

FEB 22 1991

Decision 91-02-035 February 21, 1991

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California Utilities Services, Inc. (U-418-S) for an order authorizing it to increase rates charged for sewer service, and to record a historical cost appraisal and accumulated depreciation requirement study.

ORIGINAL

Application 90-10-017 (Filed October 11, 1990)

INTERIM OPINION

Summary of Decision

In this decision, we grant applicant an interim emergency rate increase, subject to refund following our final decision, in an amount intended to increase revenues from \$92,900 annually to \$131,000, or 41.0%. Monthly flat rates charged to ratepayers would increase from a current \$8.47 to \$11.94, based on 914 current connections. Applicant sought an emergency increase of 167%, with a final permanent increase of 299%. The additional final increase granted to applicant, if any, will be set forth in our final decision following the company's first general rate case, commencing with hearings on April 22, 1991, at the Commission's courtroom in San Francisco. Based on comments by ratepayers at a public participating hearing conducted January 15, 1991, this interim order also directs that at least one day of the evidentiary hearings be scheduled in Salinas to accommodate any witnesses who otherwise could not appear at the hearings in San Francisco.

Background

California Utilities Service, Inc. (applicant or CUS) provided sewer service in 1990 to some 870 customers in the Toro area, about four miles southwest of Salinas. The service area lies in a valley between the Salinas-Monterey Highway and the Fort Ord Military Reservation.

Applicant took over this system in March 1986, as authorized by Decision (D.) 87-05-033. Before CUS stepped in, the system had been effectively abandoned by its previous owners and was in a state of disrepair. The system operated under restrictions imposed by the Central Coast Regional Water Quality Control Board (Regional Board), requiring substantial improvements before new customers could be served. CUS began a rebuilding and expansion program to bring the system up to contemporary standards.

Applicant's waste water treatment plant is located on the south bank of the Salinas River. It is designed to process an average dry weather flow of 300,000 gallons daily. The new treatment facility, a Sequencing Batch Reactor system (SBR), is composed of two large SBR tanks and a chlorine contact chamber. After treatment, the disinfected wastewater is piped through an irrigation pumping system to some 40 acres of spray fields.

On August 16, 1988, CUS by advice letter filing sought authority to increase rates to offset a \$9,239 increase in purchased power. By Resolution W-3410, the Commission on September 14, 1988, granted the request. As a result, flat rate charges for all customers increased from \$7.50 per month to \$8.47, or 12.9%. The prior rates had been in effect since June 1, 1979, when a general rate increase had been granted to a predecessor company by Resolution W-2515.

Interim Emergency Increase

CUS seeks authority for an immediate emergency increase in 1991 revenue to \$163,178, or 167%, and for a permanent increase in annual revenue to \$291,875, or 299%. The company states that it needs the increase because of higher operating expenses of its new treatment plant. CUS proposes to increase rates as follows:

General Residential Sewer Service

	<u>Present Rate</u>	<u>Proposed Immediate Emergency Rate</u>	<u>Proposed Permanent Rate</u>
Single and Multiple Family Residence Per Month	\$8.47	\$22.62	\$33.78

Applicant states that it was required to construct a new sewage treatment plant and expand existing spray fields in order to comply with discharge specifications of the Regional Board. While much of this capital cost was contributed by developers (in order to permit the system to serve new customers), the additional facilities resulted in a near doubling of CUS operating costs. Applicant states that it has been required to add two full-time employees, a treatment plant operator, and a spray field maintenance employee, and that other operating costs have similarly increased. (See Application, Exhibit D.)

Prehearing Conference

A prehearing conference was conducted on December 19, 1990. At the conference, parties presented arguments on the request for interim emergency relief, and they agreed on dates for a public participation hearing in Salinas and evidentiary hearing dates in San Francisco (April 22 through April 26, 1991) to consider applicant's request for a permanent rate increase.

Public Participation Hearing

The public participation hearing was conducted on the evening of January 15, 1991, in Salinas. An administrative law judge (ALJ) presided. Approximately 200 persons attended, many arriving by special bus from communities served by CUS.

CUS General Manager Thomas Adcock told the meeting that expenses of the utility are running about three times the \$90,000 annual revenues. Among these expenses, he stated, are \$25,000 for

power, \$15,000 for chemicals, the salaries of two full-time employees, plus significant insurance, interest, depreciation, and general operating expenses.

Daniel R. Paige of the Commission's Water Utilities Branch (Branch) reported to ratepayers that an investigation of the utility's rate request is under way, and that an audit of its income and expense statements is being conducted. Branch's report on the rate application is due March 29, 1991, and Paige offered to send a copy to ratepayers on request.

Sixteen ratepayers made statements at the meeting. In general, speakers objected to the size of the requested increase, noting that many CUS customers are retirees on fixed incomes. Speakers urged the Commission to investigate CUS operations to be certain that developer contributions have been used prudently and that costs have been held to a minimum. Specific points raised by speakers included:

- o Billing practices. A number of speakers complained that they had not been billed for periods of several months. While they eventually received adjusted bills when they called the company, they questioned whether other accounts had gone uncollected, causing reduced revenue.
- o Affiliated companies. Speakers said that when they called CUS, they reached Alco Water Service (Alco), another utility in which the Adcock family is the principal shareholder. They questioned whether Alco costs were being imposed on CUS ratepayers and, if so, whether the allocation was proportionate to services rendered.
- o Developer funds. At least two developers questioned CUS practices in dealing with some \$1 million in developer contributions and fees. One developer alleged that CUS awarded new construction work to family members, without consideration of competitive bidding.

- o Management practices. Several speakers questioned management efficiency, citing the billing problems, the practice of billing monthly instead of quarterly, and the allocation of costs for services by other Adcock companies.

On the other hand, apart from the billing problem, most speakers said that they had experienced no service problems since CUS took over the sewer utility. One speaker praised the management of CUS, noted that sewer service is critical to homeowners, and observed that no other company appears interested in taking over the CUS service.

Numerous individuals objected to holding evidentiary hearings in San Francisco, instead of Salinas. Based on these comments, the ALJ announced that the Commission would consider conducting one or more days of the hearing in Salinas to accommodate any witnesses who would find it difficult to appear in San Francisco.

Position of Applicant

Applicant states that it is losing \$450 a day in operating its sewer system. For the first nine months of 1990, it reports revenue of \$67,206 and expenses of \$179,897, a net loss of \$112,691. For the same nine-month period the prior year, applicant states that its net loss was \$48,747. CUS states that this increase in operating costs was unavoidable, adding:

"CUS wishes to address the erroneous belief held by some customers that the sole purpose of expanding the sewer system was to serve new developments. Simply put, expansion was mandated by the environmental and health department whether or not new customers were added. The plant was old and in need of repair whether or not new customers were added. The additional customers have only helped to spread and defray costs and are not the cause of the present financial emergency. The old plant served about 850 connections. The new subdivisions added only about 245 more connections. The developers of the new

subdivisions contributed more than \$1,000,000 toward the construction of the new plant, costs which would have been borne alone by the 850 customers on the old system. Further, financial emergency has been significantly exacerbated by the new operating costs which would have been borne by the existing 850 customers alone if CUS was not able to spread the costs among the new customers as well."

Applicant states that an interim rate increase is justified by prior Commission decisions, including Re Little Lake Water Company (1983) 12 CPUC 2d 21, Re Hillview Water Company, Inc. (1984) 16 CPUC 2d 417, and Western Union Telegraph Co. (1971) 72 CPUC 135. CUS states that in Western Union, interim relief was granted on a showing similar to that here. That is, the applicant had shown:

1. It has not received a significant rate increase for seven years,
2. Its expenses had sharply increased because of wage and pension obligations,
3. It needed additional revenues to carry forward a modernization program,
4. Recorded actual revenues for the prior year clearly reflected a loss in operations, and
5. Based upon available data, the estimates for the coming year showed a negative return.

In the two water company cases cited by applicant, interim rate increases were authorized upon a finding of financial emergency. In Little Lake, the Commission granted a 32.8% interim increase (as opposed to the 269.2% increase sought by the utility) on representations by the company that it would have to cease operation without emergency relief. In Hillview Water, an emergency service revenue increase of 24.3% was granted, for a limited period of time, upon a showing of "ongoing significant revenue shortfall." 16 CPUC 2d at 417.

CUS argues that its application and accompanying cost exhibits more than meet any requirement of emergency justifying interim relief, since basic operating costs clearly exceed revenue. It argues that a utility need not show that it is on the brink of financial disaster to justify interim relief. It asserts that in Re Southern California Edison Company, (1988) 28 CPUC 2d 203, the Commission did not require the existence of a financial emergency in granting interim relief. Instead, the Commission relied upon a combination of other factors, including a substantial increase in fuel costs, probable delay in issuing a final decision and the advantage of phasing in the likely rate increase. 28 CPUC 2d at 212.

Water Utilities Branch

Branch opposes an interim rate increase on three grounds. First, it argues that CUS could have sought a general rate increase earlier, and has not done so. Second, Branch states that there is no showing that CUS is unable to meet payroll or faces other financial emergency. Finally, Branch believes that applicant's cost estimates need to be tested in the staff investigation and hearing. Branch notes that it is moving expeditiously in investigating the application, and that it intends to file its report on March 29, 1991, and has proposed a schedule that contemplates Commission action by about July 1991.

Branch calls our attention to TURN v. PUC (1988) 44 Cal. 3d 870, and to Re Pacific Telephone and Telegraph Co. (1949) 48 CPUC 488. It argues that these decisions state that the historical tests for an interim rate increase are (1) a financial emergency threatening the continuation of the utility's service, and (2) a lack of dispute over the reasonableness of the utility's costs. (See Turn v. PUC, 44 Cal. 3d at 875.)

Branch states that the principal owners of CUS are Robert T. and N. Patricia Adcock, and that CUS is a part of a larger Adcock group of utilities, with Alco being the largest.

Alco personnel perform and are paid for numerous office services on behalf of CUS, Branch states. Thus, Branch argues, the evidence may show that all of the Adcock utilities should be grouped together in considering their allocation of expenses and needs for rate relief. Branch notes that interim relief was denied in the recent case of Re Apple Valley Ranchos Water Company, D.90-02-045 (February 23, 1990), partly on the basis that Valley Ranchos was wholly owned by a financially healthy parent, Park Water Company. Homeowners Associations

Homeowners associations represented at the prehearing conference include the Toro Hills Homeowners Association, the Palm Grove Homeowners Association, the Creekside Homeowners Association, Serra Village, the Meadows, Toro Park Estates, and the Villas Homeowner Association, along with approximately 20 individual homeowners. Understandably, homeowners argue that the proposed interim rate of \$22.62 per month, compared to the \$8.47 they pay now, is a shock. Before such an increase is granted, they urge that the Commission and ratepayers have an opportunity to examine CUS cost figures and to question company representatives.

John D. Reader, spokesman for the homeowners, stated:

"(W)e feel that the company has not made an adequate showing for interim relief. The \$450 a day [loss] I would assume is based upon the expenses that they show in this application, and they are asking as interim relief the total amount of those expenses, which have not been tested and which the staff and I will be looking at. [However,] there certainly may be an emergency, and the customers of the sewer district are concerned about continued service."

Because of their concern that an emergency may face the utility, homeowners state that they would not oppose an interim increase, subject to refund, of 10% of estimated 1990 revenue, or an interim increase of about \$9,000.

Discussion

This order considers only the applicant's request for interim emergency rate relief, pending a final decision on what permanent rate increase, if any, is justified by the evidence. The company has stipulated that it will refund any amounts collected under an interim emergency rate if the Commission later determines that such a refund is appropriate.

There are two issues to be considered in determining whether an interim emergency rate increase is appropriate:

1. Has the company shown that emergency relief is warranted?
2. If so, what interim rate increase is justified?

Is Emergency Relief Warranted?

CUS argues that its application and accompanying financial exhibits establish a prima facie showing of the need for an interim emergency rate increase to help meet increased costs necessitated by new facilities that the utility was required to construct. Homeowners acknowledge that, subject to their verification of the company's costs, an emergency may exist that could threaten continued service. Only Branch takes the position that no interim rate relief is warranted.

Branch argues that any shortfall experienced by CUS can be met by earnings of other Adcock-operated utilities, and that the Commission in Apple Valley Ranches, D.90-02-045, endorsed the principle of grouping the earnings and expenses of affiliated utilities. The case cited is distinguishable, however, in that the utility there was wholly owned by a larger, profitable parent company. It is not unreasonable to expect a profitable parent company to absorb losses of a division or affiliate for a period of time while the affiliate's rate case is being heard.

Here, however, applicant has submitted copies of its incorporation status (Exhibit A). At this point, the record

indicates that CUS is an independent corporation. Absent some contrary showing of corporate control, it would be inappropriate for an independent utility to pass operating losses on to another utility.

Branch also argues that CUS has failed to show a financial emergency threatening the continuation of the utility's service. While that certainly is one test of whether an emergency, interim rate increase is warranted (see Little Lake Water Company, supra), it is not the only test. Indeed, we read TURN v. PUC, supra, as recognizing the Commission's authority to grant rate relief on an interim basis where there is a showing that fairness to both the utility and the public require immediate action. 44 Cal. 3d at 879.

One factor influencing both the Commission and the Court in TURN v. PUC was that a final decision on rates could be months or years away. Here, by contrast, Branch has proposed an expedited consideration of the CUS application, and a final decision may be anticipated well before the end of the year. Nevertheless, CUS filed its application for interim relief on October 11, 1990, and fairness dictates that we act upon that request, one way or the other, as soon as we have a sufficient record on which to do so.

We note Homeowners' objection that the evidence may show that applicant's expanded plant should be more generously funded by developers and shareholders, since the expansion will serve in part to permit expansion of the utility's business. We note also Branch's suggestion that applicant's costs may be subject to adjustment because of the use of personnel and services from other companies that share a common ownership. These concerns can be adequately addressed by making any interim rate increase subject to refund, with interest, if the evidence shows that the interim increase is not justified.

What Interim Rate Increase Is Justified?

Having determined that applicant has presented a prima facie showing of an emergency condition justifying rate relief on an interim basis, we turn now to consideration of the amount of interim increase that has been justified by the applicant. Under Public Utilities Code § 454, the burden is on the utility to show that an interim increase, as well as any permanent increase, is justified.

We agree with Homeowners that applicant's proposed interim rate appears designed to cover most, if not all, of current increased operating expenses. That is, the proposed interim rate (to \$22.62) would represent a 167% increase over the current rate (\$8.47), whereas the following permanent increase (to \$33.78) would represent a 49% increase over the interim rate. Applicant has not persuaded us that the major portion of its proposed increase should be granted prior to evidentiary hearing, particularly since the proposed date for a final decision in this case is relatively close at hand.

We also agree with Branch that the sudden increase in applicant's costs in 1990 was plainly foreseeable. Applicant had the option of seeking a rate adjustment long before its new facility was completed and additional staff went on payroll. While that does not lessen applicant's need for additional revenue, it mitigates against the urgency for final relief.

In determining the amount of increase appropriate on an interim basis, we are guided by two ratemaking principles. First, rates must be reasonably maintained at the lowest practical level for the benefit of current ratepayers and future ratepayers. Second, revenue should be sufficient to cover legitimate costs and encourage owners to maintain an efficient utility service. (TURN v. PUC, 44 Cal. 3d at 878.) Moreover, where, as here, a company takes over and improves an otherwise failing utility, it should be

permitted reasonable rate relief upon a showing that its efforts to rescue the utility service have required increased costs.

Since CUS has not previously applied for a general rate increase, and since the staff investigation and evidentiary hearings will not be completed for several weeks, the record before us consists only of company exhibits that have not yet been verified. Accordingly, the amount of interim increase is of necessity somewhat arbitrary. Homeowners suggest a 10% interim increase in revenue, or approximately \$9,000 annually. CUS seeks a 167% increase in revenue, or approximately \$178,000. In this order, we authorize a \$38,100 interim increase to achieve 1991 earnings of \$131,000, or an approximate 41.0% increase over current revenue. Since the number of connections served by CUS appears to have grown to 914 at the end of 1990, the monthly charge assessed customers will be \$11.94, or a monthly increase of \$3.47 per connection.

We base this amount on our analysis, assisted by staff, of the CUS Income Statement for the years 1988, 1989, and the first six months of 1990. In effect, we have doubled the amount of revenues and expenses shown for the first six months of 1990 to establish anticipated revenue and expenses for the full year. However, we have discounted new employee labor costs from 2 employees to 1.5 employees, and we have eliminated management salaries and depreciation expenses pending the results of Branch's investigation and the evidentiary hearings. Based on the public participation hearing, these costs appear to be the ones likely to be challenged, in view of services performed by other companies in which the Adcocks are principal shareholders. The result of this calculation is estimated projected income of \$92,900 for 1990 and estimated projected expenses of \$131,000, for a projected loss of approximately \$38,100, which represents the amount of annual increase authorized on an interim basis.

While a 41.0% interim increase is substantial, we note that current owners apparently have absorbed losses since they took over the system, and current ratepayers for some time apparently have enjoyed a monthly fee that is lower than they would have paid had CUS sought a general rate increase at an earlier time. To the extent our estimates should prove to be excessive, we will in our final order require a refund to ratepayers.

Findings of Fact

1. CUS acquired this service in March 1986 under authorization granted by the Commission in D.87-05-033.

2. Since acquisition, CUS has conducted a reconstruction program to bring the system into compliance with requirements of the Regional Board.

3. The last rate increase for the system was authorized by Resolution W-3410 on August 16, 1988, to increase rates to offset a \$9,239 increase in purchased power. It was the first rate increase authorized for this service since June 1979.

4. Asserting that increased operating costs will cause the system to incur losses in 1990 of approximately \$150,000, CUS filed this application seeking a 167% emergency interim increase in rates and a 299% permanent increase in rates.

5. CUS has stipulated that it will refund to ratepayers any interim rate increase determined not to be justified in the Commission's final order in this proceeding.

6. An increase in revenue of 41.0% would be just and reasonable on an interim basis pending our final order in this proceeding, based on estimates of 1990 operations.

Conclusions of Law

1. CUS in its application and exhibits has presented a prima facie showing that operating costs have exceeded revenue by a substantial amount, constituting a threat to the system's continued operation.
2. An interim rate increase, subject to refund, should be granted pending our final order in this proceeding.
3. The effective date of this order should be the date of signature because of the threat to the system's operation.
4. Upon written request of any party, one or more days of public hearing should be scheduled in Salinas, as well as in San Francisco, to receive testimony or other evidence that can more conveniently be received in Salinas.

INTERIM ORDER

IT IS ORDERED that:

1. After the effective date of this order, California Utilities Service, Inc., is authorized to file the revised rate schedules attached to this order as Appendix A. Such filing shall comply with General Order 96-A. Such filing shall state that the interim rate increase is subject to refund pending the Commission's final order in this proceeding.
2. The effective date of the revised schedules shall be 5 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.

3. Upon the written request of any party, the administrative law judge will schedule one or more days of public hearing in Salinas, as well as in San Francisco, to receive testimony or other evidence.

This order is effective today.

Dated February 21, 1991, at San Francisco, California.

PATRICIA M. ECKERT
President
G. MITCHELL WILK
JOHN B. OHANIAN
Commissioners

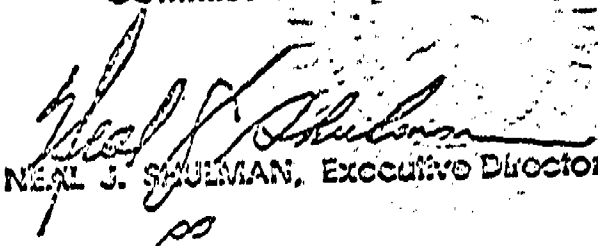
I abstain.

DANIEL WM. FESSLER
Commissioner

I abstain.

NORMAN D. SHUMWAY
Commissioner

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


NEAL J. SCHULMAN, Executive Director

APPENDIX A
CALIFORNIA UTILITIES SERVICES
Schedule No. 1
GENERAL RESIDENTIAL SERVICE

APPLICABILITY

Applicable to General Residential Sewer Service

TERRITORY

An area midway between the cities of Salinas and Monterey in the vicinity of and along State Highway 68, Monterey County.

RATES

Per Month

Single Family Residence	\$ 11.94	(I)
Multiple Residence per residential dwelling unit	11.94	(I)

SPECIAL CONDITIONS

1. All bills are subject to the reimbursement fee set forth in Schedule No. UF (N)
|
(N)

(END OF APPENDIX A)