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Decision 88 05 026 MAY 11 1988

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of Stirling Bluffs Corporation)
for a general rate increase for)
water service in Stirling City,)
Butte County.)

Application 87-04-002
(Filed April 3, 1987)

William G. Fleckles, Attorney at Law, for
Stirling Bluffs Corporation, applicant.
Kenneth Brower, for Kinshaw Cemetery District,
and Willard W. Connor, for Rate Payers of
Water, protestants.
James E. Scarff, Attorney at Law, and Jasjit S.
Sekhon, for the Commission Advisory and
Compliance Division.

OPINION

Stirling Bluffs Corporation (applicant) is a wholly owned subsidiary of DIA Holdings (Overseas), B.V. (parent), a Netherlands corporation. It serves the community of Stirling City in Butte County. By this application, it has requested a general increase of \$36,323 or 150%, based on a 1987 test year. This increase would have produced a negative rate of return, -9.59%. Applicant did not seek a positive return on its investment, apparently in recognition that recent plant additions costing more than \$1 million resulted in excess capacity.

The request was originally filed as an advice letter; the advice letter was converted on April 7, 1987 to a formal application, in response to numerous consumer protests. There were also issues too complex to be addressed in the informal advice letter procedure. Those issues include the magnitude of the increase, and the excess capacity. The staff was also concerned about ownership changes which took place without Commission authorization.

Ownership

At the time of this application, Diamond International Corporation was recognized by the Commission as applicant's parent. That corporation was in turn owned by the DIA corporate family. Diamond was sold in June of 1984, with ownership of applicant being retained by DIA corporations. The buyer and seller did not seek approval of this transaction from the Commission, on the theory that there was no ultimate change of control.

Subsequent to the submission of this proceeding, there was a further change in the ownership of applicant. Applicant's stock is now wholly owned by DIA holdings (Overseas), B.V., a Netherlands corporation. This change was authorized by the Commission in Decision (D.) 87-12-062 in Application (A.) 87-12-027 with a finding that there was no significant change in ownership.

Hearing

Hearing in this proceeding was held before Administrative Law Judge (ALJ) Gilman in Stirling City on September 24, 1987. The matter was taken under submission as of October 30, 1987 with the filing of late-filed exhibits. The matter is now ready for decision.

On January 5, 1988, the assigned ALJ received a letter from Mr. Connor, acting as representative of local consumers. The letter opposed the rate design presented in the late-filed exhibit, claiming it was significantly different from what the staff proposed at hearing. The letter also alleged additional facts and advanced new arguments, in support of lower rates. Finally, it proposed that the rate increase be postponed indefinitely. We have not considered the issues raised by this document, since it should have been filed before submission.

DISCUSSION

I. Revenue Requirements

The table below compares the staff's and the applicant's final position on the components considered in establishing a revenue requirement. It should be noted that applicant has accepted the staff's position on most items. The "proposed rate" column assumes that the staff's recommended rates are adopted.

As explained below, we will adopt the staff's estimates at present and proposed rates.

Table I

SUMMARY OF EARNINGS

ITEM	Recorded			Test Year 1987			
	1984	1985	1986	Utility Estimate		Staff Estimated and Adopted	
				Pres. Rates	Prop. Rates	Pres. Rates	Prop. Rates
OPERATING REVENUES							
Flat	14,548	0	0	0	0	0	0
Fire	0	0	0	0	0	0	0
Irrig.	0	0	0	0	0	0	0
Metered	1,764	23,626	23,626	23,626	60,606	23,625	49,690
Other	0	667	667	667	0	1,875	3,845
Total Revenues	16,312	24,293	24,293	24,293	60,606	25,500	53,535
OPERATING EXPENSES							
Plant Oper. & Maint. Exp.							
(Volume Related Exp)							
610 Purchased Water	0	0	0	0	0	0	0
615 Power	565	13,410	13,493	7,790	7,790	7,790	7,790
618 Other Volume Related Exp	0	0	1,000	0	0	0	0
(Non-Volume Rel. Exp)							
630 Employee Labor	0	0	0	0	0	0	0
640 Materials	529	4,272	8,738	5,727	5,727	5,727	5,727
650 Contract Work	21,980	28,904	32,847	11,300	11,300	11,300	11,300
660 Transportation Exp	1,303	3,577	3,857	1,400	1,400	1,400	1,400
664 Other Plant Maintenance	0	0	0	0	0	0	0
Admin. and Gen. Exp							
670 Office Salaries	0	0	0	0	0	0	0
671 Management Salaries	0	0	0	0	0	0	0
674 Employee Pension and Ben	0	0	0	0	0	0	0
676 Uncoll. Account Exp	0	0	0	0	0	0	0
678 Office Service and Rental	650	650	650	650	650	650	650
681 Office Supplies and Exp	673	2,087	2,498	2,498	2,498	760	760
682 Professional Services	16,531	24,963	32,228	2,900	2,900	2,900	2,900
684 Insurance	0	0	18,785	24,785	24,785	7,000	7,000
688 Regulatory Commission Exp	0	0	2,000	2,000	2,000	1,000	1,000
689 General Exp	241	0	0	2,000	2,000	0	0
800 Expenses Capitalized	0	0	0	0	0	0	0
Total Expenses	42,472	77,863	116,096	61,050	61,050	38,527	38,527
Depreciation	1,102	9,613	44,936	9,790	9,790	2,590	2,590
Property Taxes	294	5,840	11,136	11,936	11,936	4,400	4,400
Payroll Taxes	0	0	0	1,000	1,000	1,000	1,000
Income Taxes	200	200	200	0	0	200	1,625
Total Deductions	44,068	93,516	172,368	83,776	83,776	46,717	48,142
Net Revenue	(27,756)	(69,223)	(148,075)	(59,483)	(23,170)	(21,217)	5,395
RATE BASE							
Average Plant	21,039	1,115,597	1,122,940	416,128	416,128	416,128	416,128
Average Depr. Reserve	17,120	11,735	56,671	14,690	14,690	3,890	3,890
Net Plant	3,919	1,103,862	1,066,269	401,438	401,438	412,238	412,238
Less: Advances	0	0	0	0	0	0	0
Contributions	0	0	0	0	0	364,200	364,200
ITC	0	0	0	0	0	3,866	3,866
Plus: Working Cash	0	0	4,316	20,950	20,950	7,170	7,170
Mat'l. & Supp.	0	0	0	0	0	0	0
Rate Base	3,919	1,103,862	1,070,585	422,388	422,388	51,342	51,342
Return on Rate Base	Loss	Loss	Loss	Loss	Loss	Loss	10,50%

A. Revenues

Both staff and applicant used the present recorded number of customers--165--as a basis for their revenue projections for the test year.

Applicant and staff agree that at present rates applicant will realize gross income of roughly \$25,000 a year; they also agree that at applicant's proposed rates its gross revenue would be somewhat in excess of \$60,000 per year.

Applicant in the past sold truckloads of water for the purpose of watering lumber roads for parent's logging operations. In 1985, applicant recorded revenue of \$676 from this source; applicant did not project any test year revenue for such sales. There are no existing tariff schedules for such service.

Staff estimated that, based on prior experience, applicant should be able to realize roughly \$1,875 in revenue from this source. It recommended a tariff which would charge approximately \$2 per truckload multiplied by the overall increase granted in this proceeding. Applicant has not opposed this recommendation.

B. Purchased Power

Staff contended that applicant had excessive unaccounted-for water loss. Its purchased power cost estimate (81,314 kilowatt-hours) is based on the total amount of water billed to customers in 1986, plus a 10% allowance for unaccounted-for water and another 2% for filter backflushing. The dollar figure in the tariff was derived by applying Pacific Gas and Electric Company's (PG&E) most recent rates to this consumption figure. Applicant has accepted these adjustments.

C. Other Volume-Related Expenses

Applicant originally included its cost for chemicals in this item. Staff believed that chemical expenses should be included in materials expense.

D. Materials

Applicant's original estimate of materials expense was based on an estimate of 1986 expenses in this category. After all 1986 expenditures were recorded, staff reviewed applicant's books and was able to substantiate only a smaller amount. Staff used this figure plus an adjustment for inflation to derive its own expense estimate. It also included in the estimate an amount for chemical expenses. As noted in Table I, applicant has adopted the staff's estimate.

E. Contract Work

Applicant's recorded figure in this category included a \$13,000 per year management cost; the remainder represented employee labor. Both kinds of services are provided by employees of parent. Staff estimated that a single employee working 15 hours per week at a rate of \$10 per hour should be sufficient to operate the water system. Staff estimated that the manager should be paid \$12.50 per hour and spend roughly 20 hours per month.

Applicant noted that the staff's estimate did not include an allowance for Social Security and unemployment insurance. After the staff increased its estimate to allow for those items, it was adopted by applicant.

F. Transportation Expense

Staff calculated its transportation expense estimate on a basis of 6,600 miles at a cost of 21¢ per mile. This is the rate currently allowed by the Internal Revenue Service for business. Applicant's estimate was based on a vehicle mileage of roughly 15,000 miles and a rate of 25.7¢ per mile. Applicant has accepted staff's estimate.

G. Office Supplies and Expenses

Since applicant submitted its test year estimates before all of 1986 expenses had been recorded, its estimate for 1986 significantly exceeded what was finally recorded for 1986.

Staff had the advantage of examining the applicant's final records for 1986; its estimate is based on recorded expenditures, increased for inflation using the standard escalation factors. Staff also excluded the 1-1/2% PUC fee from its \$760 allowance.

Applicant, on the other hand, contends that it will need to expend roughly \$2,500 to conduct this utility's office function.

H. Professional Expenses

A major portion of applicant's recorded Professional Expenses was legal fees attributable to rate increase work; another was fees for its regulatory consultant, also for rate increase work. Staff excluded all these items from this account and transferred them to Account 688, Regulatory Commission Expense. The discussion of the staff allowance is contained in that topic below.

For 1986, applicant expended roughly \$6,500 for accounting. Staff contended that that sum is too large an amount for a utility of this size. Staff estimated that required bookkeeping could be done by an employee paid \$10 per hour, working 24 hours per month. Applicant has adopted this estimate.

I. Insurance

Staff adjusted applicant's total estimated insurance expense to exclude the cost of insuring overbuilt plant (see discussion below). It did not allow anything for liability insurance.

Applicant's estimate seeks an additional \$6,000 for liability insurance. Applicant claims that an independently owned company would have to pay that much for an adequate liability policy.

J. General Expense

Staff reviewed applicant's books and found no charges properly attributable to this account during applicant's last

fiscal year in 1986/87. Accordingly, staff projected a zero expenditure in this category.

Applicant projects that future operations will require \$2,000 of expenditures in this category.

K. Regulatory Commission Expense

As noted above, staff reclassified professional fees associated with the rate increase and amortized them over three years. Staff proposed to disallow most of the actual attorney and expert witness fees for presenting this application, claiming that they were too large to be shared among this utility's few customers

Applicant claims that the fees were a prudent, necessary response to staff's election to make this a formal hearing and to demand an evidentiary hearing. However, it has been willing to stipulate to most of the staff's adjustment. As can be seen from Table I, this means that it is willing to accept an amortized recovery of only \$2,000 per year, in contrast to the staff's recommended \$1,000.

L. Taxes

Applicant originally estimated property taxes of nearly \$12,000. Staff wrote this sum down to \$4,400, because of overbuilt plant, discussed below.

Staff noted that tax law changes approved recently by Congress can affect applicant's income tax liabilities during the test year. The Commission is currently investigating the effects of changed tax law. Staff recommended that any effects due to such changes in law be handled separately under the principles ultimately determined in Investigation 86-11-019.

M. Utility Plant

1. Overbuilding

According to applicant, its actual plant in the test year would be \$1,122,940. Rather than accept the applicant's proposal for a negative rate of return as a means of dealing with

concededly overbuilt plant, staff reduced this amount to \$416,128. Applicant has accepted this adjustment.

In the early 1980's, applicant's then-parent contemplated building a lumber mill in Stirling City. The operation of this plant would have required a large volume of water. In addition, there would have been additional customer growth because of new employees needed to operate the mill. Accordingly, a new treatment plant was constructed, sized to accommodate these additional demands.

However, after the new plant was completed, it was decided not to proceed with mill construction. As a result, the plant now in service has capacity far in excess of applicant's currently projected needs.

Staff accordingly disallowed much of the new construction. It did allow all of the cost of water source, meters, and services. However, it estimated that it would have cost no more than \$100,000 for a properly sized water treatment facility to provide chlorination and filtration of particulate matter. Staff allowed only 50% of pumping equipment and one-third of plant used for treatment and delivery. Staff also reduced engineering costs in the same proportion.

While staff recommended that the proposed rates be based on its rate base figure, it noted that future development might provide a new justification for the excess capacity. For example, if a mill were to be built or a substantial amount of the excess water could be sold to other utilities, the disallowance would need to be reevaluated.

2. Alternative Valuation Theory

Mr. Connor, acting as a spokesman for local consumers, recommended that instead of allowing some portion of the newly constructed plant under the staff's theory, Commission should disallow all recent plant investment. He argued that the old plant performed its function adequately. He contended that there are too

few customers to bear the cost of any new plant that was not absolutely necessary to maintain minimum service.

3. Contributions

When applicant exchanged water rights with PG&E for an infeasible water supply, it also received \$375,000. The water rights were never explicitly carried on the books as part of utility plant, and they may have provided a supply much in excess of any public need. Staff recommends that we treat this transaction as producing a contribution, rather than an investment, of this sum in the new plant. If there were such a contribution, applicant would be permanently barred from collecting depreciation or return on the value of the plant.

This transaction was authorized by D.82-11-021 in A.82-05-08. Finding 9 of that decision stated:

- "9. Customers will reap the full benefit from the appreciation of the water rights in that the \$375,000 consideration to be paid to Stirling by PG&E will be devoted to construction of the new filter plant and related facilities."

Based on that finding, staff recommends that this \$375,000 be treated as if a third party had contributed this sum, thereby further reducing the rate base attributable to the added plant. Applicant has not accepted this adjustment.

N. Depreciation Expense and Reserves

A major difference between applicant's and staff's estimates of depreciation expense and reserve is a result of the different treatment of the proceeds of the sale of water rights to PG&E.

Applicant used a depreciation accrual rate of 5%. Staff recommended a rate of 2.4%. Staff believed that allowing a remaining life of only 20 years would be unrealistic in light of the fact that most of the plant was recently constructed. In its

opinion, many plant elements such as pipeline and treatment facilities have normal useful lives of as much as 50 years.

O. Working Cash

The staff's and applicant's estimates were both based on the staff's Standard Practice U-16. The differences reflect the different expense estimates.

P. Rate Base Comparison

Table II, below, compares applicant's and staff's original projections of depreciated rate base for 1987.

Table II

Test Year 1987

<u>Item</u>	<u>Applicant</u>	<u>Staff</u>	<u>Applicant Exceeds Staff</u>
Average Plant	\$1,222,940	\$416,128	\$ 706,812
Average Depreciation Reserve	79,140	3,890	72,250
Net Plant	1,043,800	412,238	631,562
Less: Advance	0	0	0
Contributions	0	364,200	(364,200)
ITC	0	3,866	(3,866)
Plus: Working Cash	20,950	7,110	13,840
Rate Base	1,064,750	51,282	1,013,468

Table I above indicates that applicant has accepted the staff's proposed disallowance of over \$700,000 of plant on the grounds of excess capacity

Q. Rate of Return

Staff's recommendation, 10.50%, is the usual rate of return usually awarded to small water companies. Applicant does not dispute that this is an appropriate rate of return consistent with the staff's proposed method of adjusting for overcapacity.

II. Adopted Projections

A. Adopted Cost Projections

At hearing the applicant's regulatory witness indicated that with certain minor modifications, he could accept most of the staff's estimates as reasonable. These items include the projected costs of purchased power, materials, and contract services, as well as transportation, professional services, and office rent. Table I reflects the adjustments. Table I also reflects that applicant accepted further adjustments after hearing.

There are differences with regard to office and general expenses, insurance, and regulatory expense.

The categories of office and general costs provide an opportunity for this small water company to benefit from some economies of scale, because it can share with a parent corporation. Sharing with the utility can often be a realistic way of providing such services without producing any substantial increase in costs.

Applicant has not demonstrated that it takes maximum advantage of this cost-saving technique. We will therefore adopt the staff's estimate.

Staff claims that the utility can be covered under the parent's liability insurance without any increase in cost. It has therefore recommended that there be no allowance for such insurance. Applicant seems to claim a hypothetical cost equal to that which would be borne if applicant were to purchase its own liability insurance. Applicant has failed to show why the customers should be burdened with a hypothetical cost rather than an allocation of the actual expense which affects both parent and utility subsidiary. Since we do not have sufficient information to allocate the total cost of liability protection between parent and subsidiary, we will adopt the staff's estimate.

With regard to the costs of professional representation for the rate case, staff does not claim that the utility was

imprudent in engaging an attorney and a regulatory expert when the advice letter was converted to a formal proceeding. It merely claims that there are too few customers to bear the cost.

We have adopted the staff's position. The amount we have allowed is roughly comparable on a per-customer basis to what we might allow to a utility which is not excessively small.

Appendix B attached hereto sets forth the adopted quantities and income tax calculations upon which the adopted summary of earnings is based.

B. Rate Base

1. Contributions

We take official notice that staff and applicant's predecessor/parent Diamond International Corporation came to an agreement (adopted in A.49783, D.74094 (1968)) concerning ratemaking and accounting for the plant in service when public water service commenced. This agreement would include the utility's original water rights. Under that decision, Diamond was "...permitted to continue its present practice of not accounting for plant costs and depreciation thereon...so long as it does not seek a return" on such items as rate base. If, however, it wished to include the original plant as rate base in a rate increase application, it was directed to prepare a study developing the "original cost and related depreciation reserve requirement of plant used and useful at that time..." Because of the parent/subsidiary relationship between Diamond and Stirling Bluffs, the latter is now subject to the obligation.

Applicant no longer owns the water rights directly governed by the terms of D.74094. The transaction approved by the Commission in D.82-11-021 supra, allowed it to exchange them for another kind of right to receive water plus \$375,000 of cash. The company, to win approval of this transaction, forwarded a written statement making the undertaking described in the finding quoted in II.M.3. above.

Staff has concluded that this finding abrogated the D.74094 holding. Instead, it claims, the D.82-11-021 finding recognizes a gift of the cash (or of the plant to be built with such cash) to the customers. If there had been a gift, applicant would be forever barred from adding this portion of its plant to rate base.

However, staff's interpretation of the word "devote" as meaning "donate" or "contribute" is not acceptable. That word could also be used to denote "dedicate," indicating that the new plant would continue to be dedicated to public use under the same restrictions as the original water rights. Since staff has given us no other support for its interpretation, we will adopt the more conservative interpretation, holding that the new plant should receive the same rate base and accounting treatment as the original water rights. Since applicant has not furnished the proof required by D.74094, the plant purchased with the proceeds from the sale of the original plant will not be recognized for ratemaking purposes. However, applicant retains the right, until further order of the Commission, to make an appropriate filing to establish a ratemaking and book value for this portion of its investment. It will not be required at this time to record this plant as a gift to ratepayers.

2. Working Cash

The staff allowance appears reasonable, especially in light of the fact that a substantial portion of applicant's recurring bills represent a transfer of funds between subsidiary and parent.

The higher applicant figure in Table I apparently reflects a failure to recalculate this item when other adjustments in expense were adopted, rather than a genuine difference of opinion. Since we have adopted all staff's expense estimates, we will also accept its working cash calculation.

3. Depreciation

Staff's proposed depreciation rate, 2.4%, is in line with the rates allowed other water utilities. Applicant has not demonstrated that the abnormally short useful lives it supported are reasonable. We will adopt the staff's recommendation and require applicant to make appropriate adjustments to its books.

4. Alternative Valuation

The evidence now before us is insufficient to support a rate base finding based on this theory.

First, we cannot be sure that applicant's results of operation would have been more favorable if it were still operating the old plant. For example, we would almost certainly be required to allow a much higher contract labor expense; this would account for the work needed to repair the old plant after nearly every winter. We would also almost certainly be required to allow a return on the used and useful portion of the original water rights; the sale to PG&E would compel a finding that all of those rights were worth \$375,000 plus the present worth of PG&E's obligation to supply water. There might be other hypothetical allowances which would be needed if this theory were adopted.

Moreover, this record will not permit a finding that the old system was functioning well. Aside from seasonal outages caused by weather damage (cf. applicant's response to ALJ's ruling in A.82-05-08), the local health authorities were very concerned about the effectiveness of chlorination with the old system.

We therefore are unable to use this theory to justify a lower rate base than that recommended by staff.

III. Service

A. Water Quality and Pressure

According to staff, the new plant has substantially improved water quality. Before the plant came on line, applicant

had problems with turbid water. The foreign matter in the water created a chlorination problem. According to the Butte County Environmental Services, water quality is now satisfactory.

A field investigation of the applicant's service area was conducted on March 25, 1987. Pressure was checked in various locations throughout the system; all readings fell within the ranges required by General Order 103.

B. Hydrants

There was some confusion between the utility and the Stirling City Volunteer Fire Department concerning the responsibility for maintaining hydrants in an operative condition. As a result, some hydrants were allowed to deteriorate. While we cannot find that there was an actual threat to the public safety, we have determined that applicant's management should have noted the misunderstanding earlier.

The misunderstanding has now been resolved. Applicant is willing to assume the responsibility for maintaining the hydrants. Applicant's costs will be increased to cover the cost of such maintenance. There will be a one-time charge of \$2,000 amortized over three years; there will also be an annual cost of \$100.

C. Source of Supply

When applicant sought Commission approval of the exchange of water supply with PG&E, it represented that the new system and source would be reliable. The application (A.82-05-08) did disclose that PG&E had the right to temporarily interrupt its supply for maintenance. However, there was no hint that PG&E would regularly shut down its supply system for a month every year for maintenance and repairs.

Applicant has reacted to the interruptions in its supply by banning outside watering; the bans lasted for several weeks. While these shutdowns come in late summer, they are still early enough to adversely affect gardens and shrubbery, especially new plantings.

In a late-filed exhibit to the Commission, applicant's regulatory expert indicated that it probably could manage its existing storage capacity to carry it through future curtailments without any ban on outside watering.

In any event, management should have foreseen the problem and made plans to deal with it before making the cutover from the old to new supply. Whether the appropriate measure was a supplementary well supply, or added storage, or simply better water management, it should have been adopted before consumers lost any plants.

This record is sufficient to support a finding that the company's management was inadequate in failing to foresee and to deal with this problem before completing the cutover to the PG&E supply.

D. Bugs and Ferns

During the hearing one customer complained of finding "bugs and ferns" in the water. Apparently, this is not an isolated occurrence.

During the hearing, applicant was directed to determine how foreign solid material could be delivered to its customers. In a post-hearing letter to the Commission, applicant's expert witness indicated his belief that the foreign material was "dislodged pieces of pipe scale." He advised the company to institute a program of regular flushing of its mains by opening hydrants. He recommended that this be done on a regular basis at least twice a year. In his opinion, such a program would relieve the conditions described by the customer.

E. Quality of Management

We have found applicant's management unsatisfactory since it failed to respond on its own initiative to the annual PG&E shutdown, to foreign material in customer's water, or to the hydrant problem. We expect utility managements to diagnose such

problems and to devise adequate responses without prodding from our staff or from dissatisfied customers.

While applicant has belatedly moved to correct specific problems, it has not indicated any moves to identify or correct the underlying deficiencies in training, attitude, or organizational structure which permitted these problems to occur.

In our opinion, the management was unsatisfactory enough to warrant a sanction. In this instance, it appears that delaying the onset of the rate increase for 60 days will provide an adequate sanction.

It should be noted that selecting this sanction also reduces gross amount of the first year's increase enough so that there is no conflict with the Commission's "caps" policy.

IV. Rate Design

Staff recommended that the rate design should conform, insofar as possible, to the standards set forth in Commission D.86-05-064. Under these standards the revenue requirement should be allocated between consumers under these guidelines:

1. Service charges should be set to allow utilities to recover up to 50% of their fixed cost.
2. The number of commodity blocks should be limited to three.
3. No customer bill should be increased substantially more than the system average increase.

In addition, the staff has, as noted above, recommended a new tariff schedule assessing a charge of \$2 per truckload multiplied by the overall increase granted in this proceeding. That new charge would be \$4.20 per truckload.

Staff also explained that the Commission has a policy that any revenue increase of more than 100% should be instituted in

two stages; the first increase should be limited to 100% with any additional increase being postponed for an additional 12 months.

V. Late-filed Exhibits

At hearing the ALJ directed the parties to prepare a joint exhibit detailing and comparing the final position of applicant and staff on expenses, revenues, rate base, and revenue requirement.

A. Increase Timing

Adopting all of the staff's recommended final adjustments would require an increase in revenue of 109.9%.

This exceeds the 100% limitation set forth in the Commission's policy for small water utilities. Staff contended, however, that strict adherence to this policy would result in more "rate complication than was intended for small water utilities." It also noted that the applicant has not received rate relief in 10 years. It consequently recommended that all of the staff's recommended rate increases be granted in the first year.

Our decision to postpone the initial rate increase resolves the problem. Because of this delay in implementing the new rates, the total amount of increase in the first 12 months after the effective date of this decision is less than 100%.

B. Rate Spread

All but a handful of applicant's customers are domestic consumers with a 3/4" meter. The staff's service charge for a 3/4" meter would be \$10.50 per month, with proportional increases for larger meters. Staff recommended that the quantity charge be \$0.788 per hundred cubic feet (Ccf).

Most of applicant's customers use between 1,500 and 2,000 cubic feet of water per month. Under applicant's current rate structure, customers consuming in that range will pay the minimum charge of \$10 per month. Under the staff's recommended rate spread

and staff's recommended rates, the household which consumes 10 Ccf would experience an increase to \$18.38, an 84% increase. The household consuming 15 Ccf would find its \$10 bill increased to \$22.32, a 123% increase. Households which consume 20 Ccf or more would find very high increases ranging from 163% to 233%. Staff asserts that these very high increases at the upper end of the consumption range are "unavoidable because of applicant's present minimum rate schedules."

We note that applicant's recommended rate design had similar effects to that of staff. Those using little or no water would have found their monthly bills increased by substantially less than 100%. Those using 10 to 15 Ccf would have experienced a substantial increase; for those using 30 Ccf, the bill would have nearly tripled.

Of particular concern is the water bill for the Kinshaw Cemetery District. The district has a one-inch meter. Based on 1986 recorded consumption, the present annual bill of \$442.48 would increase by \$644.48, an increase of 145.7%. The district's representative argued that its income is, for all practical purposes, fixed and that it would not be able to pay any significant increase in its water rates.

To deal with these problems we have modified the staff's recommended rate design to charge more to those customers who consume less than the average amounts, reducing the burden on the average consumer and on the district.

The table below compares current and adopted charges for domestic customers at various levels of consumption.

Table III
Stirling Bluffs Corporation
RATE COMPARISON

Residential Metered Service 3/4-inch meters

Usage per Month, Ccf	<u>Present</u>	<u>Adopted</u>	<u>Increase Amount</u>	<u>% Increase</u>
0.00	10.00	20.00	10.00	100.00
3.00	10.00	20.75	10.75	107.50
5.00	10.00	21.25	11.25	112.50
10.00	10.00	22.50	12.50	125.00
15.00	10.00	23.75	13.75	137.50
20.00	10.00	25.00	15.00	150.00
30.00	10.37	27.50	17.13	165.19
50.00	17.17	32.50	15.33	89.28
100.00	39.95	45.00	5.05	12.64

Bill Comparison
for the Kinshaw Cemetary District
(Based on 1986 Recorded Consumption)

Mo.	Usage per Month, CCf 1-inch	<u>Present</u>	<u>Adopted</u>	<u>Increase Amount</u>	<u>% Increase</u>
J	3	16.00	32.01	16.01	100.04
F	3	16.00	32.01	16.01	100.04
M	3	16.00	32.01	16.01	100.05
A	3	16.00	32.01	16.01	100.05
M	22,874	70.22	89.19	18.97	27.01
J	22,874	70.22	89.19	18.97	27.01
J	27,413	82.93	100.53	17.60	21.23
A	27,413	82.93	100.53	17.60	21.23
S	5,860	20.09	46.65	26.56	132.21
O	5,860	20.09	46.65	26.56	132.21
N	24	16.00	32.06	16.06	100.38
D	24	16.00	32.06	16.06	100.38
Total		442.48	664.88	222.40	50.3%

VI. Customer Input-Rates

Some consumers suspect that applicant's past and present parents had profited unfairly from the parent/subsidiary relationship. We have examined the applicant's annual reports from 1981 to 1986. In each of those years, applicant's recorded operating expenses exceeded its operating revenues by factors ranging from 2.5 to over 4. The recorded cumulative operating loss exceeds \$225,000.

Even if it had applied expense adjustments as severe as those used by the staff in Table I, applicant would clearly have experienced a substantial operating loss in each of those years. On an adjusted basis, cumulative operating losses are in the range of \$100,000.

Instead of exploiting the local community, it appears that applicant and its parents have, on a long-term basis, subsidized water company operations.

To reduce future misunderstandings, it might be advisable for the utility to make copies of its past and future annual reports available to its consumers in the same manner as its tariff. It might also be advisable to publicize the availability each time a new report is filed.

Some customers believe that applicant intended to saddle them with the cost of the plant's excess capacity. However, if it had sought to achieve a normal rate of return, after taxes, on its full investment it would have requested roughly \$240,000 of additional revenue per year. It appears, therefore, that its proposal for a negative rate of return was intended as a device by which applicant's parent intended to absorb at least some of such costs. It also should be noted that the company voluntarily adopted the staff's more sophisticated methodology for ensuring that customers do not pay for any aspect of the overcapacity.

Staff notes that other nearby water systems might wish to purchase surplus water from applicant. If this were to occur, there might be enough additional revenue to reduce the share of expenses borne by applicant's present customers. Staff also notes that it might be possible to sell the utility to a neighboring system. In that event, applicant would no longer face the economic problems caused by its small size. If there are negotiations for a sale we place applicant and its parent on notice that they should be concerned with the long-term interests of utility customers, as well as their own private interests.

On April 18, 1988, staff filed to indicate that it felt that the ALJ's Proposed Decision had reached a fair resolution of the issues. No other comments were filed. We have accordingly adopted the Proposed Decision, except for a nonsubstantive change in the text under Adopted Cost Projections.

Findings of Fact

1. Applicant's plant has capacity in excess of the needs of its customers.
2. Its customers should be required to pay rates based only on the portion of its plant needed to serve the foreseeable number of customers.
3. Applicant's proposal to accept a negative rate of return does not adequately adjust its results of operation to eliminate all effects of the overbuilt plant.
4. The staff's method for dealing with overbuilding adjusts rate base, depreciation, depreciation reserve, fire insurance, and property taxes.
5. There is insufficient evidence to support an alternative means of establishing rate base, by assuming that the applicant had not constructed any new plant or exchanged water sources. There is insufficient evidence to determine whether such evaluation would produce rates lower than those adopted herein.

6. The staff's method for adjusting for overbuilt plant should be adopted.

7. The proceeds of the transaction with PG&E should continue to be treated for record and ratemaking purposes as provided by D.74094.

8. A rate of return of 10.50% is reasonable and comparable to the rate of return allowed for other similar utilities. Applicant's rates should be set to cover its reasonable expenses and to earn this return on its adjusted rate base.

9. The stipulated level of expenses for power, materials contract services, transportation, professional services, and office are reasonable and should be adopted.

10. Applicant's recorded expenses for representation in this proceeding should be absorbed by its parent except for \$3,000 amortized over three years.

11. Staff's estimates for office supplies and expenses, general expense and insurance, are reasonable and should be adopted.

12. An amount should be allowed for income tax based on the projected earnings and allowed expenses, under previous tax law, with a subsequent adjustment as permitted by the final decision in Investigation 86-11-019.

13. Applicant's management was unsatisfactory because:

- a. It failed to anticipate and deal with the annual shutdown of the PG&E supply;
- b. It failed to anticipate the need for maintaining hydrants; and
- c. It failed to institute a program to eliminate foreign material from water delivered to customers.

14. When PG&E curtailed water service to applicant, applicant had enough advance warning to notify its customers. Applicant did

not notify the Commission of its interruption of service for outside watering.

15. This rate increase should be suspended for 60 days because of unsatisfactory management.

16. The revenue requirement should be spread between customer classes so as to shift some of the burden of the rate increase to customers who consume less than the average.

17. With the 60-day delay, the amount of increase in the 12 months succeeding this decision will be less than 100%.

18. Applicant's current rates are unreasonably low and should be increased.

19. Applicant should be required to establish a tariff for truckload sales.

20. Depreciation should be at the rate of 2.4%.

21. The allowance for income tax should be calculated under prior law. Current law should be applied by the method to be established in Investigation 86-11-019.

22. The increase in revenue produced by the rates authorized herein is \$28,035 (109.9%); the authorized rate of return on adjusted rate base is 10.50%.

23. To ensure that the rates go into effect when intended, this order should be effective today.

Conclusions of Law

1. Applicant's rates should be established at the levels set forth in Appendix A.

2. There is insufficient evidence to dispose of the proceeds of sale to PG&E on a permanent basis.

3. Applicant's interruptions of service for outside watering were not emergency interruptions. No notice to the Commission was required.

4. Applicant should be required to submit reports on its progress in dealing with the annual PG&E shutdown.

5. If applicant is required to curtail any service because of a PG&E supply curtailment whether scheduled or unscheduled, it should be required to notify the affected customers, the Commission, and the local Fire Department.

ORDER

IT IS ORDERED that:

1. Within 90 days after the date hereof Stirling Bluffs Corporation (applicant) shall file and serve written reports on steps taken to deal with the Pacific Gas and Electric Company's (PG&E) source of supply shutdown. It shall make copies of its reports accessible in Stirling City to consumers on request.

2. If applicant is required to curtail any service because of a PG&E supply curtailment, whether scheduled or unscheduled, it shall notify the affected customers, the Commission, and the local Fire Department as soon as possible.

3. Applicant is authorized to file the revised rate schedules in Appendix A in compliance with General Order Series 96 after the effective date of this order. The revised schedules shall apply only to service rendered on and after their effective date, which shall be no less than 60 days after the date hereof, and 5 days after filing.

4. Within 90 days after the effective date of this order applicant shall file any changes needed to conform its service area map, general rules, and customer forms to current conditions, in compliance with General Order Series 96 and 103. Its map rules and forms shall be promptly updated to reflect all future changes in operations.

5. Applicant shall apply a depreciation rate of 2.4% to the original cost of depreciable plant until a future depreciation study reviewed by the Water Utilities Branch indicates that a revision is warranted.

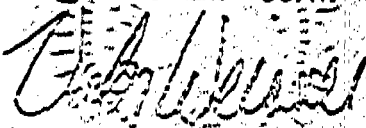
This order is effective today.

Dated MAY 11 1988, at San Francisco, California.

STANLEY W. HULETT
President

DONALD VIAL
FREDERICK R. DUDA
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

I CERTIFY THAT THIS DECISION
WAS APPROVED BY THE ABOVE
COMMISSIONERS TODAY.


Victor Wenzel, Executive Director

APPENDIX A

Page 1

Schedule No. 1

METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Stirling City and vicinity, Butte County.

RATES

		<u>Per Meter</u>
		<u>Per Month</u>
Service Charge:		
For	5/8 x 3/4-inch meter.....	\$ 11.90
For	3/4-inch meter.....	20.00
For	1-inch meter.....	32.00
For	1-1/2-inch meter.....	48.00
For	2-inch meter.....	80.00
For	3-inch meter.....	120.00
For	4-inch meter.....	240.00

Quantity Rates:

For all water delivered, per 100 cu. ft..... .25

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

APPENDIX A
Page 2

Schedule No. 9M

TANK TRUCK WATER SERVICE

APPLICABILITY

Applicable to all tank truck water sales furnished for dust control on logging roads.

TERRITORY

Stirling City and vicinity, Butte County.

RATES

*For each water tank truck load with tank capacity not to exceed 2,500 gallons..... \$4.20

SPECIAL CONDITION

Water is to be delivered at fire hydrants predesignated by the utility.

*For tank trucks exceeding 2,500-gallon capacity, add \$0.84 for each 500 gallons in excess of 2,500 gallons.

(END OF APPENDIX A)

APPENDIX B
Page 1
ADOPTED QUANTITIES
(1987 Test Year)

Name of Company: Stirling Bluffs Corporation

Net-to-Gross Multiplier: None
Federal Tax Rate: 15.00%
State Tax Rates: 9.60%
Business License: 0.00
Uncollectible Rates: 0.00

Expenses Test Year 1986

1. Purchased Power:
 - Electric:
 - Pacific Gas and Electric Company
 - Total Cost (\$) \$ 7,790
 - kWh Used 81,314
 - Eff. Sch. Date 7/1/87
 - \$/kWh Used (Avg) 0.09697
 - Schedule PG&E A-1

2. Purchased Water: None
3. Pump Tax-Replenishment Tax: None
4. Payroll and Employee Benefits:
 - Operation and Maintenance Payroll \$ 8,300
 - Administrative & General Salaries 3,000
 - Total \$ 11,300

 - Payroll Taxes \$ 1,000

5. Ad Valorem Taxes: \$ 4,400
 - Tax Rate 1.049%
 - Assessed Value \$413,886

Service Connections:

1. Metered - Size		
5/8 x 3/4-inch	.....	0
3/4-inch	.....	162
1-inch	.....	1
1-1/2-inch	.....	1
2-inch	.....	0
3-inch	.....	1
4-inch	.....	0
6-inch	.....	0
Total		165

3. Metered Water Sales used to Design Rates: 35,565 ccf

APPENDIX B
Page 2

ADOPTED TAX CALCULATIONS

line No.	Item	At 1986 Rates	
		State Tax	FIT
1.	Operating Revenues	\$53,535	\$53,535
2.	O & M Expenses	\$26,217	\$26,217
3.	A & G Expenses	\$12,310	\$12,310
4.	Taxes Other Than Income	\$5,400	\$5,400
5.	Depreciation	\$2,590	\$2,590
6.	Interest	\$0	\$0
7.	State Tax	\$0	\$674
8.	Subtotal	\$46,517	\$47,191
9.	Net Taxable Income for State Tax	\$7,018	
10.	State Tax	\$674	
11.	Total State Tax	\$674	
12.	Net Taxable Income for FIT		\$6,344
13.	Federal Income Tax		\$952
14.	Total FIT		\$952

(END OF APPENDIX B)

II. Adopted Projections

A. Adopted Cost Projections

At hearing the applicant's regulatory witness indicated that with certain minor modifications, he could accept most of the staff's estimates as reasonable. These items include the projected costs of purchased power, materials, and contract services, as well as transportation, professional services, and office rent. Table I reflects the adjustments. Table I also reflects that applicant accepted further adjustments after hearing.

There are differences with regard to office and general expenses, insurance, and regulatory expense.

The categories of office and general costs provide an opportunity for this small water company to benefit from some economies of scale, because it can share with a parent corporation. Sharing with the utility can often be a realistic way of providing such services without producing any substantial increase in costs.

Applicant has not demonstrated that it takes maximum advantage of this cost-saving technique. We will therefore adopt the staff's estimate.

Staff claims that the utility can be covered under the parent's liability insurance without any increase in cost. It has therefore recommended that there be no allowance for such insurance. Applicant seems to claim a hypothetical cost equal to that which would be borne if applicant were to purchase its own liability insurance. This is another area where consumers should receive some economic benefit from the parent-subsidiary relationship. Since we do not have sufficient information to allocate the total cost of liability protection between parent and subsidiary, we will adopt the staff's estimate.

With regard to the costs of professional representation for the rate case, staff does not claim that the utility was imprudent in engaging an attorney and a regulatory expert when the

advice letter was converted to a formal proceeding. It merely claims that there are too few customers to bear the cost.

We have adopted the staff's position. The amount we have allowed is roughly comparable on a per-customer basis to what we might allow to a utility which is not excessively small.

Appendix B attached hereto sets forth the adopted quantities and income tax calculations upon which the adopted summary of earnings is based.

B. Rate Base.

1. Contributions

We take official notice that staff and applicant's predecessor/parent Diamond International Corporation came to an agreement (adopted in A.49783, D.74094 (1968)) concerning ratemaking and accounting for the plant in service when public water service commenced. This agreement would include the utility's original water rights. Under that decision, Diamond was "...permitted to continue its present practice of not accounting for plant costs and depreciation thereon...so long as it does not seek a return" on such items as rate base. If, however, it wished to include the original plant as rate base in a rate increase application, it was directed to prepare a study developing the "original cost and related depreciation reserve requirement of plant used and useful at that time..." Because of the parent/subsidiary relationship between Diamond and Stirling Bluffs, the latter is now subject to the obligation.

Applicant no longer owns the water rights directly governed by the terms of D.74094. The transaction approved by the Commission in D.82-11-021 supra, allowed it to exchange them for another kind of right to receive water plus \$375,000 of cash. The company, to win approval of this transaction, forwarded a written statement making the undertaking described in the finding quoted in II.M.3. above.

Staff notes that other nearby water systems might wish to purchase surplus water from applicant. If this were to occur, there might be enough additional revenue to reduce the share of expenses borne by applicant's present customers. Staff also notes that it might be possible to sell the utility to a neighboring system. In that event, applicant would no longer face the economic problems caused by its small size. If there are negotiations for a sale we place applicant and its parent on notice that they should be concerned with the long-term interests of utility customers, as well as their own private interests.

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3. Applicant is authorized to file the revised rate schedules in Appendix A in compliance with General Order Series 96 after the effective date of this order. The revised schedules shall apply only to service rendered on and after their effective date, which shall be no less than 60 days after the date hereof, and 5 days after filing.

4. Within 90 days after the effective date of this order applicant shall file any changes needed to conform its service area map, general rules, and customer forms to current conditions, in compliance with General Order Series 96 and 103. Its map rules and forms shall be promptly updated to reflect all future changes in operations.