

ORIGINAL

Decision No. 76573

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application )

of )

PALOS VERDES WATER COMPANY,  
a California corporation )

for general rate increases. )

Application No. 50886  
(Filed February 14, 1969)

David P. Evans and William P. Arnold,  
for applicant.

Charlton A. Mewborn, for Green Hills  
Memorial Park, Marineland of The  
Pacific, Inc., and Bud Oakley,  
Palos Verdes Golf Course, Lessee;  
Leo A. Connolly, for Sunnyside  
Ridge Road Community Association;  
Patricia H. Gribbin, for Palos  
Verdes Homes Association; Robert  
DeJernett, for Villa Grande Home-  
owners Association; Andrew H. Rendall,  
for Rolling Hills Riveria Homeowners  
Association; Benjamin T. Kenney, for  
Green Hills Memorial Park; Rowland E.  
"Bud" Oakley, for Palos Verdes Golf  
Course; Michael E. Hulme, for Marine-  
land of The Pacific, Inc.; Vernon M.  
Fay, for City Council of Rolling Hills;  
Jaryl W. Cranton, for Mira Costa  
Terrace Homeowners Association; and  
Joseph W. Strauss; Jean M. Dobbins;  
Joseph T. Barnett; and Leonard N.  
LaFornara, in propria personae,  
protestants.

F. M. Sutton, for Southwest Division,  
Naval Facilities Engineering Command;  
Joseph P. Leach, City Manager, for  
City of Rolling Hills Estates; F. W.  
Hesse, for City of Rolling Hills; and  
Mrs. Verna Sitterly, in propria persona,  
interested parties.

Elinore C. Morgan, Counsel, and Raymond E.  
Heytens, for the Commission staff.

O P I N I O N

Palos Verdes Water Company, which furnishes water service to nearly 17,000 residential and commercial and extraordinarily large users, and offers and provides public and private fire protection service on the Palos Verdes Peninsula in the Cities of Palos Verdes Estates, Rolling Hills, Rolling Hills Estates, and Lomita, and adjacent unincorporated territory in Los Angeles County, by this application seeks authority to increase its rates, according to its estimates based on operations for the test year 1969, in the total amount of \$627,378, or 26.1 percent (the Commission staff estimated the gross annual increase requested would be \$655,700, or 26.2 percent over the staff estimates of the revenues which would be produced by the present rates).

Public hearings were held before Examiner Warner on August 5 and 6, 1969, at Palos Verdes Estates, and adjourned hearings were held there on November 4 and 5, 1969. At the latter series of hearings, the applicant was provided an opportunity to improve its showing, particularly with respect to financial and rate of return requirements. Many customers protested the application in writing because of the high level of present rates and the magnitude of the proposed increase, and several complained of service conditions, particularly three major outages, the last of which occurred on August 5, 1969, and, because of rupture of a transmission line, some 8,000 customers were without water from early evening until late the next morning. The company explained that the outages were caused by an engineering design deficiency

in the pipeline leading to and being the major source of supply for a large area where Reservoir No. 25, a new 9,500,000-gallon reservoir, costing some \$800,000, has been under construction and was expected to have been completed in August or September, but probably will not be ready for service until the end of the year 1969, or early 1970. The various cities and property owners' associations all protested the application in various degrees, but most conceded that the utility should be permitted an opportunity to maintain a healthy financial condition in order to maintain and improve its present water service. Some parties questioned the relationship and possible advantages to Great Lakes Carbon Corporation, which acquired 79 percent of applicant's common stock in 1954, thereby becoming its principal and responsible manager, and which acquired the remaining 21 percent from Transamerica Development Company in December, 1968, thus attaining complete control of applicant. The record shows that, originally, Great Lakes owned and developed about 7,000 acres of the total 16,000 acres in applicant's service area, of which 1,668 acres of Great Lakes' ownership still remains to be developed and sold by property development subsidiaries of Great Lakes.

Applicant's witnesses were its vice president for operations, a rate consultant, its treasurer, a senior investment counsellor, a water system architect and designer, one of its directors and a vice president, who is also a vice president of Great Lakes Carbon Corporation, a financial consultant, and its administrative vice president. Various city managers, a mayor, two councilmen and officers of home owners' associations and

officers of Green Hills Memorial Park, Palos Verdes Golf Course, and Marineland testified regarding the position of their constituents or themselves. Commission staff witnesses were a hydraulic engineer and a financial expert. The record comprises 16 exhibits and 497 pages of transcripts. At the direction of the presiding officer, Exhibit 2, a report on the results of applicant's investigation of every complaint of service, has been submitted. The matter is now ready for decision.

Rates

Applicant's present rates were authorized by Decision No. 60447, dated August 2, 1960, in Application No. 41569, except that a tariff schedule for private fire hydrant service on private property became effective by advice letter on July 18, 1965. The following tabulations compare applicant's present, proposed and authorized rates for general metered service:

Comparison of Present, Proposed,  
and Authorized Rates

General Metered Service  
5/8 x 3/4-inch Meter

	<u>Per Meter Per Month</u>		
	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Authorized Rates</u> <sup>1/</sup>
Quantity Rates:			
First 400 cu.ft., or less .....	\$2.50	\$3.00	\$2.70
Next 1,600 cu.ft., per 100 cu.ft..	.50	.63	.535
Next 3,000 cu.ft., per 100 cu.ft..	.41	.53	.44
Next 5,000 cu.ft., per 100 cu.ft..	.35	.45	.37
Next 40,000 cu.ft., per 100 cu.ft..	.29	.39	.31
Over 50,000 cu.ft., per 100 cu.ft..	.25	.35	.27

<sup>1/</sup> Exclusive of Federal Income Tax Surcharge.

Comparison of Present, Proposed,  
and Authorized Rates

General Metered Service  
5/8 x 3/4-inch Meter

: Monthly : Consumption : Cubic Feet	:	Present Rates	:	Proposed Rates	:	Authorized Rates <sup>2/</sup>	:
400		\$ 2.50		\$ 3.00		\$ 2.70	
500		3.00		3.63		3.23	
600		3.50		4.26		3.77	
1,000		5.50		6.78		5.91	
2,000		10.50		13.08		11.26	
3,000		14.60		18.38		15.66	
5,000		22.80		28.98		24.46	
10,000		40.30		51.48		42.96	
50,000		156.30		207.48		166.96	
100,000		281.30		382.48		301.96	

Average Monthly Use and Billing

: Class of Customer	:	Present Cubic Feet	:	Present Rates	:	Proposed Rates	:	Authorized Rates <sup>2/</sup>
Residential & Commercial		2,300		\$ 11.73		\$ 14.67		\$ 12.58
Extraordinary Users		413,000		1,063.80		1,547.98		1,147.06
Public Authority		13,300		51.32		66.30		54.74
Irrigation		29,000		95.40		125.58		101.86

No increase in rates is requested for private fire hydrant service on private property, private fire protection service, or public fire hydrant service.

The record shows that applicant's present rates for general metered service are the third highest in California <sup>3/</sup> and substantially higher than the rates of adjacent public utility water purveyors. It should be noted, however, that the topography of applicant's service area varies from sea level to about 1,500 feet and at elevations requiring the distribution of water at

<sup>2/</sup> See Footnote, page 4.

<sup>3/</sup> For Class A, B, and C, public utility water corporations.

various heights and the installation of regulators to keep water pressures below maximum allowable standards pursuant to General Order No. 103; the density of applicant's service area is relatively sparse, although it is becoming increasingly less so due to development and attendant customer growth which had increased the number of customers from 8,495 as of December 31, 1959, to 16,749 as of September 30, 1969; an increase of 8,254 customers, or 97.2 percent in the 10-3/4-year period; applicant's source of water supply is obtained from the West Basin Municipal Water District, a member agency of the Metropolitan Water District of Southern California, which has announced incremental annual charges of \$3.00 or \$4.00 per acre-foot at least through the year 1971; and other operating characteristics contribute to high water costs and rates for water service.

Revised Exhibit "C" is a report on applicant's operations for the adjusted year 1968 and the estimated year 1969 at present and proposed rates, submitted by its rate consultant, and its treasurer. Exhibit 4 is a report on the results of applicant's operations for the year 1968 adjusted and the year 1969 estimated at present and proposed rates, submitted by the

Commission staff. The earnings data contained in said exhibits is summarized as follows:

Summary of Earnings

Item	Year 1968	Year 1969 Estimated			
	Adjusted	Present Rates		Proposed Rates	
	Present	Per Co.	Per PUC	Per Co.	Per PUC
	Rates	Ex. C, Rev.	Ex. 4	Ex. C, Rev.	Ex. 4
Item	PUC Ex. 4	Rev.	Ex. 4	Rev.	Ex. 4
Oper. Revenue	\$2,340,600	\$2,400,355	\$2,498,400	\$3,027,733	\$3,154,100
Oper. Expense	1,285,700	1,450,790	1,400,500	1,458,744	1,407,900
Depreciation	291,300	312,730	303,900	312,730	303,900
Taxes*	322,400	258,600	326,100	606,122	660,900
Subtotal	1,899,400	2,022,120	2,030,500	2,377,596	2,372,700
Net Revenues	441,200	378,235	467,900	650,137	781,400
Rate Base	7,891,700	8,297,284	7,945,400	8,297,284	7,945,400
Rate of Return	5.6%	4.56%	5.9%	7.84%	9.8%

\*10% FIT Surcharge included in Exhibit C, Revised; not included in Exhibit 4.

There are numerous differences between the estimates of rate of return components submitted by the applicant and the staff which combine to produce the differences in rates of return set forth in the preceding tabulation.

Applicant's estimate of revenues for the test year 1969 at present and proposed rates was based on the simple average of customer water usage over the past six years, whereas the staff utilized the Modified Bean statistical method of normalizing such usages to reflect the effects of temperature variations and amounts of precipitation. This method has been proven to be accurate, but applicant's witness stated that he was not familiar

with it. Applicant's method of normalizing water use for residential and commercial customers resulted in a lowering of average consumption, whereas the staff studies show that there is an upward trend in average consumption. The customer growth for the year 1969 over the year 1968 was estimated by the staff to be 174 customers higher than that estimated by the applicant and this resulted in higher estimated revenues at both present and proposed rates, according to the staff studies.

A detailed explanation of the major differences in the estimates of operating expenses, taxes, utility plant, depreciation expense and reserve, and rate base between those submitted by the applicant and the staff for the year 1969 is set forth in Exhibit 4, and such explanation was elaborated by the staff engineering witness in his testimony.

Cost of Money  
and Rate of Return

Exhibits 3 and 13 are cost of money studies submitted by applicant's investment counsellor, and a financial consultant. Exhibit 5 is a report on cost of money and rate of return submitted by the Commission staff. Both applicant's exhibits purport and attempt to support applicant's request for a 7.84 percent rate of return on its estimated rate base of \$8,297,284 for the test year 1969 (including \$400,000 for the new reservoir No. 25 on an average beginning and end-of-year basis) to service debt charges at an actual annual cost of \$291,704, preferred dividends of \$18,702, and net credit to common equity allowance of \$340,101, and producing a 12.1 percent return on average common equity of \$2,805,497.



The staff's Exhibit 5 recommended a rate of return of 7 percent on the staff's estimated rate base of \$7,945,400, which would yield approximately 9.5 percent on common stock equity. The considerations which the staff deemed important in its rate of return recommendation were: (a) little or no future financing needs from external sources beyond 1969; (b) maintenance of credit standing; (c) lack of consumer saturation; (d) high cost of money in the future; and (e) applicant's continued above-average customer growth. Table 3 of the staff exhibit shows the effective cost of applicant's senior capital, on a pro forma basis at December 31, 1969, to have been 5.94 percent at the time of the staff report, July 18, 1969.

As to the relationship between applicant and its parent, Great Lakes Carbon, and the latter's ability or inability and efforts to finance applicant on better terms during 1969, the record shows that Great Lakes is limited by Equitable Life Assurance Society of America to investing not more than \$1,500,000 in its subsidiary Palos Verdes Water Company, and that as of March, 1969, that investment was \$1,455,000; the \$1,000,000 of Series "D" first mortgage bonds due August 1, 1988 were sold to Pacific Mutual Life Insurance Company bearing an interest rate of 7 percent; an additional \$1,000,000 comprising 8.5 percent non-secured debentures, due July 1, 1989, was also contracted for by Pacific Mutual, but could not be issued as a mortgage because applicant's debt exceeded 60 percent of its bondable plant.

Findings

Based upon a careful review of the record, the Commission finds as follows:

1. Palos Verdes Water Company is a public utility water corporation under the jurisdiction of this Commission, furnishing water service to some 17,000 residential and commercial and ten extraordinarily large users, and offering public and private fire hydrant service and public fire protection service within its service area comprising some 16,000 acres in the Cities of Palos Verdes Estates, Rolling Hills, Rolling Hills Estates and Lomita and adjacent unincorporated territory of the Palos Verdes Peninsula in Los Angeles County.

2. Applicant's present rates have been in effect since August, 1960, except its rate for private fire hydrant service on private property, which has been in effect since July, 1965.

3.a. Applicant seeks to increase its rates in the gross annual amount of \$627,378, or 26.1 percent, according to its estimates based on operations for the test year 1969.

b. Commission staff estimated the gross annual increase requested would be \$655,700, or 26.2 percent over the staff estimates of the revenues which would be produced by the present rates.

4. The rates of return of 4.56 percent on the rate base estimated by the applicant for the test year 1969 of \$8,297,284, and of 5.9 percent on the rate base estimated by the staff of \$7,945,400, which would be produced by the present rates, is deficient and applicant is in need of financial relief.

5.a. The reasonableness of the rate of return of 7.84 percent on applicant's estimate of its rate base for the test year 1969 and other rate components, including its estimates of operating revenues at the proposed rates, operating expenses, depreciation, and local state and federal taxes, together with the resultant 12.1 percent yield on equity, sought by the applicant, is not supported by the record. Applicant's estimates of operating revenues were based on erroneous and conflicting customer growth estimates and did not utilize the most accurate statistical methods with which the Commission is familiar and which the Commission has universally adopted over the past several years in decisions on public utility water company rate proceedings.

b. The Commission staff estimates of rate components at both present and proposed rates for the test year 1969 are reasonable.

6.a. The upward trend in rate of return of .3 percent annually shown on the record may reasonably be expected because of applicant's above-average growth prognosis and the fact that such growth will not require significant capital additions, at least to rate base, since the backbone system to serve additional

customers already exists and extensions to subdivisions will be financed by subdividers under Main Extension Rule No. 15 and such extensions are not immediately includable in rate base.

b. A rate of return of 6.95 percent for the test year 1969 on the Commission staff rate base estimate of \$7,945,400, which should produce an average rate of return of 7.25 percent for the three years 1969, 1970, and 1971, is reasonable. In this finding we have considered, among other things, applicant's present and foreseeable future cost of money, applicant's ownership - developmental relationship, applicant's special topographical operating characteristics, the customer density of applicant's service area and its immediate growth potential, the foreseeable costs of water and water service, the history of applicant's rates and operations, and the impact of any adjustment in applicant's rates for water service on its customers.

7. Applicant's request to deviate in the percentage increase impact on users of increasingly large quantities of water is not supported by the record and is unreasonable.

8. 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.

Conclusion

The Commission concludes that this application should be granted in part and denied in part, and Palos Verdes Water Company should be authorized to file new schedules of rates which will produce gross annual revenues, exclusive of the federal income tax surcharge, of \$2,674,600 an increase of \$176,200 or 7.1 percent over the revenues which would be produced by the present rates, but about \$479,500 less than sought in the application. Said gross annual revenues which will be produced by the authorized rates, after taking into account operating expenses of \$1,402,700, depreciation of \$303,900, and taxes of \$416,000, will result in net revenues of \$552,000, which, when related to the estimated rate base for the test year 1969 of \$7,945,400 hereinbefore found to be reasonable, will result in the rate of return of 6.95 percent for the test year 1969 and an average of 7.25 percent over the next three years, also hereinbefore found to be reasonable.

With respect to the complaint of the Mayor of the City of Rolling Hills regarding fire protection service, applicant should proceed to carry out its planned water facility improvements contained in Exhibit 11.

In all other respects, this application should be denied.

O R D E R

IT IS ORDERED that:

1. Application No. 50886 of Palos Verdes Water Company is granted in part and denied in part, and applicant is authorized to file, after the effective date of this order, the

revised schedule of rates as set forth in Appendix A attached hereto. Said rates shall be effective four days after the date of filing and shall apply only to service rendered on and after said effective date. Such filing shall comply with General Order No. 96-A.

2. Applicant shall proceed to carry out its planned water facility improvements relating to fire protection service in the City of Rolling Hills contained in Exhibit 11.

3. In all other respects, the application is denied.

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

Dated at San Francisco, California, this 16<sup>th</sup> day of DECEMBER, 1969.

William J. ...  
President

August ...

J. ...

...

Vernon L. Sturgeon  
Commissioners

APPENDIX A

Schedule No. 1

(T)

METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Palos Verdes Estates, Rolling Hills, Rolling Hills Estates, Lomita, and vicinity, Los Angeles County.

(T)

(T)

RATES

Quantity Rates:

		<u>Per Meter</u> <u>Per Month</u>	
First	400 cu.ft. or less .....	\$ 2.70	(I)
Next	1,600 cu.ft., per 100 cu.ft. ....	.535	
Next	3,000 cu.ft., per 100 cu.ft. ....	.44	
Next	5,000 cu.ft., per 100 cu.ft. ....	.37	
Next	40,000 cu.ft., per 100 cu.ft. ....	.31	
Over	50,000 cu.ft., per 100 cu.ft. ....	.27	(I)

Minimum Charge:

For	5/8 x 3/4-inch meter .....	\$ 2.70	(I)
For	3/4-inch meter .....	3.25	
For	1-inch meter .....	4.40	
For	1 1/2-inch meter .....	6.50	
For	2-inch meter .....	11.00	
For	3-inch meter .....	16.00	
For	4-inch meter .....	27.00	
For	6-inch meter .....	60.00	
For	8-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.

SPECIAL CONDITION

(N)

While the 10 percent surcharge to federal income tax is in effect, bills computed under the above tariff will be increased by 1.4 percent. At such time as the tax surcharge is effectively terminated or reduced, the above percentage shall be eliminated or reduced to the extent of the net reduction in the tax surcharge.

(N)