

Decision No. 76696

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
OLEMA WATER SYSTEM, under Section 454)
of the Public Utilities Code for)
authority to increase rates for water)
service.)

Application No. 50294
(Filed June 7, 1968;
Amended July 10, 1968)

J. Thomas Hannan, Esq., for applicant.
John D. Reader, for the Commission staff.

O P I N I O N

The applicant serves 28 metered customers and two small dairies in the unincorporated town of Olema, two miles south of Point Reyes Station in Marin County. Over the last ten years the total number of customers has varied from 27 to 32.

The water supply is obtained from a spring fed, surface impounding reservoir created by a dam at elevation 297.5 in Canyon No. 1, Bear Valley Ranch, from which point it is fed into a settlement tank, thence through a 3-inch line, 1,600 feet to a concrete storage tank, capacity 10,400 gallons, thence through 4,377 feet of 3-inch line. At this point it reduces to a 2-inch line running 786 feet to a 16,900-gallon tank, and thence through a 2-inch line, 1,182 feet to the county road in the town of Olema. At a point approximately 3,300 feet from the first storage tank a chlorinator and filtration unit have been added to the system. Distribution in the town of Olema is handled through 3/4-inch to 2-inch mains.

Olema Water System is a California corporation. Its president is Robert Phillips. The common stock is owned by Alexandra Phillips, Rawson Kelham and Mrs. Grace Kelham, their mother.

The record indicates that the utility system was initially constructed by E. C. Compton who at that time was owner of the Bear

Valley Ranch. When the ranch was sold to the Kelham family in 1949, they also acquired the utility. At that time the water system was incorporated.

The present rates were established in 1923 and no increase has been sought under the Kelham regime until this proceeding was filed, subsequent to the sale of the Bear Valley Ranch to the Federal government under threat of condemnation. The ranch property is now part of the Point Reyes National Seashore.

This application sought a threefold increase in metered rates for water service. Under the present rate structure the average monthly water bill for residential customers is \$2.47. Under the proposed rates the average residential bill would increase to \$7.41.

This application was previously determined ex parte by Decision No. 75315 issued February 11, 1969. That decision relied heavily on a staff report (Exhibit No. 1) which suggested replacements of major segments of applicant's mains and modifications to allow flushing of dead ends of the non-circulating mains. The report also recommended that applicant be ordered to complete certain maintenance procedures and comply with various administrative regulations.

The staff estimated that the pipe replacements would cost nearly \$7,000. These replacements were intended to remedy the problems of low pressure, which are especially critical at points on the periphery of the system.

The staff report recommended an immediate rate increase to produce additional annual revenues of \$950 per year. The report further recommended a second level of higher rates to become effective when the system improvements had been completed. This second level increase would produce a rate of return of 9 percent on existing rate base plus improvements. The staff report was accepted by the

Commission and Decision No. 75315 based thereon was issued February 11, 1969.

On February 18, 1969 applicant petitioned for rehearing; the petition claimed that applicant intended to take issue with portions of the staff report, but had been surprised by issuance of Decision No. 75315 without notice of submission. The petition was filed in time to automatically stay the decision; consequently, the 1923 rates are still in effect. The rehearing was granted by Decision No. 75539 issued April 8, 1969.

Hearing was held before Examiner Gilman on July 1 and 2, 1969 in Point Reyes Station, California.

Two customers and a staff engineer and financial examiner testified at the hearing. Applicant's attorney testified on behalf of applicant.

Pressure Problems

A letter to the Commission (received as Exhibit 8), signed by 17 individuals, indicated serious customer concern with these problems and urged that no major rate increase be granted until it is resolved.

According to the staff engineering witness, the small diameter of the mains is almost completely responsible for the pressure problems.

The staff exhibit indicates that static pressures ranged from 30 to 40 psi. However, when any demand was placed on the system by flushing toilets, or turning on washers or watering systems, the pressure dropped to "almost nothing".

The staff witness testified that, in his opinion, replacement of 1,200 feet of 2-inch pipe between the lower tank and the intersection of Bear Valley Road and State Route No. 1 and of 800 feet

of 3/4-inch and other size pipe in the southern area with 4-inch pipe would, to a large extent, cure the pressure problems.

The staff made no suggestion of a possible source for the estimated \$7,000 required to make these improvements. Applicant's witness indicated that the stockholders had been making up operating deficits in the system for many years and would not willingly put more capital into the system. He testified that he had made inquiries of a large banking concern to determine if the corporation could qualify for a loan based on the second level of rates recommended by the staff; he was informed that the corporation could not qualify.

Staff introduced no evidence to indicate that Kelham family has sufficient assets to make such an investment on their own. Nor did it undertake to demonstrate any reasons why the Commission should "pierce the corporate veil" to compel dedication of the personal assets of the Kelhams as a source of funds for needed improvements.

Consequently, based on the present state of the record, we cannot conclude that there is any practicable program for providing the assets necessary to improve the system, and we have little choice but to modify our prior order by eliminating the time schedule for completing those improvements. This modification should not, however, be interpreted as excusing the utility's ultimate duty to provide adequate service.

Supply

Another potential problem was disclosed at the hearing. At the time the staff report was prepared, applicant's water supply was sufficient for the number of customers served and there was little prospect for rapid growth. However, subsequently one of applicant's customers began to develop his property as a trailer park,

with facilities for 50 trailers. The addition of 50 more users to the system could well produce water shortages. Under the present rate structure, the increased usage is not expected to be accompanied by any substantial increase in gross revenues. While there appears to be no present emergency, this aspect may prove to be serious enough to warrant extended consideration in further proceedings.

The circumstances surrounding the sale of the Bear Valley Ranch to the Federal government may further complicate the supply picture. Under pressure of a threatened condemnation proceeding the Kelham interests consented to execute a deed which excepted only:

"Such right, title and interest as Olema Water System, Inc. may have in and to any land or interest therein and appurtenant works for the purpose of providing water to persons presently obtaining water from said corporation." [Emphasis added]

If any potential competitor for the water supply were to appear, we would expect the utility's owner to defend its water supply. Section 851 of the Public Utilities Code may invalidate the deed, insofar as it is a threat to that supply.

Potability

The records of the Marin County Health Department indicate that no water supply permit has been issued to the system. However, periodic tests of the water have been made by the Department. Between the end of 1964 and March of 1968 sixteen tests were performed, of which 6 showed excessive coliform bacteria. The system has a chlorinator and filtration system, but this high incidence of unsatisfactory reports demonstrates a need for further attention to the problem.

In the opinion of the staff engineer, cleaning the water source, cleaning the settling tank and providing a cover for it will help to solve the bacteriological problems.

Since the costs of these improvements appear minimal, the utility will be ordered to complete them in the near future.

Salaries

The staff's estimate for payroll amounts to \$620, compared to applicant's claim for \$1,550.

The claimed current expenses are \$100 per month to the caretaker/operator and \$20 per month to the bookkeeper. The bookkeeping expense is presently being borne by Mrs. Kelham and the caretaker/operator expense is absorbed by the trustees of various trusts established by Mrs. Kelham. Neither Mrs. Kelham nor the trustees of the trusts involved desire to continue to absorb these costs.

Staff's estimate is based on an analysis of the amounts allowed by the Commission for payroll costs for comparable water utilities in several similar cases, set forth in the table below:

<u>UTILITY</u>	<u>CITATION</u>	<u>ANNUAL PAYROLL COST/CUSTOMER</u>	<u>NUMBER OF CUSTOMERS</u>
Snobowl Water System	A.49985 D.74644	\$20.80	25
*Panorama Hts. Water Co.	A.49584 D.74093	26.20	60
*Brentwood Water Co.	A.50317 D.75131	16.10	70
Strawberry Hts. Water Co.	A.50184 D.74980	29.60	81
*Rancho Sequoia Water Co.	A.49323 D.73221	17.00	66

*Ex Parte proceeding

As noted three of the cases cited by staff were ex parte. In another (Strawberry Heights), the applicant stipulated to staff's costs, in order to expedite decision, while claiming the staff's estimate to be unreasonably low. In the Snobowl proceeding, the staff's salary estimate was apparently not seriously contested, and there are only general findings on the issue.

The staff recommended cost would allow \$22.20 payroll costs per year per customer for this utility. Staff points out that all of the utilities listed for comparison have one or more wells or booster pumps requiring regular cleaning and maintenance, whereas the Olema system is gravity fed and therefore should require somewhat less labor.

Applicant claims that \$1,550 will actually be expended and thus should be allowed in full.

Both employees have other economic relationships with the Kelham family. The caretaker/operator also leases farmland from the Kelham interests. The total consideration for the lease is \$1,500 per year in cash plus the obligation to maintain and operate the system. The bookkeeper is employed full time by Mrs. Kelham and the \$20 per month claim for her services represents an allocated portion of her time.

Thus, applicant's salary claims are not founded on actual cash expenditures, but upon a valuation agreed to by applicant and its employees; such a valuation is not in itself a probative measure of the value of the services rendered. The record is not adequate to develop an alternate measure of the value of these services.

On the other hand, none of the cases cited by staff discloses a considered decision of a contested issue. Consequently, they provide no guidance for the determination of this issue presented here, or for the establishment of generally applicable guidelines for testing the reasonableness of salary claims for small water utilities.

We conclude that the staff showing on the issue of salaries is without adequate foundation and must be rejected; applicant's estimates are likewise without an adequate foundation. Future proceedings are contemplated herein and will provide an opportunity for a re-examination of this issue.

Appendix B demonstrates the crucial importance of this issue. If the staff's estimate is accepted, the rate increase adopted herein covers depreciation expense, and returns approximately 5 percent on the staff-developed unadjusted rate base. If, on the other hand, applicant's salary claims were adopted, the new revenue will approximately equal out-of-pocket expenses.

Liabilities

The company's only liability according to its balance sheet (Exhibit A to the application) consists of a single debt owed to Mrs. Kelham. According to applicant the debt arose between the years 1949 and 1963; during this period Mrs. Kelham, rather than applicant, paid the salary costs of \$100 per month. Mrs. Kelham's payments were apparently required because the company's gross revenues were insufficient to cover out-of-pocket expenses. Inferrably, this same cause accounts for the Negative Earned Surplus of \$14,034.41 (compared to total outstanding capital stock of \$9,000).

Staff claims that recognition of this "debt" to the utility's principal stockholder would be "retroactive ratemaking" and violate the principle of Pacific Tel. & Tel. (48 Cal.P.U.C. 823, 836) by charging today's customers with expenses attributable to prior years' operations.

Applicant sought a rate of return of 13.8 percent; in justification for this rate of return it claims that part of the projected profit is required to reduce the Negative Earned Surplus. If the Commission were to allow an added increment in rate of return in order to reduce the negative surplus, such a step might indeed involve elements of retroactivity. However, the issue is moot, for present purposes. Even assuming the staff's salary figures, the rates authorized herein will yield no more than 5 percent on unadjusted

depreciated rate base (or less than 3 percent on capital stock). Of course, if substantial reductions in rate base are ultimately made it is possible that the actual rate of return from the rates adopted herein may be significantly higher; however, the total dollar amount will be small enough that we will not impose a refund provision.

Rate Base

Applicant's witness was not able to fully describe the conditions under which the Bear Valley Ranch received water during the period of common ownership. If the ranch obtained water free or at less than tariff rates, we may be required to find that the utility's property was only partially dedicated to public use, the remainder having been reserved for the proprietary benefit of the utility's true owners.^{1/}

Such a finding probably would require an adjustment to rate base so that customers would not be required to pay a return on properties used in the proprietary service to the ranch.

While pipe sizes are almost certainly not a completely reliable basis for allocation they provide a measure of the capacity available to the ranch as opposed to the public. As noted above, the total system requirements, including those of the ranch, were carried in a three-inch main, whereas the main from the ranch boundaries to the town is of two-inch diameter. Consequently, the ranch and the utility customers had roughly equal shares of the total capacity.

Since we cannot determine the need for, or the amount of, adjustment to rate base to eliminate non-dedicated property, we cannot establish a proper allowance for either depreciation or return.

^{1/} The terms of the deed to Federal government imply a proprietary share in the "works" and would tend to support a finding that the system was not completely dedicated to public use.

Interim Rates

When a disappointed applicant for a rate increase is granted rehearing of a decision which has allowed only a part of the requested increase, the applicant undertakes the burden of establishing that the newly established rates are unreasonably low. Applicant and petitioner have failed to convince us that the rate increase previously granted is unreasonable. Applicant may in the course of the further proceedings contemplated seek to convince us that the rates established herein should be raised: either by demonstrating that these rates will seriously detract from its ability to continue operations; or by demonstrating that it has committed itself to system improvements.

Consequently, the Commission will adopt the "first level" rates authorized in Decision No. 73515, on an interim basis.

As previously noted, the rates adopted cannot be precisely analyzed. Since we cannot determine the true value of the employee's services, we can find, with assurance, only that the revenues allowed will at least cover out-of-pocket costs. Except for the uncertainty as to rate base, it is most probable that the rate of return will not significantly exceed 5 percent; however, any reduction in rate base would of course produce a corresponding increase in the percentage rate of return.

This level of rates is intended to promote an early improvement in service, while avoiding for the future the damaging effects of a continued out-of-pocket deficit.

We are of the opinion, further, that these rates offer the consumer a rate commensurate with the quality of service. We could not find a rate to be just and reasonable if these customers were forced to pay the same rate as they would pay for a fully adequate service.

The operating revenues as estimated by staff (cf. Appendix B) reflect expected consumption of 26 residential customers and 2 dairies under normal climatological conditions. No attempt has been made to estimate additional revenues, if any, from the trailer camp.

Operating and maintenance expenses are based on staff's analysis of the utility's experience in recent years. Vehicle expenses reflect the staff's estimate for reasonable mileage for the operation of such a system at 11 cents a mile.

Findings

The Commission finds that:

1. Applicant is in need of additional revenue.
2. Applicant's service to its customers is inadequate and insufficient.
3. Applicant's service will continue to be inadequate and insufficient until 800 feet of 3/4-inch and other size mains in the southern end of its system and 1,200 feet of 2-inch pipe running from the lowest tank to the intersection of Bear Valley Road and State Route No. 1 are replaced with 4-inch pipe.
4. The costs of such improvements will approximate \$7,000.
5. Applicant should also be:
 - (a) Required to clean and fence source of supply.
 - (b) Required to clean and install tight cover on the settling tank.
 - (c) Required to provide means of flushing dead ends of mains.
 - (d) Required to file up-dated rules and a service area map.
 - (e) Ordered to prepare, and keep current, the system map required by paragraph I-10a of General Order No. 103. Within 90 days after the effective date of the order in this proceeding, applicant should file two copies of the map with the Commission.

- (f) Required to record in its books of account the staff adjusted balances for utility plant and reserve for depreciation, as of December 31, 1967, as set forth in the tabulation titled, "Utility Plant in Service, Depreciation Reserve and Net Plant Investment" in Exhibit No. 1.
- (g) Required to keep its books of account current, and to retain all invoices and other documents needed to support entries in the books of account.
- (h) Required to compute depreciation by the straight-line remaining life method.
- (i) Required to apply for a water supply permit as required by the Health and Safety Code of the State of California.

The costs of the requirements in 5 above will be minimal.

6. Under the rates stated in Appendix A applicant's annual revenues will approximate at least \$2,328.

7. Applicant's estimated annual expenses before taxes and depreciation will be between \$1,442 and \$2,263 as detailed in Appendix B.

8. The rates set forth in Appendix A are not unjust and unreasonable for the quality of service presently rendered and the present rates and charges insofar as they differ from those authorized herein are for the future unjust and unreasonable.

Conclusions

1. Applicant has a duty to improve its system as detailed in Finding No. 3.

2. Applicant should be ordered to perform the requirements detailed in Finding No. 5.

3. Applicant has not proven the "first level" rates authorized by Decision No. 75315 to be unjust, unreasonable or confiscatory.

4. The application should be granted to the extent set forth in the order which follows.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, applicant corporation Olema Water System is authorized to file the revised rate schedule attached to this order as Appendix A. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedule shall be four days after the date of filing. The revised schedule shall apply only to service rendered on or after the effective date thereof.

2. Within three months after the effective date of this order, applicant shall:

- (a) Clean and fence source of supply.
- (b) Clean and install tight cover on the settling tank.
- (c) Provide means of flushing dead ends of mains.
- (d) File up-dated rules and a service area map.
- (e) Prepare, and keep current, the system map required by Paragraph I.10a of General Order No. 103. Applicant shall file two copies of the system map with the Commission.
- (f) Record in its books of account the staff adjusted balances for utility plant and reserve for depreciation, as of December 31, 1967, as set forth in the tabulation titled, "Utility Plant in Service, Depreciation Reserve and Net Plant Investment" in Exhibit No. 1.
- (g) Keep its books of account current, and retain all invoices and other documents needed to support entries in the books of account.
- (h) Compute depreciation by the straight-line remaining life method.
- (i) Apply for a water supply permit as required by the Health and Safety Code of the State of California.

3. For the year 1969, applicant shall apply a composite depreciation rate of 3.5 percent to the original cost of plant. Until

review indicates otherwise, using the straight-line remaining life method, applicant shall continue to use this rate. Applicant shall review the depreciation rates at intervals of five years and whenever a major change in depreciable plant occurs. Any revised depreciation rate shall be determined by: (1) subtracting the estimated future net salvage and the depreciation reserve from the original cost of plant; (2) dividing the result by the estimated remaining life of the plant; and (3) dividing the quotient by the original cost of plant. The results of each review shall be submitted promptly to the Commission.

4. Applicant has an obligation to install new 4-inch mains to replace 800 feet of existing undersized mains on the south end of the system and 1,200 feet of 2-inch main between the lower tank and the intersection of Bear Valley Road and State Route No. 1.

5. Applicant shall reclassify the cost of "Survey of Water System", a nonutility expense, from Account No. 301, Intangible Plant to Account No. 202, Earned Surplus.

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

Dated at San Francisco, California, this 20th day of JANUARY, 1970.

William L. S. S. S.
President
[Signature]
Vernon L. S. S.
Commissioners

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Commissioner A. W. Gatov, being necessarily absent, did not participate in the disposition of this proceeding.

Commissioner Thomas Moran, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A

Schedule No. 1

METERED SERVICEAPPLICABILITY

Applicable to all metered water service.

TERRITORY

Olema and vicinity, 2 miles south of Point Reyes Station, Marin County, California.

RATES

Per Meter
Per Month

Quantity Rates:

First 400 cu. ft. or less	\$ 1.75
Next 4,600 cu. ft., per 100 cu. ft.42
Over 5,000 cu. ft., per 100 cu. ft.34

Minimum Charge:

For 5/8 x 3/4-inch meter	\$ 1.75
For 3/4-inch meter	3.00
For 1-inch meter	4.25
For 1 1/2-inch meter	7.50
For 2-inch meter	13.50

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

APPENDIX B

		Assuming Applicant's Salary Costs	Assuming Staff Salary Costs
Revenue			
	1968 Estimated Rate Increase	\$1,378	\$1,378
	Total	950	950
		<u>2,328</u>	<u>2,328</u>
Account No.	Expenses		
726	Power	25	25
735	O&M Materials	35	35
736	O&M Contract Work	200	200
792	Office Supplies	83	83
791.1	Office Salary	240	120
791.2	Management Salary	1,200	500
793	Insurance	200	200
798	Accounting & Legal Services	50	50
799	General Expenses	50	50
801	Vehicle Expenses	130	130
811	Office & Storage Space	50	50
	Total	<u>2,263</u>	<u>1,443</u>
503	Depreciation	443	443
507.4	California Tax	100	100
507.5	Federal Tax	-	84
	Net	<u>2,806</u> (478)	<u>2,070</u> 258

(Red Figure)