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ORIGINAL

Decision No. 85569

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 Authorization to Increase Rates and Charges for Water Service.

Application No. 55316
(Filed November 12, 1974)

Frank W. Doherty, Attorney at Law, for applicant.
Luc P. Benoit, Attorney at Law, Kent Frewing, Attorney at Law, and Maynard Morris, for Mesa Crest Water Users Group, protestant.
William J. Jennings, Attorney at Law, Ichiro Nagao, and Andrew Tokmakoff, for the Commission staff.

O P I N I O N

By this application filed November 12, 1974, Mesa Crest Water Company, a closely held California corporation, seeks authority to increase its rates and charges for water service. The increases sought would, according to the revenue requirement study accompanying the application, increase applicant's revenues estimated for 1975 by $63,888, or 35 percent.

Notice and Public Hearing

The following notice of filing of this application was sent, in late November 1974, to each of applicant's customers in accordance with this Commission's rules of procedure:

> "Notice is hereby given that on November 14, 1974, Mesa Crest Water Company filed Application No. 55316 with the Public Utilities Commission of the State of California for authorization to increase rates for water service. The Company has also requested that the structure of its metered service rate be changed from a minimum charge type rate to a service charge type rate and that zone rates be established to recover costs of additional pumping from customers at higher elevations. The rate increase is required to pass through to customers' increased costs to the Company and to allow the Company a fair return on its investment in utility plant. The proposed rates will increase revenues by $63,888 for test year 1975 which represents an increase of approximately 35 percent. Requests by customers to receive notice of the date, time, and place of any hearing on this application or for other information relative to the proposed increase may be directed to the California Public Utilities Commission, 5109 State Office Building, 107 South Broadway, Los Angeles, California 90012."

Protestant, Mesa Crest Water Users Group, has asserted that this notice misled its members and others, who are also applicant's customers, into assuming a uniform 35 percent increase in rates and charges was being requested by applicant.

The notice, although accurate, did not define the rate increase request in sufficient detail to fully preclude so simplistic an interpretation. But, in stating "that the structure of its metered service rate be changed from a minimum charge type rate to a service charge type rate and that zone rates be established to recover costs of additional pumping from customers at higher elevation", the notice did disclose, nonetheless, an intended restructuring of rates in two ways, both of which were clearly indicative that there would not be a uniform percentage increase for all bills of all users.

By the time this matter was heard, some nine months after the application was filed, it appears that the customers were generally aware that, under applicant's proposed rate increases, the percentage increases in customers' bills would vary widely depending upon the amount of water used and in which pressure zone it was used. They were also aware that the percentage increase to the golf course, the largest user, would be well below 35 percent as a result of applicant's proposing a smaller than average percentage increase to the tail block of the general metered water service schedule.

Public hearing was held before Examiner Main on August 5, 6, 7, and 8, 1975, at La Canada. Notice of the hearing was provided to customers by bill insert or a direct mailing, publication in a newspaper of general circulation in applicant's service area, and posting in its business office. Evidence was presented by applicant through the consultant, who prepared the revenue requirement study, which accompanied the application, and through its president; by the staff through a financial examiner and a hydraulic engineer; and by the protestant through one witness.

Service Area and Water System

Applicant's service area, approximately 600 acres in the northerly portion of the community of La Canada, Los Angeles County, consists of the La Canada Country Club and the surrounding residential areas. Prior to year 1972, the residential development consisted of relatively large single-family homes on large lots. Since then, development has consisted of condominium residential dwelling units. About 550 customers are presently provided metered service.

The service area is mostly on steep hillside terrain and is divided into four pressure zones ranging in elevation from 1,100 to 2,000 feet. The service area is entirely within the Foothill Municipal Water District.

Applicant's entire water supply is purchased from that district, which is a member agency of the Metropolitan Water District of Southern California. It is softened and filtered water which is received at a metered connection at a point on the district's system near the intersection of Foothill Boulevard and Hampton Road, approximately five-eighths of a mile south of applicant's service area. From this point all water must be boosted some 400 feet in elevation to facilities serving pressure zone 1, and most of the water must be boosted several times thereafter to the higher pressure zones. The booster pumps on the system operate in conjunction with storage located above the pressure zones.

The principal storage reservoirs are located at an elevation of about 2,000 feet and are designed to meet the large water requirements and demand flows for domestic use, golf course irrigation, and fire flow service within the third pressure zone. Water from those reservoirs can be released to the lower pressure zones through regulators located at the lower reservoir sites.

Transmission and distribution mains range in size from four to 14 inches and total 38,948 feet in length. There are about 550 metered services, 11 private fire protection services, and 58 public hydrants.

No service complaints were received by the Commission in 1973, 1974, or 1975. The staff engineer made a field inspection of applicant's water system, reviewed records, and interviewed customers. He concludes that applicant is providing good water service. High rates are a source of customer dissatisfaction, however.

<u>Accounting Recommendations</u>

The staff witness from the Finance and Accounts Division summarized his accounting exceptions and recommendations on pages 4 and 5 of Exhibit 3 as follows:

"1. Account 133, Prepayments, contains a recorded debit balance of $80.00 for Workmen's Compensation Deposit which should be written off.

"2. Account 227, Customer Deposits, contains a recorded debit balance of $59.45 which should be written off.

"3. Account 222, Accounts Payable, contains a recorded amount of $38,456.53 for Advances for Construction refunds due and payable. This balance should be transferred back to Account 241, Advances for Construction, because it is a "rate base" item and should be removed only when paid or transferred to Account 265, Contributions in Aid of Construction.

"4. The applicant should set up a Sales Journal as of January 1, 1975.

"5. The applicant should set up a Payroll Clearing Account as of January 1, 1975.

"6. The applicant should post the accounting records on a monthly basis, consistently."

Applicant neither takes exception to the propriety of the above recommendations nor contends that the additional accounting requirements would prove unduly burdensome. Those recommendations will be adopted.

Rates

Through an extraordinary combination of high costs, including an expensive purchased water source and a hillside terrain which causes not only high pumping costs but high utility plant investment per customer as well, applicant's rates for general metered service are already among the highest in the State. The existing high rate levels, however, do not alter, much to the bewilderment of many of its customers, applicant's posture of being constitutionally entitled to a reasonable opportunity to earn a fair rate of return on its investment in plant devoted to public use.

Applicant's present tariffs include rates for general metered service, private fire protection service, and public fire protection service. Applicant does not propose to increase or otherwise modify the rates in the latter two schedules.

The existing schedule for general metered service contains, as shown below, four quantity rate blocks, with minimum charges for various meter sizes which entitle customers to the quantity of water that the minimum charge will purchase at the quantity rates. The quantity rates are applicable to all pressure zones. Under applicant's proposal, these rates would be increased and restructured. They would be restructured by replacing the minimum charge with a service charge, by reducing to three the quantity rate blocks, and by establishing separate quantity rates for each pressure zone.

The rates for metered service, which were in effect as of the date of filing of this application, are designated "present" rates. The "present" rates continued in effect until July 20, 1975. At that time offset rates were placed in effect pursuant to Resolution No. W-1763. The two sets of rates are set forth below:

Quantity Rates

	Per Meter Per Month 7-20-75 Offset	A.55316 "Present"
First 700 cu.ft. or less	$ 8.79	$ 8.45
Next 2,300 cu.ft., per 100 cu.ft.	.78	.75
Next 2,000 cu.ft., per 100 cu.ft.	.70	.67
Over 5,000 cu.ft., per 100 cu.ft.	.57	.54

Minimum Charge

For 5/8 x 3/4-inch meter	$ 8.79	$ 8.45
For 3/4-inch meter	11.00	11.00
For 1-inch meter	13.00	13.00
For 1½-inch meter	18.00	18.00
For 2-inch meter	26.00	26.00
For 3-inch meter	40.00	40.00
For 4-inch meter	64.00	64.00
For 6-inch meter	126.00	126.00

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

Applicant's proposed rates for metered service are as follows:

Quantity Rates

	Per Meter Per Month Zone 1	Zone 2	Zone 3	Zone 4
First 3,000 cu.ft., per 100 cu.ft.	$0.75	$0.79	$0.83	$0.89
Next 2,000 cu.ft., per 100 cu.ft.	0.67	0.71	0.75	0.81
Over 5,000 cu.ft., per 100 cu.ft.	0.54	0.58	0.62	0.68

The following service charges apply to all pressure zones:

Service Charge

For 5/8 x 3/4-inch meter	$ 8.00
For 3/4-inch meter	9.00
For 1-inch meter	12.00
For 1½-inch meter	16.00
For 2-inch meter	22.00
For 3-inch meter	40.00
For 4-inch meter	55.00
For 6-inch meter	90.00

The service charge is applicable to all metered service. It is a readiness-to-serve charge to which is added the charge, computed at the quantity rates, for water used during the month.

Rate of Return

Applicant's consultant recommended 9.4 percent as a fair rate of return on rate base. In contrast, the staff witness recommended an 8.7 percent rate of return. The capital ratios, cost factors, and weighted costs associated with these recommendations are:

Item	Applicant Capital Ratios	Applicant Cost Factors	Applicant Weighted Cost	Staff Capital Ratios	Staff Cost Factors	Staff Weighted Cost
Long-Term Debt	30%	8.00%	2.40%	27.98%	8.00%	2.24%
Preferred Stock	12	5.25	.62	12.65	5.25	.66
Common Stock	58	11.00	6.38	59.37	9.77	5.80
Total	100%		9.40%	100.00%		8.70%

Both witnesses imputed a cost factor of 8 percent for long-term debt. According to applicant's witness, it "is based on the approximate average yield of high grade utility bonds issued during year 1973 with optimistic expectations that such rates will prevail in the long-term future. The return on common equity of 11 percent is believed to be consistent with a debt interest of 8 percent considering the debt equity ratio...."

The debt component of this capital structure consists of advances from companies associated with applicant which in substantial part are, in fact, noninterest bearing. To develop a cost of capital it appears appropriate either to so impute interest or to include the noninterest bearing portion in common equity capital. The outcome of the latter is to disadvantage the ratepayer because the cost factor for common equity is higher than for debt and the interest deduction from taxable income would be smaller.

In reaching his recommendation on fair rate of return, the staff witness considered a number of factors, including (1) recent rates of return found reasonable for water utilities under our jurisdiction; (2) components and costs in applicant's capital structure; (3) quality of service; (4) the high ratio of capital stock and advances from associated companies to total liabilities; (5) restricted growth; and (6) high water rates.

The staff's judgment on fair rate of return is persuasive in light of all the evidence. The fair rate of return for applicant, accordingly, is 8.7 percent.

Results of Operation

Applicant's estimates of revenues, expenses, and rate base are provided in Exhibits 1 and 9, and the staff estimates of applicant's operating results are contained in Exhibits 3 and 3-A. Their respective estimates are summarized, and compared with our adopted estimates under "present rates", in Table I below. For convenience, the results of operation at the rates authorized herein are also shown:

TABLE I

Mesa Crest Water Company
Results of Operation
Test Year 1975

Item	"Present" Rates				Rates Authorized Herein
	Applicant	Staff	Difference	Adopted	
Operating Revenues	$183,760	$182,020	$ 1,740	$182,020	$234,700
Operating Expenses					
Purchased Water	64,915	60,375	4,540	62,000	62,000
Purchased Power	20,207	19,650	557	20,570	20,570
Payroll	32,140	23,800	8,340	23,800	23,800
Other O&M. A&G Expenses	31,590	32,230	(640)	32,230	32,700
Subtotal	$148,852	$136,055	$12,797	$138,600	$139,070
Depreciation Expense	$ 15,681	$ 16,455	$ (774)	$ 16,455	$ 16,455
Taxes Other Than on Income	17,850	18,160	(310)	18,160	18,160
Income Taxes	200	390	(190)	200	20,210
Total Operating Exp.	$182,583	$171,060	$11,523	$173,415	$193,895
Net Revenue	$ 1,177	$ 10,960	$(9,783)	$ 8,605	$ 40,805
Rate Base	$482,012	$468,830	$13,182	$468,830	$468,830
Rate of Return	0.24%	2.34%	(2.10)%	1.84%	8.7%

(Red Figure)

The staff's estimate of revenues is based in part on later data than applicant's estimate. The later data disclosed somewhat lower water usage patterns in new condominiums than anticipated by applicant. Revenues amounting to $234,700 at the rates authorized herein have been determined consistent with a staff estimate of water sales of 222,430 ccf.

The staff's estimate of total operating expenses also reflects in part later data than that available to applicant at the time its estimates were prepared. For this reason, where their respective estimates for expense categories are not far apart, the staff estimates have been adopted, as the entries in Table I for Other O&M and A&G Expenses, Depreciation Expense, and Taxes Other Than on Income show. The major differences, however, are another matter; they are not attributable to later data, but to divergent treatment by applicant and the staff of loss and unaccounted for water and payroll.

Applicant's estimate of $64,915, shown in Table I, for purchased water exceeded the staff's estimate by $4,540, primarily because it used a higher level of loss and unaccounted for water. The $64,915 figure is based on water purchases of 255,900 ccf at $110.50 per acre-foot (25.367¢ per ccf), whereas the staff's estimate of $60,375 is based on water purchases of 238,000 ccf also at $110.50 per acre-foot. Applicant used 12.5 percent of water purchases (equivalent to about 14.3 percent of water sales), or 31,988 ccf, as the proper allowance for water losses, whereas the staff used 7 percent of water sales (equivalent to about 6.5 percent of water purchases), or 15,570 ccf. Losses and unaccounted for water, reported as a percent of water purchased, for years 1972, 1973, and 1974, were 11.8 percent, 12.0 percent, and 15.4 percent, respectively.

Applicant's witness estimated water requirements for 1975, which included loss and unaccounted for water at 12½ percent of purchases based on the experience in years 1972 and 1973. He testified in this regard as follows:

> "These were years after the last rate case. They were years during which the company had been making diligent efforts to find any leaks, to patrol any unauthorized use of water, had been checking the larger meters, had been sampling the accuracy of the smaller meters, and I believe that to be a reasonable estimate of what the company could accomplish with their operating conditions."

In Decision No. 79364 dated November 22, 1971, the Commission adopted a 7 percent figure for loss and unaccounted for water as reasonable for this utility. In this proceeding the staff has continued to use the 7 percent allowance set in that decision.

The water system is of good design and sound construction, and continues to be well maintained. Nonetheless, we are persuaded, in light of this record, that an overly stringent ratemaking treatment would result if we were to continue the allowance for loss and unaccounted for water as 7 percent of sales. We view an allowance of 9 percent of water purchases as both more reasonable and an attainable objective for loss and unaccounted for water. Accordingly, the latter allowance was used in arriving at water requirements of 244,400 ccf for the test year.

Our adopted expenses for purchased water and purchased power of $62,000 and $20,570, respectively, reflect that water requirement. The former was computed by applying a water cost of $110.50 per acre-foot to the water requirement; the latter was computed in part by using a kilowatt-hour surcharge of

.959 cents, i.e., a fuel cost adjustment of .969 cents per kilowatt-hour effective November 13, 1974, less a marine transportation adjustment of .020 cents per kilowatt-hour included therein which has now expired, plus an Energy Resource Surcharge of .010 cents per kilowatt-hour effective January 1, 1975.

The other principal difference in estimates of operating expenses, as brought out earlier, was in payroll, where applicant's estimate of $32,140 exceeded the staff's estimate by $8,340. The lower staff estimate was the result of adjusting downward the manager's salary from $1,600 to $905 per month. Its purpose is to make management compensation in this utility comparable to that in other utilities of similar size and compatible with the salary allowed in applicant's 1971 rate case, had that salary increased since then by 6 percent per annum. We consider the staff adjustment to be appropriate and have adopted as reasonable the estimate of $23,800 for payroll.

We have also adopted the staff's estimate of rate base of $468,830, in preference to applicant's estimate. In addition to reflecting later plant data, the staff estimate was arrived at by deducting a more probable level of advances for construction.

Rate Spread

As can be seen by comparing the last two columns of Table I on page 10 of this decision, the increase in operating revenues needed to bring the rate of return up from 1.84 percent at "present" rates to the fair rate of return of 8.7 percent is $52,680, or a 29 percent increase. The proper spread of this increase into the rates for general metered service is a contested issue, which has brought forth diverse viewpoints.

As described in an earlier section of this decision, applicant has proposed to redesign its two-part rates for general metered service. Those rates would be restructured under that proposal by replacing the minimum charge with a service charge, by reducing the quantity rate blocks from four to three, i.e., combining of the first two blocks, and by establishing separate quantity rates for each pressure zone. Under such proposed restructuring there would be a wide variation in percentage increases in the bills of water users.

The Commission staff does not take exception to the basic changes in rate design proposed by applicant. However, the Mesa Crest Water Users Group opposes most aspects of the proposed rate restructuring, contending among other things that declining quantity rates are regressive and therefore anti-conservation oriented; that the golf course is not paying its fair share of costs and should bear at least the same percentage increase in billings as other customers; and that an adequate cost allocation study has not been made.

In examining these contentions, one should keep clearly in mind that under the present rate structure, and for that matter under any rate structure which appears practicable at this time, fixed costs will be recovered in large part through quantity rates. Accordingly, unless quantity rates tilt downward in some fashion as consumption increases, high load factor users will absorb more than their fair share of fixed costs. Similarly, heavy irrigation users will be burdened with an inordinate portion of the costs associated with required fire flows.

In the latter regard the required fire flows, by representing the most stringent requirement imposed on the design of this water system, indicate that a substantial part of the fixed costs of operation of this system is allocable to public fire protection service. Rates for that service, however, are neither compensatory nor susceptible of substantial increase, and the costs attributable to the required fire flows must therefore be recovered primarily through the rates for general metered service.

The required fire flows are structure-oriented and are available to protect residences and the clubhouse of the country club. In this context the golf course, which represents the largest single use of water on the system, and the watered green belts in the residential areas have a much lesser requirement and, in fact, can be viewed as fire barriers rather than fire hazards in this area of high fire risk.

Placing a disproportionate cost burden on the golf course and on other large users under the guise of conservation could only have some validity if reduced water use were both a likely result and a requirement of sound public policy. We are unconvinced that total water consumption would change if the adopted rate spread were on the basis of either a uniform percentage increase for all bills of all users or a higher percentage increase to large users. Good public policy, while discouraging waste, should not necessarily tend to cause attractive green areas, such as the golf course and the green belts in residential areas, to be inadequately watered. The existing exceptionally high rates of themselves discourage waste.

With regard to applicant's proposal to establish zone rates, it is noted that historically zone rates have not been used in this service area and that the proposal to establish them comes at a time when a substantial increase in the customer density in the pressure zone 3 area is occurring. About one-half of the customers are located in that pressure zone. Our concern is that such a density change and perhaps other factors can tend to offset pumping cost increments by zones. In our view the record is inadequate to support any conclusion other than the one that zone rates result in a more complex rate design, the fairness of which is undetermined because of a lack of study in sufficient depth.

With regard to applicant's proposal to change from a minimum charge to a service charge in its two-part rate, the Commission has looked with favor on this type of change in rate design in numerous instances. The service charge is a readiness-to-serve charge which tends to better reflect cost incurrence than a minimum charge which entitles the customer to the quantity of water that the minimum charge will purchase at the quantity rates.

However, the elimination of one or more blocks in the existing quantity rates, associated with properly implementing this change, would cause large shifts in revenue distribution among customers. The record is not adequate, in our view, to justify such a redistribution.

Consistent with a careful evaluation of the evidence on rate spread, we are persuaded that neither a conversion from a minimum charge to a service charge, nor the establishment of zone rates should be undertaken at this time; we are persuaded that the existing quantity rate blocks should be retained and the rates for each block raised by a uniform increase of 29 percent.

Under the adopted rate spread a uniform percentage increase results for all bills of all users. The following Table II shows the charges under "present" rates and rates authorized herein (1) for a typical customer using 2,600 cubic feet of water through a one-inch meter in an average month; (2) for the same customer during a low consumption month of one-half the average; and (3) for the same customer during a high consumption month of twice the average.

TABLE II

Comparison of Charges for Various Monthly Usages

Quantity	"Present" Rates	Rates Authorized Herein
13 ccf (one-half average)	$13.00	$16.80
26 ccf (average)	22.70	29.33
52 ccf (twice average)	40.18	51.81

Findings

1. Applicant is in need of additional revenues but not to the extent set forth in the application.

2. The adopted estimates previously discussed in this decision of operating revenues, operating expenses and rate base for the test year 1975 reasonably indicate the results of applicant's operation in the near future.

3. A rate of return of 8.7 percent on a rate base of $468,830 is reasonable. Such rate of return will provide a return on common equity of approximately 9.8 percent.

4. The authorized increase in rates over "present" rates is expected to provide increased revenues of approximately $52,700 ($46,300 over "offset" rates), an increase of 29 percent.

5. The rate design contained in Appendix A to this decision is reasonable.

6. The increases in rates and charges authorized by this decision are justified and are reasonable; and the present rates and charges, insofar as they differ from those prescribed by this decision, are for the future unjust and unreasonable.

7. Applicant should be required, as recommended by the staff engineer, to file semiannual reports showing by months the mix of State Project and Colorado River waters delivered and the price per acre-foot billed by the Foothill Municipal Water District. The reports are due at the end of each July and January and are to cover, respectively, the first and second half of the calendar year.

8. The six recommendations of the staff accountant specified on page 5 of this decision are reasonable and should be carried out by applicant.

The application should be granted to the extent set forth in the order which follows.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, applicant 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 five days after the date of filing. The revised schedules shall apply only to service rendered on and after the effective date of the revised schedules.

2. Applicant shall file semiannual reports providing certain data on water purchases, as prescribed in Finding 7.

3. Applicant shall carry out the accounting recommendations of Finding 8.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 16th day of MARCH, 1976.

President

Commissioners

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	$ 10.90	(I)
Next 2,300 cu.ft., per 100 cu.ft.	0.97	|
Next 2,000 cu.ft., per 100 cu.ft.	0.86	|
Over 5,000 cu.ft., per 100 cu.ft.	0.70	(I)

Minimum Charge:

For 5/8 x 3/4-inch meter	$ 10.90	(I)
For 3/4-inch meter	14.20	|
For 1-inch meter	16.80	|
For 1½-inch meter	23.25	|
For 2-inch meter	34.00	|
For 3-inch meter	52.00	|
For 4-inch meter	83.00	|
For 6-inch meter	163.00	(I)

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