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ORIGINAL

Decision No. 83676

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of Application of SAN GABRIEL VALLEY WATER COMPANY for authority to increase rates charged for water service in its El Monte Division.	Application No. 53003 (Filed November 17, 1971)

OPINION

Commission Decision No. 80779 dated December 5, 1972, granted rehearing of Decision No. 80315 dated July 25, 1972. Rehearing was limited to the issue of the treatment to be accorded for rate-making purposes of the acquisition of Clayton Mutual Water Company (Clayton) and the accounting entries with respect thereto. Pursuant to Commission order, further hearings were held before Examiner Mattson on November 19, 1973 and February 1, 1974 in Los Angeles, California. San Gabriel Valley Water Company (San Gabriel) and the Commission staff each presented one witness at the hearings. The matter was submitted on statements by counsel for San Gabriel and the staff.

The Issue on Rehearing

On March 30, 1971 San Gabriel acquired the water system of Clayton for a purchase price of $80,000. The Commission, by Decision No. 80315, ordered San Gabriel to charge its plant accounts with the purchase price paid plus reasonable costs of acquisition. San Gabriel sought to include the depreciated original cost appraisal to Clayton in its utility plant accounts in the net amount of $157,422.

San Gabriel's petition for rehearing requested that the matter be reopened for the purpose of receiving further evidence on the ratemaking treatment to be accorded the acquisition of the Clayton water system and to authorize journal entries reflecting such cost. Rehearing was granted limited to the matter of ratemaking treatment of the acquisition of Clayton.

San Gabriel's Position

The petition for rehearing sets forth in detail the argument and facts relied upon by San Gabriel in support of the relief it requests.

The fundamental error alleged is that the Commission, contrary to long standing practice and policy and contrary to the unanimous recommendations of its staff, refused to recognize for ratemaking purposes the depreciated original cost of the Clayton properties. Depreciated original cost may be described as net historical cost to Clayton.

San Gabriel's argument is grounded upon its view of established Commission practice. Additional argument is based upon factual claims that net historical cost is reasonable, that valuation for tax purposes is irrelevant for ratemaking purposes, and that certain plant constructed by the Division of Highways should be allowed in rate base when the facilities become operative. Finally, San Gabriel argues that fairness and equity require the recognition of net historical cost in rate base.

The Staff Position

At the original hearings, the staff engineer included in rate base the historical cost depreciated of the Clayton system without regard to the acquisition adjustment. The staff figures did reflect a lower adjusted original cost appraisal and depreciation reserve. The staff position was not entirely clear, for a second staff witness requested that the Commission make a finding that the treatment of the Clayton acquisition would not necessarily be indicative of the manner in which acquisitions of mutuals would be treated in the future. On cross-examination this staff witness stated that as a general principle he would recommend use of historical cost or purchase price, whichever is lower.

Upon rehearing, the staff recommended that Decision No. 80315 be affirmed. Specifically, the staff position is that San Gabriel should be directed to record the Clayton acquisition by entering the difference between depreciated historical cost and the lower purchase price in Account No. 265, Contributions in Aid of Construction.

The basic argument of the staff is that if its recommendations are followed, the utility will be earning a full return on every dollar that it has invested in the Clayton system. In short, the staff position is that actual acquisition costs reflect the proper original cost to San Gabriel of the Clayton system for ratemaking purposes.

Commission Practice and Policy

San Gabriel argues that Commission practice and policy support its position that the acquisition of a mutual water system should be reflected at net historical cost to the mutual. The cases relied upon by San Gabriel may be summarized as follows:

<u>Duarte Domestic Water Company</u> (1952) 51 CPUC 483. In this case the Commission established the value of a mutual water company system and authorized the issuance of stock by the acquiring utility. The case involved the transformation of the mutual company into a regulated public utility. The Commission authorized a rate base evaluation at estimated depreciated historical cost, including some property donated by ranch owners to the mutual.

<u>John Sciarra</u>. Decision No. 63581 dated April 17, 1962 affirmed Decision No. 62830 dated November 21, 1961 in Application No. 43428. The Commission established a rate base for Fitch Mountain Water Co. based on net book accounts and ignored a lower purchase price. The decision does not discuss the acquisition of a mutual water company. In <u>Fitch Mountain Water Co., Inc.</u> (1965) 64 CPUC 558, the net worth of utility plant was used when the applicant suggested use of the higher price paid for stock in an acquisition of utility system.

<u>Rancho Las Posas Water Company</u> (1965) 64 CPUC 92. The Commission based valuation of the assets of a mutual water company at net historical cost. Stock had been exchanged for utility plant. The applicant used a cost to itself which exceeded the net historical cost recommended by the staff.

<u>Pomona Valley Water Company</u> (1965) 64 CPUC 522. Stock was issued for assets of a public utility. The assets were evaluated for rate base at net original cost. The stock was also valued at original depreciated costs.

Conejo Valley Water Company (1965) 64 CPUC 212. The Commission authorized the use of the purchase price of two mutual water systems, rather than the higher net historical cost, for ratemaking purposes.

Inverness Water Company (1962) 60 CPUC 167. The Commission ordered that the purchase price paid for a mutual water company, rather than the higher net historical cost, be used in valuation of an acquisition.

None of the preceding cases appear to hold that the acquisition of a mutual water company should be reflected in the rate base at amounts in excess of a lower purchase price. Some of the decisions do not appear to involve acquisitions of mutual water companies (Sciarra, Fitch Mountain, and Pomona Valley). Several decisions deal with evaluation of stock or utility plant when mutual water companies are transformed into regulated public utilities (Duarte and Rancho Las Posas). In the two decisions involving purchases of mutual water companies at prices below net historical cost, the Commission reflected the lower purchase price in the rate base (Conejo Valley and Inverness). The decisions support the staff position.

The Uniform System of Accounts

San Gabriel suggests that its position is supported by the Uniform System of Accounts for Water Utilities (Classes A, B, and C), Instructions - Utility Plant Accounts, 4.B. The Commission advised all water utilities, when it adopted the uniform system of accounts, that it did not commit itself to approve or accept any item set out in any account for the purpose of fixing rates or of determining other matters which may come before it. Moreover, the instruction referred to by San Gabriel provides that the difference between balances in a seller's utility plant accounts and net purchase price would be closed to Account No. 100-5, Utility Plant Acquisition Adjustments. San Gabriel overlooks the fact that the instructions provide that Account No. 100-5 shall be disposed of as the Commission may approve or direct. The Uniform System of Accounts does not support San Gabriel's position. See Cal. Water & Tel. Co. (1966) 65 CPUC 281 for a detailed discussion of the treatment of a utility plant acquisition adjustment.

Clayton Mutual Water Company

San Gabriel urges that the evidence establishes that Clayton was not a true mutual, and that the Clayton properties are deemed to have been devoted to public use. The fact is that Clayton was incorporated on April 6, 1964 by Frank F. Pellissier & Sons, Inc. to furnish water service to lessees of industrial sites on Pellissier's property. (See Decision No. 67599 dated July 28, 1964 in Application No. 46282 filed March 11, 1964.) Clayton subsequently operated as a mutual water company not subject to Commission jurisdiction and control. Moreover, Clayton would not necessarily be subject to Commission jurisdiction if it sold water to Pellissier lessees who were not shareholders of Clayton. (See California Public Utilities Code, Section 2705(b).)

Discussion and Conclusion

The staff recommendation is grounded upon the proposition that the original cost of the Clayton system to San Gabriel is the purchase price plus acquisition costs. The relief requested by San Gabriel would increase the rate base of San Gabriel by an amount in excess of the actual acquisition costs.

As noted above, the past decisions of this Commission support the staff recommendation. The applicable Uniform System of Accounts is consistent with such a result. Moreover, the Clayton system was constructed as a mutual water company not subject to Commission jurisdiction or control. The Clayton system, operating as a mutual, could deliver water at cost to Pellissier lessees.

The additional arguments advanced by San Gabriel are not persuasive. As the staff points out, if San Gabriel's ratemaking treatment is followed, ratepayers will be disadvantaged by a higher rate base, higher depreciation expense (while depreciation for tax purposes cannot exceed the actual purchase price), and higher property taxes. San Gabriel regards the tax consequences as "irrelevant". The adverse effects upon the ratepayers would appear to be as relevant as the reduction of rate base is to San Gabriel.

San Gabriel suggests that it has acted in reliance upon its own experience in acquiring mutuals. As pointed out earlier, accounting entries made pursuant to the established Uniform System of Accounts are not determinative of the proper ratemaking treatment of an item. The use of such journal entries in subsequent rate proceeding without Commission objection does not establish a general ratemaking principle. In this case, San Gabriel was advised by the staff of the proper accounting entries.

Our conclusion herein should not result in future purchase prices in excess of the lowest price otherwise available. The Commission must assume that competent management will always seek the lowest and most advantageous price. No reason exists to assume the purchase of a mutual system will be regarded differently than other purchases made by San Gabriel management. Nor should utilities lose their incentive to purchase a distressed mutual water company when such purchase is advantageous to the utility company.

It is our conclusion that the acquisition of Clayton should be recorded at the purchase price paid plus acquisition costs. This disposition is consistent with the principle that regulated utilities under Commission jurisdiction are entitled to earn a just and reasonable return on the depreciated original cost of the utility plant necessarily dedicated to serving the public.

Findings

1. San Gabriel is a public utility water corporation subject to the jurisdiction of this Commission.

2. Clayton was organized as a mutual water company by Pellissier on April 6, 1964 for the purpose of furnishing water to lessees of industrial sites on Pellissier property. On March 30, 1971 the Clayton system was purchased by San Gabriel at a purchase price of $80,000. At all times during its existence Clayton operated as a mutual water company not subject to Commission jurisdiction.

3. The Clayton system purchased by San Gabriel had an original cost appraisal to Clayton of $189,877 with related accumulated depreciation of $32,455 as of April 1, 1971. The depreciated original cost to Clayton was $157,422.

4. The Uniform System of Accounts for Water Utilities (Classes A, B, and C) authorizes San Gabriel to record the difference between the plant accounts less depreciation reserve and the lower purchase price in Account No. 100-5, Utility Plant Acquisition Adjustments. The Uniform System provides that Account No. 100-5 shall be disposed of as the Commission may direct. Acquisition expenses are charged to Account No. 100-1, Subaccount No. 391.

5. The acquisition adjustment resulting from the Clayton purchase is $77,422.

6. San Gabriel requests that the depreciated original cost to Clayton be included in its rate base as utility plant, without regard to the acquisition adjustment. The effect is to treat the amount reflected by the lower purchase price as a capital account.

7. The staff recommends that the acquisition adjustment be closed to Account No. 265, Contributions in Aid of Construction. The staff recommendation would affirm the ratemaking treatment ordered in Decision No. 80315.

8. The ratemaking treatment requested by San Gabriel would increase rate base by an amount in excess of $77,000 above the $80,000 paid for the Clayton system. Rates to San Gabriel ratepayers would, under applicable principles, include the return required for the additional rate base.

9. The ratemaking treatment requested by San Gabriel would result in higher property taxes to San Gabriel, based upon the increase reflected in the plant accounts.

10. The ratemaking treatment requested by San Gabriel would result in higher depreciation expense for ratemaking purposes. However, San Gabriel's depreciation for tax purposes would be limited to the amount of the actual purchase price of the Clayton system.

11. San Gabriel purchased the Clayton system as a result of negotiations conducted in good faith. The purchase price was reasonable.

12. The net plant investment of San Gabriel in 1971 exceeded $13 million. The 1972 rate base of San Gabriel's El Monte Division was in excess of $6 million.

Conclusions

1. San Gabriel acquired the Clayton system at an original cost to San Gabriel of $80,000 plus reasonable acquisition expenses.

2. No reason exists to reflect amounts in the rate base of San Gabriel in excess of San Gabriel's original cost.

3. For ratemaking purposes, San Gabriel is entitled to earn a just and reasonable return on the original cost less reasonable depreciation of the utility plant necessarily devoted to providing water service. The inclusion in San Gabriel's rate base of amounts in excess of the original cost to San Gabriel of the Clayton system would improperly depart from the use of an original cost rate base.

4. The original treatment for ratemaking purposes of the Clayton acquisition ordered by Decision No. 80315 is proper. The staff recommendation is to affirm the original order, and to close the Acquisition Adjustment account to Account No. 265, Contributions in Aid of Construction. The use of Account No. 265 is proper if the plant accounts reflect amounts in excess of the purchase price plus reasonable acquisition costs.

O R D E R

IT IS ORDERED that Decision No. 80315 is affirmed.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 6th day of NOVEMBER, 1974.

Vernon L. Sturgeon
President

William Symons, Jr.

D. W. Holmes

Robert E. McHarle
Commissioners

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