)
Increase investment in accounts receivable	5,761
Amortization of contributions in aid of construction arising from discounts on refund contracts canceled	11,785
Total	(90,914)

Accounting Deficiencies

A Commission staff accounting witness pointed out two areas of deficiency which caused delay in the completion of audit work related to Suburban. First, in the recordation of the receipt of cash particularly arising from miscellaneous water service revenues, and deposits by subdividers, contractors and others for water service or main extensions, a number of instances were found by the staff where either the names of depositors were misstated or were unsupported by evidentiary papers. Second, Suburban was found by the staff not to conform with the requirements of General Instruction 8, Transactions with Associated Companies, as contained in the uniform system of accounts for Class A water utilities, nor with the requirements of ordering paragraph 9 of Decision No. 46782 issued February 19, 1952, in Applications Nos. 32350 and 32362, involving transactions with associated companies.

Suburban will be expected forthwith to remedy these deficiencies in the recordation of cash and to comply fully with the above-indicated requirements of the uniform system of accounts and of said Decision No. 46782.

Amendment to Application

In its amendment to the application, Suburban requested authority to include in its utility plant accounts an amount for water rights at an estimated current appraised value of \$4,125,000 rather than at cost as required by the uniform system of accounts for water utilities (Class A) prescribed by this Commission. Applicant does not seek at this time to include such amount in its rate base for rate-making purposes.

A representative of the Commission's Finance and Accounts Division recommended that for financial reporting the amount for water

rights carried in the plant accounts of Suburban in excess of cost be eliminated so as to comply with the requirements of the uniform system of accounts.

This record reveals that without seeking or obtaining prior Commission authorization to depart from the requirement that fixed capital, both tangible and intangible, be included in the accounts at cost as set forth in the uniform system of accounts for water utilities, in 1952 applicant incorporated in its balance sheet as part of its utility plant account a 1952 appraised value for its water rights in the amount of \$444,000. Moreover, we take official notice of the fact that during the pendency of this proceeding and without obtaining prior Commission authorization, applicant in its 1961 verified annual report to this Commission included in its utility plant account the \$4,125,000 estimated current appraised value for water rights which applicant here seeks authorization to include in its utility plant accounts. Such action by Suburban is in violation of the requirements imposed upon Suburban by the uniform system of accounts for water utilities prescribed by this Commission. We expect Suburban to fully comply with such requirements.

We find that neither the \$444,000 amount nor the \$4,125,000 amount represent cost as defined by the uniform system of accounts and further find that it would be contrary to the public interest to permit applicant to record such amounts in its utility plant accounts as requested. The order herein will require applicant forthwith to eliminate such amounts from its utility plant accounts and to comply fully with the requirements of the uniform system of accounts with respect thereto.

Case No. 6323

On July 28, 1959, the Commission issued its order instituting investigation under Case No. 6323 into the operations, rules, regulations, contracts and practices of the Suburban Water Systems for the following purposes:

1. To determine whether Suburban should be ordered to record the sum of \$138,724.06 as a credit in Account No. 265, Contributions in Aid of Construction, as numbered and described in the uniform system of accounts for water utilities, and to reverse or modify whatever entries Suburban may heretofore have made in its books of account to whatever extent may be necessary, pursuant to conventional accounting practices, to effectuate the recording of said sum in said Account No. 265.

2. To enter any other order or orders that may be appropriate or necessary in the lawful exercise of the Commission's jurisdiction in the premises.

At the opening of hearings beginning November 1, 1961, at Los Angeles, Case No. 6323 was consolidated for hearing with Application No. 43241.

The record reveals that during a period prior to June 18, 1957, Suburban entered into contracts from time to time with a number of different persons pursuant to its published tariff Rule No. 15, whereby such persons agreed to advance to Suburban various sums of money for the purpose of defraying the cost of extensions of Suburban's water mains into various subdivisions, and whereby Suburban agreed to pay to such persons from time to time during periods of time not exceeding 20 years, various sums of money representing 22 percent of the annual revenue from customers

connected to such extensions (except customers served prior to the times advances for such extensions were made).

By Decision No. 55135, dated June 18, 1957, in Application No. 38292, the Commission authorized Suburban to issue and sell, within a year from the date of said decision (which period of time was extended to and including June 30, 1960, by order of the Commission dated June 2, 1959), 8,000 shares of its Class "A" 5½ percent cumulative preferred shares of stock of a par value of \$50 per share for the purpose of enabling Suburban to exchange such shares for the unpaid balances owed by Suburban to various persons under said contracts on the basis of \$1 of par value for each \$1 of the present worth of said balances. Suburban terminated a number of said contracts during 1957 and 1958 by the above method and when entering the transactions on its books, it credited that portion of the unpaid balance of the contracts aggregating \$138,724.06, for which stock was not issued, to Account No. 265, Contributions in Aid of Construction.

In its letter to the Commission dated December 30, 1958 (Exhibit 20), Suburban stated in part: "Posting these amounts to account 265 was in error because it was not a donation to the company but actually a negotiated settlement of an outstanding obligation of the company and the amounts should have been credited to Capital Surplus." Without approval of this Commission, Suburban transferred said amount of \$138,724.06 from Account No. 265, Contributions in Aid of Construction, to Account No. 270, Capital Surplus. Thereafter, by letter dated January 13, 1959 (Exhibit 20), the Commission advised Suburban as follows:

"At the Commission's regular meeting today it considered your letter of December 30, 1958, and decided that the unpaid balances of subdividers'

refund contracts, which had been terminated through the issue of preferred stock as indicated in your letter, should be credited to Account 265, Contributions in Aid of Construction, instead of to capital surplus.

"Will you therefore, as of December 31, 1958, reverse the entries which appear in your letter of December 30 and on or before January 31, 1959, advise us of your compliance with this letter."

The record discloses that Suburban has not made the accounting adjustments referred to in the Commission's letter of January 13, 1959 and that Suburban's capital surplus account as of December 31, 1960 included \$208,875.18 representing discounts on exchange of Series A preferred stock for outstanding refund contracts. Suburban urged that the unpaid balances represent forgiveness of debt, properly accounted as capital surplus. On the other hand, the Commission staff took the position that benefits derived by Suburban from discounting its refund agreements with subdividers should not be recorded as capital surplus for inclusion in the rate base upon which consumers must pay a return.

On the record we find that the public interest requires that Suburban's unpaid balances of subdividers' refund contracts, which have been terminated through the issue of preferred stock should be credited to Account 265, Contributions in Aid of Construction, instead of to Account 270, Capital Surplus. The order herein will require Suburban to conform its books of accounts to such finding.⁵

⁵ We remind Suburban that Section 702 of the Public Utilities Code provides: "Every public utility shall obey and comply with every order, decision, direction, or rule made or prescribed by the commission in the matters specified in this part, or any other matter in any way relating to or affecting its business as a public utility, and shall do everything necessary or proper to secure compliance therewith by all of its officers, agents and employees."

Applicant's Position on Rate Increase

Applicant asserted that its rate of return on its estimated 1961 depreciated rate base at present rates for water service is 4.23 percent. Such rate of return, according to applicant, is unreasonably low and confiscatory. The rates proposed by applicant are designed to produce a rate of return of 7 percent based on operations for the test year 1961. However, applicant claimed a declining trend in rate of return will produce an effective rate of return of only 6.6 percent at its proposed rates over a three-year future period. Such rate of return, applicant claimed, is fair and reasonable.

Summary of Earnings

In support of its request, applicant presented earning results for the years 1959 and 1960 on both recorded and adjusted bases and for the estimated year 1961 at both present and requested rate levels. The Commission staff also presented earning results based on its independent investigation of applicant's operations. These results are compared in the following tabulation:

<u>Year</u>	<u>Rate of Return on Depreciated Rate Base</u>	
	<u>Applicant Exh.1</u>	<u>CPUC Staff Exh.10, 13</u>
1959 Recorded	5.22%	Not shown
1959 Adjusted	4.78	Not shown
1960 Recorded	4.66	Not shown
1960 Adjusted at Present Rates ..	4.60	6.02%
1961 Estimated at Present Rates	4.23	5.81
1961 Estimated at Requested Rates	7.00	9.08

The respective estimates of operating revenues, expenses, net revenue, rate base and rate of return for 1961 at present rates, as well as the amounts adopted herein to test the validity of

applicant's requested increase in rates are compared in the tabulation which follows:

SUMMARY OF EARNINGS
ESTIMATED TEST YEAR 1961 AT PRESENT RATES

Item	Applicant		CPUC Staff		Adopted at	
	Exhibit 1	Exhibit 10	Exh.13*	Exhibits 10 and 13	Present	Rates
Operating Revenues	\$ 2,424,534	\$ 2,422,000	\$ -	\$ 2,422,000	\$ 2,500,000	
Operating Expenses						
Source of Supply	273,120	234,920				
Pumping	306,300	303,800				
Water Treatment ...	11,030	9,530				
Transmission and Distribution	171,280	155,930				
Customer Account ..	165,350	164,950				
Sales	4,300	2,060				
Administrative and General	343,560	291,000				
Miscellaneous	(48,000)	(36,000)				
Subtotal	1,226,940	1,126,000	(3,000)#	1,123,000	1,168,100	
Deprec. & Amortization	352,106	344,000	(23,000)	321,000	321,000	
Taxes other than Income	231,226	230,000	(13,000)	217,000	217,000	
Taxes on Income	83,515	133,000	24,000	157,000	175,400	
Total Exp. & Taxes	1,893,787	1,833,000	(15,000)	1,818,000	1,881,500	
Net Revenue	530,747	589,000	15,000	604,000	618,500	
Rate Base, Avg. Deprec.	12,536,703	11,400,000	(998,000)	10,402,000	10,410,000	
Rate of Return	4.23%	5.17%	-	5.81%	5.94%	

(Red Figure)

* At 6% rate of return assumed for associated companies. In Exhibit 13 the staff also developed adjustments at an assumed 7% rate of return for associated companies resulting in net revenues of \$604,000, a rate base of \$10,422,000 and a rate of return of 5.80% for Suburban.

a Rounded from \$1,126,190.

Not distributed to accounts.

Rate Base

The components of the average depreciated rate base for test year 1961 as developed by the applicant and by the staff, as

well as the amounts adopted herein, are compared in the tabulation following:

AVERAGE DEPRECIATED RATE BASE
TEST YEAR 1961 ESTIMATED

Item	Applicant Exhibit 1	CPUC Staff Exhibits 10 and 13	Adopted
Avg. Utility Plant and Construction			
Work in Progress	\$16,400,203	\$16,234,000	\$16,234,000
Deduction for Depreciation and Amortization	2,395,893	2,398,000	2,398,000
Average Net Utility Plant	14,004,310	13,836,000	13,836,000
Modifications:			
Investments	506,311	492,000	492,000
Advances for Construction	(1,687,675)	(1,808,000)	(1,808,000)
Tract Extensions without Refund Contracts	-	(483,000)	(483,000)
Contributions in Aid of Construction ..	(468,256)	(474,000)	(474,000)
Accounting Modifications	-	(305,000)	(305,000)
Adjustment for Purchases from Associated Companies (Exhibit 13)	-	(808,000)*	(808,000)
Adjustment for Mutual Water Company Stocks (Exhibit 13)	-	(190,000)	(190,000)
Materials and Supplies	79,768	63,000	70,000
Working Cash Allowance	102,245	79,000	80,000
Total Modifications	(1,467,607)	(3,434,000)	(3,426,000)
Average Depreciated Rate Base	12,536,703	10,402,000	10,410,000

(Red Figure)

* At a 6% rate of return for associated companies.

Average Utility Plant

The staff's estimate of average utility plant and construction work in progress is \$166,203 lower than applicant's estimate. This difference results from the staff's use of a lower customer estimate than that used by applicant and from the staff's use of weighted net additions compared with applicant's use of a simple average. We find that weighted average utility plant and construction work in progress of \$16,234,000, as estimated by the staff, is reasonable for the test year.

Deduction for Depreciation and Amortization

There is no appreciable difference in the estimated amount of the deduction for depreciation and amortization. We find the staff's estimate of \$2,398,000 is reasonable for this item.

Investments

The staff's estimate of investments represents the estimated weighted average amounts in Account 112, Other Investments. Applicant, on the other hand, used an estimated simple average amount. We adopt the staff's estimate for this item as reasonable.

Advances for Construction

With respect to advances for construction, applicant carries such advances in Account 242, Other Deferred Credits, until the main extension is approximately 50 percent completed, at which time it transfers such amounts to Account 241, Advances for Construction. Applicant urged that advances should not be deducted from rate base until there is plan to offset it. The staff, on the other hand, included not only amounts in Account 241 but also that portion of Account 242 pertaining to advances for construction. We find the staff's approach in deducting the weighted average of the entire amount of advances for construction from rate base is consistent with past Commission rate-making practices⁶ and is more reasonable than the applicant's approach. Accordingly, we adopt the staff's estimate of \$1,803,000 as reasonable for this item.

Tract Extensions Without Refund Contracts

The staff urged a deduction of \$483,000 from rate base representing the estimated weighted average unextinguished amount for tract extensions made by applicant without collecting an advance

⁶ See Decision No. 61284, dated December 23, 1960, in Application No. 41337.

under refund contract as required by the terms of applicant's main extension rule. The staff noted that many issues of applicant's Series A preferred stock sold for cash had been related to concurrent transactions involving the construction of water distribution facilities to serve properties being developed by the person or entities purchasing stock for cash. From its analysis of certain subdivision tracts in Los Angeles County, the staff indicated in Exhibit 10 that there were 42 subdivision tracts for which no refund contract was issued, even though applicant had expended \$570,016.88 to install mains, services, hydrants and other facilities. The staff indicated further that out of 167 tracts wherein an advance had been received by applicant, applicant installed facilities in an amount of \$151,549 in excess of the monies initially received and that a substantial portion of the amounts originally advanced by subdividers was subsequently converted to either Series A or Series B preferred stock.

Applicant maintained that the staff's recommended deduction of \$483,000 from rate base is illegal and transcends the bounds of fair play. While applicant acknowledged that it had extended its facilities into subdivision tracts without collecting an advance under refund contracts, applicant urged that it viewed its main extension rule as permitting such a practice. We find, however, that applicant's tariffs do not so permit.⁷

⁷ Applicant's Rule No. 15, Section C, states in Part: "C. Extensions to Serve Subdivisions, Tracts, Housing Projects, Industrial Developments or Organized Service Districts 1. An applicant for a main extension to serve a new subdivision, tract, housing project, industrial development or organized service district shall be required to advance to the utility before construction is commenced the estimated reasonable cost of installation of the mains, from the nearest existing main at least equal in size to the main required to serve such development, including necessary service stubs or service pipelines, fittings, gates and housings therefor, and including fire hydrants when requested by the applicant or required by public authority, exclusive of meters." (Emphasis added.)

Applicant also urged, based on Exhibit 45, that even if it had secured advances under refund contracts in the 42 tracts mentioned by the staff and had used the proportionate cost method of refunding subdivider advances as permitted by its tariffs, some 95 percent of the total of such advances would have been repaid and as a consequence there has been no appreciable difference in effect on rate base from applicant's having invested its own funds in subdivision plant. It is of record, however, that applicant has never utilized the proportionate cost method of refunding in those cases where it has secured advances under refund contracts. Applicant has consistently used the alternate percentage of revenue refund method, which is the refund method used by the staff in developing the \$483,000 adjustment amount.

Applicant further urged that it was led to the conclusion that construction of in-tract plant with its own funds, without collecting advances and executing refund contracts, was proper based on various Commission decisions authorizing applicant or Southwest Water Company to issue securities.⁸ However, these decisions do not authorize applicant to depart, in any respect, from its tariffs. As a matter of fact, decisions affecting the issuance of securities contain the general provision: "The authorization herein granted is for the issue of securities and is not to be construed as indicative of amounts to be included in a future rate base for the determination of just and reasonable rates."

We are persuaded that applicant's failure in the past to conform to its filed main extension rule affords no justification

⁸ Decision No. 57782, dated December 30, 1958, in Application No. 40628; Decision No. 58716, dated July 7, 1959, in First Supplemental Application No. 40628 and Application No. 40954; and Decision No. 58835, dated July 28, 1959, in Application No. 41144.

for now inflating its rate base. We find that the staff's adjustment for this item is reasonable and necessary for rate-making purpose to protect the public interest.

Contributions in Aid of Construction

There is no significant difference in the estimates for this item. We adopt the staff's amount of \$474,000, representing the estimated weighted average for the test year, as reasonable.

Accounting Modifications

The \$305,000 deduction urged by the staff as accounting adjustments for rate base purposes is the rounded amount for a reduction in plant of \$5,629 for a Valencia Water Company line charged to applicant in error in 1957, a reduction in depreciation reserve of \$810 related to a Valencia Water Company line and Temple Avenue Mutual Water Company facilities, a reduction of \$102,816 in investment relating to the acquisition of 5,414 shares of Murphy Ranch Mutual Water Company stock from Sun Gold for 5 cents on the dollar, and an increase in contributions in aid of construction of \$197,090 relating to discounts on exchange of Series A preferred stock for outstanding refund contracts less applicable amortization. These items are explained in Exhibit 10, Chapter 4. We find that the staff's adjustments for these items are reasonable.

Adjustments for Purchases from Associated Companies

The staff urged a deduction of \$308,000 from rate base for rate-making purposes relating to purchases by Suburban or its predecessor companies during the period 1945 through 1961 from five associated companies (Garnier Construction Company, Garnier Pipeline Construction Company, Whittier Utility Supply Company, Garnier Utility Service Company and Valinda Engineering Company). Such adjustment was based on the principle, among others that services and

facilities purchased by the utility from its associates should not, for rate-making purposes, include a return greater than that which would exist had the utility performed the services or installed the facilities itself. Details of this adjustment are set forth in Exhibit 13.

Essentially this adjustment is the same as that made in the last rate proceedings of this applicant, Applications No. 34829 for San Jose Hills District and No. 39299 for Whittier District. By Decisions Nos. 59631 and 59646, respectively, in those proceedings, \$541,300 was excluded from Suburban's rate base applicable to said districts relating to purchases from associated companies. Applicant's petition for Writ of Review, S. F. No. 20484, was denied by the Supreme Court of the State of California. In the instant proceeding the staff used as a starting point the adjustment previously adopted by the Commission for the above-mentioned two districts to which was added adjustments developed in a similar manner for years and districts not before the Commission at the time of the previous proceedings.

A fundamental principle involving public utilities and their regulation by governmental authority is that the burden rests heavily upon a utility to prove that it is entitled to rate relief and not upon the Commission, the Commission staff, or any interested party, or protestant to prove the contrary. In this proceeding the burden is upon applicant to establish all necessary facts which would justify the requested increase in rates. A public utility is created for public purposes and performs a function of the State. It acquires the status of a quasi trustee (Smyth v. Ames, 169 U.S. 466, 544; Western Canal Co. v. R. R. Comm., 216 Cal. 639, 647).

The evidence in this proceeding is not convincing that this Commission should depart in any respect from its heretofore

established conclusions as to the principles or the methods to be applied to the problems presented by Suburban's purchases from associated companies.

It is our opinion and we so find that all of the adjustments made by the staff relating to purchases from associated companies, including adjustments to rate base, maintenance expense, depreciation expense, and taxes are reasonable. Such adjustments assure that applicant's ratepayers will not be unduly burdened with profits of an associated company that directly or indirectly, through one or more intermediaries, control, or are controlled by, or are under common control with, Suburban Water Systems. They produce a fair and reasonable result, which is in the public interest. The staff adjustments are hereby adopted for rate-making purposes after giving consideration to the rate of return to be accorded applicant herein.

Adjustment for Mutual Water Company Stocks

A deduction of \$190,000 from applicant's claimed rate base for 1961 was made by the staff related to applicant's booked investment in mutual water company stocks. The staff claimed that Suburban had secured a substantial amount of such mutual stocks by exchange for shares of Suburban's stock regardless of the dollar value assigned to the stocks and that the staff lacked any substantial proof that the booked amounts for such stocks represented the actual equivalent cash cost to Suburban. The staff maintained that its adjustment was conservative in that it had excluded only one half of the amount claimed by applicant.

While applicant presented considerable testimony and several exhibits relating to its acquisition of mutual water company stocks and urged that such stocks were bought and sold for cash at par, the

evidence reveals payments in some 108 transactions were by the same check endorsed back to the order of the original maker and carrying a second endorsement of applicant, an officer of applicant, or an associated company of applicant. Further, the evidence reveals that Cal-Fin Company and other entities closely associated with applicant sold shares of mutual stock to applicant at prices substantially greater than the cost to the entity making the transfer and in some instances officers and employees of Suburban acquired shares of such mutual stock at a price substantially below that paid by Suburban.

We find that the staff's adjustment is reasonable and necessary for rate-making purposes in light of the entire record.

Materials and Supplies

The staff's estimate of \$63,000 is equivalent to approximately four months' net issues for Account 131-1, Inventory, and 1960 recorded levels for plant and meter repair parts. Applicant claimed that its estimate of \$79,768 was the same as the end of year 1960 recorded amount for materials and supplies, and that it must carry a larger inventory because applicant is increasingly performing its own work. We adopt \$70,000 as a reasonable allowance for this item for rate-making purposes.

Working Cash

An allowance for working cash is included in rate base in order that stockholders may be compensated for monies which they have supplied over and above the investment in tangible and intangible property in order to enable the utility to operate efficiently and economically. The staff's estimate of \$79,000 is a judgment amount which gives effect to one month's purchased power and water and two months' other expenses, excluding taxes

and depreciation, and to the offsetting effect of average federal income tax accruals available because of lag in the payment of federal income taxes. Applicant's estimate of \$102,245 is equivalent to one-twelfth of applicant's estimated annual operating expense without consideration of the offsetting effect of average federal income tax accruals. We find an allowance of \$80,000 reasonable for this item.

To Summarize: The Commission hereby finds a depreciated rate base of \$10,410,000 to be fair and reasonable for test year 1961.

Operating Revenues

Applicant's operating revenues are obtained primarily from the sale of water to domestic, commercial, industrial, and public authority customers on a meter rate basis. Other sources of revenue include public and private fire protection service, construction water sales and miscellaneous revenues.

Applicant's revenue estimate for 1961, at present rates, amounts to \$2,424,534 and exceeds the staff's estimate by \$2,534. Both estimates reflect normalized average water usage per customer based on the 5-year period 1956-1960, inclusive. Applicant used the average consumption per customer in the Rivera and in the Glendora tariff areas as representative for the purpose of computing average normalized revenue factors which it used in developing its 1961 normalized revenue estimate. The staff, on the other hand, used the five-year 1956-1960 average consumption per customer for each of the seven tariff areas separately in developing its estimate. A comparison of the average consumption per customer for the

five-year period 1956-1960, with the three-year period 1958-1960, based on the staff's analysis follows:

<u>Tariff Area</u>	<u>Average Consumption Per Customer</u> <u>Per Month in Hundreds of Cubic Feet</u>	
	<u>5-Year Average</u>	<u>3-Year Average</u>
	<u>1956-1960</u>	<u>1958-1960</u>
Covina Knolls	36.85	38.12
Highlands	33.55	33.66
Glendora	21.66	22.92
West Covina	22.75	23.69
South Puente	22.39	23.20
Whittier	21.56	22.68
Rivera	18.63	19.48

The above comparison indicates an increasing trend in average consumption per customer which, in our opinion, has not been reflected adequately in the normalized revenue estimates for 1961 either by the applicant or by the staff. The staff in Exhibit 23 showed that applicant's recorded revenues for the 12 months ended October 31, 1961 amounted to \$2,527,197. The applicant, on the other hand, in Exhibit 49 developed an amount of \$2,548,000 as the apparent 1961 revenues based on projections of actual operating revenues for the first 10 months of 1961.

On this record we adopt as reasonable for the purpose of testing applicant's need for an increase in rates operating revenues of \$2,500,000 for test year 1961 at present rates.

Source of Supply Expense

The principal difference between applicant's and the staff's estimate for source of supply expense is in Account 704, Purchased Water. The staff urged that applicant's own-source water was cheaper than its purchased water from so-called mutual water companies and for that reason the staff made greater use of applicant's available own-source water during the test year. Applicant's witness admitted that he had never made a study of the

relative cost of purchased water as against own-source water. He maintained, however, that based on the staff's estimated quantities of purchased and own-source water, the staff's figure was \$21,400 low because the staff did not include mutual water company assessments in developing the unit cost of water and because the staff made an error in its computation of the cost of water purchased from San Jose Ranch.

On this record we find reasonable an amount of \$250,000 for such expense for test year 1961 on a basis consistent with the revenues heretofore adopted.

Pumping Expense

There is no material difference between applicant's and the staff's estimate of pumping expense. We find reasonable an amount of \$309,800, which is the staff's estimate augmented by \$6,000 to reflect an increase in pumping expense resulting from the higher water usage adopted herein consistent with the adopted amount for operating revenues.

Water Treatment Expense

The staff's estimate of water treatment expense is \$1,500 lower than applicant's estimate. Applicant took no exception to the staff's estimate for this item. We find an amount of \$9,600 to be reasonable.

Transmission and Distribution Expense

The staff's estimate of transmission and distribution expense is \$155,930, or \$15,350 less than applicant's estimate. Applicant took exception to the staff's estimate for Account 753, Transmission and Distribution Lines Expenses, Account 753,

Maintenance Supervision and Engineering, and Account 760, Maintenance of Reservoirs. For these three accounts in total, the staff's estimate is \$28,750, applicant's estimate is \$41,110.

On this record we adopt as reasonable an amount of \$156,000 for transmission and distribution expense.

Customer Account Expense

Applicant and the staff were in substantial agreement as to estimated 1961 customer account expense. We find \$165,000 to be reasonable for the purposes of this decision.

Sales Expense

The staff's estimate for sales expense is \$2,060 while applicant's estimate is \$4,300. Such expense amounted to \$471 in 1955, \$326 in 1956, \$79 in 1957, \$102 in 1958, \$1,974 in 1959, and \$4,083 in 1960. For rate-making purposes we adopt an allowance of \$2,100 as reasonable for sales expense for test year 1961.

Administrative and General Expense

Applicant's estimate for administrative and general expense is \$343,560, or \$52,560 in excess of the staff's estimate. The major difference lies in three accounts: Account 791, Administrative and General Salaries; Account 793, Property Insurance; and Account 797, Regulatory Commission Expense.

With respect to Account 791, Administrative and General Salaries, applicant's estimate is \$154,350 while the staff's estimate is \$125,000, a difference of \$29,350. This difference reflects an adjustment by the staff, for rate-making purposes, of the salary allowance for Camille A. Garnier and C. H. Deitz. The staff included for rate-making purposes an allowance of \$14,400 for

Camille A. Garnier and \$13,000 for C. H. Deitz on a judgment basis giving consideration to: (a) top management estimated normal participation in the business, (b) salaries paid by other water utilities in the state, and (c) salary levels of Suburban during the period 1957 to 1961 increased from 10 to 20 percent for jobs excluding officers, compared to an increase of 105 percent for the president and 88 percent for the secretary-treasurer. In this connection Exhibit 43 reveals that Camille A. Garnier and C. H. Deitz drew the following salaries from Suburban for the years 1954 to 1960, inclusive:

<u>Year</u>	<u>Camille A. Garnier</u>	<u>C. H. Deitz</u>
1954	\$16,750	\$12,000
1955	16,800	12,000
1956	12,000	10,800
1957	12,400	11,200
1958	13,800	12,600
1959	19,347	18,138
1960	26,700	22,327

Camille Garnier testified that he devoted between 100 and 105 hours a month in the effort for Suburban Water Systems as president and chief executive officer, that he was president of seven other companies beside Suburban and explained his interests in a number of other enterprises. C. H. Deitz testified that, based on a three months' time record, he devoted about 80 hours a month to Suburban and that he devoted time to a number of other enterprises including Southwest Water Company, various so-called mutual water companies, Covina Irrigating Company, Western Pacific Sanitation Company, three house building companies, and Valinda Engineering Company.

On this record we find reasonable for rate-making purposes an allowance of \$32,000 for the combined executive salaries of C. A. Garnier and C. H. Deitz.

With respect to Account 793, Property Insurance, the staff's estimate for 1961 is \$4,000, while that of the applicant is \$9,300. These estimated amounts compare with \$4,905 for 1958, \$3,621 for 1959 and \$9,323 for 1960. The staff allowed for rate-making purposes what it considered to be a reasonable amount on a judgment basis, giving consideration to amounts charged by other water utilities, the type of insurance coverage and the insurance on property of others. Valinda Insurance Company, owned 40 percent by Camille A. Garnier and 60 percent by other interests, carries the insurance policies on Suburban's risks.

The record reveals that applicant recently had increased its insurance coverage on the basis of a complete analysis and review of its requirements. We adopt applicant's amount as reasonable for this item.

For Account 797, Regulatory Commission Expense, applicant's estimate for 1961 of \$25,000 compares with the staff's estimate of \$11,000. Applicant's figure is composed of some \$12,000 of prior rate case expense for Whittier District, \$10,000 representing one third of the estimated expense for the instant proceeding, and \$3,000 of miscellaneous expenses. The staff's allowance is composed of \$8,000 representing one third of its estimated expense for the instant proceeding and \$3,000 of miscellaneous expenses. On this record we adopt \$13,000 as reasonable for this item.

Accordingly, we find reasonable for rate-making purposes an amount of \$314,600 for administrative and general expenses under present rates.

Miscellaneous Expense

The difference of \$12,000 between applicant's estimate and the staff's estimate lies in the amount of administrative expenses

estimated to be transferred to construction costs. We find the staff's estimate for miscellaneous expense reasonable for rate-making purposes. We further find the staff's adjustment of \$3,000 to maintenance expense for purchases from associated companies is reasonable.

Depreciation and Amortization Expense

The staff's estimate for depreciation and amortization expense is \$31,106 lower than applicant's estimate. Some \$23,000 of this difference resulted from the staff's rate-making adjustments for transactions with associated companies and the remaining difference of \$8,106 resulted from the staff's use of a remaining life of 29 years for services compared with 25.5 years used by applicant. It appears that the difference in remaining life computation resulted from the staff's use of an Iowa R-1.5 curve applied to statistical data compared with applicant's use of an Iowa R-2 curve. On this record we find that a remaining life of 29 years for services as computed by the staff is reasonable. The adjustments for transactions with associated companies are discussed above under the subject of rate base.

On this record we find \$321,000 reasonable for depreciation and amortization expense for the test year 1961.

Taxes Other Than On Income

Except for staff's adjustment of \$13,000 for transactions with associated companies, there is no significant difference in the estimates for the item of taxes other than on income. We find the staff's estimate of \$217,000 reasonable for rate-making purposes.

Taxes On Income

The significant difference between the estimates of income taxes presented by applicant and the staff results from a difference in the respective estimates for expenses as heretofore indicated.

Applicant indicated that it had not in the past nor does it intend in the future to claim liberalized depreciation. After giving effect to the revenues and expenses adopted herein, we compute and adopt an income tax amount of \$175,400 for purposes of this decision for test year 1961 at applicant's present rate levels. Such computation reflects a 5.5 percent state income tax rate and a 52 percent federal income tax rate.

To Summarize: The Commission hereby finds total operating expenses and taxes of \$1,281,500 at present rates to be reasonable for rate-making purposes in the test year 1961.

Rate of Return

Suburban seeks a 7 percent rate of return on its claimed 1961 depreciated rate base of \$12,536,703. A witness for Suburban asserted, however, that there was an indicated decline in rate of return so that the average rate of return over the next three years would not exceed 6.6 percent assuming the requested rates were in effect during such period.

Suburban computed its capital structure at December 31, 1960 (Exhibit 4) and estimated such structure at December 31, 1961 (Exhibit 5) as follows:

Item	Amount Outstanding			
	December 31, 1960		Company Estimated December 31, 1961	
	Amount	Percent	Amount	Percent
Bonds	\$ 6,622,000	55.9%	\$ 7,077,000	53.8%
Notes	63,931	.5	51,145	.4
Preferred Stock	3,638,379	30.4	4,058,379	30.9
Common Equity	1,571,282	13.2	1,956,953	14.9
Total	11,955,592	100.0	13,143,477	100.0

The amount of common equity computed by Suburban included the following items:

	December 31, 1960	Company Estimated December 31, 1961
Common Stock	\$ 433,550	\$ 723,550
Earned Surplus	582,932	598,609
Capital Surplus	999,505	1,079,505
Less Water Rights and Other Intangibles	(444,711)	(444,711)
Total Common Equity	1,571,282	1,956,953

Based upon Exhibits 4 and 5, Suburban computed the average cost of bonds, notes and preferred stock at 4.79 percent as of December 31, 1960 and 4.85 percent as of December 31, 1961. Under these assumptions, Suburban's requested rate of return of 7 percent on its depreciated rate base would produce an earning on Suburban's claimed common equity of about 19.9 percent as of December 31, 1960 and about 17.5 percent as of December 31, 1961.

Applicant's witness urged that it was necessary for Suburban to earn between 14 and 18 percent on the claimed common equity, but he produced no proof to support such conclusion other than to state, "This matter has been discussed with persons from the brokerage houses in Los Angeles and a return of 14 percent on common equity is considered to be necessary in order to sell common stock." (Tr.296.)

The Commission staff, in Exhibit 12, showed that applicant has financed its properties with first mortgage bonds, main extension contracts (with subsequent conversion to Series B 3% and Series A 5½% preferred stock in many instances), sale of Series A preferred for cash, exchange of Series A preferred for shares of mutual water companies, short-term borrowings preliminary to permanent financing, and with retained earnings. Based upon its analysis, the staff developed applicant's capitalization at December 31, 1960, as follows:

<u>Item</u>	<u>Amount</u>	<u>Percent</u>
Long-term debt	\$ 6,745,931	58%
Preferred stock	3,638,379	31
Common stock equity	1,272,543	11
Total capitalization	11,656,853	100

The staff's amount for common stock equity includes \$433,550 for common stock, \$492,389 for earned surplus and \$346,604 for capital surplus, after adjustment for certain items detailed in

Exhibit 10. The staff, in Exhibit 12, computed 4.80 percent as the effective composite cost of long-term debt and preferred stock for Suburban as of December 31, 1960.

The staff further indicated in Exhibit 12 that 12 water utilities with revenues in the range of from \$2,000,000 to \$20,000,000 for the year 1960 realized returns on total capitalization ranging from 4.7 to 6.8 percent and returns on common equity ranging from 5.5 to 12.7 percent. There is an indication of a declining trend in rate of return. Under all of the circumstances set forth in the record, we find that a rate of return of 6.2 percent based on the test period 1961 is sufficient to allow applicant a rate of return for the future of at least 6.0 percent, which rate of return we hereby find to be fair and reasonable.

The aforesaid rate of return will be sufficient to service all of applicant's outstanding senior securities and, in view of the relatively small proportion of equity in total capitalization, can reasonably be expected to provide an adequate return on equity. Return on equity in this case, as in other cases, of course is not the only factor in determining a fair rate of return. The other factors important in such a determination have elsewhere been stated numerous times. Suffice it to say that they have been considered in the determination herein.

Authorized Revenue Increase

Applying a rate of return of 6.2 percent to the test year rate base of \$10,410,000 found to be reasonable, indicates a need for approximately \$645,400 in net revenues, or \$26,900 more than the net revenues produced at present rate levels. We find an increase in gross revenues of \$60,500 is required to produce such results.

Spread of Rates

While applicant seeks authority to establish two rate zones to replace the present seven rate schedules applicable on its system and to change the blocking of its quantity charges we do not

find on this record that such changes are in the public interest. The rates authorized herein retain the present seven rate schedules and blocking and provide for more uniform increases in the several areas for quantities of water used than proposed by applicant. They are designed to increase gross revenues \$60,500 based on test year 1961 conditions.

Applicant will be required to file copies of contracts or agreements pertaining to public utility services rendered to Southwest Water Company, La Puente Co-op, Valencia Water Company and South Covina Water Service, which are furnished at rates or under conditions other than those contained in Suburban's filed tariffs, in conformity with the provisions of Section X.A. of General Order No. 96-A.

A comparison of present, requested and authorized charges for water service, based on a monthly usage of 2,000 cubic feet, follows:

	Charge per Month for 2,000 Cu.Ft. of Water		
	<u>Present</u>	<u>Re- quested</u>	<u>Author- ized</u>
LaPuente - South Covina	\$3.30	\$5.51	\$3.45
West Covina	4.00	5.51	4.10
Glendora	4.30	5.51	4.40
Rivera	4.30	5.51	4.45
Whittier, except 600 ft. Pressure Zone	4.82	5.51	4.92
Covina Knolls	5.00	6.51	5.10
Eighlands	5.00	6.51	5.00
Whittier, 600 ft. Pressure Zone	4.82	6.51	4.92

In the considered judgment of the Commission, the increases in rates to be authorized by the order herein will provide such additional gross revenues as should enable applicant to meet its reasonable expenses of operation and afford it the opportunity to earn a fair and just return on its depreciated rate base hereinbefore found reasonable.

After considering all factors pertinent to this proceeding, it is our finding and conclusion that an order should be issued authorizing increases in rates in the over-all amount of \$60,500 in the manner hereinbefore outlined, and to the extent set forth in Appendix A following the order herein. Accordingly, we find that the increases in rates and charges authorized herein are justified, that the rates and charges authorized herein are reasonable, and that the present rates and charges insofar as they differ from those herein prescribed, are for the future unjust and unreasonable.

O R D E R

Based on the evidence and the findings thereon as hereinabove set forth,

IT IS ORDERED as follows:

1.a. Suburban Water Systems is authorized to file with this Commission, after the effective date of this order and in conformity with General Order No. 96-A, the schedules of rates attached to this order as Appendix A and, upon not less than five days' notice to the Commission and to the public, to make such rates effective for service rendered on and after October 10, 1962.

b. Concurrently with the filing authorized herein, Suburban Water Systems is authorized and directed to withdraw and cancel, by appropriate advice letter, its presently effective rate Schedule No. RI-2, Rivera Tariff Area, General Flat Rate Service.

2.a. Within sixty days after the effective date of this order, Suburban Water Systems shall file with this Commission in conformity with General Order No. 96-A, copies of contracts or agreements pertaining to public utility services rendered to Southwest Water

Company, La Puente Co-op, Valencia Water Company and South Covina Water Service, which are furnished at rates or under conditions other than those contained in Suburban's filed tariffs.

b. Within one hundred eighty days after the effective date of this order, Suburban Water Systems shall file with this Commission, in conformity with General Order No. 96-A, the summary required by that general order, listing all contracts and deviations, including the contracts or agreements in Paragraph 2.a. Such summary shall become effective upon five days' notice to the Commission and to the public after filing as hereinabove provided.

3. Request of Suburban Water Systems to include in its utility plant accounts an amount for water rights at an estimated current appraised value of \$4,125,000 is denied. Suburban Water Systems forthwith shall eliminate such estimated current appraised value from its books of account and comply fully with the requirements of the applicable uniform systems of accounts with respect thereto. Within thirty days after the effective date of this order, Suburban Water Systems shall file a written report with this Commission setting forth a copy of the journal entries made in its books of account to fully comply with this portion of the order herein.

4. Suburban Water Systems forthwith shall make appropriate journal entries in its books of accounts so that unpaid balances of subdivider's refund contracts, which have been terminated through the issue of preferred stock, shall be credited to Account 265, Contributions in Aid of Construction, instead of to Account 270, Capital Surplus. Transactions of a similar nature for the future shall be credited to Account 265, Contributions in Aid of Construction. Within thirty days after the effective date of this order, Suburban Water Systems shall file a written report with this

Commission setting forth a copy of the journal entries made in its books of accounts to fully comply with this portion of the order herein.

5. Within sixty days after the effective date of this order, Suburban Water Systems shall file a written report with this Commission setting forth fully the steps it has taken to remedy deficiencies in the recordation of cash and the steps it has taken to comply fully with the requirements of General Instruction 8, Transactions with Associated Companies, as contained in the Uniform System of Accounts for Class A Water Utilities, and with the requirements of ordering paragraph 9 of Decision No. 46782 issued February 19, 1952.

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

Dated at San Francisco, California, this 14th day of SEPTEMBER, 1962.

George E. Grover
President
Fredrick B. Haloboff

Commissioners

Commissioner Peter E. Mitchell, being necessarily absent, did not participate in the disposition of this proceeding.

Commissioner Everett C. McKeage, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A
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Schedule No. PU-1

Puente-South Covina Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Portions of West Covina, Puente, and vicinity, Los Angeles County. (T)

RATES

	<u>Per Meter</u> <u>Per Month</u>	
Quantity Rates:		
First 1,000 cu.ft. or less	\$ 1.95	(I)
Next 2,000 cu.ft., per 100 cu.ft. ....	.15	(I)
Next 7,000 cu.ft., per 100 cu.ft. ....	.12	
Over 10,000 cu.ft., per 100 cu.ft. ....	.09	
Minimum Charge:		
For 5/8 x 3/4-inch meter	\$ 1.95	(I)
For 3/4-inch meter	2.70	|
For 1-inch meter	4.75	|
For 1 1/2-inch meter	8.50	|
For 2-inch meter	13.00	(I)
For 3-inch meter	25.00	
For 4-inch meter	40.00	
For 6-inch meter	80.00	(I)

The Minimum Charge will entitle the customer to the quantity of water which that minimum charge will purchase at the Quantity Rates. (T)

(T)

APPENDIX A
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Schedule No. PU-9CM

Fuente-South Covina Tariff Area

METERED CONSTRUCTION AND TANK TRUCK SERVICE

APPLICABILITY

Applicable to all measured water service furnished for street paving, grading and trench flooding and for delivery to tank trucks. (T)
(T)

TERRITORY

Portions of West Covina, Puente, and vicinity, Los Angeles County. (T)

RATES

	<u>Per Meter</u> <u>Per Month</u>	
Quantity Rates:		
First 1,000 cu.ft. or less	\$ 1.95	(I)
Next 2,000 cu.ft., per 100 cu.ft. ....	.15	(I)
Next 7,000 cu.ft., per 100 cu.ft. ....	.12	
Over 10,000 cu.ft., per 100 cu.ft. ....	.09	
Minimum Charge:		
For 5/8 x 3/4-inch meter	\$ 1.95	(I)
For 3/4-inch meter	2.70	|
For 1-inch meter	4.75	|
For 1 1/2-inch meter	8.50	|
For 2-inch meter	13.00	(I)

The Minimum Charge will entitle the customer to the quantity of water which that minimum charge will purchase at the Quantity Rates. (N)
(N)

(D)

APPENDIX A
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Schedule No. WC-1

West Covina Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Portions of West Covina and vicinity, Los Angeles County. (T)

RATES

	<u>Per Meter</u> <u>Per Month</u>	
Quantity Rates:		
First 1,000 cu.ft. or less	\$ 2.50	
Next 2,000 cu.ft., per 100 cu.ft. ....	.16	(I)
Next 2,000 cu.ft., per 100 cu.ft. ....	.13	
Over 5,000 cu.ft., per 100 cu.ft. ....	.12	
Minimum Charge:		
For 5/8 x 3/4-inch meter	\$ 2.50	
For 3/4-inch meter	3.10	(I)
For 1-inch meter	5.50	|
For 1 1/2-inch meter	10.00	|
For 2-inch meter	14.00	(I)
For 3-inch meter	25.00	
For 4-inch meter	40.00	
For 6-inch meter	80.00	

The Minimum Charge will entitle the customer to the quantity of water which that minimum charge will purchase at the Quantity Rates. (T)
(T)

APPENDIX A
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Schedule No. WC-9CM

West Covina Tariff Area

METERED CONSTRUCTION AND TANK TRUCK SERVICE (T)

APPLICABILITY

Applicable to all measured water service furnished for street paving, grading and trench flooding and for delivery to tank trucks. (T)
(T)

TERRITORY

Portions of West Covina and vicinity, Los Angeles County. (T)

RATES

	<u>Per Meter</u> <u>Per Month</u>	
Quantity Rates:		
First 1,000 cu.ft. or less	\$ 2.50	
Next 2,000 cu.ft., per 100 cu.ft. ....	.16	(I)
Next 2,000 cu.ft., per 100 cu.ft. ....	.13	
Over 5,000 cu.ft., per 100 cu.ft. ....	.12	
Minimum Charge:		
For 5/8 x 3/4-inch meter	\$ 2.50	
For 3/4-inch meter	3.10	(I)
For 1-inch meter	5.50	|
For 1 1/2-inch meter	10.00	|
For 2-inch meter	14.00	(I)

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

(D)

APPENDIX A
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Schedule No. GL-1
Glendora Tariff Area
GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Portions of Glendora and Covina and vicinity, Los Angeles County.(T)

RATES

	<u>Per Meter</u> <u>Per Month</u>	
Quantity Rates:		
First 1,000 cu.ft. or less	\$ 2.50	
Next 2,000 cu.ft., per 100 cu.ft. ....	.19	(T)
Next 2,000 cu.ft., per 100 cu.ft. ....	.16	(T)
Over 5,000 cu.ft., per 100 cu.ft. ....	.12	
Minimum Charge:		
For 5/8 x 3/4-inch meter	\$ 2.50	
For 3/4-inch meter	3.60	(T)
For 1-inch meter	6.00	(T)
For 1 1/2-inch meter	11.00	(T)
For 2-inch meter	15.00	(T)
For 3-inch meter	25.00	
For 4-inch meter	40.00	
For 6-inch meter	80.00	

The Minimum Charge will entitle the customer to the quantity of water which that minimum charge will purchase at the Quantity Rates. (T)
(T)

APPENDIX A
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Schedule No. GL-9CM

Glendora Tariff Area

METERED CONSTRUCTION AND TANK TRUCK SERVICE

(T)

APPLICABILITY

Applicable to all measured water service furnished for street paving, grading and trench flooding and for delivery to tank trucks. (T)

TERRITORY

Portions of Glendora and Covina and vicinity, Los Angeles County. (T)

RATES

Per Meter
Per Month

Quantity Rates:

First 1,000 cu.ft. or less	\$ 2.50	
Next 2,000 cu.ft., per 100 cu.ft. ....	.19	(I)
Next 2,000 cu.ft., per 100 cu.ft. ....	.16	(I)
Over 5,000 cu.ft., per 100 cu.ft. ....	.12	

Minimum Charge:

For 5/8 x 3/4-inch meter	\$ 2.50	
For 3/4-inch meter	3.60	(I)
For 1-inch meter	5.00	|
For 1 1/2-inch meter	11.00	
For 2-inch meter	15.00	(I)

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

(D)

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Schedule No. CK-1

Covina Knolls Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

The area known as Tract No. 18310, located north of Garvey Boulevard and north of Covina Hills Road $\frac{1}{2}$ mile east of West Covina, Los Angeles County.

(T)
|
(T)

RATES

Quantity Rates:	<u>Per Meter</u> <u>Per Month</u>	
First 1,000 cu.ft. or less	\$ 3.00	
Next 4,000 cu.ft., per 100 cu.ft. ....	.21	(T)
Next 10,000 cu.ft., per 100 cu.ft. ....	.16	|
Over 15,000 cu.ft., per 100 cu.ft. ....	.13	(T)

Minimum Charge:

For 3/4-inch meter	\$ 3.00	
For 1-inch meter	5.00	
For 1 1/2-inch meter	8.00	(T)
For 2-inch meter	15.00	
For 3-inch meter	25.00	
For 4-inch meter	40.00	
For 6-inch meter	80.00	(T)

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

(T)
(T)

APPENDIX A
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Schedule No. CK-9CM

Covina Knolls Tariff Area

METERED CONSTRUCTION AND TANK TRUCK SERVICE (T)

APPLICABILITY

Applicable to all measured water service furnished for street paving, grading and trench flooding and for delivery to tank trucks. (T)
(T)

TERRITORY

The area known as Tract No. 18310, located north of Garvey Boulevard and north of Covina Hills Road, 1/2 mile east of West Covina, Los Angeles County. (T)
|
(T)

RATES

Quantity Rates:	<u>Per Meter</u> <u>Per Month</u>	
First 1,000 cu. ft. or less	\$ 3.00	
Next 4,000 cu. ft., per 100 cu. ft. ....	.21	(T)
Next 10,000 cu. ft., per 100 cu. ft. ....	.16	|
Over 15,000 cu. ft., per 100 cu. ft. ....	.13	(T)

Minimum Charge:

For 3/4-inch meter	\$ 3.00	
For 1-inch meter	5.00	
For 1 1/2-inch meter	8.00	(I)
For 2-inch meter	15.00	

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

(D)

Schedule No. HI-1

Highlands Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Portions of West Covina and vicinity, Los Angeles County.

(T)

RATES

Quantity Rates:	<u>Per Meter</u> <u>Per Month</u>	
First 3,000 cu. ft. or less	\$ 5.00	
Next 1,000 cu. ft., per 100 cu. ft. ....	.21	(I)
Next 1,000 cu. ft., per 100 cu. ft. ....	.16	|
Over 5,000 cu. ft., per 100 cu. ft. ....	.13	(I)
 Minimum Charge:		
For 3/4-inch meter	\$ 5.00	
For 1-inch meter	8.00	(I)
For 1 1/2-inch meter	13.00	|
For 2-inch meter	20.00	(I)
For 3-inch meter	35.00	
For 4-inch meter	60.00	
For 6-inch meter	125.00	

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

(T)

(D)

Schedule No. HI-9CM

Highlands Tariff Area

METERED CONSTRUCTION AND TANK TRUCK SERVICE

(T)

APPLICABILITY

Applicable to all measured water service furnished for street paving, grading and trench flooding and for delivery to tank trucks.

(T)
(T)

TERRITORY

Portions of West Covina and vicinity, Los Angeles County.

(T)

RATES

Per Meter
Per Month

Quantity Rates:

First 3,000 cu. ft. or less	\$ 5.00	(I) ✓
Next 1,000 cu. ft., per 100 cu. ft. ....	.21	|
Next 1,000 cu. ft., per 100 cu. ft. ....	.16	|
Over 5,000 cu. ft., per 100 cu. ft. ....	.13	(I)

Minimum Charge:

For 3/4-inch meter	\$ 5.00	(N) ✓
For 1-inch meter	8.00	(I)
For 1 1/2-inch meter	13.00	|
For 2-inch meter	20.00	(I)

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

(D)

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Schedule No. WH-1

Whittier Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Near Whittier, Los Angeles County.

(T)

RATES

	<u>Per Meter</u> <u>Per Month</u>	
Quantity Rates:		
First 800 cu. ft. or less	\$ 2.40	(I)
Next 1,200 cu. ft., per 100 cu. ft. ....	.21	
Next 3,000 cu. ft., per 100 cu. ft. ....	.17	
Next 15,000 cu. ft., per 100 cu. ft. ....	.14	
Over 20,000 cu. ft., per 100 cu. ft. ....	.11	
Minimum Charge:		
For 5/8 x 3/4-inch meter	\$ 2.40	(I)
For 3/4-inch meter	3.60	|
For 1-inch meter	5.50	|
For 1 1/2-inch meter	10.00	(I)
For 2-inch meter	15.00	
For 3-inch meter	35.00	
For 4-inch meter	60.00	
For 6-inch meter	125.00	

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

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Schedule No. RI-1

Rivera Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Rivera and vicinity, Los Angeles County.

(T)

RATES

Quantity Rates:	<u>Per Meter</u> <u>Per Month</u>	
First 600 cu. ft. or less	\$ 1.65	(I)
Next 2,400 cu. ft., per 100 cu. ft. ....	.20	
Over 3,000 cu. ft., per 100 cu. ft. ....	.12	
 Minimum Charge:		
For 5/8 x 3/4-inch meter	\$ 1.65	(I)
For 3/4-inch meter	2.50	
For 1-inch meter	4.00	
For 1 1/2-inch meter	8.00	
For 2-inch meter	11.00	
For 3-inch meter	25.00	
For 4-inch meter	40.00	(I)
For 6-inch meter	100.00	

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

APPENDIX A
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Schedule No. RI-9CM

Rivera Tariff Area

METERED CONSTRUCTION AND TANK TRUCK SERVICE

(T)

APPLICABILITY

Applicable to all measured water service furnished for street paving, grading and trench flooding and for delivery to tank trucks.

(T)
(T)

TERRITORY

Rivera and vicinity, Los Angeles County.

(T)

RATES

	<u>Per Meter</u> <u>Per Month</u>	
Quantity Rates:		
First 600 cu.ft. or less	\$ 1.65	(I)
Next 2,400 cu.ft., per 100 cu.ft. ....	.20	
Over 3,000 cu.ft., per 100 cu.ft. ....	.12	
Minimum Charge:		
For 5/8 x 3/4-inch meter	\$ 1.65	(I)
For 3/4-inch meter	2.50	|
For 1-inch meter	4.00	|
For 1 1/2-inch meter	8.00	|
For 2-inch meter	11.00	(I)

(D)

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

(D)

I concur in the major portions of this decision including the rate of return. I specifically concur in the order and in the finding that the increase in rates and charges authorized in the decision is justified, but I dissent to the manner in which the majority treats business transacted by the applicant with its non-utility affiliates. I do not approve of the multiple affiliates with which applicant has surrounded itself; but bad practices on the part of one utility should not prompt this Commission to meet the problem thus generated with a formula equally as bad.

In my opinion, there is raised a fundamental issue that goes far beyond the instant proceedings, and which might in future be used as a precedent in decisions of cases in no way comparable to the present one. It is on this fundamental issue that my dissent is based.

This fundamental issue can be stated briefly as whether the Commission has the power to regulate, either directly or indirectly, the profits of a nonutility affiliate of any utility under its jurisdiction.

There is no statute, insofar as I have been able to ascertain, which confers such authority upon the Commission. In my opinion, the earnings of such nonutility affiliates are no concern of this Commission either in a legal or a moral sense.

This Commission is concerned with, and charged with, the responsibility by law of making reasonably certain that prices paid for services and/or materials by a utility under Commission jurisdiction are the lowest prices possible under the circumstances and at the times such services and materials are purchased. This concern and responsibility exist whether a utility buys from a nonutility affiliate or from independent sources. As a general rule, prices paid by a utility to independent businesses at arm's length dealing or as a result of sealed competitive bids are assumed to be reasonable. But, I submit, there is a vast difference between ascertaining reasonable prices and determining what profits a nonregulated business may earn.

When a utility purchases services and/or supplies from a nonutility affiliate, the proper and legal test for reasonableness should be whether such prices were as low, or lower, than the utility would have been required to pay an independent supplier and/or contractor at arm's length dealing, or as a result of competitive sealed bids, or prices for which the utility could have purchased the materials from initial suppliers and have performed the services itself.

The staff in the instant proceeding, however, and the Commission majority assumes the power, "for rate-making purposes", to determine what profits applicant's nonutility affiliates are permitted to make. This assumption of authority by the majority is stated concisely in one of the three decisions cited by it^{1/} (page 7 of the mimeographed copy, Decision 59646) as follows:

"The Commission recognizes that these affiliates are entitled to include in such prices (to the utility) a reasonable margin of profit. However, the Commission will necessarily sedulously scrutinize the relations between a utility and its affiliates where the affiliate renders services or sells articles to the utility, in order to determine whether or not the profits inuring to the affiliate in such transactions are reasonable and, among other tests, commensurate with those which would result from strictly arm's length dealing between the utility and a nonaffiliate." (Emphasis added)

It must be noted that this dictum of the Commission majority deals with the profits inuring to the affiliate rather than with the issue of whether prices charged by the affiliates were fair and reasonable.

It must be noted also that, in the decisions cited, the Commission did not permit the affiliated companies a "reasonable margin of profit" as determined by the profits of comparable nonutility concerns, but arbitrarily fixed those profits at a rate

^{1/} It must be noted that I did not participate in any of the three decisions cited.

equal to, or approximately equal to, the rate of return allowed the utility on its property devoted to the public service.


I am fully cognizant of the fact that the utility in question petitioned the Supreme Court of the State of California for a writ of review of two of the decisions cited by the majority in this instance (Decisions No. 59631 and 59646) and that the Court denied said petition.

A review of the record discloses that, in my opinion, the denial of the Supreme Court was based upon the fact that this respondent in those cases had excessively delegated its normal functions to a multitude of interlocking corporations; that the resultant prices charged the utility were excessive, and that a consolidation of their multiple functions was in order.

This should not be construed as the Court's conferring upon this Commission blanket authority to regulate the profits of an affiliate, either directly or indirectly, where a contract is bona fide entered into pursuant to the proper exercise of managerial discretion, or where costs to a utility would not exceed cost for comparable materials and/or services procured at arm's length dealing.

As I have stated above, there is no statute, that I have been able to unearth, which gives this Commission such power over a nonregulated business. As a matter of fact, this assumed regulation of the profits of nonutility affiliates on business transacted with the utility is no guarantee that prices paid by the utility are, in fact, fair or reasonable. It is entirely possible, through mismanagement, that a nonutility affiliate might make a narrow profit or even lose money on a transaction with a utility while at the same time charging more for the services and materials than the utility could have obtained the same services and materials elsewhere at arm's length dealing.

By the same token, a nonaffiliated supplier or contractor, through "under the table dealings" could overcharge a utility while appearing to deal with it at arm's length. I submit that the only proper and legal method available to this Commission in such circumstances is to ascertain the fairness and reasonableness of prices paid by a utility, irrespective of the affiliation or nonaffiliation with the supplier and/or contractor. Since the burden of proof is always upon the utility, such a determination can be made readily by the technical staff of the Commission through legal channels always open to it. Thus the assumption of authority to regulate profits of nonutility affiliates, in my opinion, is not only an arbitrary and bureaucratic usurpation of power, but is faulty and unnecessary as well.


C. LYN FOX
Commissioner

San Francisco, California
September 14, 1962