

ORIGINAL

Decision No. 72215

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Investigation)
on the Commission's own motion into)
the reasonableness of Water Main)
Extension Rules presently effective)
for water utilities throughout the)
State, and the development of such)
revised extension rule as appears)
reasonable.)

Case No. 5501
(Reopened August 24, 1965)

In the Matter of the Application of)
SUBURBAN WATER SYSTEMS, a corpora-)
tion, for authority to revise its)
rules applicable to the new exten-)
sion of distribution facilities to)
new subdivisions.)

Application No. 40579
(Reopened August 24, 1965)

PRELIMINARY OPINION

Order Reopening Proceeding

Decision No. 69604 reopened these proceedings for the limited purpose of receiving evidence as to the desirability of (a) placing a ceiling of 35 percent of the outstanding refundable balance upon the lump-sum payment that may be made upon termination of water main extension contracts, (b) permitting or requiring contributions rather than refundable advances from subdividers for financing in-tract facilities, and (c) requiring contributions rather than advances for financing in-tract facilities whenever a utility's advances exceed 40 percent of depreciated utility plant and the utility's main extension refunds during the preceding year exceeded 5 percent of gross operating revenues. Copies of the reopening order were sent to appearances of record in these proceedings and to all water utilities under this Commission's jurisdiction.

Prehearing Conference

At the request of representatives of the water utility industry and the home-building industry, a prehearing conference was held on March 3, 1966. The results of that conference are summarized in a letter dated March 15, 1966 to all appearances and water utilities. A copy of that letter is received as Exhibit No. 68 in Case No. 5501.

At the prehearing conference, the following procedure was formulated:

1. Any party wishing the proceedings to be discontinued or broadened was to present support for its position in the form of a petition filed on or before May 31, 1966.
2. Any party wishing to dispute or concur in the position of a petitioner was to file an answer or concurring pleading before July 31, 1966.
3. Each party who contemplated filing a pleading as outlined in 1 and 2 was to so notify this Commission by March 31, 1966.
4. A mailing list for exchange of pleadings was to be sent by the Commission to all parties contemplating filing pleadings by April 30, 1966.
5. After review of all pleadings, the Commission was to issue its order closing the investigation or reaffirming or modifying the scope of the reopened proceeding.

Petitions and Answer

Pursuant to the procedure formulated at the prehearing conference, seven parties indicated that they might file a petition or other pleading. Of these, four¹ petitioned for discontinuance of the reopened proceeding, one² petitioned for either

¹ The Campbell Water Company, San Jose Water Works, California Water Service Company, and California Water Association.

² Home Builders Council of California.

discontinuance of the proceeding or modification of its scope, and one³ concurred with the others' petitions for discontinuance. The answer of the Commission staff, filed under the agreed procedure, urges that the petitions be denied and that the matter be set for hearing.

Termination of Main Extension Contracts

The various petitioners contend that a lump-sum termination price ceiling based upon a fixed percentage of the outstanding refundable balance of a main extension agreement is not appropriate because:

1. It would be arbitrary and unfair.
2. The Commission already has adequate means of preventing abuses in the termination of main extension contracts.
3. Requiring designated information from utilities seeking authority to terminate main extension agreements would be more reasonable than establishing a fixed ceiling price.

The staff contends, in its reply to the petitions, that:

1. The market value of extension contracts providing for refund of advances is, on the average, about 35 percent of the outstanding refundable balance, which is substantially below the present termination price ceiling determined by the "6% present-worth" formula.
2. The staff cannot review adequately or keep continuing account of the many transactions involving assignment of and termination of main extension contracts. To attempt to correct rather than prevent abuses, through rate base adjustments in rate proceedings, would shift the burden of proof from applicant to the staff.
3. The present rule already requires the furnishing of information regarding termination of contracts.

³ Pacific Gas and Electric Company.

Rule-making necessarily involves compromises between precision of result and simplicity of application. A termination ceiling price which is a fixed percentage of the outstanding refundable balance would be reasonably simple to apply but would give no consideration to the fact that the contracts, prior to their termination, result in widely varying rates of refund of advances and thus have widely varying values. On the other hand, the present-worth formula based on a 6 percent interest factor may result in an unrealistic termination price. This warrants further review and we do not wish to foreclose any of the parties from suggesting a realistic basis for determining the ceiling price to be paid upon lump-sum termination. The scope of the proceeding will be broadened to permit this.

Contribution Rule - All Water Utilities

The various petitioners contend that consideration of an optional or mandatory main extension rule providing for subdividers' contribution of cost of in-tract facilities is not appropriate because:

1. The record in this proceeding is already thorough and complete on this subject and does not justify such a rule, and conditions have not changed to a degree that would warrant reopening of the proceeding.
2. The present rule has served its purposes reasonably well.
3. A contribution rule would place investor-owned utilities at a competitive disadvantage.
4. Financing subdivision main extensions by subdividers' contributions would increase the cost of homes, pricing some families out of the market.
5. Requiring Commission authorization before Class D water utilities install extensions which result in more than a 25 percent increase in depreciated utility plant in one year is more reasonable than permitting or requiring contributions by subdividers.

The staff's answer contends that:

1. (No specific answer).
2. Although petitioners are satisfied with the present rule, it may not serve its purposes reasonably well for all water utilities.
3. (Not disputed.)
4. The major home developments are in or near urban areas furnished water by public agencies, almost all of which now require subdividers' contributions, and the price of homes is determined by the competition of the market price.
5. A limitation on rate of growth of Class D utilities would not necessarily protect a small utility's capital structure, financial condition and ability to meet refund obligations because the criterion is not rate of growth but rather the effect of aggregate growth on total advances and refunds.

Although three utilities⁴ previously proposed a water main extension rule (Exhibit No. 47) requiring financing of main extensions by means of subdividers' contributions, and presented evidence that such a rule would result in lower water rates (Exhibit No. 46) and would benefit customers (Exhibit No. 45), the receipt of additional evidence as to the propriety, feasibility and effect of such a rule is not unreasonable.

Sufficient justification has not been presented for modifying the scope of the portion of the reopened proceeding regarding permissive or mandatory contributions in the main extension rule. The term "desirability" used in the order reopening the proceeding will be clarified, however, by adding "propriety, feasibility and effect."

⁴ San Jose Water Works, California Water Service Company and Del Este Water Company.

Contribution Rule - Specific Utilities

The various petitioners contend that consideration of a mandatory main extension rule, applicable to utilities whose advances for construction balances are in excess of 40 percent of depreciated utility plant and whose main extension refunds during the preceding year exceeded 5 percent of gross operating revenue, is not appropriate because:

1. The present rule affords an opportunity for Commission review of the situation whenever the level of advances exceeds 50 percent of a utility's depreciated utility plant.
2. Requiring contributions for some of a utility's main extensions and not others would be discriminatory.
3. Requiring designated information from utilities with an excessive level of advances would be more reasonable than requiring contributions from subdividers.

The staff contends that:

1. The objective of braking expansion by inadequately financed utilities which might encounter difficulties in meeting refund requirements could better be met by a rule which gives consideration to refund requirements as well as percentages of advances.
2. An automatic, mandatory contribution rule for utilities with an excessive level of advances is no more discriminatory than the piecemeal granting of authority for a contribution rule upon request by specific utilities, as suggested in one of the petitions.
3. (No specific answer.)

There may well be infirmities in the establishment of a contribution rule automatically whenever it is triggered by an excessive level of advances and refunds. We are particularly concerned that radically different treatment of applicants for main extensions by the same utility would be in effect from year to year

or even month to month. Section 532 of the Public Utilities Code states in part:

"... no public utility shall ... extend to any corporation or person any form of contract or agreement or any rule or regulation ... except such as are regularly and uniformly extended to all corporations and persons." (Emphasis added.)

Exhibit No. 57 sets forth one of the reasons the staff originally proposed the "Limitation of Expansion" provision of the present rule;

"... if a water system is designed to serve adequately a given area and, for some reason, most of the lots remain vacant, there is little that any main extension rule can do to make the utility operation economical under normal water rates. ... Closer control of this situation will be effected by the proposed rule because if extensions are made which do not develop customers, the level of advances will become abnormally high, requiring notification to the Commission and prohibiting further expansion without first obtaining Commission authorization."

The establishment of a provision that both the level of advances and the level of refunds must be excessive could reduce the efficacy of the present rule in alerting the Commission to widespread extensions which are uneconomic and speculative even if the utility has not yet reached an excessive level of refunds. Also, in such instances, the further expansion of the system, even though financed by subdividers' contributions, may not be in the public interest.

The scope of the reopened proceeding will be broadened to permit introduction by any of the parties of evidence as to alternative modifications to the present "Limitation of Expansion" provisions of the water main extension rule.

Applicability of Rule to New Utilities

Section A.1.a. of the present rule states, in part, that the rule applies to:

"All extensions of distribution mains, from the utility's basic production and transmission system or existing distribution system ..."
(Emphasis added.)

Despite this provision, in most recent certificate proceedings for new water utilities, the distribution system for some "initial unit" defined in each decision has been exempted from the applicability of the rule.

The scope of the reopened proceeding will be broadened to consider possible revision of the "Applicability" provisions as they relate to new utilities.

Contingent Liability for Refunds

Section C.2.d. of the present rule guarantees ultimate full refund of all of the advance for a particular subdivision if that subdivision develops to 80 percent occupancy. Under the previous rule, some utilities had been precluded from using depreciation on main extensions as a deduction for income tax purposes because the advances used to finance the extension advances theoretically had only a contingent liability for refund.

It is recognized that, in some instances, this provision might result in eventual full refunding of the cost of uneconomic developments, thus defeating one of the fundamental purposes of the rule.

The scope of the reopened proceeding will be broadened to review the need and propriety for this provision of the rule.

Findings and Conclusion

The Commission finds that:

1. Any showing that the applicant, in Application No. 40579, may wish to present regarding the issues discussed herein would more appropriately be introduced in Case No. 5501.

2. The scope of this reopened proceeding must be broadened slightly, as discussed in the foregoing opinion, if it is to provide adequate flexibility to consider possible alternative modifications of the main extension rule.

3. In view of the various petitions filed herein, it is appropriate that the Commission staff presentation be made first, and that other parties be given an opportunity to hear that presentation before preparing their own.

4. Circulation of advance copies of proposed exhibits to all parties requesting them may save hearing time and expedite the proceeding.

5. Sufficient cause for discontinuance of Case No. 5501 does not appear in the various petitions filed herein.

The Commission concludes that reopened Application No. 40579 should be dismissed and that reopened Case No. 5501 should be heard, with its scope modified as set forth in the order which follows:

PRELIMINARY ORDER

IT IS ORDERED that:

1. Application No. 40579, as reopened by Decision No. 69604, dated August 24, 1965, is dismissed.

2. The order in Decision No. 69604 is modified to read as follows:

Good cause appearing, it is hereby ordered that Case No. 5501 is reopened for the limited purpose of receiving evidence as to the desirability, propriety, feasibility and effect of:

- a. Modifying Section C.3.a. of the present rule so as to place a more realistic ceiling than is now provided on the payment that may be made by a utility for the purpose of terminating a main extension agreement.
- b. Adding a new provision to the main extension rule which would permit or require any water utility to file an amendment to the rule requiring that all in-tract facilities be financed by contributions rather than refundable advances.
- c. Modifying Section A.2. of the present rule so as to (1) establish a different basis for limitation of expansion, (2) provide automatic relief from such limitation under appropriate circumstances, or (c) both.
- d. Modifying Section A.1.a. of the present rule to remove its applicability to the initial unit served by a new utility, and to define such initial unit.
- e. Modifying or deleting Section C.2.d. of the present rule, which now guarantees eventual full refund of advances related to a subdivision with 80 percent occupancy.

3. Public hearing in reopened Case No. 5501 shall be held before Commissioner Gatov or Examiner Catey, as follows:

- a. On Monday, September 18, 1967, at 10 a.m. in the Commission Courtroom, State Building, San Francisco, for the purpose of receiving the presentation of the Commission staff.

- b. On Monday, October 16, 1967, at 10 a.m., in the Commission Courtroom, State Building, Los Angeles, for the purpose of receiving the presentation of other parties.
 - c. At such time and place as may be established upon adjournment if the matter is not submitted by October 16, 1967.
4. Prior to July 31, 1967 parties desiring advance copies of proposed staff exhibits shall request them by mail.
5. Except to the extent granted in the foregoing paragraphs of this order, all petitions for modification of the order reopening these proceedings and petitions for discontinuance of these proceedings are denied.

The Secretary is directed to cause a copy of this order to be served upon each of the respondents.

Dated at San Francisco, California, this 28th day of MARCH, 1967.

John F. Mitchell
President

Stallman Bennett

Augustine

William Sproule

Fred P. Morrissey
Commissioners