ALJ/FJO/fs

Decision 89 12 047 DEC 18 1989

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

ORIGINAL

In the Matter of the Application of Rural Water Company for General Rate Increase for Water Service of $47,100 for 1988 in San Luis Obispo County.	Application 88-01-021 (Filed January 21, 1988)

(See Decision 88-10-029 for appearances.)

Additional Appearance

Barry H. Epstein, Attorney at Law, for customers of applicant, protestants.

O P I N I O N

Introduction

Rural Water Company (Rural) requested authority to increase its rates by draft advice letter filed December 14, 1987. After receiving 5 letters and a petition containing 138 signatures representing 94 service addresses opposing the proposed increase, the draft advice letter was docketed as a formal application on January 21, 1988. Public hearings were held before Administrative Law Judge (ALJ) O'Leary at Halcyon on June 1 and 2, 1988. The matter was submitted with the filing of the transcript on June 14, 1988. During the hearings that were held on June 1 and 2, 1988, Richard Finnstrom (Finnstrom) testified that he was responsible for updating Rural's rate base for the years 1982 through 1985, no mention was made of a written report. At those hearings the customers of Rural were represented by Russell C. McGee (McGee) who is also a customer of Rural. ALJ O'Leary's opinion setting forth recommendations, findings and conclusions was filed on August 18, 1988. On September 20, 1988, McGee filed a petition to set aside

submission (petition) in accordance with the Commission's Rules of Practice and Procedure. The petition alleged that certain materials, namely:

1. A report by Finnstrom, entitled "Rural Water Company--Correction of Plant and Depreciation Reserve Records through 1985" dated 3/16/87, and

2. Decision (D.) 83-06-009 in Application (A.) 82-12-69. (The documents are attached to the petition as Attachments A and B, respectively.)

had become available after the record was completed. The petition further alleged that the material may reduce staff's estimate of rate base.

On October 14, 1988, we issued D.88-10-029 which was an Interim Opinion and Order authorizing an increase in rates. The rates authorized were made subject to refund as provided in Ordering Paragraph 2 as follows:

> "2. The rates authorized in this decision shall be subject to refund upon further order of the Commission. The amount of revenue subject to refund is $9,845 annually plus income tax attributable thereto for the non-contributed plant reduction in rate base issue, and $7,560 annually plus income tax attributable thereto for the cash contributions accounting issue."

Shortly after the filing of the petition to set aside submission, the customers of Rural formed "Water Association to Curtail Higher Rates" (Watcher). McGee is the lead representative of Watcher.

On February 8, 1989, we issued D.89-02-015 which was an Order Setting Aside Submission. Ordering Paragraph 1 of D.89-02-015 provided the following:

> "1. The submission heretofore entered in the above-entitled proceeding is set aside and the matter reopened for the limited purpose of receiving in evidence the report entitled "Rural Water Company--Correction of Plant and

Depreciation Reserve Records through 1985" dated 3/16/87."

Further Hearing

Further hearing was held before ALJ O'Leary at Pismo Beach on May 18, 1989. At that hearing the matter was submitted with the filing of concurrent briefs on July 28, 1989.

The report by Finnstrom, entitled "Rural Water Company--Correction of Plant and Depreciation Reserve Records through 1985" was received in evidence as Exhibit 4. Finnstrom also sponsored Exhibit 3 which a list of the Tract Numbers with their common names and developers and Exhibit 5 entitled "Rural Water Co. Plant." Exhibit 5 is a summary of the data set forth in Exhibit 4.

Watcher contends that Rural collected excess cash contributions in the amount of at least $77,650 from developers in connection with Tract 841 ($65,350) and Tract 760 ($12,300). Watcher further contends that an additional $40,050 of the water system in Tract 1088 should be treated as contributed plant rather than non-contributed plant.

Tracts 841 and 760

Exhibit 4 classifies Tracts 841 and 760 as contributed plant. The actual cost of both tracts is not known. Exhibit 4 estimates the costs of the plants associated with these tracts as follows:

Tract 841	
Mains, Valves, and Hydrants	$36,975
Transmission Line	34,650
Total	$71,625
Tract 760	
Mains, Valves, and Hydrants	$43,200

Both of these estimates are Engineering estimates that Finnstrom received from Los Padres Engineers which is the firm that designed the water systems in Tracts 841 and 760.

The only evidence of the actual cost of the water system associated with Tract 841 is an agreement, and copies of two cancelled checks totaling $100,000. The checks were made payable to the owners of Rural Robert A. Smith (Smith) and Robert H. Newdoll (Newdoll) by Phillips-Nichols, the developer of Tract 841. Herbert Phillips (Phillips), the person who signed the checks, testified that it was necessary for him to pay the $100,000 to obtain water to Tract 841. He further testified that the transmission line cost approximately $30,000 and that he thought the line was to serve two tracts and that therefore his responsibility would be 1/2 of that amount or $15,000. Phillips was also asked the following:

> "Q. If you were to hypothetically -- if you were to learn that a water company were not permitted to charge you this kind of money, would you want that money back?" (RT 328; 13-16.)

The reply by Phillips was:

> "A. I made my deal. I made my bed. I'll live with it." (RT 828; 17-18.)

The closest evidence to an accounting of the actual cost of the water system associated with Tract 760 is set forth in Exhibit 7 which is a handwritten list of expenditures prepared by Bert Huston (Huston), one of the developers of Tract 760. Exhibit 7 discloses the total cost to be $63,470.90. That amount includes $11,900 paid to Rural and $400 paid to Palo Mesa Water Company (Palo Mesa) as a condition of providing water service to Tract 760. Huston, one of the developers of Tract 760, testified that he did not know of any physical improvement that was installed as a result of those payments.

Watcher urges that the excess contributions be deducted from rate base.

The undisputed evidence discloses that Rural may have collected excess contributions in connection with Tracts 841 and 760. The evidence further discloses that said excess contributions could be as much as $77,650 ($65,350 by Phillips-Nichols for water service to Tract 841 and $12,300 by Huston and his partners for water service to Tract 760).

Tract 1088

The water system in Tract 1088 (formerly Tract 666) is classified in Exhibit 4 as both contributed and non-contributed plant. Watcher asserts that Tract 1088 is the only tract within Rural's service territory that was developed by the sole shareholders of Rural during the relevant time period. While all tracts not developed by Rural's owners are treated as contributed in Exhibit 4, only a portion of Tract 1088 is categorized in the exhibit as contributed. Watcher further asserts that the sole reason Finnstrom offered for categorizing a portion as non-contributed is his interpretation of D.82-04-082 in A.60651. That proceeding was an application by Palo Mesa to extend its service territory to additional tracts including Tract 666, the former number of Tract 1088.

Finding 12 of D.82-04-082 is as follows:

> "12. The developers of all tracts, except Tract 666, have agreed to contribute the water systems in these tracts. The amount of these contributions is $800,124 which does not include amounts for additional sources of water supply. It is reasonable to grant Palo Mesa a deviation from its main extension rule to accept these contributions."

Ordering Paragraph 3 of the decision is as follows:

> "3. Applicants are granted a deviation from their main extension rule and are authorized to accept $800,124 as contributions from the developers of all tracts, except Tract 666.

Watcher alleges that:

> "Contrary to Water Branch Staff's interpretation, D.82-04-082 does not hold that Tract 1088 is to be treated as noncontributed. What the decision does do is direct the treatment of <u>other</u> tracts; it grants Palo Mesa a deviation from its main extension rule and authorizes Palo Mesa 'to accept $800,124 as contributions from the developers of all tracts, except Tract 666.' D.82-04-082, Ordering Paragraph 3. Nowhere does the decision mandate <u>any</u> treatment for Tract 1088. As to Tract 1088, the decision is simply -- and plainly -- neutral. As a result, since it has not been waived, the main extension rule (Rule 15) still applies to Tract 1088.
>
> "Staff's erroneous attempt to turn neutrality into a directive to treat the Tract 1088 system as noncontributed at some time later finds <u>absolutely no support</u> in the decision."

Tract 1088 is categorized as both contributed and noncontributed. The contributed portion is not a part of Rate Base. The noncontributed portion of Tract 1088 is as follows:

<u>Tract #1088 (Rural)</u>

Well & Pump	$24,444	D.82-04-082, Order No. 3. Cost provided by Rural (letters 6/10/86, 7/3/87 & verbally)
Office & Storage Building	15,251	
Main Valves, etc.	40,050	
Hydrants	5,200	
Meters	700	Standard Policy, costs estimated

<u>Tract #1088 to #933</u>

Transm. Line	$41,349	Considered as part of Tract #1088 for connection to Palo Mesa (costs provided by Rural, see above)
Total	$126,994	

as set forth in Exhibit 5. Watcher believes the $40,050 for Main Valves etc. should be categorized contributed plant rather than non-contributed plant.

Discussion

There is no dispute with respect to the fact that Tracts 841 and 760 are classified in Exhibit 4 as contributed plant. Generally contributed plant is not included in rate base. Such is the case with respect to Tracts 841 and 760. If plant is not included in rate base it follows that there is no rate of return earned on the portion of plant not included in rate base. There is also no dispute that Rural may have requested from the developers of these tracts excess monies for the main extensions to those tracts.

Rule No. 15 of Rural's tariff covers Main Extensions. Section C of the rule covers Extensions to Serve Subdivisions, Tracts, Housing Projects, Industrial Developments, Commercial Buildings, or Shopping Centers. Paragraph 1d. of Section C provides the following:

> "d. If, in the opinion of the utility it appears that a proposed main extension will not, within a reasonable period, develop sufficient revenue to make the extension self-supporting, or if for some other reason it appears to the utility that a main extension contract would place an excessive burden on customers, the utility may require nonrefundable contributions of plant facilities from developers in lieu of a main extension contract.
>
> "If an applicant for a main extension contract who is asked to contribute the facilities believes such request to be unreasonable, such applicant may refer the matter to the Commission for determination, as provided for in Section A.8. of this rule."

The remedy for excess contributions lies within Rule 15. In the event a developer does not desire to pursue remedies set

forth in the rule it does not follow that the benefit of the excess contributions should be passed on to the ratepayers in the form of deductions from rate base especially when the so-called excess contributions are classified as contributed plant and not a part of rate base.

The request of Watcher to reduce rate base should be denied.

We now turn to whether $40,050 of the water system in Tract 1088 should be changed from non-contributed to contributed plant.

D.82-04-082 was a decision authorizing Palo Mesa, the predecessor of Rural to extend its service territory. Review of that decision leads us to the conclusion that Finnstrom's interpretation of the decision is correct. Had we intended that Tract 1088 (formerly Tract 666) be treated as contributed plant even though the developers did not so agree we would have authorized the extension to Tract 666 on the condition that the developers contribute the water system to the utility.

Furthermore, in D.83-06-009, which authorized the transfer of Palo Mesa's certificate of public convenience and necessity to Rural, we found that Palo Mesa's owners stopped providing public water service in mid 1982; Newdoll and Smith were the sole shareholders, directors and officers of Rural and that Newdoll and Smith have operated Palo Mesa at their own expense since mid 1982 (Findings of Fact 4, 5, and 6, respectively).

At the time of the transfer, as best we can determine, Rural had already borne the expenses that have been categorized as non-contributed plant in Exhibit 4. The categorization of that portion of the plant as non-contributed is proper especially in view of the fact that the owners of Rural spent the money for the plant categorized as non-contributed and were entitled to a return on their investment.

We concur with Finnstrom that the $40,050 for Main Valves etc. is properly categorized as non-contributed plant.

Comments to the Proposed Decision

The ALJ's proposed decision was filed and mailed to the parties on November 13, 1989. On December 1, 1989, the Water Branch requested an extension of time to file comments. By ruling dated December 5, 1989, the ALJ extended the time for filing comments to December 8, 1989. Comments on the proposed decision were filed by Watcher and the Water Branch on December 8, 1989.

The comments focus on the absence of a remedy in the ALJ's Proposed Decision regarding the excess monies that Rural may have exacted from the developers of Tracts 841 and 760. Watcher and Water Branch both point out that this Commission has a responsibility to insure that entities regulated by it do not engage in improper acts such as is the case in this instance. Watcher avers that the proposed decision of the ALJ offers no such protection for the integrity of this Commission's regulatory conduct. It further avers that the proposed decision simply ignores admittedly improper conduct. We have carefully reviewed the record and the ALJ's proposed decision. Watcher's criticism of the ALJ's proposed decision is unfounded. In its brief Watcher urged that the excess contributions be subtracted from rate base. The brief filed by the Water Branch concluded as follows:

> "The Branch urges the Commission to affirm that the rate base adopted in D.88-10-029 is just and reasonable. But, if the Commission can determine the amount of overpayment by developers in connection with Tracts 760 and 841, and if it is satisfied that the developers will not seek the refund they may be entitled to, then a ratemaking remedy should be fashioned to eliminate the windfall to the utility, without reducing a rate base."

In the discussion portion of his proposed decision, the ALJ rejected the remedy proposed by Watcher which discussion we have adopted herein. The ALJ's proposed decision contains no discussion

concerning the Water Branch's recommended "ratemaking remedy" contained in its brief. We do not know why, the ALJ chose not to mention this "ratemaking remedy", however it would appear that he did not discuss it because Water Branch did not recommend how the "ratemaking remedy" should be implemented.

Watcher, in its comments requests additional findings of fact and conclusions of law, which provide for a reduction of rate base in the amount of $77,650. Watcher under the guise of comments is rearguing what it has previously set forth in its brief in this matter.

The failure of the developers to seek a refund of their apparently excess contributions pursuant to Rule 15 presents us with an unusual situation. Rule 15 does not itself provide for ratemaking adjustments in the absence of a main extension contract. Having rejected Watcher's rate base adjustment as inappropriate, we face the prospect of fashioning a unique ratemaking adjustment to ensure that those who overcharged to developers do not profit from their improper activities. Unfortunately, the implementation of such an adjustment would be complicated by a number of factors.

First, we take official notice of D.88-10-023, which shows that the utility ownership has changed since the apparent excess contributions were collected. This change in ownership means that any ratemaking adjustment we make will not directly reach those responsible for the overcharges and would force the present owner to seek recovery of the money lost through the adjustment from the former owners. If recovery were not possible, for whatever reason, the present owner would suffer for the apparent sins of the former owners. Customers would also suffer, since we could hardly deny the present owner the opportunity to recover from ratepayers the legitimate litigation costs that would undoubtedly be incurred in any attempt to seek recovery from the former owners. If there were evidence that the utility itself, as

opposed to its former owners, benefited from the excess contributions, we would be less reluctant to impose an adjustment at this time.

Second, Watcher and Water Branch fail to consider that had the developers pursued their remedies under Rule 15, the ratepayers would not have received any benefits through reduced rates. Watcher and Water Branch are here seeking to have monies which may be due to the developers accrue to the ratepayers when the developers fail to pursue their remedies. In this instance, the ratepayers have already received a benefit because, in the absence of a main extension contract, Rural is unable to obtain the standard depreciation expense on any of the contributions. While we do not wish to downplay the importance of compliance with our regulations, we do not see the proposed ratemaking adjustment as critical to our regulatory integrity.

Third, we lack precise information regarding the extent of the apparent overcharges. The developers have not been helpful in evaluating the apparent overcharge amounts.

Ultimately, we must decide whether an admittedly serious breach of Commission rules and policy which led to an apparent windfall of excess contributions to the former owners of a small water utility justifies the imposition of a uniquely fashioned ratemaking adjustment on the current owner. If we were more confident that the consequences of an adjustment could easily be passed on to the apparent wrongdoers, we would not hesitate to do so. However, we feel that it is more likely that the current owner and customers would be the ones to suffer most. The owner would suffer the need to engage in costly, time consuming, and possibly fruitless litigation against the former owners. If the litigation did not result in recovery of both the revenue adjustment loss and the litigation costs, the customers would also be likely to suffer both because they would have to pay through rates the reasonable cost of such litigation and because the operations of the utility

might suffer from the absence of the revenue the utility lost through the ratemaking adjustment.

In a perfect world, we would order a ratemaking adjustment such as that requested by Watcher and Water Branch. In light of the absence of a remedy in Rule 15, the probable hardships for the current owner and customers that would result from a necessarily unique and imprecise ratemaking adjustment, the questionable ability of the current owner to recover from the former owners, the reluctance of the developers harmed by the overcharge to pursue their remedies and to aid the Commission in its investigative efforts, and the failure of Water Branch to present suggested details of its "ratemaking remedy," we decline to impose the requested "ratemaking remedy." Given the unique facts of this case, we will not punish the innocent and make them seek to punish the apparently guilty in order to defend the sanctity of our ratemaking principles.

We do, however, believe the case points out the need to amend Rule 15 to address the situation presented here, and we will order Water Branch to recommend such an amendment in the near future.

Findings of Fact

1. Rural may have collected excess contributions in connection with Tracts 841 and 760.

2. The excess contributions could be as much as $65,350 in connection with Tract 841.

3. The excess contributions could be as much as $12,300 in connection with Tract 760.

4. Tracts 841 and 760 are categorized as contributed plant.

5. Contributed plant is not a part of rate base.

6. Watcher requests that Rural's rate base be reduced by the amount of the excess contributions.

7. Remedies with respect to excess contributions are covered by Rule 15 of Rural's tariff.

8. Tract 1088 is categorized in Exhibit 4 as both contributed plant and non-contributed plant.

9. Watcher requests that the portion of non-contributed plant in connection with Tract 1088 entitled Main Valves etc. in the amount of $40,050 be changed from non-contributed plant to contributed plant.

10. Watcher interprets D.82-04-082 differently than the author of Exhibit 4.

Conclusions of Law

No refunds of the rates authorized by D.88-10-029 should be ordered.

O R D E R

IT IS ORDERED that:

1. The Rates authorized by Decision (D.) 88-10-029 are no longer subject to refund.

2. D.88-10-029 is made final.

This order becomes effective 30 days from today.

Dated DEC 1 8 1989, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

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

Wesley Franklin

WESLEY FRANKLIN, Acting Executive Direc

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ORDER

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Dated _____, at San Francisco, California.