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ORIGINAL

Decision No. 77365

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of the SOUTHERN CALIFORNIA WATER COMPANY for an order authorizing it to increase the rates for water service in its Culver City District.	Application No. 51412 (Filed October 7, 1969)

O'Melveny & Myers, by Donn B. Miller, for applicant.
Dale Austin, for City of Culver City, protestant.
Cyril M. Saroyan, Counsel, and Richard A. Norton, for the Commission staff.

OPINION

Applicant Southern California Water Company seeks authority to increase rates for water service in its Culver City District.

Public hearing was held before Examiner Catey in Culver City on February 25 and 26, 1970, and in San Francisco on May 4, 1970. 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 May 4, 1970.

Testimony on behalf of applicant[1/] was presented by its vice presidents in charge of revenue requirements and operations, its secretary-treasurer, its Rate and Valuation Department assistant manager, and a consulting accountant. The City Attorney testified for the City Council of Culver City. Two customers testified in their own behalf. The Commission staff presentation[1/] was made through two accountants and two engineers.

1/ Testimony and exhibits relating to overall company operations had been presented by witnesses for applicant and the staff in Application No. 51165, the Central Basin District rate proceeding. The testimony and exhibits were incorporated by reference in Application No. 51412.

Service Area and Water System

Applicant owns and operates water systems in 16 districts and an electric system in one district, all in California. Its Culver City District includes generally the City of Culver City and a small area in the unincorporated territory of Los Angeles County adjacent to that city. The area is primarily residential but includes some industrial and business areas.

The principal water supply for this district is purchased water from Metropolitan Water District of Southern California (MWD) obtained through the facilities of West Basin Municipal Water District (WBMWD). Water from three of applicant's local wells normally is blended with the purchased water. Two other wells provide an emergency standby source.

The distribution system includes about 88 miles of distribution mains, ranging in size up to 17-inch. There are about 8,000 metered services, 90 private fire protection services and 600 public fire hydrants. Two storage tanks on elevated ground and additional forebay storage with booster pumps maintain system pressure and provide storage for the system.

Service

Field investigations of applicant's operations, service and facilities in its Culver City District were made by the Commission staff. A staff engineer testified that no informal service complaints have been registered with the Commission by customers in the Culver City District since 1967. The engineer's review of applicant's records indicated that the various complaints registered directly with the utility have been resolved satisfactorily.

Staff interviews with customers in various parts of the district indicate that service generally is good. The City Attorney testified, however, that many customers have complained to the city council concerning the quality of the water.

Water from the local wells is very hard. Prior to the importing of MWD water, the local well water was the only available source for the Culver City system. Over a period of years, the hard water apparently has built up incrustations of scale inside some of applicant's distribution mains and service pipes and also inside the customers' own piping. Even though the MWD water is much softer than the water previously served in Culver City, it tends to dissolve or loosen some of the existing scale and to lower somewhat the quality of the water which ultimately reaches the customers' outlets.

A staff engineer testified that applicant has eliminated several dead ends and is on a main replacement program which generally should contribute to the upgrading of the Culver City system. Applicant's vice president in charge of operations testified that applicant intends to continue its replacement program into the future on a planned basis and also to replace other mains as appropriate at the time various streets are being improved by the city.

Rates

Applicant's present tariffs applicable to the Culver City District include schedules for general metered service, private fire protection service, public fire hydrant service, construction flat rate service, and service to company employees.

Applicant proposes to change the general metered service schedule from the present minimum charge type of schedule to a service charge type. The cost-of-service study presented by applicant shows that the service charge type of schedule results in a more equitable distribution of charges among customers with various sizes of meters and among customers with the same size of meters but with various monthly consumptions.

Applicant's proposed rate changes would, in general, increase metered service rates. The following Table I presents a comparison of applicant's present general metered service rates and those requested by applicant.

Table I

Comparison of Monthly General Metered Service Rates

Item	Present	Proposed[a]
Minimum or Service Charge[b]	$2.75	$1.90
Quantity Rate:		
First 800 cu.ft., per 100 cu.ft.	.00[c]	.274
Next 1,700 cu.ft., per 100 cu.ft.	.286	.274
Next 7,500 cu.ft., per 100 cu.ft.	.254	.274
Over 10,000 cu.ft., per 100 cu.ft.	.201	.274

a. Before surcharge to offset income tax surcharge.

b. Minimum or service charge for a 5/8 x 3/4-inch meter. A graduated scale of increased charges is provided for larger meters.

c. Included in minimum charge under present rates.

In overcoming existing inequities in the rates, there will not be a uniform percentage increase for all bills of all users. In fact, for extremely small monthly consumption, the bills will in some cases be lower under a service charge type of schedule than under the present schedule. The following Table II shows the charges under present and proposed rates (1) for a typical commercial customer using 2,000 cubic feet of water through a 5/8 x 3/4-inch meter in an average month, (2) for the same customer during a low-consumption month of half the average, and (3) for the same customer during a high-consumption month of twice the average. These comparisons exclude the effect of the temporary small surcharges under proposed rates.

Table II

Comparison of Charges for Various Monthly Usages

Quantity	Present Rates	Proposed Rates
1,000 c.f. (1/2 average)	$ 3.32	$ 4.64
2,000 c.f. (average)	6.18	7.38
4,000 c.f. (twice average)	11.42	12.86

Results of Operation

Witnesses for applicant and the Commission staff have analyzed and estimated applicant's operational results. Summarized in Table III, from applicant's Exhibit No. 1 and the staff's Exhibit No. 3, are the estimated results of operation for the test year 1970, under present rates and under those proposed by applicant, before considering the additional expenses and offsetting revenue requirement resulting from the surcharge to federal income tax. For comparison, this table also shows the corresponding results of operation modified as discussed hereinafter.

Table III

Estimated Results of Operation
(Test Year 1970)

(Dollars in Thousands)

Item	Applicant	Staff	Modified
At Present Rates			
Operating Revenues	$ 754.3	$ 754.3	$ 754.3
Deductions			
Purchased Water	292.6	289.4	289.4
Direct Payroll	71.8	72.8	72.8
Gen'l Office Billing Allocation	16.9	14.9	14.9
Regulatory Commission Exp.	4.0	2.2	4.0
Other Allocated Admin. & Gen'l Exp.	28.2	25.6	25.6
Other Exp. Excl. Taxes & Depr.	56.6	56.3	56.3
Taxes, Excl. Franchise & Inc. Taxes	74.3	75.2	75.2
Depreciation	71.6	70.7	70.7
Subtotal	616.0	607.1	608.9
Local Franchise Taxes	13.1	13.1	13.1
Income Taxes	7.3	8.2	10.6
Total	636.4	628.4	632.6
Net Revenue	117.9	125.9	121.7
Rate Base	2,603.2	2,474.8	2,560.0
Rate of Return	4.53%	5.09%	4.75%
At Rates Proposed by Applicant			
Operating Revenues	$ 917.1	$ 917.1	$ 917.1
Deductions			
Excl. Franchise & Income Taxes	616.0	607.1	608.9
Local Franchise Taxes	15.9	15.9	15.9
Income Taxes	89.9	90.8	93.2
Total	721.8	713.8	717.0
Net Revenue	195.3	203.3	200.1
Rate Base	2,603.2	2,474.8	2,560.0
Rate of Return	7.50%	8.21%	7.82%

From Table III it can be determined that, exclusive of any temporary increase due to an income tax surcharge, the increase in operating revenues will be 22 percent under applicant's proposed rates.

Operating Expenses

Applicant's estimate of cost of purchased water is based upon an estimate that 91 percent of the water requirements would be met through purchase of MWD water. The staff estimate is based upon 90 percent purchased water, which was the actual percentage for the 12-month period ended September 30, 1969. Applicant makes daily tests of the blended MWD and local water to keep the hardness below 170 parts per million. The proportions of MWD water required to achieve this vary substantially from day to day and seasonally, but the average for the past three years has been closer to 90 percent than 91 percent. The staff estimate of cost of purchased water is adopted in Table III.

Applicant's 1970 estimate of direct payroll for this district includes the 5.5 percent increase over the 1969 level of wages that appeared likely to applicant when its estimates were being prepared. The staff 1970 estimate reflects the 6.47 percent wage increase authorized in October 1969 by applicant's board of directors. The staff's estimate of direct payroll is adopted in Table III.

Many aspects of applicant's electronic data processing (EDP) operations are being reviewed currently by applicant's management. In view of this, applicant stipulated that it would accept as reasonable for purposes of this proceeding the staff estimates of EDP costs to be used as utility expenses in fixing rates. The staff's estimate of general office billing allocation is lower than applicant's primarily because of the staff's lower estimate of EDP costs. The staff's modified estimate of those expenses, which reflects the 6.47 percent increase on the payroll portion of the expenses, is adopted in Table III.

Applicant's and the staff's estimates of regulatory commission expenses differ primarily because applicant averaged the costs of the current proceeding over a three-year period, whereas the staff used a five-year period. Applicant's estimate is based upon its estimate of the frequency of future rate proceedings in this district, as indicated by the apparent trend in rate of return. The staff's estimate is based upon the long-term average frequency of prior rate proceedings in this district. As discussed hereinafter under "Trend in Rate of Return", the rates authorized herein are expected to produce a reasonable return for the next four years but there will be intervening offset proceedings for MWD rate increases. Applicant's estimate of average annual regulatory commission expense is adopted in Table III.

Most of the difference between applicant's and the staff's estimates of other allocated administrative and general expenses results from differences in estimates of general office wage levels and cost of EDP operations. A small portion of the difference is due to the staff's exclusion of a portion of the salary of one of applicant's directors. As discussed earlier herein, (1) applicant's actual wage levels for 1970 are 6.47 percent higher than for 1969, and (2) applicant stipulated to the staff's EDP estimates for this proceeding. The staff's modified estimate of this group of expenses, which reflect the 1970 wage increase is adopted in Table III.

Applicant's estimates of ad valorem taxes were prepared prior to receipt of tax bills for the fiscal year 1969-70. Those tax bills had been received by the time the staff's estimates were being prepared, and showed a higher composite effective tax rate than had been estimated by applicant. The staff used the actual composite rate of approximately 1.89 percent for 1969-70 and averaged that rate with the actual 1968-69 rate of 1.79 percent to arrive at an estimated 1.84 percent applicable to 1970-71.

Composite average effective ad valorem tax rates in the Culver City District historically have been quite erratic. The rate has increased from 1960-61 level of 1.64 percent to the 1969-70 level of 1.89 percent but the trend has reversed its direction four times in that period. Under these circumstances, the staff's use of an average 1968-69-70 composite rate for the estimated 1970-71 rate, instead of using the latest known (1969-70) rate for 1970-71, does not appear unreasonable. The staff's estimate is adopted in Table III.

Applicant's depreciation expense estimate is somewhat higher than the staff's primarily because of applicant's estimate of beginning-of-year plant for 1970 was too high. The staff's plant estimate was too low, but the effect of this on book depreciation is approximately offset by the tax effect of the corresponding liberalized depreciation. The staff's depreciation expense estimate is adopted in Table III.

Income Taxes

The various differences between applicant's, the staff's and the adopted estimates of expenses, excluding depreciation, affect the corresponding estimates of income taxes. The 1970 income taxes adopted in Table II are consistent with the expenses adopted in that table.

The depreciation deductions used for income tax calculations differ from book depreciation primarily because (1) applicant has availed itself of the double-rate declining-balance form of liberalized depreciation permitted by tax agencies and (2) applicant has been using shorter estimated plant lives for tax purposes than for book purposes.

It is not uncommon for utilities other than telephone and telegraph utilities to use different lives for tax purposes than for book purposes. In fact, Publication No. 456, revised August, 1964, published by the Internal Revenue Service of the U. S. Treasury Department, a copy of which is Exhibit No. 9, states in part: "Since regulated public utilities may be required to use depreciable lives for book purposes that differ from those used in computing the depreciation deduction, their booking practice is not a significant factor."

Publication No. 456 sets 50 years as the normal guideline life to be used by water utilities. It permits other lives to be used but requires that the reserve ratio remain within prescribed limits, which prevents excessive under- or over-accruals. Since 1959, applicant has followed the practice of making gradual adjustments to the lives used for tax purposes which, over a period of year, should keep the reserve ratio close to the middle of the allowable range.[2/]

Tax agencies require that all assets of the same class in all divisions of a company be combined for determining depreciation deductions. Applicant determines the total company class lives, however, by computing the composite of the class lives assumed for each district. This permits the adjustment of class lives for any particular district to take place concurrently with a review of that district's earnings in a rate proceeding. If the class life assumed for tax depreciation in a district is reasonable, the customers in that district are neither subsidizing nor being subsidized by customers in other districts. Eventually, as all districts have their class lives adjusted at the time of a rate proceeding, the overall company tax depreciation reserve ratio should become stabilized near the midpoint of its allowable range.

2/ The "Revenue Procedures" and depreciation reserve ratio limits set forth in Publication No. 456 were not actually in effect prior to applicant's 1962 returns.

Inasmuch as there is quite a bit of latitude within the permissible range of tax depreciation reserve ratio, it is not necessary that applicant make an abrupt change to the overall 48-year life which is its ultimate goal. Instead, applicant proposes in the future to adopt temporarily a 44-year life in proceedings where eight districts now use less than 44 years for tax purposes and a 48-year life only in proceedings involving five districts already using a life of about 44 years. Two other districts would be given separate treatment and a further intermediate step of a 46 1/2-year life is proposed by applicant for the Culver City District in this proceeding.

Applicant points out that the installation of longer lived plant in recent years tends to accentuate the problem. Applicant thus believes that it should take some action to keep the tax depreciation reserve safely within limits that will not be challenged by tax agencies.

The staff used, in its tax calculations for this district, the approximately 44-year life heretofore used by applicant for this district in deriving its composite total company depreciation rate for its actual tax returns. The staff concedes, however, that the use of a 46 1/2-year life is not unreasonable in this proceeding. The staff estimate of depreciation deduction for tax purposes is decreased by $6,400 in calculating the income taxes adopted in Table III.

Applicant asks Commission approval now of its projected plan for eventual use of a 48-year life for the depreciation deduction to be used on its tax returns and in calculating taxes in future rate proceedings. The staff recommends against any commitment now for treatment of this item in future rate proceedings. We concur with the staff. There are too many factors which might change in the decade that could elapse before completion of the plan. For example, the taxing agencies could adopt a wider range within which the tax depreciation reserve may fall, making it unnecessary to complete the conversion to longer lives. On the other hand, earnings of some districts could remain adequate without future rate proceedings, thus delaying unreasonably long the conversion to longer lives in those districts.

We do concede, however, that under present known circumstances applicant's plan may be reasonable on a long-range basis, except for the eventual use of a uniform tax depreciation rate for districts with widely differing book depreciation rates. Before the next rate proceeding, applicant should attempt to work out a program that will develop ultimate tax depreciation rates, by districts, which will give the desired composite life for the total company but will be in proportion to each district's book depreciation rate. Applicant also should at that time review the trend of its tax depreciation reserve ratio to determine whether a 48-year or some other life should be the ultimate goal.

It is always possible that, on some technicality, taxing authorities could contend that applicant does not qualify for the use of the reserve ratio test as evidence of the assumption of reasonable lives for tax depreciation purposes. It is difficult to believe, however, that tax authorities would subject applicant to harsher criteria because it did not wait for the reserve ratio to exceed permissible limits before taking reasonable steps to avoid an excessive ratio. We will assume that, on a long-range basis, the reserve ratio is a valid test.

Rate Base

The principal difference between the 1970 rate base estimates of applicant and the staff results from differences in estimated 1969 year-end plant. Applicant's year-end plant estimate was based upon scheduled completion of a $73,000 carryover of 1968 budgeted capital additions plus completion of the $195,000 of 1969 budgeted capital addition. The staff's corresponding estimate was based upon eleven months' recorded plant additions plus the staff's estimate of December 1969 entries.

Due to delays in scheduled construction of new and replacement facilities, the summary of 1969 budgeted jobs shows that there was a carryover of some $58,000 of 1969 work into 1970. In effect, applicant's estimates assume no carryover of 1969 budgeted capital additions into 1970 and the staff's estimates assume a $133,000 carryover. Further, since the 1970 additions estimated by applicant and the staff are the same, the $133,000 beginning-of-year 1970 difference between the two estimates is reflected for the full year 1970 in plant figures used in estimating the weighted average rate base for 1970. The net difference in rate base is about $120,000, due to offsetting differences in estimates of related depreciation reserve, advances and retirements.

The staff's estimated rate base has been increased by about $75,000 in Table III to give proper recognition to actual year-end 1969 balance sheet items. Consistent with Decision No. 76920, dated March 10, 1970, in Application No. 51165, applicant's Central Basin District rate proceeding, an additional $10,500 is added in Table III to the staff's rate base, for allocated general office working cash allowance.

Surcharge to Federal Income Tax

A 10 percent surcharge to federal income taxes was imposed by the Revenue and Expenditure Control Act of 1968. The surcharge was retroactive for the full year 1968 and expired December 31, 1969. The previous surcharge was reduced by the 1969 Tax Reform and Reduction Act. A 5 percent surcharge became effective January 1, 1970 and is scheduled to expire June 30, 1970.

Applicant's Exhibit No. 1 indicates that a 1.97 percent surcharge on bills computed under the metered service rates requested in the application would have been required to offset the effect of the 10 percent income tax surcharge and produce the same net revenues indicated hereinbefore in Table III. Revised calculations show that the surcharge, at the rates authorized herein, should be 1.0 percent, to offset the effect of the present 5 percent tax surcharge. 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.

Rate of Return

In a recent rate proceeding, Application No. 51165, involving applicant's Central Basin District, the Commission found that an average rate of return of 7.3 percent over the next three years was reasonable for applicant's operations in that district. Decision No. 76920, dated March 10, 1970, in that proceeding discussed at length the evidence presented relating to rate of return. Essentially the same evidence was either incorporated by reference or again introduced in the current proceeding. Without repeating the detailed discussion, a 7.3 percent return also appears reasonable for the Culver City District. Staff Exhibit No. 7 in the current proceeding indicates about 11.6 percent return on common equity would result from a 7.3 percent return on total capital.

Trend in Rate of Return

Applicant's estimates for the test years 1969 and 1970 indicate an annual decline of 0.30 percent in rate of return at proposed rates. The staff's estimates show an annual decline of 0.19 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 1969 and 1970, applicant prepared Exhibit No. 2, a comprehensive analysis of the many changes in recorded items of revenues, expenses and rate base during the years 1963 through 1968. Applicant analyzed and evaluated distortions during these years caused by such factors as changes in its water rates, changes in MWD rates, and changes in income tax rates and allowances.

Exhibits Nos. 1 and 2 show that, eliminating the effects of changes in water rates, MWD rates, and changes in income tax rates and allowances, the average annual decline in rate of return during the period from 1963 through 1968 would have been 0.36 percent at applicant's present water rates and somewhat steeper at its proposed rates. This adjusted decline for the five-year period differs from the 0.23 percent per year at present water rates projected by applicant and the 0.18 percent projected by the staff, as a net result of numerous relatively small differences, some of which offset others, in the projected trend of the various items of revenues, expenses and rate base. There is no reason to believe that the trend in rate of return at applicant's proposed water rates in the next few years would be less than the 0.19 to 0.30 percent per year indicated by the staff's and applicant's 1969 and 1970 estimates. We will adopt an indicated downward trend of 0.25 percent per year.

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, except that future changes in MWD rates from the July 1, 1970 level will be considered in future "offset" rate proceedings rather than in the current proceeding. With the annual "offset" proceedings resulting from this approach, but recognizing that there is still a significant indicated downward trend, it is appropriate to project about four years into the future for the basic rates established herein.

In many instances, we have limited the future projection of trends in rate of return to three years. In this case, however, the difference in rates required to provide the same average rate of return over a three-year period as those rates authorized herein, based on a four-year projection, is relatively insignificant. The difference in rates would be about 2 mills per hundred cubic feet, or about 4 cents per month for an average customer.

The rate increase authorized herein will not be in effect for about the first half of the year 1970. With the indicated future trend in rate of return, the 7.8 percent return under the rates authorized herein for the test year 1970 should produce an average rate of return of 7.3 percent for a four-year period after the rates become effective.

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 1970,

and an annual decline of 0.25 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 7.3 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.

The Commission concludes that the application should be granted as set forth in the ensuing order.

O R D E R

IT IS ORDERED that, after the effective date of this order, applicant Southern California Water Company is authorized to file for its Culver City 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 16th day of JUNE, 1970.

William Symons Jr.
President

Commissioners

APPENDIX A

Schedule No. CC-1

Culver City Tariff Area

METERED SERVICE (T)

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Culver City and vicinity, Los Angeles County.

RATES

		Per Meter Per Month	
Service Charges:			(C)
For 5/8 x 3/4-inch meter	....	$ 1.90	
For	3/4-inch meter	2.10	
For	1-inch meter	2.70	
For	1½-inch meter	4.50	
For	2-inch meter	7.00	
For	3-inch meter	14.00	
For	4-inch meter	21.00	
For	6-inch meter	35.00	
For	8-inch meter	60.00	
For	10-inch meter	90.00	(C)

Quantity Rate:

For all water delivered, per 100 cu.ft. .... $ 0.274 (C)

The 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 Rate. (T)

SPECIAL CONDITION

While the 5% Surcharge to Federal Income Tax is in effect, bills computed under the above tariff will be increased by 1.0%. 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 reduction in the tax surcharge. (T)