

ORIGINALDecision No. 67225

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of COWAN HEIGHTS WATER COMPANY,)
for an order authorizing a raise)
in rates and for an order)
authorizing issuance of stock.)

Application No. 45706
(Filed August 23, 1963)

Milford W. Dahl, for applicant.

Raymond E. Hevtens and C. O. Newman, for the
Commission staff.

O P I N I O N

Applicant, Cowan Heights Water Company, a corporation, seeks authority to increase its rates for water service and to issue securities.

This application was heard before Examiner Catey at Los Angeles on February 20 and 21, 1964, and was submitted on March 13, 1964, the date of receipt of late-filed Exhibit No. 6. Copies of the application and notice of hearing had been served in accordance with this Commission's rules of procedure. Testimony on behalf of applicant was presented by its president, its secretary-manager and an accountant; the Commission staff presentation was made by two accountants and an engineer. There were no protestants.

Service Area and Water System

Applicant's original service area, known as the Cowan Ranch, consisted of some 200 acres in Orange County which were to be subdivided into about 200 lots. That area, located about four miles northeast of Santa Ana, was certificated to applicant in 1959. Additional areas were included in 1960, 1962 and 1963, making

a total certificated area of 1,200 acres, ranging in elevation from 280 to 900 feet above sea level, divided into four pressure zones, and having an estimated ultimate development of 1,600 customers. Exhibit No. 1, a map, shows that less than half of the total area is under development. Applicant's secretary-manager testified that, even within the developed areas, only about 360 customers are being served.

Applicant now purchases all of its water from Seven Hills Mutual Water Company (Seven Hills). Applicant owns 98 percent of the stock of Seven Hills, which in turn owns stock in three other mutuals from which Seven Hills purchases the water which it stores, transmits and delivers to applicant. The rather complex relationships between applicant and the mutuals are described in the Commission staff's Exhibit No. 3. To augment the local well supply from the mutuals, applicant has applied for two connections from East Orange County Water District, a constituent agency of Metropolitan Water District of Southern California.

Water from Seven Hills' reservoir is distributed by applicant through its own system by gravity to the lower two zones and by means of booster pumps for the upper two zones. When water is available from the local water district, it will be delivered at a location and pressure which will permit its storage in Seven Hills' reservoir. Because of the relatively low customer density, there are more than 200 feet of distribution mains per active service connection.

Rates

Applicant's present rates were established in its original certificate proceeding in 1959. They provide for general metered service, public fire hydrant service and construction flat rate service.

The following Table I is a comparison of applicant's present general metered service rates, those requested in this application, and those authorized by this decision:

TABLE I

Comparison of Rates

<u>Quantity</u>	<u>Present</u>	<u>Requested</u>	<u>Authorized</u>
First 700 cu.ft. or less	\$2.55	\$5.40	\$4.00
Next 19,300 cu.ft., per 100 cu.ft.	.15	.27	.23
Over 20,000 cu.ft., per 100 cu.ft.	.105	.20	.18

The requested rates also provide for increases in minimum monthly charges for all sizes of meters. No increase is requested in the present charge of \$4 per month per hydrant for public fire hydrant service and, in fact, there is not yet any duly constituted local fire protection district to pay the present rates. Applicant proposes to continue the present \$3 per month for house construction flat rate service and to add a large-volume construction metered service rate of 20 cents per hundred cubic feet. A special rate of 20 cents per hundred cubic feet is also requested for irrigation service. The requested rates would result in an increase of about 87 percent in applicant's annual revenues.

The Commission staff recommended that the rates for general metered service should cover irrigation service and large-volume construction water service. The general metered service schedule authorized herein is designed to establish equitable charges for irrigation and construction service.

Customer Complaints and Service Improvements

The Commission staff investigation indicates that applicant provides satisfactory service. Exhibit No. 3 shows that there has been only one informal complaint received by the Commission relating to this company since 1959. In order to maintain pressure

in an upper zone of the system within the requirements of General Order No. 103, applicant recently installed approximately 4,000 feet of 8-inch connecting main between two portions of the distribution system.

Results of Operations

Applicant's accountant and the Commission staff have each analyzed and estimated applicant's operational results. Summarized in Table II, from Exhibit No. 3 presented by the staff and from Schedules 2 and 3 of Exhibit "C" attached to the application, modified by the oral testimony of applicant's accountant, are the estimated results of operations for the year 1964 under present rates and under those proposed by applicant. For comparison, Table III shows the results of operations adopted herein under present rates, under applicant's proposed rates and under the rates authorized herein, as discussed in more detail in subsequent paragraphs.

TABLE II

Results of Operations
Year 1964 - Estimated

<u>Item</u>	<u>Results at</u>	<u>Results at</u>	
	<u>Present Rates*</u>	<u>Proposed Rates:</u>	
	<u>Staff</u>	<u>Staff</u>	<u>Applicant</u>
Operating Revenues	\$47,960	\$85,290	\$78,230
Deductions:			
Operating Expenses	47,770	47,770	55,520
Taxes (Excl. Income Taxes)	1,580	1,580	3,410
Income Taxes	100	6,840	870
Depreciation	<u>8,130</u>	<u>8,130</u>	<u>9,110</u>
Total Deductions	\$57,580	\$64,320	\$68,910
Net Revenue	\$(9,620)	\$20,970	\$ 9,320
Rate Base	\$188,300	\$188,300	\$197,290
Rate of Return	-	11.1%	4.7%

* 1964 results under present rates not estimated by applicant.
(Red Figure)

TABLE III
Results of Operations
Year 1964 - Adopted

<u>Item</u>	<u>Results at Various Rates</u>		
	<u>Present</u>	<u>Proposed</u>	<u>Authorized</u>
Operating Revenues	\$45,600	\$85,300	\$70,300
Deductions:			
Operating Expenses	55,700	55,700	55,700
Taxes (Excl. Income Taxes)	1,600	1,600	1,600
Income Taxes	100	2,800	200
Depreciation	<u>8,100</u>	<u>8,100</u>	<u>8,100</u>
Total Deductions	\$65,500	\$68,200	\$65,600
Net Revenue	\$(19,900)	\$17,100	\$ 4,700
Rate Base	\$188,000	\$188,000	\$188,000
Rate of Return	-	9%	2½%

(Red Figure)

Operating Revenues

The principal difference between the 1964 revenue estimates of the staff and applicant under proposed rates results from the difference in projected average number of customers. The staff estimates of revenues under proposed rates appear reasonable and are adopted. Under present rates, however, applicant did not present any estimates for 1964 and the staff estimates appear inconsistent with the percentage increase shown by the exhibits of both applicant and staff. This inconsistency has been corrected in the revenues adopted in Table III.

Operating Expenses

Detailed analyses of many of applicant's operating expenses are not available in the record because a large proportion of such expenses are paid to mutual water companies in which applicant is a major stockholder. Other expenses are paid by Cowan Ranch, apparently owned or controlled by an officer of applicant, and

the accumulated charges reimbursed long after they are incurred. An example of the difficulties this creates is applicant's stated position in this proceeding that the price applicant is required to pay for water by Seven Hills should be controlling and that the price which the mutual paid for the water is immaterial and does not enter into the picture. Another example is the year-end closing charges by Cowan Ranch, which might well have justified somewhat higher staff estimates of expense of pumping, transmission and distribution, and customer accounting, had the charges been accrued on a current basis during the period reviewed by the staff.

In the absence of detailed analyses of expenses incurred by the mutuals, and in view of the rate of \$42 per acre foot charged for imported water by East Orange County Water District, the staff concluded that the \$55 charge per acre foot for local water purchased from the mutuals is excessive. The staff assumed that the high rate was due to inclusion by the mutuals of capital charges in operating expense but the record indicates that such charges were not significant. A more likely cause of the high rate is disclosed by the testimony of applicant's secretary-manager relating to certain expenses incurred by the mutuals which would remain relatively unchanged even if no water were sold. Conversely, when the area is more fully developed, the unit cost of the water would necessarily be lower.

It is evident that applicant will need both local and imported water for its ultimate development. Applicant estimates that it can obtain 60 percent of its 1964 requirements from the water district and purchase the remainder from the mutuals at \$55.05 per acre foot. The staff estimates of expenses based upon assuming

a cost of \$42 per acre foot for all water purchased are increased by \$3,900 in the expenses adopted in Table III, to reflect a weighted average cost of water of approximately \$48 per acre foot. This also recognizes the \$1 increase in cost of imported water to become effective on July 1, 1964. Applicant is hereby placed on notice that in any future rate proceeding it will be required to present detailed analyses of the expenses incurred by the mutuals and considered by them in establishing their rates for water purchased by applicant.

In view of the testimony of applicant's accountant relative to year-end closing charges by Cowan Ranch, Table III includes applicant's estimated expenses for power, transmission and distribution, and customer accounting. The staff estimates of water treatment expense and administrative and general expenses are adopted as reasonable.

Taxes and Depreciation

The staff estimates of ad valorem taxes are based upon the latest known tax rates and assessment ratios, whereas applicant's estimates are based upon similar data for the previous year. The staff estimates of taxes other than on income are adopted in Table III.

Both the staff and applicant used the 1963 income tax rates. Since their estimates were prepared, there have been reductions in those rates for 1964 and 1965, of which this Commission takes official notice. The 1965 level of income tax rates is considered in the income taxes shown in Table III.

A detailed derivation of the staff's depreciation accrual estimates is shown in Exhibit No. 3. Those estimates are reflected in Table III.

Rate Base

The staff rate base estimate is about \$9,000 lower than that of applicant. Applicant's estimate included \$10,000 for a connection to the East Orange County Water District feeder main but there is conflicting testimony as to whether or not this charge will be levied by the district. The staff rate base estimate, which excludes this connection charge, is adopted as reasonable.

Financial and Rate Requirements

A staff witness on financial and accounting aspects of this proceeding concluded, in his Exhibit No. 5, that the present relatively low percentage of the ultimate number of customers served, together with the sharply rising trend of rate of return indicated in Exhibit No. 3, would justify the allowance of a lower rate of return for the year 1964 than is normally considered reasonable. The rate of return recommended by the staff of 2½ percent on the rate base estimated by it is adopted for the test year 1964, with the expectation that the return will increase as additional customers are served by the system. Such additional customers will reduce the operating expense per customer and will not require proportionate increases in plant investment.

Based upon the estimates of revenues, expenses and rate base adopted herein, an increase of \$24,700, or 54 percent, in annual revenues will provide a 2½ percent return. The rates set forth in Appendix A to the order herein are designed to produce the required \$24,700 increase. At the year-round average consumption of 3,900 cubic feet per customer month indicated in Exhibit No. 3, the present monthly charge would be \$7.35 as compared with \$11.36 under the rates authorized herein.

Applicant requests authority to issue 2,061 shares of its no par value common stock, at a price of \$66.18 per share, to an

affiliated developer, partly in payment of \$59,940 of notes issued in exchange for a water system installed to serve Tracts 3193 and 3338, and partly to obtain \$76,400 in cash for additional capital improvements. Exhibit No. 3 shows that \$66.18 is the book value per share and that the facilities to be acquired are not required to be covered by subdividers' advances. We find that the requested authority should be granted.

Applicant also requests authority to issue promissory notes in the principal amount of \$34,000 to stockholders and other investors. The notes would be payable on or before five years from date of issue, and would provide for interest at the rate of six percent per year, payable annually. The funds thus provided would be used to finance in part the cost of plant additions other than those required to be covered by subdividers' advances. We find that the requested authority should be granted.

Limitation of Expansion

Applicant's present level of main extension advances exceeds 50 percent of net plant, the point above which applicant's main extension rule prohibits further expansion without specific Commission authorization. Properly deducted from advances, however, is the cost of the water system to serve a portion of the initial development, which plant is to be exchanged for the securities authorized herein. Also, staff accountant testified that applicant's stock in mutual water companies can appropriately be considered as intangible plant. After those adjustments, the percentage of net plant covered by outstanding advances will be close to, but less than, the maximum prescribed by the main extension rule. Applicant did not request relief from the provisions of that rule.

Findings and Conclusion

The Commission finds that:

1. Applicant is in need of increased revenues but the rates it proposes are excessive.

2. The adopted estimates, previously summarized and discussed herein, of operating revenues, operating expenses and rate base for the year 1964 are reasonable and represent the results of applicant's operations, and, in view of the present low customer density and the indicated increase in rate of return as the customer density increases, that a rate of return of 2½ percent on said rate base is reasonable for the purposes of this proceeding.

3. The increases in rates and charges authorized herein are justified, the rates and charges authorized herein are reasonable, and the present rates and charges, insofar as they differ from those prescribed herein, are for the future unjust and unreasonable.

4. The initial development, to which in this case applicant's main extension rule shall not apply, includes Tracts 3193 and 3338, Orange County, in addition to the territory considered in previous decisions as being the initial development.

5. The money, property or labor to be procured or paid for by the issuance of the stock and the notes authorized herein is reasonably required for the purposes specified herein and such purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

The Commission concludes that the application should be granted to the extent set forth in the ensuing order.

The authorization given herein to issue securities is not to be construed as a finding as to the value of applicant's stock or properties, nor is it necessarily indicative of amounts to be included in proceedings for the determination of just and reasonable rates.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, applicant Cowan Heights Water Company is authorized to file the revised schedule of rates set forth in Appendix A to this order. Such filing shall comply with General Order No. 96-A. The revised rate schedule shall become effective for service rendered on and after June 15, 1964, or on and after the fourth day following the date of filing, whichever is later.

2. Within sixty days after the effective date of this order, applicant shall file in this proceeding four copies of a comprehensive map drawn to an indicated scale of not more than 400 feet to the inch, delineating by appropriate markings the various tracts of land and territory served; the principal water production, storage, and distribution facilities; and the location of the various water system properties of applicant.

3. After the effective date of this order and on or before December 31, 1964, applicant may issue not to exceed 2,061 shares of its no par value common stock at \$66.18 per share in exchange for cash and in payment of notes, as discussed in the foregoing opinion.

4. After the effective date of this order, and on or before December 31, 1965, applicant may issue notes in the principal amount of not to exceed \$34,000, in the form, under the terms, and for the purpose set forth in the application.

5. Applicant shall file with this Commission a report, or reports, as required by General Order No. 24-A, which order, insofar as applicable, is made a part of this order.

The authority herein granted to issue notes will become effective when applicant has paid the fee prescribed by Section

1904(b) of the Public Utilities Code, which fee is \$34. In all other respects, the effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 19th day of May, 1964.

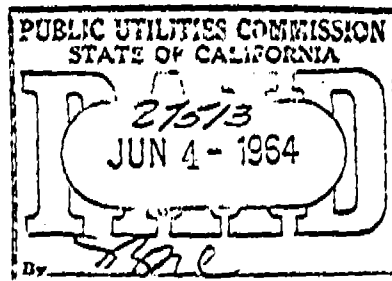
William A. Seemiller
 President

John J. Mitchell

Robert W. Leary

George J. Brown

Fredrick B. Halberoff
 Commissioners



APPENDIX A

Schedule No. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

The areas known as Cowan Ranch, Peacock Hills and vicinity, (T)
 located 2 miles northeast of Tustin, Orange County. (T)

RATES

Quantity Rates:	<u>Per Meter</u> <u>Per Month</u>	
First 700 cu.ft. or less	\$4.00	(I)
Next 19,300 cu.ft., per 100 cu.ft.23	
Over 20,000 cu.ft., per 100 cu.ft.18	
 Minimum Charge:		
For 5/8 x 3/4-inch meter	\$4.00	
For 3/4-inch meter	5.00	
For 1-inch meter	7.00	
For 1 1/2-inch meter	11.00	
For 2-inch meter	17.00	
For 3-inch meter	23.00	
For 4-inch meter	28.00	(I)

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