

**ORIGINAL**

Decision No. 75531

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of )  
CALIFORNIA WATER SERVICE COMPANY, a )  
corporation, for an order authorizing )  
it to increase rates charged for water )  
service in the Willows district. )

Application No. 50352  
(Filed June 26, 1968;  
Amended July 24, 1968)

McCutchen, Doyle, Brown & Enersen, by A. Crawford  
Greene, Jr., for applicant.  
Peter M. Towne, for Willows City Council,  
protestant.  
Elinore C. Morgan, Counsel, and J. E. Johnson,  
for the Commission staff.

O P I N I O N

Applicant California Water Service Company seeks authority to increase rates for water service in its Willows district.

Public hearing was held before Examiner Catey in Willows on December 17, 1968. Copies of the application had been served, notice of filing of the application published, and notice of hearing published and posted, in accordance with this Commission's rules of procedure. The matter was submitted on December 17, 1968.

Testimony on behalf of applicant <sup>1/</sup> was presented by its vice-president and his assistant and by its general manager. A statement on behalf of protestant was presented by the vice-mayor of the City of Willows. The Commission staff presentation was made through an accountant and two engineers.

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1/ Testimony relating to overall company operations had been presented by witnesses for applicant and the staff in Application No. 50351, the Stockton district rate proceeding. This testimony was incorporated by references in Application No. 50352.

Service Area and Water System

Applicant owns and operates water systems in twenty-one districts in California. Its Willows district includes the City of Willows and unincorporated areas of Glenn County adjacent to the city. The relatively flat area is approximately 130 feet above sea level. Total population served in the district is estimated at 5,700.

The entire water supply for this district is obtained from applicant's six wells and one leased well. The distribution system includes about 28 miles of distribution mains, ranging in size up to 12-inches. There are about 670 metered services, 1,040 flat rate residential services, six private fire protection services and 156 public fire hydrants. A storage tank maintains system pressure and provides storage for the system. Each well pump has an electric motor, and two well pumps have provision for emergency operation with auxiliary gasoline engines.

Service

A field investigation of applicant's operations, service and facilities in its Willows district was made by the Commission staff. The system was found to be well-maintained and appeared to be providing good service. A staff engineer testified that no informal complaints have been registered with the Commission during the past three years.

Rates

Applicant's present tariffs include schedules for general metered service, residential flat rate service, private fire protection service, public fire hydrant service and service to company employees. The present rates became effective in 1958.

Applicant proposes to increase its rates for general metered service and residential flat rate service. There are no proposed changes in the other schedules. The following Table I presents a comparison of applicant's present general metered service and residential flat rate service rates, those requested by applicant, and those authorized herein.

Table I  
Comparison of Monthly Rates

<u>Item</u>	<u>Present</u>	<u>Proposed</u>	<u>Authorized<sup>#</sup></u>
<u>General Metered Service</u>			
Service Charge*	\$2.40	\$ 3.00	\$ 3.00
Quantity Rate: All water delivered, per 100 cu.ft.	.17	.222	.222
<u>Residential Flat Rate Service</u>			
Basic Rate	3.00	4.29	-
Additions:			
Each room in excess of five	.25	.36	-
Each flush toilet, tub or shower	.40	.57	-
Irrigation, May-October:			
1st 3,000 sq.ft., per 100 sq.ft.	.12	.171	-
Over 3,000 sq.ft., per 100 sq.ft.	.05	.072	-
Single-family residential unit, including premises having area of:			
6,000 sq.ft. or less	-	6.45+	6.35
6,001 to 10,000 sq.ft.	-	8.60+	8.45
10,001 to 16,000 sq.ft.	-	10.85+	10.60
16,001 to 25,000 sq.ft.	-	14.10+	13.80
Additional single-family residential unit	-	5.10+	5.00

\* Service charge for a 5/8 x 3/4-inch meter. A graduated scale of increased charges is provided for larger meters.

# Until the 10 percent surcharge to Federal income tax is removed, bills computed under authorized rates to be increased by 2.93 percent.

+ Alternative rates proposed by applicant to comply with staff's recommendation for simplification of rate structure.

The Commission staff recommended simplification of the cumbersome form of the present flat rate schedule. Applicant had no objection to this suggestion. The flat rates authorized herein follow the simplified format already in effect in all of applicant's other districts which provide flat rate service. In Exhibit No. 7-A, applicant assumed that, when it meters all customers with premises in excess of 25,000 square feet, the service revenue from each such customer will be less than from the smallest flat rate customer. This assumption is unreasonable. Inasmuch as there is presumably a reasonable correlation between the flat rates and metered service rates, we will assume that average revenue from each of these metered customers with premises larger than 25,000 square feet will equal the revenue from the flat rate customer with premises of 25,000 square feet.

Table 12-C of Exhibit No. 7 shows that, for a typical commercial metered service customer with average monthly consumption of 1,850 cubic feet through a 5/8 x 3/4-inch meter, the average monthly charge will increase 28 percent from \$5.54 under present rates to \$7.11 under the rates proposed in the original application. The temporary 2.93 percent surcharge authorized herein will add \$0.21 to this average monthly charge.

Cost-of-service studies prepared by applicant and summarized in Exhibit No. 7 show that the present relationship between rates for metered and flat rate service unduly favors the flat rate customers, who are provided unlimited quantities of water. To overcome this, applicant proposes a greater percentage increase for flat rates than for metered. The rates authorized herein also result in a greater

percentage increase for flat rates than for metered. Table 12-C of Exhibit No. 7 shows that, for a typical flat rate customer with a five-room house, one bath, one toilet, and 4,600 square feet of irrigable land, the average monthly charge would increase 43 percent from \$6.00 under present rates to \$8.57 under the rates proposed in the original application. The temporary 2.82 percent surcharge requested in the amendment would add \$0.24 to this average monthly charge at proposed rates. The flat rates authorized herein are designed to increase average monthly charges to present flat rate customers by 43 percent, plus the temporary 2.93 percent surcharge.

Results of Operation

Witnesses for applicant and the Commission staff have analyzed and estimated applicant's operational results. Summarized in Table II, from applicant's Exhibit No. 7 and the staff's Exhibit No. 9, are the estimated results of operation for the test year 1969, under present rates and under those proposed by applicant, before considering the additional expenses and offsetting revenue requirement resulting from the 10 percent surcharge to Federal income tax. For comparison, this table also shows the corresponding results of operation modified as discussed hereinafter.

Table II  
Estimated Results of Operation  
Test Year 1969

<u>Item</u>	<u>Applicant</u>	<u>Staff</u>	<u>Modified</u>
<u>At Present Rates</u>			
Operating Revenues	\$134,100	\$134,100	\$134,100
<u>Deductions</u>			
District Operation Expenses	44,700	43,900	43,900
District Maintenance Expenses	9,800	9,000	9,000
Other Expenses, Excl. Taxes & Depr.	15,100	15,100	15,100
Taxes, Excl. Bus. Lic. & Inc. Taxes	21,000	20,400	21,800
Depreciation	18,800	19,000	19,000
Subtotal	109,400	107,400	108,800
Business License	2,400	2,400	2,400
Income Taxes	100	1,100	400
Total	111,900	110,900	111,600
Net Revenue	22,200	23,200	22,500
Rate Base	594,500	601,700	601,700
Rate of Return	3.73%	3.86%	3.74%
<u>At Rates Proposed by Applicant*</u>			
Operating Revenues	\$183,500	\$183,500	\$183,500
<u>Deductions</u>			
Excl. Bus. Lic. & Income Taxes	109,400	107,400	108,800
Business License	3,200	3,200	3,200
Income Taxes	25,100	26,200	25,500
Total	137,700	136,800	137,500
Net Revenue	45,800	46,700	46,000
Rate Base	594,500	601,700	601,700
Rate of Return	7.70%	7.76%	7.65%

\*Prior to amendment for income tax surcharge.

From Table II it can be determined that, exclusive of the temporary increase due to the income tax surcharge, the increase in operating revenues would be 37 percent under applicant's proposed rates and will be 37 percent under the rates authorized herein.

Expenses and Rate Base

In developing the historical trend of district operation expenses, applicant applied a "labor factor" to certain nonlabor items, whereas, the staff projected separate estimates for those items. In developing the historical trend of district maintenance expenses, applicant used a shorter period of years than did the staff. The staff's methods of estimating district operation and maintenance expenses appear reasonable and the staff's estimates are adopted in Table II.

Protestant questions the reasonableness of applicant's expense estimates. In particular, protestant objects to the \$139 annual charge to the Willows district for amortization of abnormal costs related to conversion of billing functions to electronic data processing. The independent expense estimates prepared by the staff, however, are only slightly lower than those of applicant.

The overall effective ad valorem tax rate for this district shows a gradually steepening upward trend over the past decade, with a sharp jump for the fiscal year 1967-68, as is portrayed by Chart 7-A of Exhibit No. 7. The sharp jump was caused by a revision of the assessment ratio to 25 percent from the former 20 percent. Applicant and the staff projected different estimated trends into 1968-69 and 1969-70. Protestant expressed doubt that the taxes paid to it and the County of Glenn would increase at the rate projected by applicant. By the time of the December 17 hearing, actual tax bills for 1968-69 were available and proved to be higher than estimated by either applicant or the staff. The taxes adopted in Table II are based upon projection of the trend of effective tax rates through a point midway between the rates applicable to 1967-68 and 1968-69, after adjusting

the periods prior to 1967-68 for the reassessment program. The projected rates are applied after adjusting 1968-69 and 1969-70 plant for the additional investment required as a result of street improvements.

The staff's estimates of depreciation expense and rate base are higher than applicant's because the aforementioned street improvements were not anticipated at the time applicant's estimates were being prepared. The staff estimates are adopted in Table II.

The various differences between applicant's, the staff's and the adopted estimates of revenues and expenses affect the corresponding estimates of income taxes. The income taxes adopted in Table II reflect the revenues and expenses adopted in that table.

Surcharge to Federal Income Tax

Subsequent to the filing of the application, a 10 percent surcharge to Federal income taxes was imposed by the Revenue and Expenditure Control Act of 1968. The surcharge is retroactive for the full year 1968 and, unless extended, expires June 30, 1969. In the amended application, applicant estimates that a 2.82 percent surcharge on bills computed under the general metered service rates requested in the original application would be required to offset the effect of the income tax surcharge and produce the same net revenues indicated hereinbefore in Table II. Revised calculations show that the surcharge should be 2.93 percent. This surcharge on applicant's bills will offset only the future effect of the tax surcharge and is not designed to recoup any of the increased taxes on net revenue produced prior to the effective date of the increased water rates authorized in this proceeding.



Protestant opposes any recognition of the tax surcharge as an operating expense for rate making purposes, on the grounds that the surcharge was intended to curb inflation and that reflection of the surcharge in applicant's rates would defeat that purpose. We discussed this subject in Decision No. 74835, dated October 15, 1968, in Application No. 50403 and related applications of California Water Service Company:

"The courts have long held that income taxes must be recognized as operating expenses in setting rates for a regulated utility. This Commission historically has determined the amount of such income tax allowances based upon the tax rates and credits actually to be in effect. Thus, when the federal corporate tax rate was lowered to 48 percent from the former 52 percent, the lower tax rate was thereafter used in determining utilities' tax allowances for rate-making purposes. Similarly, when taxes are reduced because of the 'investment tax credit', this saving is passed on to the customers in setting the utility's rates.

"We now face the opposite situation, where the utility's tax liability will be greater than allowed for when present water rates were established. When those water rates have been determined as recently as in the districts involved herein, it is apparent that the utility will not achieve the rate of return found reasonable without additional rate relief." (Emphasis added)

#### Rate of Return

In the recent rate proceeding involving applicant's Stockton district, the Commission found that an average rate of return of 6.9 percent over the next three years is reasonable for applicant's operations in that district. Applicant asks that rates be authorized for its Willows district which will produce a 7 percent rate of return over the next five years.

Protestant contends that a 15 percent increase in water rates would provide the necessary revenues, but this is predicated upon an increase of 15 percent company-wide, not just for the Willows district. Many of applicant's other districts recently have had rate

adjustments resulting in a reasonable return from those portions of applicant's overall operations. Because of widely differing characteristics of the various districts, rates for each district are reviewed and established individually. Each district should provide a reasonable return on the investment in that district. It would not be proper to require customers in other districts to provide more than their fair share of the total earnings requirements so that the Willows district could have lower rates.

Protestant points out that applicant's earnings and dividends per share have been increasing over the years. This is to be expected when, as in the case of applicant, only a portion of the earnings are distributed to the stockholders and the remainder is invested in utility plant, thus increasing the equity per share of common stock.

The staff recommends, as a reasonable average allowable rate of return for applicant's near future operations, 6.7 to 6.9 percent. There do not appear to be any factors in the Willows district warranting a different allowable rate of return from the 6.9 percent found reasonable for applicant's Stockton district.

#### Trend in Rate of Return

Applicant's estimates for the test years 1968 and 1969 indicate an annual decline of 0.54 percent in rate of return at proposed rates. The staff's estimates show an annual decline of 0.47 percent at proposed rates.

The comparative rates of return for two successive test years, or for a series of recorded years, are indicative of the future trend in rate of return only if the rates of change of major individual components of revenues, expenses and rate base in the test years, or recorded years, are reasonably indicative of the future

trend of those items. Distortions caused by abnormal, nonrecurring or sporadically recurring changes in revenues, expenses, or rate base items must be avoided to provide a valid basis for projection of the anticipated future trend in rate of return.

As an indication of the reasonableness of the trend in rate of return derived from the test years 1968 and 1969, applicant prepared Exhibit No. 8, a comprehensive analysis of the many changes in recorded items of revenues, expenses and rate base during the years 1962 through 1967. Applicant analyzed and evaluated distortions during these years caused by such factors as changes in income tax rates and allowances.

Exhibit No. 8 shows that, eliminating the effects of changes in income tax rates and allowances, the average annual decline in rate of return during the period from 1962 through 1967 would have been 0.47 percent at applicant's present water rates and slightly greater at its proposed rates. This adjusted decline for the five-year period is close to the 0.53 percent per year at present water rates projected by applicant and the 0.46 percent projected by the staff. There is no reason to believe that the trend in rate of return at applicant's proposed water rates in the next few years will be less than the 0.4 percent per year which applicant requests be considered for rate-making purposes.

In most of the recent decisions in rate proceedings involving other districts of applicant, the apparent future trend in rate of return has been offset by the authorization of a level of rates to remain in effect for several years and designed to produce, on the average over that period, the rate of return found reasonable. That same approach is adopted for this proceeding. In the Stockton proceeding, with so much of the additional revenue requirement having

been due to capital additions, the cost of which could not be exactly determined at that time, it was not deemed appropriate to project more than three years into the future. Although the estimates for the Willows district are not as subject to variation as for the Stockton district, Exhibit No. 8 shows that significant changes can take place in a five-year period. For this district, a four-year projection appears reasonable.

The rate increase authorized herein will not be in effect for about the first one-third of the year 1969. With the indicated future trend in rate of return, the 7.65 percent return under the rates authorized herein for the test year 1969 should produce an average rate of return of 6.9 percent for the next four years, approximately 6.3 percent for the year 1969 (with about two-thirds of the year at the new rates), 7.2 percent for the year 1970, 6.8 percent for the year 1971, and 6.4 percent for 1972.

Findings and Conclusion

The Commission finds that:

1. Applicant is in need of additional revenues.
2. The adopted estimates, previously discussed herein, of operating revenues, operating expenses and rate base for the test year 1969, and an annual decline of 0.4 percent in rate of return, reasonably indicate the probable range of results of applicant's operations for the near future.
3. An average rate of return of 6.9 percent on applicant's rate base for the next four years is reasonable.
4. 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.

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5. The surcharges requested by applicant and authorized herein are designed to provide only sufficient additional revenue to offset the future effect of the income tax surcharge which is not reflected in the basic rate schedules.

The Commission concludes that the application should be granted as provided by the following order.

O R D E R

IT IS ORDERED that after the effective date of this order, applicant California Water Service Company is authorized to file for its Willows district 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 four days after the date of filing. The revised schedules shall apply only to service rendered on and after the effective date thereof.

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

Dated at San Francisco, California, this 8<sup>th</sup> day of APRIL, 1969.

William Squares, Jr.  
President

August  
Shed M. Moseley  
G. M. Moseley  
Thomas M. Moseley  
Commissioners

APPENDIX A  
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Schedule No. WL-1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

The City of Willows and vicinity, Glenn County.

RATES

Service Charge:	<u>Per Meter</u> <u>Per Month</u>	
For 5/8 x 3/4-inch meter .....	\$ 3.00	(I)
For 3/4-inch meter .....	3.30	
For 1-inch meter .....	4.50	
For 1 1/2-inch meter .....	6.30	
For 2-inch meter .....	8.10	
For 3-inch meter .....	15.00	
For 4-inch meter .....	20.00	
For 6-inch meter .....	34.00	
For 8-inch meter .....	50.00	
For 10-inch meter .....	62.00	

Quantity Rate:		
For all water delivered, per 100 cu.ft. ....	\$ 0.222	(I)

The Service Charge is applicable to all metered service. It is a readiness-for-service charge to which is added the charge, computed at the Quantity Rate, for water used during the month. (T)

SPECIAL CONDITION

Until the 10 percent surcharge to federal income taxes is removed, bills computed under the above tariff will be increased by 2.93 percent. (N)

Schedule No. WL-2R

RESIDENTIAL FLAT RATE SERVICE

APPLICABILITY

Applicable to all residential water service furnished on a flat rate basis.

TERRITORY

The City of Willows and vicinity, Glenn County.

RATES

Per Service Connection  
Per Month

For a single-family residential unit,  
including premises having the following  
areas:

6,000 sq.ft., or less .....	\$ 6.35
6,001 to 10,000 sq.ft. ....	8.45
10,001 to 16,000 sq.ft. ....	10.60
16,001 to 25,000 sq.ft. ....	13.80

For each additional single-family  
residential unit on the same premises  
and served from the same service  
connection .....

5.00

(N)

SPECIAL CONDITIONS

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

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

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

4. Until the 10 percent surcharge to federal income taxes is removed, bills computed under the above tariff will be increased by 2.93 percent.

(N)