

ORIGINAL

Decision No. 68706

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application )  
 of CITIZENS UTILITIES COMPANY OF )  
 CALIFORNIA, a corporation, for )  
 authority to increase its rates )  
 and charges for water service to )  
 Boulder Creek, Brookdale, Ben )  
 Lomond and Felton and adjacent )  
 territory in Santa Cruz County. )

Application No. 45164  
 (Filed February 5, 1963).

Bacigalupi, Elkus & Salinger, by William G. Fleckles and Claude N. Rosenberg, for applicant.

Alice Earl Wilder, for San Lorenzo Valley Chamber of Commerce; Edward F. Mullany and J. Elwood Andresen, in propria personae; Anne S. Newlands, for United Property Owners' Association of San Lorenzo Valley; and John E. Lynch, in propria persona and for Messrs. Wilson, Haasfeld, Jones and Morton, interested parties.

Cyril M. Saroyan, Elmer Sjostrom, L. L. Thornd, Milton J. De Barr and Robert W. Beardslee, for the Commission staff.

OPINION ON REHEARING

After five days of public hearing in this proceeding, at which 18 exhibits and the testimony of some 29 witnesses were received, Decision No. 66729, dated January 28, 1964, denied the request of applicant, Citizens Utilities Company of California, for a general rate increase in its Boulder Creek District, but authorized changes in the form of the rates to remove certain inequities.

On February 17, 1964, applicant filed a petition for rehearing in respect to four matters determined in the proceeding.

The four matters are:

1. The appropriate amount of Administrative and General, and Miscellaneous Expenses chargeable to the operations of applicant's Boulder Creek District.
2. The appropriate amount to be included in rate base for a pipeline designated in this proceeding as the "Central Supply Line."
3. The appropriate amount to be included in rate base for facilities designated in this proceeding as "Big Concrete Reservoir."
4. The appropriate rate of return to be allowed on applicant's Boulder Creek District rate base.

There are certain ancillary items to the above four matters, which items properly are within the scope of the rehearing. These are the changes in depreciation, amortization, ad valorem taxes and income taxes, resulting from any changes in the treatment of the four basic issues in the rehearing. An order granting rehearing was issued on July 14, 1964. On October 2, 1964, applicant filed a petition requesting that the scope of the rehearing be broadened to include a re-examination of the appropriate amount to be included in rate base for properties designated in this proceeding as "Fetherston Lands." This request was denied by Decision No. 58154, dated November 2, 1964.

The rehearing was held before Examiner Catey at Boulder Creek on November 23 and 24, 1964. Notice of rehearing had been given to all appearances in the proceeding. At the rehearing, testimony on behalf of applicant was presented by a real estate broker, by the general manager of applicant's water properties, by two consulting engineers and by the officer in charge of accounting

for both applicant and its parent, Citizens Utilities Company, a Delaware corporation. The Commission staff presentation was made by two staff engineers. The matter was submitted at the conclusion of oral argument on the second day of rehearing.

Administrative and General  
and Miscellaneous Expenses

Decision No. 66729 adopted as reasonable an amount of \$23,900 for Administrative and General, and Miscellaneous Expenses chargeable to the Boulder Creek District operations for the test year 1963. In applicant's petition for rehearing, it challenges the adoption of that amount on the grounds that the decision failed to make sufficiently specific findings as to its derivation. Applicant contends that absence of sufficiently detailed findings deprived all interested parties of the opportunity to determine if the amount adopted is supported by the evidence.

The only evidence covering this group of expenses at the initial hearings was presented by applicant and by the Commission staff. More detailed testimony on this subject was presented subsequently by applicant and the staff in Application No. 45625 of one of applicant's affiliates, North Los Altos Water Company. Rather than to repeat this somewhat voluminous testimony, applicant and staff entered into a stipulation on November 23, 1964, that specific pertinent testimony in the North Los Altos proceeding be incorporated by reference in this proceeding.

Decision No. 68443, dated January 12, 1965, in Application No. 45625, sets forth a detailed discussion of the assignment

of direct charges, and allocation of indirect charges from the office of applicant's parent in Stamford to applicant and its affiliates. The staff estimates of the proper level of those expenses for the year 1963 were adopted, with minor modifications, in that decision. The development, in the following Table I, of those expenses chargeable to applicant's Boulder Creek District operations for the test year 1963 is consistent with the findings in the North Los Altos proceeding. We find that the amount of \$23,700 derived in Table I is reasonable.

Decision No. 66729 allowed applicant \$1,400 more than recommended by the Commission staff for annual legal and regulatory commission expense, based upon the fact that the current proceeding had become more complex and protracted than was apparent at the time the staff report had been prepared. Testimony of applicant's accounting officer near the conclusion of the rehearing now shows that the approximately \$4,100 of legal, engineering, and other fees capitalized by applicant as part of the cost of Big Concrete Reservoir actually were incurred in connection with the hearings on Case No. 6627, the Commission's investigation into the safety, operation and maintenance of that reservoir. The same witness also testified that the cost to applicant of the rehearing in the current proceeding would be approximately \$12,800, a large portion of which relates to development and presentation of testimony on Big Concrete reservoir. Because of the nature of the \$4,100 and \$12,800 expenditures, and because it is apparent that they were incurred primarily

as a result of the errors and omissions in the design and construction of the original Big Concrete Reservoir, we find that applicant's customers should not be called upon to underwrite those expenditures.

TABLE I

Administrative and General  
and Miscellaneous Expenses

<u>Item</u>	<u>All Operations</u>	<u>Calif. Operations</u>	<u>Calif.Wtr. Operations</u>	<u>Boulder Creek</u>
<u>Staff Exhibits</u>				
<u>Nos. 10 and 11</u>				
<u>Direct Charges</u>				
Stamford	\$150,000	\$ 0	\$ -	\$ 0
Redding	-	61,500	22,800	3,400
Boulder Creek	-	-	-	6,000
Subtotal				9,400
<u>Allocated Charges</u>				
Stamford	329,000	118,400	-	8,100
Redding	-	65,000	-	4,400
Subtotal				12,500
Total Exhibit No. 11				21,900
<u>Adjustments to Staff Estimates</u>				
<u>Direct Charges</u>				
Stamford	-	3,300	-	200
Boulder Creek per Dec.No.66729	-	-	-	1,400
Subtotal				1,600
<u>Allocated Charges</u>				
Stamford	10,000	3,600	-	200
Total Adjustments				1,800
Adjusted Total				23,700

Taxes other than on Income

Exhibit No. 11 shows the staff estimate of 1963 ad valorem taxes for the Boulder Creek District to be about \$3,900 lower than the estimate presented by applicant in Exhibit No. 5. Somewhat different methods of estimating were used by the staff and applicant

but, except for a \$500 reduction by the staff for taxes on non-operative land, the difference between the two estimates appears to be due almost entirely to exclusion by the staff of taxes related to the amount in plant considered by the staff to be the excess cost of Big Concrete Reservoir. The staff testified that no deduction was made for ad valorem taxes related to the Central Supply Line.

Applicant's accounting officer testified at the original hearing that applicant's then recent tax bills indicated ad valorem taxes of \$41,000 for the fiscal year 1963-64. Half of that amount plus half of the ad valorem taxes of \$33,300 for the fiscal year 1962-63 gives \$37,100 for the calendar year 1963. Deducting the staff adjustment of \$3,900 discussed in the foregoing paragraph, and adding the staff estimate of \$1,500 for payroll taxes, results in the \$34,700 found in Decision No. 66729 to be a reasonable estimate of applicant's 1963 taxes other than on income.

As discussed hereinafter, evidence in the rehearing indicates that the rate base adjustment for excess cost of Big Concrete Reservoir used in Decision No. 66729 should be modified. Consistent with that modification, we find that an additional allowance of \$2,100 is reasonable to be included for ad valorem taxes related to that reservoir.

#### Depreciation and Amortization

In Decision No. 66729, the staff estimate of \$25,900 was adopted for (1) depreciation expense and (2) amortization, over the average service life of mains, of the amount deducted from rate base for the Central Supply Line. This is reasonably equivalent to including depreciation on the entire cost of the Central Supply Line.

In addition, the decision allowed \$3,000 annual expense for amortization of the excess cost of Big Concrete Reservoir.

In applicant's petition for rehearing, the allowance for amortization related to the Central Supply Line is challenged on the grounds that the investment in the pipeline was prudent at the time of its installation. Applicant contends that, if any portion of the line is now considered obsolete by circumstances which reasonably could not have been foreseen, interest or return should be allowed on the unamortized portion of the investment. In view of the evidence at the rehearing that the entire cost of the line should be included in rate base, and the adoption of that conclusion herein, applicant's point becomes moot.

The amortization of \$164,500 of excess cost of Big Concrete Reservoir by annual charges of \$3,000 to operating expense, as allowed in Decision No. 66729, is equivalent to allowing depreciation expense using a 55-year life. This is quite close to the 60-year remaining life shown in Exhibit No. 11 for collection and impounding reservoirs. Based upon the staff's evaluation of excess costs shown in Exhibit No. 21, the staff testified that depreciation expense would be \$1,570 greater than originally recommended. We find that this should be increased to \$1,700, consistent with the modifications to rate base hereinafter discussed, but we also find that no allowance should be made for amortization of excess costs.

Applicant's consulting engineer who presented Exhibit No. 20 testified that any engineering structure such as Big Concrete Reservoir, even with good engineering and judgment, may require reconstruction and revision of improvement. Applicant argues that,

in the light of that testimony, it would not be fair to say that certain costs charged to reservoir construction were incurred as a result of some failure on the part of applicant or any lack of ability or thoroughness in planning. We cannot agree. Applicant's Exhibit No. 19 shows that in the original construction the topsoil apparently was not completely removed nor was benching performed prior to placement of fills. Obviously, the foundation of an earth-fill reservoir is not an appropriate place for trial-and-error design, nor is it the place for faulty construction or inadequate inspection. Applicant should have seen to it that proper construction was specified and performed. Indicative of the attention applicant's management paid to the construction is the fact that those officials were under the impression that the reservoir had a 50 percent greater storage capacity than it has, until advised to the contrary by a consulting engineer employed for the rehearing.

#### Income Taxes

The staff method of computing income taxes was found reasonable in Decision No. 66729. It was necessary, however, to modify the amount of income taxes derived by the staff in Exhibit No. 11 because of the adoption of somewhat different amounts than shown in that exhibit for operating revenues, operating expenses, and taxes other than on income. It is now necessary to modify the allowance for income taxes further to reflect the changes adopted herein for operating expenses, depreciation, amortization, and taxes other than on income. We also take official notice of the changes in federal income tax rates which have occurred since Decision No. 66729 was rendered, and reflect the 1965 rates in the



income taxes adopted herein. Table II summarizes the income tax derivations at present rates and at those authorized herein. We find the amounts derived in that table to be reasonable.

TABLE II

Derivation of Income Taxes

Item	Exhibit No. 11	Decision No. 66729	Adopted Herein	
			Present Rates	Authorized Rates
Operating Revenues	\$193,500	\$192,000	\$192,000	\$212,000
<u>Deductions</u>				
Oper. Expense exclusive of Taxes and Depreciation	65,600	67,600	67,400	67,400
Taxes other than on Income	31,300	34,700	36,800	36,800
Expense Capitalized and Interest	27,000	27,000	27,000	27,000
Subtotal Deductions	123,900	129,300	131,200	131,200
<u>Taxable Net Income</u>				
Before Depreciation	69,600	62,700	60,800	80,800
Deduct Depreciation, State	(36,800)	(36,800)	(38,500)	(38,500)
Taxable Net, State	32,800	25,900	22,300	42,300
Add for Lower Depr., Federal	600	600	600	600
Deduct State Corp. Fr. Tax	(1,800)	(1,400)	(1,200)	(2,300)
Deduct Pref. Stock Div. Cr.	(1,200)	(1,200)	(1,200)	(1,200)
Taxable Net, Federal	30,400	23,900	20,500	39,400
<u>Income Taxes</u>				
State (5.5%)	1,800	1,400	1,200	2,300
Federal				
(formerly 52%, now 48%)	15,800	12,400	9,800	18,900
Deduct Surtax Exemption	(600)	(600)	(700)	(700)
Deduct Invest. Tax Credit	(2,100)	(2,100)	(2,100)	(2,100)
Deduct Amort., Deferred F.I.T.	(300)	(300)	(300)	(300)
Net Federal Income Tax	12,800	9,400	6,700	15,800
Total Income Taxes	14,600	10,800	7,900	18,100

(Deduction)

Central Supply Line

At the time of the original hearings, the evidence indicated that a portion of the pipeline known as Central Supply Line was no longer used nor useful in applicant's operations. Additional testimony of applicant's witnesses and of a Commission staff engineer presented upon rehearing shows, and we so find, that the pipeline

will be beneficial to the utility customers in providing a reserve and standby source of water supply. In fact, it had been so used by applicant during August and September of 1964 to avoid a water shortage and possible rationing.

The rate base adopted in Decision No. 66729 reflected a reduction of \$50,200 related to the portion of the Central Supply Line then considered unused and useless. In view of the evidence on rehearing, this amount will be restored in the rate base adopted herein. As previously explained, no comparable adjustments are necessary in ad valorem taxes and depreciation expense.

#### Big Concrete Reservoir

The evidence adduced at the original hearings shows conclusively that applicant has incurred excessive costs in constructing, repairing and reconstructing its Big Concrete Reservoir. These excessive costs appear to be due to a combination of faulty design, poor workmanship, and inadequate inspection during construction. Nevertheless, applicant included the entire cost of the reservoir in its estimates of rate base set forth in Exhibit No. 5 presented at the original hearings.

The staff, on the other hand, deducted \$164,500 from rate base in Exhibit No. 11, based upon the damage claims by applicant in a civil action against the original builder of the reservoir. Although this basis is not conclusive, it was the best evidence presented at that time as to the probable extent of excess costs incurred. The adjustment recommended by the staff was adopted in Decision No. 66729.

Upon rehearing, both applicant and the staff have reviewed the question of the proper amount to deduct from rate base as

excessive cost of Big Concrete Reservoir. A consulting engineer for applicant presented evidence in support of a \$41,000 deduction from rate base whereas, based upon the testimony of a staff engineer, a deduction of \$69,700 would be made.

Applicant's consulting engineer derived an estimated historical cost of the reconstructed Big Concrete Reservoir, assuming that it had been designed and built in its present condition initially rather than having been constructed and, after partial and incipient failure of the structure, repaired and reconstructed. The engineer testified that, in his opinion, the amount of earthwork and the reservoir appurtenances now comprising Big Concrete Reservoir and used in his cost estimate are not less than are reasonably required for its construction but do not include anything unnecessary to give a usable structure. He testified further, however, that it was not part of his assignment to determine whether he would have designed it in the same manner and shape as it presently exists. Also, he apparently made no study of the cost of possible alternative facilities, such as steel tanks or other fabricated structures.

A Commission staff engineer also developed an estimate of the reasonable cost of the reservoir in its present condition. This estimate was based upon identifying actual expenditures with specific portions of the physical properties and excluding those expenditures which could not be identified or which relate to facilities that no longer exist, were removed during the reconstruction period, or subsequently lost their value due to replacement by other facilities. Overheads were adjusted down to the five percent currently chargeable to new construction. No study was presented as to the cost of possible alternative facilities.

We find that, with minor modifications, the staff's method of determining the portion of actual expenditures to be included in

rate base is more reasonable than that of applicant's witness. Certain identifiable items, such as a toe drain filter blanket and an asphalt plank lining, appeared in applicant's historical cost study at amounts which the staff showed were significantly greater than actual recorded costs. Also, applicant's consultant predicated his cost estimates upon a complete stripping and removal of all of the underbrush and other organic material, whereas another of applicant's consultants testified that perhaps 20 percent of the organic material was left, because not all of the embankment was completely rebuilt.

The modifications to the items excluded by the staff in Exhibit No. 21 are shown in Table III. We find that the additional amount of rate base derived in that table is reasonable.

TABLE III

Big Concrete Reservoir Cost Exclusions

<u>Item No.</u>	<u>Item</u>	<u>Staff Recommended</u>	<u>Adopted Herein</u>
a	Original Earthwork	\$ 22,440	\$ 22,440
b	Filter Blanket	561	561
c	Legal Cost, Land	300	-
d	Construction Overhead	5,287	2,300
e	Thoroseal Coating	6,481	6,481
f	Legal Expenses	4,504	4,504
g	Miscellaneous	885	885
h	Stamford Legal Expenses	5,123	5,123
i	Freight Charges	516	516
j	Construction Overhead	4,113	1,453
k	Interest During Construction	19,472	19,472
	Total Exclusions	69,682	63,735
	Increase in Depreciation Reserve	820	870
	Exclusions Adopted in Decision No. 66729	164,500	164,500
	Additional Rate Base	93,998	99,895
	USE		99,900

In Table III, the \$300 legal costs (Item c) are properly included in rate base even though not a part of the cost of the structure. Construction overheads (Items d and j) should have been based upon the 10 percent and 7 percent properly chargeable at the time of construction, rather than at the 5 percent currently chargeable. Applicant contends that the "Stamford Legal Expenses" (Item h)

should not be excluded because these charges were mislabeled by applicant and represent payroll, travel and per diem expense. The timing of the latter charges indicates, however, that they were related to the reconstruction of the reservoir, and no showing was made that they would have been incurred if the reservoir initially had been constructed properly.

#### Rate of Return

At the original hearings, applicant's accounting officer suggested that applicant was entitled to a rate of return of 7 percent. A staff witness recommended that the allowed rate of return be between 6.4 and 6.6 percent. The staff did not recommend amortization of any portion of the excess cost of Big Concrete Reservoir.

We concur with the staff that a 6.4 to 6.6 rate of return would normally be considered reasonable for applicant's operations. However, in Decision No. 66729, an allowance of \$3,000 was made for amortization of the excess cost of Big Concrete Reservoir. Consistent with this partial removal of an element of risk (i.e. that moneys would be expended which may not be recoverable because they are in excess of that which would have been required by careful planning and supervision) the rate of return allowed in that decision was less than suggested by the staff. It now appears, and we so find, that it is more appropriate to exclude the effects of the excess cost of the reservoir from both rate base and operating expenses. Consistent with this treatment, we find that a 6.5 percent return on rate base is reasonable.

#### Other Issues

At the rehearing, applicant introduced additional testimony regarding cost of land at Quail Hollow Well No. 2. No

additional testimony was presented regarding the cost of the "Fetherston Lands", but applicant asked that the Commission reconsider the evidence on this issue which had been presented at the original hearings. We find that both of these issues are beyond the scope of the rehearing.

#### Summary of Earnings

Table IV shows the summary of earnings adopted by Decision No. 66729 at present water rates, and brings forward the modifications of that decision adopted herein, showing the revised summary of earnings both at the present rates and at the increased rates authorized herein.

TABLE IV

Summary of Earnings  
(Test Year 1963)

<u>Item</u>	<u>Decision No. 66729</u>	<u>Adopted Herein</u>	
		<u>Present Rates</u>	<u>Authorized Rates</u>
Operating Revenues	\$192,000	\$192,000	\$212,000
<u>Operating Expenses</u>			
Oper. & Maintenance Expenses	43,700	43,700	43,700
Admin. & Gen. & Misc. Expenses	23,900	23,700	23,700
Taxes other than on Income	34,700	36,800	36,800
Depreciation & Amortization	28,900	27,600	27,600
Income Taxes	10,800	7,900	18,100
Total Operating Expenses	142,000	139,700	149,900
Net Revenue	50,000	52,300	62,100
Rate Base	805,100	955,000	955,000
Rate of Return	6.2%	5.5%	6.5%

#### Rates

Table IV shows that an increase of about \$20,000 in annual revenue at the 1963 level of business is required to provide the 6.5 percent return on rate base found reasonable herein. This is equivalent to a rate increase of about 10 percent. A comparison of the present rates and those authorized herein is set forth in Table V.

TABLE V  
Comparison of Rates

<u>Rates</u>	<u>Present</u>	<u>Authorized</u>
<u>Monthly Quantity Rates (Per Meter per Month)</u>		
First 5,000 cu.ft., per 100 cu.ft.	\$ 0.35	\$ 0.38
Over 5,000 cu.ft., per 100 cu.ft.	0.28	0.31
<u>Annual Service Charge (Per Meter per Year)</u>		
For 5/8 x 3/4-inch meter .....	27.00	30.00
For 3/4-inch meter .....	42.00	45.00
For 1-inch meter .....	66.00	72.00
For 1½-inch meter .....	105.00	120.00
For 2-inch meter .....	174.00	192.00
For 3-inch meter .....	324.00	360.00
For 4-inch meter .....	474.00	528.00
<u>Service Establishment Charge</u>		
For each establishment or re-establishment of water service .....	4.00	4.00

Findings and Conclusions

In addition to the detailed findings made throughout this opinion, the Commission finds that:

1. Applicant is in need of additional revenues in its Boulder Creek District.
2. The adopted estimates, previously summarized and discussed herein, of operating revenues, operating expenses and rate base for the year 1963, reasonably represent the results of applicant's future operations and are reasonable.
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 herein prescribed, are for the future unjust and unreasonable.

The Commission concludes that a rate increase should be authorized.

ORDER ON REHEARING

IT IS ORDERED that, after the effective date of this order, Citizens Utilities Company of California is authorized to file the revised rate schedules attached to this order as Appendix A. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall be April 1, 1965, or four days after the date of filing, whichever is later.

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

Dated at San Francisco, California, this 9<sup>th</sup> day of MARCH, 1965.

Frederick B. Holmbeck  
President

George H. Trover

William W. Deane &  
Commissioners



APPENDIX A  
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Schedule No. BC-1

Boulder Creek Tariff Area

ANNUAL GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service furnished on an annual basis.

TERRITORY

The communities of Boulder Creek, Brookdale, Ben Lomond and Felton and vicinity, Santa Cruz County.

RATES

Monthly Quantity Rates:

	Per Meter Per Month	
First 5,000 cu.ft., per 100 cu.ft. ....	\$ 0.38	(I)
Over 5,000 cu.ft., per 100 cu.ft. ....	.31	

Annual Service Charge:

	Per Meter Per Year	
For 5/8 x 3/4-inch meter .....	\$ 30.00	(I)
For 3/4-inch meter .....	45.00	
For 1-inch meter .....	72.00	
For 1 1/2-inch meter .....	120.00	
For 2-inch meter .....	192.00	
For 3-inch meter .....	360.00	
For 4-inch meter .....	528.00	

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

Service Establishment Charge:

For each establishment or re-establishment of water service .....	\$ 4.00
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(Continued)

APPENDIX A  
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Schedule No. BC-1

Boulder Creek Tariff Area

ANNUAL GENERAL METERED SERVICE

SPECIAL CONDITIONS

1. The opening bill for general metered service shall be the established annual service charge. Where initial service is established after the first day of any year, the portion of such annual charge applicable to the current year shall be determined by multiplying the annual charge by one three hundred sixty-fifth ( $1/365$ ) of the number of days remaining in the calendar year. The balance of the payment of the initial annual charge shall be credited against the charges for the succeeding annual period. If service is not continued for at least one year after the date of initial service, no refund of the initial annual charges shall be due the customer. If a permanent resident of the areas has been a customer of the utility for at least 12 months, he may elect, at the beginning of the billing year, to pay a prorated service charge in advance on a bimonthly basis equal to one-sixth of the annual service charge.

2. The service establishment charge provided for herein is in addition to the charges calculated in accordance with this schedule and will be made each time an account is opened or reopened for a customer at the time water service is to be established, restored after discontinuance at customer's request or transferred to a different customer which requires a meter reading.