

ORIGINAL

Decision No. 79364

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application
of MESA CREST WATER COMPANY, a
California corporation, for an
increase in rates for water service.)

Application No. 52251
(Filed October 15, 1970)

Frank W. Doherty, Attorney at Law, for
Mesa Crest Water Company, applicant.
Dominick Don Razzano, Joseph M. Conley,
H. Kent Frewing, Attorney at Law,
Robert V. Lewis, C. F. Wharton, Harris,
Nobel, McCormac & Uhler, by
Frank Punelli, Jr., Attorney at Law,
Mervin E. Johnson, and Gray, Whyte, Burkitt
and Jackson, by William R. Burkitt, Attorney
at Law, for themselves, protestants.
Robert C. Durkin, for the Commission staff.

O P I N I O N

After due notice, public hearing in this matter was held before Examiner Coffey on May 27 and 28, 1971, at Pasadena, California. The matter was submitted on June 16, 1971, upon the receipt of the hearing transcript.

Applicant, a closely held California corporation, seeks authority to increase its rates for water service to about 450 residential customers and a country club, and for green belt irrigation in the vicinity of La Canada, Los Angeles County.

Applicant presented the testimony of 3 witnesses and 2 exhibits in support of its request for increased rates. Eleven public witnesses protested the proposed rate increase and presented 3 exhibits. A financial examiner and a hydraulic engineer presented a staff report based on a field investigation of applicant's operations made during January and February, 1971, an examination of applicant's accounting records and a study of the application.

Rates

Applicant proposes to increase revenues by approximately \$39,630, an increase of 32.3 percent, by increasing rates for General Metered Service. Rearrangement of the first two rate blocks is proposed by decreasing the consumption from 1,000 cu.ft. to 500 cu.ft. in the first block and increasing the consumption in the second block from 2,000 cu.ft. to 2,500 cu.ft. No other blocking changes are proposed.

The present and proposed general metered service quantity rates are set forth in the following tabulation:

<u>Quantity Rates</u>	<u>Per Meter Per Month</u>	
	<u>Present Rates</u>	<u>Proposed Rates</u>
0- 500 cu.ft. or less	\$ -	\$7.80
0-1,000 cu.ft. or less	7.80	-
Next 2,000 cu.ft., per 100 cu.ft.	.59	-
Next 2,500 cu.ft., per 100 cu.ft.	-	.71
Next 2,000 cu.ft., per 100 cu.ft.	.48	.65
Over 5,000 cu.ft., per 100 cu.ft.	.38	.52

The following present minimum charges for general metered service would also apply under the proposed rates:

Minimum Charge

5/8 x 3/4-inch meter	\$ 7.80
3/4-inch meter	10.00
1-inch meter	12.00
1-1/2-inch meter	16.00
2-inch meter	20.00
3-inch meter	35.00
4-inch meter	55.00
6-inch meter	110.00

No change in existing public and private fire protection service rates is proposed.

Results of Operation

The following tabulation compares the estimated summary of earnings for the test year 1971, under present and proposed rates,

prepared by the applicant and by the staff, with the summary of operations adopted for the purposes of this proceeding.

SUMMARY OF EARNINGS
(Estimated Year 1971)

Item	Present Rates		Proposed Rates		Adopted Rates
	Applicant	Staff	Applicant	Staff	
Operating Revenues	\$122,670	\$122,670	\$162,300	\$162,300	\$143,290
<u>Deductions</u>					
Operating Expenses	88,110	76,320	88,110	76,320	76,350
Depreciation Expenses	15,360	15,170	15,360	15,170	15,170
Taxes Other Than Income	15,470	16,660	15,770	17,000	17,250
Taxes on Income	1,020	3,990	15,730	21,290	7,300
Total Deductions.....	119,960	112,140	134,970	129,780	116,370
Net Revenue	2,710	10,530	27,330	32,520	27,220
Average Rate Base	\$388,850		\$388,850		388,350
Rate of Return	0.70%	2.72%	7.0%	8.36%	7.0%

The staff accepted as reasonable applicant's estimate of operating revenues although the staff estimated three new general metered service customers would be added in 1971 and applicant estimated no growth in customers.

Major differences between staff's and applicant's operating and maintenance expenses for the year 1971 are set forth as follows:

- a. Staff estimates of purchased water for the year 1971 included water losses of 10 percent and applicant estimated water losses to be 14.5 percent. For the year 1971 applicant estimated the cost of wholesale water at \$78 per acre-foot. This price was finalized at \$75 per acre-foot, which amount was used by the staff. Staff estimates were lower than applicant's estimates for the year 1971 by \$3,610.
- b. A staff witness testified that water losses for this system should be no greater than 7 percent. Applicant's witness testified that a fast meter measuring purchased water had been located which accounted for 4 percent of the water losses and that a 10 percent water loss was a reasonable level of loss considering system operations, fire flow testing and "what have you." A public

witness testified he had observed as many as three or four construction tank trucks lined up to fill their water tanks from a water hydrant.

The adopted summary of earnings will include water losses of 7 percent. Applicant should discontinue its practice of allowing free construction water or should file appropriate tariffs if it wishes to sell either metered¹ or unmetered water for construction purposes.

- b. Staff estimates for purchased power exceed applicant's estimate by \$180 for 1971. The staff computed the 1969 recorded power consumption at rates currently in effect and for the year 1971 added the estimated incremental cost of pumping the estimated additional water purchases. Southern California Edison Company, the power supplier, at the time of the hearing in this matter had an application for rate increase before the Commission.

Southern California Edison Company having recently been authorized increased electric power rates in the adopted results, we shall add \$1,200 to the staff estimate of purchased power cost.

- c. Applicant's estimate of transmission and distribution operation and maintenance expense exceeds staff estimates by \$3,620 for 1971. Applicant's estimate for operation and maintenance of meters for 1971 was \$4,320, amounting to approximately \$9 per meter per year. The staff considers that \$2 per meter per year is adequate for this expense and estimates that \$940 for the year 1971 is a reasonable amount for this expense. Applicant's estimate for maintenance of services of \$2,010 for the year 1971 was reduced by the staff to \$640. Applicant's estimate for this expense amounts to approximately \$3.65 per service per year. The staff considers its estimate of approximately \$1.15 per service per year to be a reasonable amount for this expense. Applicant's estimate

¹ It appears from this record that appropriate nomenclature for said service would be "What Have You Water Service."

of \$1,010 for the year 1971 for the operation and maintenance of approximately 36,500 feet of main ranging in size from 4- to 14-inch appears to the staff to be insufficient to properly maintain the system. The staff has estimated this expense for the year 1971 at \$3,030.

- d. Staff and applicant estimates of expense for accounting and collecting do not differ significantly. However, the staff estimated that 80 percent of clerical salaries should be charged to this account and applicant allocated 50 percent of clerical salaries to this account. Also, the staff estimated office supplies appropriately chargeable to this account and applicant applied this expense to administrative and general expense.
- e. Applicant's estimate of administrative and general expenses exceed staff's by \$3,450 for the year 1971. Major differences are due to the staff allocation of 20 percent of clerical salaries to this account instead of the 50 percent allocation by applicant. After staff adjustment of office supplies and other expense, Account 792, by allocating a portion of this expense to customer records and collection expense, Account 773, applicant's estimates exceed staff's by \$1,300 for the year 1971.

We find reasonable the staff estimates of operation and maintenance expenses, but will decrease in the adopted results the allowance for water losses to 7 percent and will include allowances for increased power and postage rates of \$1,200 and \$120, respectively.

The depreciation rates developed by applicant were reviewed by the staff and accepted as reasonable. Depreciation expenses were computed by the staff by applying these rates to the various plant items.

Property taxes for 1971 were estimated by the staff by application of the tax rate in effect for the 1970-71 fiscal year. The staff estimate of property taxes for 1971 is \$1,120 higher than that of applicant.

One of the issues arising at the hearing was the propriety of using the net operating loss carry forwards available through 1973 to reduce the allowance for federal income taxes. Witness for applicant justified not using such available tax credits to reduce his estimates of future federal income tax liabilities on the basis that the passing of past gains and losses into the future would be retroactive rate making. Neither applicant nor the staff included the tax reduction effect of applicant's net operating loss carry forwards in their estimates of taxes on income in the test year. Applicant's accounting witness testified that applicant has sustained losses in all years since he first worked on applicant's books and records in 1962, except 1969 and 1970. The witness confirmed that no federal income taxes are paid by the utility. A staff witness testified that as of September 30, 1971, applicant had available five-year net operating carry forwards totaling \$71,441 which expire as follows: In 1970, \$15,234; in 1971, \$26,011; in 1972, \$13,058 and in 1973, \$17,138.

Rate base items as developed by applicant were reviewed by the staff and accepted as adequate for the purpose of this proceeding.

Based on its estimates of expenses and rate base for the test year 1971, applicant proposes to increase its annual gross revenues from \$122,670 to \$162,300, thereby producing a 7.0 percent rate of return.

In recommending a rate of return for the applicant, the staff has given consideration to (a) the high equity ratio reflected in the capital structure and the company's financial requirements; (b) the composition of the service area and the slow growth prospects in the near future; (c) the particular circumstances which contribute to relatively higher operating costs and their effect on rates, and (d) rates of return granted to other small water utilities.

After considering these factors, the staff recommended as reasonable a rate of return ranging from 7.0 percent to 7.5 percent.

We find reasonable a rate of return of 7 percent for the test year which will produce a return of 8.1 percent on common equity.

Public Presentation

Eleven customers testified in opposition to the requested rates. They compared applicant's rates unfavorably with the lower rates of nearby publicly owned water systems. A complaint was voiced that this system, considered to be charging excessively high rates and to be uneconomic, was granted a certificate of public convenience and necessity. Representations by public witnesses that the country club and golf course receives preferential treatment is not substantiated by this record.

The staff considers the service to be satisfactory.

Findings and Conclusion

The Commission finds that:

1. Applicant is in need of additional revenues, but the proposed rates set forth in the application are excessive.
2. The adopted estimates, previously discussed herein, of operating revenues, operating expenses, and rate base for the test year 1971, reasonably indicate the results of applicant's operations in the near future.

3. A rate of return of 7.0 percent on the adopted rate base for the year 1971 is reasonable. It is estimated that such rate of return will provide a return on common equity of approximately 8.1 percent.

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 to the extent set forth in the order which follows.

For a monthly consumption of 2,500 cubic feet of water applicant requests rates which would have increased the water bill from \$16.65 to \$22.60, an increase of about 32 percent. Under the rates authorized herein, customers will pay \$19.50 for 2,500 cubic feet of water, an increase of 17 percent.

In granting the increases in rates herein authorized, the Commission has given careful consideration to the various factors involved and is of the opinion that its action is in accordance with the objectives of the Economic Stabilization Act of 1970, as amended. Admittedly, the increases in rates exceed 2-1/2 percent and the pre-tax profit margin as estimated under the new rates will exceed that realized during the base period when applicant operated with little or no profit. Nevertheless, the profit margin as estimated using the measure of rate of return on rate base is, in our opinion, at the lower end of the zone of reasonableness for the utility herein under consideration and notwithstanding the effects of inflation is at the same level as found reasonable in its last rate case which was decided on October 10, 1967. Applicant is expected to comply with the requirements of the Price Commission's regulations relating to the stabilization of prices and rents after November 13, 1971.

A.52251 a NB *

O R D E R

IT IS ORDERED that after the effective date of this order Mesa Crest Water Company is authorized to file 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 22nd day of NOVEMBER, 1971. ✓

I abstain - I do not feel that enough of a case has been made to make a decision.

[Signature]
Chairman

[Signature]

[Signature]

[Signature]

Commissioners

I will file a dissent -
Thomas Moran

APPENDIX A

Schedule No. 1

METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

The vicinity of La Canada, Los Angeles County.

RATES

Quantity Rates:

	Per Meter Per Month	
First 700 cu.ft. or less	\$ 7.80	(I)
Next 2,300 cu.ft., per 100 cu.ft.65	
Next 2,000 cu.ft., per 100 cu.ft.57	
Over 5,000 cu.ft., per 100 cu.ft.45	(I)

Minimum Charge:

For 5/8 x 3/4-inch meter	\$ 7.80
For 3/4-inch meter	10.00
For 1-inch meter	12.00
For 1 1/2-inch meter	16.00
For 2-inch meter	20.00
For 3-inch meter	35.00
For 4-inch meter	50.00
For 6-inch meter	110.00

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

COMMISSIONER THOMAS MORAN, Dissenting.

I dissent.

The majority's opinion is unfair to the utility's customers. It violates two basic, historic principles of utility rate fixing.

The first is that a utility is entitled to recoup from its customers through rates the full amount of income taxes which it reasonably and lawfully must pay - but no more. (Case No. 6148, 57 CPUC 598, 602; Application of Greyhound, 64 CPUC 641, 653.)

The second principle violated is that rates are to be fixed prospectively only, and shall neither provide for a recapture of excessive profits which the utility may theretofore have realized, nor a make-up of unreasonably low earnings or even losses which the utility may have theretofore incurred.

This decision authorizes the utility to collect from its customers under guise of income tax expense more money than the utility will be required to pay, in a sincere but nonetheless misguided desire to let the utility make up for losses it incurred in the past. In its computation of estimated income tax expense, the majority does not deduct tax loss carry-forwards which the utility will actually use as a deduction in filing its federal income tax return, thus reducing to zero its tax liability for the permissible period of the carry-forwards. The majority's view is that the customers have already had the benefit of low rates, and the stockholders should have the benefit of the tax deduction.

This assumes that past, present and future customers are and will be the same persons. The phantom taxes herein are assessed against future ratepayers to subsidize past operations of the company when it took the calculated risk of a new venture, and may have been serving different customers.

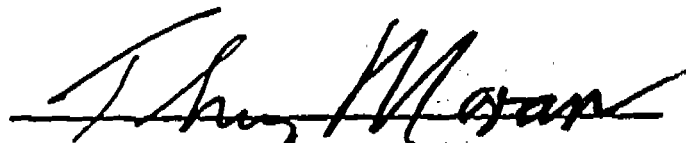
I do not believe that future utility customers should pay rates which include phantom "income taxes" which will never in fact be paid, as this burdens future ratepayers with past losses.

The tax benefit of past losses can be realized only if future customers pay rates at levels high enough to produce taxable income against which past losses can be offset, since there are no tax savings inherent in losses considered alone. When losses are carried back against prior years with taxable income and income tax payments, the effect is a cash recovery of all or a portion of the income tax actually paid. It is a commonly accepted ratemaking practice that although customers pay rates which include an allowance for income taxes, subsequent recovery by the utility of said income taxes previously paid, accrues to its benefit alone, regardless of the fact that it was the customers who bore the cost. The rationale for this practice is that the return of recovered income taxes to a ratepayer would constitute retroactive ratemaking. To allow phantom taxes in a test year when none will be paid causes tax savings generated only by current and future profitable operations also to accrue retroactively to the utility owners.

In other words, by this decision, under the holding of the majority - heads, the utility wins; tails, the customers lose.

I therefore fully concur with Examiner Coffey who alone heard all of the evidence in this case and who also disapproves of this Decision.

Dated: November 22, 1971
San Francisco, California


Thomas Moran, Commissioner