

Decision No. 80586**ORIGINAL**

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 Bay District.

Application No. 53069
(Filed December 22, 1971)

O'Melveny & Myers, by Donn B. Miller,
Attorney at Law, for applicant.
Cyril M. Saroyan, Attorney at Law, and
John E. Brown, for the Commission staff.

O P I N I O N

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

Public hearing was held before Examiner Catey in Pittsburg on July 18 and 19, 1972. Copies of the application had been served and notices of filing the application and of the hearing had been published, in accordance with this Commission's Rules of Procedure. The matter was submitted on July 19, 1972, subject to receipt of two late-filed exhibits by July 28, 1972. The exhibits have been received, the hearing transcripts have been filed and the matter is now ready for decision.

Applicant presented testimony of its board chairman - chief executive officer, its secretary-treasurer, its vice presidents in charge of revenue requirements and operations, and its assistant secretary-assistant manager of the rate evaluation department. The Commission staff presentation was made through two accountants and three engineers.

Service Area and Water System

Applicant owns and operates water systems in the Counties of Contra Costa, Imperial, Los Angeles, Orange, Sacramento, San Bernardino and Ventura, and an electric system in San Bernardino

County. The Contra Costa County system is known as the Bay District, which serves about four square miles of territory northwest of Pittsburg.

The source of water for this system is the Contra Costa Canal. After treatment and filtration, the water is pumped directly into the distribution system, consisting of some 27 miles of mains, ranging in size up to 10-inch. A 500,000-gallon reservoir and two tanks with a combined capacity of 650,000 gallons, maintain system pressures and provide storage for use during peak periods of demand. There are about 2,400 metered services supplying primarily residential and business customers, and 120 flat-rate fire protection services supplying primarily public fire hydrants.

Service

Staff Exhibit No. 6 states that there have been only two informal complaints received by the Commission from Bay District customers since the beginning of 1971, and those related to high water bills rather than any service problems. The staff engineer who reviewed the service provided by applicant and discussed service quality with some of the customers during his investigation concluded that the service in this district is generally satisfactory and that customer complaints were resolved satisfactorily. No customers appeared at the hearing to testify concerning service.

Rates

Applicant's present tariffs for the Bay District include rates for general metered service, public fire hydrant service and private fire protection service. Company-wide schedules for construction and other temporary flat-rate service and for service to employees also apply.

Applicant proposes to increase its rates for general metered service by about 12 percent. No changes are proposed in the other schedules. The following Table I presents a comparison of applicant's present general metered service rates, those requested by applicant and those authorized herein:

TABLE I

COMPARISON OF METERED SERVICE RATES

<u>Item</u>	<u>Per Service Per Month</u>		
	<u>Present</u>	<u>Proposed</u>	<u>Authorized</u>
Service Charge *	\$2.20	\$2.60	\$2.35
<u>Quantity Rates</u>			
First 1,000 c.f., per 100 c.f.	0.37	0.38	0.371
Next 4,000 c.f., per 100 c.f.	0.32	0.38	0.371
Over 5,000 c.f., per 100 c.f.	0.25	0.295	0.26

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

Results of Operation

Witnesses for applicant and the Commission staff have analyzed and estimated applicant's operational results. Summarized in Table II, from applicant's Exhibit No. 3 and from staff Exhibit No. 6, are the estimated results of operation for the test year 1972, under present water rates and under those proposed by applicant. For comparison, this table also shows the corresponding results of operations adopted in this decision, as discussed hereinafter, and the corresponding adopted results under the water rates authorized herein.

TABLE II

ESTIMATED RESULTS OF OPERATION
TEST YEAR 1972

<u>Item</u>	<u>Applicant</u>	<u>Staff</u>	<u>Adopted</u>
<u>At Present Rates</u>			
Operating Revenues	\$247,720	\$247,720	\$247,700
<u>Operating Expenses</u>			
Operation & Maintenance	94,500	94,650	94,600
Admin., Gen'l & Miscell.	19,100	16,110	16,100
Ad Valorem & Payroll Taxes	27,600	27,550	28,900
Depreciation	31,120	30,600	31,600
Allocated Common Exp.	10,700	10,300	10,300
Subtotal Excl. Taxes Based Upon Revenue & Income	183,020	179,210	181,500
Local Franchise Taxes	3,000	3,000	3,000
Income Taxes	10,100	11,500	10,300
Total Operating Expenses	196,120	193,710	194,800
Net Revenue	51,600	54,010	52,900
Rate Base	819,439	784,400	784,400
Rate of Return	6.30%	6.89%	6.75%
<u>At Applicant's Proposed Rates</u>			
Operating Revenues	\$277,210	\$277,210	\$277,200
<u>Operating Expenses</u>			
Excl. Taxes Based Upon Rev. & Inc.	183,020	179,210	181,500
Local Franchise Taxes	3,400	3,400	3,400
Income Taxes	25,200	26,600	25,500
Total Oper. Expenses	211,620	209,210	210,400
Net Revenue	65,590	68,000	66,800
Rate Base	819,439	784,400	784,400
Rate of Return	8.00%	8.67%	8.52%
<u>At Rates Authorized Herein</u>			
Operating Revenues	-	-	\$260,200
<u>Operating Expenses</u>			
Excl. Taxes Based Upon Rev. & Inc.	-	-	\$181,500
Local Franchise Taxes	-	-	3,200
Income Taxes	-	-	16,700
Total Oper. Expenses	-	-	201,400
Net Revenue	-	-	58,800
Rate Base	-	-	784,400
Rate of Return	-	-	7.50%

From Table II it can be determined that applicant's requested rates would result in an increase of about 12 percent in operating revenues, whereas the rates authorized herein will produce a 5 percent increase. The percentage increase for individual bills will vary somewhat, depending upon type of service and level of use.

Operating Revenues and Expenses

Independent checks by the Commission staff confirmed applicant's estimates of revenues and local franchise taxes under both present and proposed water rates. Those estimates, rounded, are adopted in Table II.

There are several differences between the Bay District operation and maintenance expense estimates presented by applicant and those presented by the staff. The net effect of those differences, however, is only \$150 in expenses. The staff estimates of these expenses, rounded, which are based upon more recent information than was available when applicant's estimates were being prepared, are adopted in Table II.

The principal difference between the Bay District administrative and general expense estimates presented by applicant and those presented by the staff result from differences in estimates of average annual regulatory commission expense. Applicant estimated \$13,470 as the cost of a rate case such as the current proceeding and spread this cost over a three-year period to arrive at an average annual cost. The staff estimated a total cost of \$7,781, spread over a five-year period.

Applicant's witness conceded that his personnel had been able to effect unanticipated efficiencies in preparing the various studies and exhibits and that, as a result, his estimate of total cost would now not be significantly greater than that developed by the Commission staff. He still was of the opinion, however, that a three-year recurrence of rate proceedings for this district was more likely than a five-year recurrence. He pointed out that,

although no probable future significant downward trend in rate of return was indicated by applicant's studies of the Bay District operations, some of the assumptions inherent in such studies tend to obscure a probable future decline. For example, the studies assume that rates for purchased water, purchased power, wages and taxes will remain constant at the most recently determined levels. The staff's basis for assuming an average five-year period between rate proceeding is the lack of any indication of attrition in Bay District earnings between the test years 1971 and 1972.

Although only three years have elapsed since the previous Bay District rate proceeding, prospects now appear better for less frequent full-scale proceedings in this district. Even if rates paid by applicant for purchased water, purchased power, wages and taxes increase in the near future, an application for offsetting rate relief should not require the detailed studies that are prepared when district operations have not been reviewed recently. Further, it is to be hoped that efforts on a national level to control inflation will at least slow down some of the increases in costs which in the past have eroded earnings. Considering all of these circumstances, we have adopted in Table II the staff's estimate, rounded, of average or normal administrative and general expenses for this district.

When applicant's and the staff's estimates of ad valorem taxes were being prepared, the 1972-1973 tax assessments had not been announced. Based upon the data available at the time, there was no significant difference between applicant's and the staff's estimates of ad valorem taxes for the test year 1972. Actual assessments later became available, indicating that the previous tax estimates for the calendar year 1972 were understated. In Table II we have adopted the original staff estimate, rounded, plus the additional \$1,300 effect of the revised assessment testified to by a staff engineer.

The difference between applicant's and the staff's estimates of depreciation expense is primarily due to the treatment accorded certain depreciable plant which was retired in place prematurely after

the creation in 1968 by the Navy of a "buffer zone" of unoccupied territory near the Port Chicago Ammunition Loading Dock. The staff treated the residual unrefunded balance of advances for construction as though it were a contribution from the subdivider. This gives no consideration to the fact that the terms of three of the four main extension contracts involved require ultimate full refund of the advance if the main extension has ever served eighty percent of the customers for whom it was designed. Under the Commission's applicable uniform system of accounts, amortization of contributed plant reduces the amount of depreciation accrual charged to operating expense. In Table II, the adopted depreciation expense is based upon the staff's estimate, adjusted to restore the depreciation expense of about \$1,000 erroneously deducted for the three main extensions where no contributions are involved. The end result is higher than applicant's estimate because the staff had available the actual 1971 depreciable plant additions, which were somewhat higher than previously estimated by applicant.

Certain expenses related to applicant's overall operations are of so general a nature that they cannot be assigned directly to specific districts. Both applicant and the staff estimated those various common expenses and allocated a portion of the total to Bay District on a four-factor percentage which reasonably reflects the relative size and complexity of the operations in the various districts. Although there were numerous differences in the basic estimates, the net effect of those differences when prorated to the Bay District is only \$400. Most of the differences in the overall estimates result from the availability to the staff of more recent data on actual expenditures. Although the staff's estimate of electronic data processing (EDP) expense may be understated in view of the continuously increasing use of EDP by applicant, it is reasonable to assume that efficiencies, higher productivity and other benefits of such expanded use will cover the additional payroll and other expenses related to programming additional EDP functions. The staff estimate of allocated common expense is adopted in Table II.

The various differences between applicant's and the staff's estimates of operating expenses result in differences in estimates of income taxes. The income taxes adopted in Table II are consistent with the revenues and expenses adopted in that table. Further, we have adjusted for the abnormal tax writeoff in 1969 related to the abandoned plant. We have included in the income tax calculation \$1,000 per year for amortization of this writeoff instead of the lump sum actually written off on 1969 returns.

The difference between the rate base estimates of applicant and the staff relates to the prematurely retired plant mentioned hereinabove in the discussion of depreciation expense. The staff incorrectly deducted contributions of \$38,800 in determining rate base. The end result, however, is no different from correctly deducting \$38,800 of advances. Applicant's rate base witness concedes that he incorrectly failed to deduct either advances or contributions relating to the \$38,800 unrefunded advances on abandoned plant. Other relatively minor differences between the rate base estimates result from the more recent information on rate base components that was available by the time the staff estimates were being prepared. The staff rate base estimate is adopted in Table II.

Rate of Return

Applicant originally requested a rate of return of 8 percent on rate base for this district. At the hearing, applicant's witness on rate of return testified that he still considered 8 percent to be a reasonable return but, in view of the Price Commission's regulations for utilities, now requests only a 7.61 percent return on rate base. Assuming a year-end 1973 capitalization with a new issue of preferred stock, this would result in an 11.8 percent return on common equity. That is the return on equity found reasonable in Decision No. 79382, dated November 23, 1971, in Application No. 52370, involving applicant's Orange County District. The corresponding return on rate base found reasonable in that decision is 7.50 percent.

The staff witness on rate of return also was influenced by the Price Commission regulations. Instead of recommending a range in rate of return, he concluded that the 7.50 percent composite return on total capital found reasonable in Decision No. 79382 was within the range he would normally have recommended. His recommendation is based upon a year-end 1972 capitalization which does not include applicant's planned preferred stock issue late in 1973. On that basis, a 7.5 percent return on total capitalization would result in an 11.8 percent return on common equity.

A witness for applicant testified that a 7.54 percent return on total capitalization at year-end 1972 would be required to produce an 11.8 percent return on equity, but he did not present the derivation of that estimate.

Rule 23.1 of the Commission's Rules of Procedure covers "Compliance with The Economic Stabilization Act of 1970." Adoption of Rule 23.1 resulted in the granting to this Commission of a Certificate of Compliance by the Federal Price Commission. Section (a) (3) (6a) of Rule 23.1 states, in part:

"In determining the appropriate rate of return, the Commission will consider the capital structure of the applicant at or near the date the applicant's increased rates will become effective." (Emphasis added.)

Although the rule later states that "adjustments generally will be made in the capital structure, and in the costs of various types of capital...to reflect new financings which are known to be imminent", we concur with the staff financial witness' conclusion that late 1973 is too far in the future to be considered "imminent." This is somewhat inconsistent with our treatment of regulatory Commission expense, wherein we have assumed a five-year duration of present rates and rates of return, but prognostication of type and cost of late 1973 financing is too speculative at this time.

We will adopt the staff's recommendation of 7.50 percent return on rate base and 11.8 percent return on common equity.

Findings and Conclusion

The Commission finds that:

1.a. Applicant is in need of additional revenues, but the rates proposed by applicant are excessive.

b. The adopted estimates, previously discussed herein, of operating revenues, operating expenses and rate base for the test year 1972 reasonably indicate the results of applicant's operations for the near future.

c. A rate of return of 7.5 percent on applicant's rate base for 1972, and the corresponding 11.8 percent return on common equity are reasonable.

d. 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.

2. In compliance with Rule 23.1 of the Commission's Rules of Procedure:

- a. The increased rates are expected to provide an increase of \$12,500 in applicant's annual revenues.
- b. The rate of return on the herein adopted rate base is expected to be 7.50 percent, as compared with 6.75 percent at present rates.
- c. The increases are cost-justified and do not reflect future inflationary expectations; the increases are reduced to reflect productivity gains; the increases are the minimum rates which are necessary to assure continued and adequate service; there is no increase in the rate of return allowed previously in Decision No. 79382, dated November 23, 1971, in Application No. 52370; and 7.50 percent is the minimum rate of return needed to attract capital at reasonable cost and which will not impair applicant's credit.

The Commission concludes that the application should be granted to the extent set forth in the order which follows:

W. R. Johnson
10-11-72

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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 Bay District the revised rate schedule attached to the 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 11th day of OCTOBER, 1972. ✓

Vernon L. Stanger
President
William J. ...
...
...
Commissioners

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

APPENDIX A

Schedule No. BY-1

Bay DistrictGENERAL METERED SERVICEAPPLICABILITY

Applicable to all metered water service.

TERRITORY

Portions of the City of Pittsburg and vicinity, Contra Costa County.

RATES

Quantity Rates:

Per Meter
Per Month

First 5,000 cu.ft., per 100 cu.ft.	\$ 0.371	(I)
Over 5,000 cu.ft., per 100 cu.ft.	0.26	

Service Charge:

For 5/8 x 3/4-inch meter	\$ 2.35	(I)
For 3/4-inch meter	2.80	
For 1-inch meter	3.40	
For 1 1/2-inch meter	5.25	
For 2-inch meter	8.50	
For 3-inch meter	17.00	
For 4-inch meter	24.00	
For 6-inch meter	48.00	
For 8-inch meter	68.00	(I)

The Service Charge is a readiness-to-serve charge applicable to all metered service and to which is to be added the quantity charge computed at the Quantity Rates.