

Decision No. 81462

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California Consolidated Water Company, Inc., a California corporation, under Section 454 of the Public Utilities Code for authority to increase public utility water rates in the Los Osos District of its Los Osos Division.

Application No. 53494  
(Filed July 31, 1972)

Keith R. Cardey and Fred F. Homann, for applicant.  
George H. Rathmell, for South Bay Advisory Committee, protestant.  
B. A. Peeters, Attorney at Law, and Andrew Tokmakoff, for the Commission staff.

O P I N I O N

Applicant California Cities Water Company<sup>1/</sup> seeks authority to increase rates for water service in the Los Osos Heights tariff area and Morro View tariff area of the Los Osos District of its Los Osos Division.

Public hearing was held before Examiner Catey in San Luis Obispo on March 22 and 23, 1973. Copies of the application had been served, notice of filing of the application and of the hearing had been published, and notices of hearing had been mailed and posted, in accordance with this Commission's Rules of Procedure. The matter was submitted on March 23, 1973.

1/ Subsequent to the filing of this application, California Consolidated Water Company, Inc. and its affiliate California Cities Water Company merged into New Cities Water Company, a new corporation, which then changed its name to California Cities Water Company. The merger had been authorized by Decision No. 80264 dated July 18, 1972 in Application No. 53394. In this decision we shall consider the applicant to be the present California Cities Water Company.

Applicant presented testimony by its vice president-general manager and by its consulting engineer. Protestant South Bay Advisory Committee presented testimony by its chairman. The Commission staff's presentation was made through an accountant and an engineer.

Service Area and Water System

Applicant owns and operates water systems in the counties of Lake, Los Angeles, Orange, San Bernardino, San Luis Obispo, and Santa Barbara. The Los Osos Division in San Luis Obispo County consists of the Edna Road District and the Los Osos District. The two tariff areas, Los Osos Heights and Morro View, which comprise the Los Osos District are located about 12 miles northwest of San Luis Obispo.

Los Osos Heights and Morro View were formerly served by two separate utilities. After applicant acquired the two utilities, their systems were interconnected and operated on a consolidated basis by applicant's personnel.

The water supply is obtained from four wells, with a fifth well scheduled for completion during 1973. The distribution system consists of some 18 miles of mains, ranging in size up to 8-inch. Five storage tanks with a combined capacity of 422,000 gallons maintain system pressures in the various zones and provide storage for use during peak periods of demand. There are about 1,000 metered-service customers in the Los Osos Heights area and about 50 metered-service customers in the Morro View area. There is a total of about 60 fire hydrants served from the consolidated system.

Service

The staff's field investigation of applicant's service and facilities in the Los Osos District disclosed that service was quite good and that applicant's employees maintained good public relations in serving the customers. No informal complaints have been registered with the Commission by these customers in the past four years. A staff engineer testified that the system is in a good state of repair and is well maintained.

The chairman of South Bay Advisory Committee testified that customers had been requested not to waste water during the summer of 1972. This was apparently an informal precautionary suggestion of the local management, and no curtailment was invoked. The additional well scheduled for this year will provide more reserve for peak periods and emergencies.

The South Bay Advisory Committee recommends that applicant be required to provide additional storage capacity, specifically for improved fire protection. At present, General Order No. 103 prescribes design standards which do not include any significant fire flow provisions. There is pending, however, an investigation on the Commission's own motion into possible inclusion of fire flows in the design standards of all water utilities in California. Pending the outcome of that investigation, it is not appropriate to impose more rigid design standards on applicant.

#### Rates

Applicant's tariffs for the Los Osos District include rates for general metered service, residential flat-rate service, and public fire hydrant service in the two separate tariff areas in the district, and a school flat rate in the Los Osos Heights tariff area.

Applicant proposes to increase its rates for metered service and to make them uniform throughout both tariff areas within the Los Osos District. The rates in the two tariff areas differ from each other because they were established for two separate predecessors of applicant prior to interconnection of the two systems. There are no longer any flat-rate customers but applicant requests continuation of a flat-rate residential service schedule at an increased level for temporary or emergency sale of water prior to installation of a meter. The unused school flat rate is proposed to be withdrawn. The Morro View public fire hydrant tariff schedule is inconsistent with applicant's contract with the local fire district. Applicant proposes to retain the Los Osos Heights public fire hydrant tariff schedule, which is consistent with the contract.

The following Table I presents a comparison of applicant's present rates, those proposed by applicant, and those authorized herein:

TABLE I

Comparison of Monthly Rates

| <u>Item</u>                          | <u>Present Rates</u> |                   | <u>Consolidated</u> |                   |
|--------------------------------------|----------------------|-------------------|---------------------|-------------------|
|                                      | <u>L.O. Heights</u>  | <u>Morro View</u> | <u>Proposed</u>     | <u>Authorized</u> |
| <u>General Metered Service</u>       |                      |                   |                     |                   |
| First 600 cu.ft. or less             | \$4.50*              | \$4.25*           | \$4.95*             | \$4.50*           |
| Next 200 cu.ft., per 100 cu.ft.      | .00*                 | .20               | .00*                | .00*              |
| Next 1,200 cu.ft., per 100 cu.ft.    | .25                  | .20               | .27                 | .25               |
| Next 200 cu.ft., per 100 cu.ft.      | .25                  | .16               | .27                 | .25               |
| Next 1,800 cu.ft., per 100 cu.ft.    | .20                  | .16               | .22                 | .20               |
| Next 1,200 cu.ft., per 100 cu.ft.    | .20                  | .12               | .22                 | .20               |
| Over 5,200 cu.ft., per 100 cu.ft.    | .15                  | .12               | .16                 | .15               |
| <u>Residential Flat Rate Service</u> |                      |                   |                     |                   |
| 6,000 sq.ft. lot, or less            | 4.75                 | 5.50              | 5.20                | 4.75              |
| 6,001- 9,000 sq.ft. lot              | 4.85                 | 5.50              | 5.30                | 4.85              |
| 9,001-12,000 sq.ft. lot              | 5.00                 | 5.50              | 5.50                | 5.00              |
| Over 12,000 sq.ft., per 1,000 sq.ft. | .10                  | .30               | .11                 | .10               |
| <u>Public Fire Hydrant Service</u>   |                      |                   |                     |                   |
| Hydrant furn. more than 750 g.p.m.   | 4.00                 | 3.00              | 4.00                | 4.00              |
| Hydrant furn. 500-750 g.p.m.         | 3.00                 | 3.00              | 3.00                | 3.00              |
| Hydrant furn. 250-499 g.p.m.         | 2.00                 | 3.00              | 2.00                | 2.00              |
| Hydrant furn. less than 250 g.p.m.   | Free                 | 3.00              | Free                | Free              |

\* Included in minimum charge for 5/8 x 3/4-inch meter. A graduated scale of increased minimum charges is provided for larger meters.

Results of Operation

Witnesses for applicant and the Commission staff have analyzed and estimated applicant's operational results. Applicant's 1973 estimates included in the exhibits attached to the application were of necessity prepared prior to the July 31, 1972 filing date. The staff's original 1973 estimates were presented in Exhibit No. 13 dated March 14, 1973. At the hearing, applicant presented, in Exhibit No. 8, revised estimates which reflected more recent information than was available at the time its original estimates were being prepared. By the time of the hearing, later information was also available to the staff and prompted certain revisions incorporated in Exhibit No. 14 dated March 22, 1973.

Summarized in Table II, from applicant's Exhibit No. 8 and from staff Exhibit No. 13, as modified by Exhibit No. 14, are the estimated results of operation for the test year 1973, under present water rates and under those proposed by applicant. For comparison, this table also shows the corresponding results of operation 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 1973

| <u>Item</u>                              | <u>Applicant</u> | <u>Staff</u> | <u>Adopted</u> |
|--|------------------|--------------|----------------|
| <u>At Present Rates</u>                  |                  |              |                |
| Operating Revenues                       | \$ 83,111        | \$ 82,150    | \$ 82,150      |
| <u>Operating Expenses</u>                |                  |              |                |
| Source of Supply                         | 560              | 330          | 560            |
| Pumping                                  | 11,850           | 10,330       | 10,650         |
| Water Treatment                          | 870              | 870          | 870            |
| Distribution                             | 4,640            | 4,440        | 4,640          |
| Customer Accounting                      | 8,510            | 8,230        | 8,230          |
| Admin. & General                         | 9,850            | 9,000        | 9,100          |
| Subtotal Excl. Taxes and Depreciation    | 36,280           | 33,200       | 34,050         |
| Depreciation Exp.                        | 12,624           | 10,560       | 10,560         |
| Taxes, Excl. Income Taxes                | 7,385            | 8,550        | 8,550          |
| Subtotal Excl. Income Taxes              | 56,289           | 52,310       | 53,160         |
| Income Taxes                             | 6,535            | 3,050        | 3,870          |
| Total Expenses                           | 62,824           | 55,360       | 57,030         |
| Net Revenue                              | 20,287           | 26,790       | 25,120         |
| Rate Base                                | 334,685          | 310,900      | 323,000        |
| Rate of Return                           | 6.1%             | 8.6%         | 7.8%           |
| <u>At Applicant's Proposed Rates</u>     |                  |              |                |
| Operating Revenues                       | \$ 91,230        | \$ 89,710    | \$ 89,710      |
| <u>Operating Expenses</u>                |                  |              |                |
| Excl. Inc. Taxes & Add'l. Uncollectibles | 56,289           | 52,310       | 53,160         |
| Add'l. Uncollectibles                    | 0                | 40           | 40             |
| Income Taxes                             | 10,752           | 6,720        | 7,830          |
| Total Expenses                           | 67,041           | 59,070       | 61,030         |
| Net Revenue                              | 24,189           | 30,640       | 28,680         |
| Rate Base                                | 334,685          | 310,900      | 323,000        |
| Rate of Return                           | 7.2%             | 9.9%         | 8.9%           |
| <u>At Rates Authorized Herein</u>        |                  |              |                |
| Operating Revenues                       | -                | -            | 82,550         |
| <u>Operating Expenses</u>                |                  |              |                |
| Excl. Inc. Taxes                         | -                | -            | 53,160         |
| Income Taxes                             | -                | -            | 4,080          |
| Total Expenses                           | -                | -            | 57,240         |
| Net Revenue                              | -                | -            | 25,310         |
| Rate Base                                | -                | -            | 323,000        |
| Rate of Return                           | -                | -            | 7.8%           |

From Table II it can be determined that applicant's requested rates would result in an increase of about nine percent in operating revenues, whereas applying the present Los Osos Heights rates to the present Morro View tariff area as authorized herein will increase the consolidated Los Osos District revenues by less than one-half percent. About half of the revenue increase will be from Morro View fire hydrants and half from Morro View metered service customers. The average rate increase for Morro View metered service customers will be approximately six percent and the percentage increase in individual Morro View customers' bills will vary somewhat, depending upon level of use.

#### Operating Revenues

The principal difference between the revenue estimates presented by applicant and those presented by the Commission staff results from (1) the staff's lower estimates of average general metered service customer usage, based upon the staff engineer's review of past usage and climatic variations, and (2) the staff's use of a lower estimate of projected increases in customers, based upon more recent data than were used by applicant. The staff's revenue estimates are adopted in Table II.

#### Operating Expenses

The staff, in preparing its expense estimates, made an analysis of actual expenditures in 1971. Where there were repairs which would not be likely to recur annually, the expenses were reduced to reflect the estimated frequency of recurrence of the particular repair. The staff witness conceded, however, that he did not make similar studies of actual expenditures in other years to determine whether or not other types of intermittent expenditures had been required which should also be included in arriving at an average year's estimate. The record does not indicate which groups of accounts were adjusted downward by the staff for nonrecurring items, nor the exact dollar amounts involved in each. It appears, however, that the repairs to sources of supply, pumps and distribution system could all be somewhat underestimated under the procedure

used in the staff estimates. In Table II we have adopted applicant's estimates of source of supply expense and distribution expense. For pumping expense we have modified applicant's estimates to reflect a lower quantity of water pumped consistent with the adopted revenue estimates, and assumed that about half of the resulting difference with the staff estimate is due to the proper reflection of improved pump efficiencies in the staff estimate and the remaining difference is due to unsupported staff adjustments for nonrecurring expenditures.

The difference between applicant's and the staff's estimates of customer accounting expense is due largely to the differences in estimates of number of customers. Consistent with the adoption of the staff's revenue estimates, the staff's estimates of customer accounting expenses are adopted in Table II.

There are numerous differences between the estimates of various portions of administrative and general expenses prepared by applicant and the staff. We note, however, that if applicant had assumed the staff's five-year estimated cycle of rate proceedings in this district instead of a three-year cycle, there would have been less than two hundred dollars difference between the overall estimates of administrative and general expenses. Where, as in this district, there is no demonstrated significant downward trend in rate of return, a five-year period between rate proceedings does not appear unreasonable. In regard to other relatively minor differences in the estimates, we do not concur in the staff exclusions of certain fringe benefits and expenses of employees working temporarily in a district away from their home offices. In Table II, we have revised applicant's estimate of administrative and general expenses to reflect a five-year cycle of rate proceedings for this district and then allowed half of the remaining difference with the staff estimate.



About half of the difference between the depreciation expense estimates of applicant and the staff is due to the staff's recalculation of straight-line remaining-life accrual rates. The staff's estimates of accrual rates are based upon more recent data and appear reasonable.

The remaining difference in depreciation estimates is due largely to the staff's use of a saturation adjustment factor for the sparsely settled Morro View area. This factor reduced the depreciation expense used for rate-making purposes to eliminate depreciation on the percentage of Morro View facilities not yet producing revenue. Both applicant and the staff had made an appropriate saturation adjustment to plant included in rate base, but applicant had failed to make a corresponding adjustment to depreciation expense. The staff's depreciation expense estimate is adopted in Table II.

The difference between applicant's and the staff's estimates of taxes other than on income is due to the staff's use of the most recent ad valorem tax rates for the full test period. In the absence of a reasonably well-defined trend in ad valorem tax rates, the most recent rate is appropriate. The staff's estimate of taxes other than on income is adopted in Table II.

The various differences between applicant's, the staff's, and the adopted estimates of operating revenues and expenses result in differences in estimates of income taxes. Further, there are significant differences between applicant's and the staff's estimates of the effect of accelerated depreciation and investment tax credit.

In developing the estimated depreciation deduction for income tax estimates for the test year 1973, applicant derived the ratio of tax depreciation to book depreciation for 1971 and applied this ratio of 1.0665 to 1973 straight-line depreciation expense. This method ignores the facts that (1) the ratio was low in 1971 because much of the plant was purchased from a predecessor and was not eligible for accelerated depreciation, and (2) all new plant

subsequently constructed by applicant initially has a tax depreciation deduction about twice as high as straight-line depreciation, rather than only 6.65 percent greater. The staff method of derivation of income taxes appears reasonable and will be adopted.

The income taxes adopted in Table II reflect the interest expense and surtax exemption resulting from the merger of the former California Cities Water Company and California Consolidated Water Company, Inc., utilizing the same capital structure and interest rates of the surviving company as were used by the staff's financial witness in preparing his recommended range in rate of return.

Rate Base

Except for two of the staff adjustments, the rate base estimates of applicant and the staff would have been fairly close. The two adjustments are the exclusion of \$15,000 of payments to a former owner of the Los Osos system and the exclusion of certain real estate not considered by the staff to be used or useful in the water operations.

The \$15,000 payment was made over a two-year period to the former owner as payment for his assistance in preparing system maps and property records which the former owner had kept in his head, and for his advice and assistance in operating the system.

Applicant capitalized the entire \$15,000 through charges to construction work in progress. Although sizable portions of the payment could reasonably be related to capital investment, it is clear from the record that some portions also should have been charged to operating expense.

The deductions for nonoperating plant were primarily the exclusion of portions of oversized well sites. Applicant's vice president-general manager testified that, at the time the large sites were purchased, smaller parcels could not have been acquired because of proximity requirements then imposed by the local health authorities and by the unwillingness of the sellers to split up the properties involved. Although the proximity requirements subsequently were relaxed, the unused portions of the lots have not been salable.

In the absence of more detailed information as to the percentage of time spent by the former owner on capital items and as to the market value of the unused portion of the well sites, we have adopted in Table II a rate base about midway between the estimates of applicant and the staff.

#### Rate of Return

In Exhibit No. 10, applicant derived a cost of capital ranging from 9.52 to 9.99 percent, using 12 to 13 percent return on equity capital. Applicant contends that the 12 to 13 percent range is the minimum required to attract equity capital into the company, that the parent corporation is permitted in other states to earn 12 percent or more, and that many utility companies today are seeking and being allowed to earn rates of return of 12 percent or more on equity.

The Commission staff recommends a rate of return on rate base in the range of 7.6 to 7.9 percent for applicant's Los Osos District, based in part upon a study of capital structures and rates of return of other water utilities. Basic data in Table No. 6

of Exhibit No. 12 show that this range of return on rate base is equivalent to a return of from 8.6 to 9.3 percent on applicant's common equity, after eliminating acquisition adjustments from common equity. The staff witness testified that the recommendation as to allowable earnings on common equity involved consideration of such factors as (1) financial requirements for construction and other purposes, (2) the amount of funds available from advances, contributions, and other sources, (3) capital structure and the impact of high interest rates upon the imbedded cost of senior securities, (4) earnings of other water utilities, (5) recently authorized rates of return, and (6) governmental efforts to control inflation.

Applying the present Los Osos Heights rates uniformly to both the Los Osos Heights and Morro View areas, as authorized herein, would result in a return of 7.8 percent on rate base for the test year 1973, which is within the range recommended by the staff. The corresponding return on equity would be about 9 percent.

Findings

1. Uniform rates should be charged in the Los Osos Heights and Morro View areas but the rates proposed by applicant are excessive.

2. The adopted estimates, previously discussed herein, of operating revenues, operating expenses, and rate base for the test year 1973 reasonably indicate the results of applicant's operations for the near future.

3. A rate of return of 7.8 percent on applicant's rate base for 1973 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.

5. Rule 23.1 of the Commission's Rules of Procedure does not apply since the rate increases authorized herein do not increase the utility's aggregate annual revenues by more than one percent.

Conclusion

The Commission concludes that the present Los Osos Heights rates should be made applicable to applicant's Morro View area.

O R D E R

IT IS ORDERED that, after the effective date of this order, applicant California Cities Water Company is authorized to file for its Los Osos District the revised rate schedules attached to this order as Appendix A, and concurrently to withdraw its present rate schedules applicable to the Los Osos Heights and Morro View tariff areas. 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 12<sup>th</sup> day of JUNE, 1973.

William L. Stinson  
President  
William Synovis  
[Signature]  
[Signature]  
Commissioners

Commissioner J. P. Vukasin, Jr., being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A  
Page 1 of 3

Schedule No. 10-1

Los Osos Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Los Osos Highlands, Morro View, and vicinity, located approximately ten miles northwest of San Luis Obispo, San Luis Obispo County. (T)  
(T)

RATES

Quantity Rates:

|       |                                   | Per Meter<br>Per Month |     |
|-------|-----------------------------------|------------------------|-----|
| First | 800 cu.ft., or less.....          | \$ 4.50                | (C) |
| Next  | 1,400 cu.ft., per 100 cu.ft. .... | .25                    |     |
| Next  | 3,000 cu.ft., per 100 cu.ft. .... | .20                    |     |
| Over  | 5,200 cu.ft., per 100 cu.ft. .... | .15                    |     |

Minimum Charge:

|     |                           |         |     |
|-----|---------------------------|---------|-----|
| For | 5/8 x 3/4-inch meter..... | \$ 4.50 |     |
| For | 3/4-inch meter.....       | 6.00    |     |
| For | 1-inch meter.....         | 8.00    |     |
| For | 1 1/2-inch meter.....     | 11.00   |     |
| For | 2-inch meter.....         | 15.00   |     |
| For | 3-inch meter.....         | 20.00   | (C) |

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

APPENDIX A  
Page 2 of 3

## Schedule No. 10-6

Los Osos Tariff AreaRESIDENTIAL FLAT RATE SERVICEAPPLICABILITY

Applicable to all water service furnished to residential customers on a flat rate basis.

TERRITORY

Los Osos Highlands, Morro View, and vicinity, located approximately ten miles northwest of San Luis Obispo, San Luis Obispo County. (T)

RATES

|  | Per Service Connection<br>Per Month |     |
|--|-------------------------------------|-----|
| For each residential unit, including a lot having an area of:                              |                                     |     |
| 6,000 sq. ft. or less.....   | \$ 4.75                             | (C) |
| 6,001 to 9,000 sq. ft. ....  | 4.85                                |     |
| 9,001 to 12,000 sq. ft. ....   | 5.00                                |     |
| Over 12,000 sq. ft., each additional 1,000 sq. ft. or fraction thereof.....                | .10                                 |     |
| For each additional residence on the same lot served from the same service connection..... | 3.00                                | (C) |

SPECIAL CONDITION

Meters may be installed at option of utility or customer for above classifications, in which event service will thereafter be rendered only on the basis of Schedule No. 10-1, General Metered Service. (T)

APPENDIX A  
Page 3 of 3

Schedule No. 10-4

Los Osos Tariff Area

PUBLIC FIRE HYDRANT SERVICE

APPLICABILITY

Applicable to all fire hydrant service furnished to municipalities, organized fire districts and other political subdivisions of the State. (T)

TERRITORY

Los Osos Highlands, Morro View, and vicinity, located approximately ten miles northwest of San Luis Obispo, San Luis Obispo County. (T)

RATES

|   | <u>Per Month</u> |     |
|---|------------------|-----|
| For hydrant furnishing in excess of 750 g.p.m. .. | \$4.00           | (C) |
| For hydrant furnishing 500 - 750 g.p.m. ....      | 3.00             |     |
| For hydrant furnishing 250 - 499 g.p.m. ....      | 2.00             |     |
| For hydrant furnishing less than 250 g.p.m. ....  | No Charge        | (C) |

SPECIAL CONDITIONS

1. The utility will supply only such water at such pressure as may be available from time to time as a result of its normal operation of the system.

2. The above rate includes use of water for fire fighting and for no other purpose. Quantities of water delivered through fire hydrants for any other purpose will be estimated or measured and charges therefor will be made at general metered service rates.

3. Fire hydrant will be installed only upon receipt of proper order of the local fire protection authority. Such order will designate the specific location at which each fire hydrant is to be installed.

4. Cost of installation and maintenance of hydrants will be borne by the utility.