

Decision S2 05 038 MAY - 4 1982

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
CITIZENS UTILITIES COMPANY OF)
CALIFORNIA for authority to increase) Application 60285
rates and charges for water service) (Filed February 23, 1981)
in its Felton Water District.)
_____)

Jack H. Grossman, Attorney at Law (New York),
for Citizens Utilities Company of California,
applicant.

Lynn T. Carew, Attorney at Law, and Edward L.
Cooke, for the Commission staff.

O P I N I O N

In Application (A.) 60285 Citizens Utilities Company of California (Citizens-California) seeks an increase in water rates for its Felton Water District (Felton). The amount of the proposed revenue increase for metered service is \$187,500 or an increase of 112.9% in 1981; \$22,800 or 6.3% in 1982; and \$24,300 or 6.3% in 1983. A 13.25% rate of return on rate base is requested.

A duly noticed public hearing was held before Administrative Law Judge Orville I. Wright in Felton on May 14 and 15, 1981, and in San Francisco on June 9, 1981. Final submission date for the last of the issues involved in this proceeding was September 14, 1981.

Testimony was presented by W. B. Stradley, Charles B. Bromagem, and Edward W. Schwartz for Felton, and by Frank Lindskoog, Edward L. Cooke, and Herb Chow for the Commission staff. Part of the record of these hearings was consolidated with a portion of the record of other related applications filed by Citizens Utilities Company (Citizens) subsidiaries.

Summary of Decision

Citizens-California's Felton District is granted a general rate increase of \$137,700 for test year 1981 and a further increase of \$18,300 for test year 1982. The increase for 1981 is 82.6% and the increase for 1982 is 5.6%.

A rate of return of 12.04% on rate base is found reasonable. Return on equity is 13.2%.

Table I, following, shows revenues, expenses, and rate base for test year 1981 as developed by Citizens-California and by staff, differences being labeled "at issue." Adopted revenues and expenses at present rates and at adopted rates are also depicted. Table II presents the data for 1982, and Tables III and IV show rate base issues and their resolution.

As this order will be effective in 1982 we ordinarily would base rates upon the revenue requirement for the 1982 test year. The total revenue increase for test year 1982 is \$156,000 or 82%.

Under our policy of allowing no more than a 50% raise in rates in any one year, we authorize a revenue increase of \$84,000 or 50% in metered rates for test year 1982, the revenue difference being deferred to 1983 and 1984 as shown in Appendixes A and B. Appendix E shows the method used in deferring income and in compensating Citizens-California for postponement of full rate relief.

Discussion of the issues resolved in this proceeding as shown on Tables I through IV is contained in Decision (D.) 82-02-059 in A.60132, Citizens-California's Sacramento County Water District, and in D.82-03-023 in A.60220, Citizens-California's Guerneville Water District. The referenced discussion is incorporated as if fully set forth.

This decision makes a ratemaking adjustment to flow through to customers \$266,556 realized by Felton's sale of timber on public utility watershed land; this is done by reducing Felton's revenue requirement by \$22,213 annually over a 12-year period (as we estimate the property will be logged about every 12 years) and the extraordinary gain should be amortized for ratesetting purposes.

For test year 1981 \$1,900 of the revenue requirement is due to the Economic Recovery Tax Act of 1981 (ERTA); the effect for test year 1982 is \$6,600. In the future the effect could increase. We will direct Citizens-California to notify its Felton customers of the ERTA effect on rates. (See Appendix D.)

Rate Design

Since January 1, 1976, the system average revenue has increased 32.4% while the cost to a 300 cu.ft. lifeline customer has increased only 14%. Therefore, an 18.4% lifeline differential has been obtained. These rates have been designed to provide the full 25% lifeline differential. The Annual General Metered Service Schedule is changed to a Standard Monthly Metered Service Schedule, and the deposit to establish credit shall be made according to Rule No. 7 of the company's filed tariff rules.

Citizens-California proposed no increase in rates for either private fire protection service or public fire hydrant service, and, staff concurring, these rates remain unchanged. Citizens-California entered into an agreement with the Felton Fire District on May 3, 1977 whereby the fire district agreed to assume the maintenance and installation of hydrants and thereby be relieved of payment of hydrant service charges. This agreement was filed with the Commission on June 16, 1977. We will grant Citizens-California's request that the rate schedule for public fire hydrant service be canceled.

Description of Felton

Felton serves the unincorporated area of Felton and adjacent vicinity in Santa Cruz County. The source of the water supplied is Fall and Bull Creeks, and Bennett and Bull Springs, supplemented by one well. Reservoirs and tanks of various sizes provide storage capacity of 871,000 gallons. The distribution system contains about 118,000 feet of transmission and distribution mains that vary in size up to 12 inches in diameter.

Felton is an operating division of Citizens-California which, in turn, is wholly owned by Citizens, a Delaware corporation. Administrative offices are located in Stamford, Connecticut, and Redding and Sacramento, California.

Public Witness Testimony

Nine of Felton's customers expressed the consensus opinion that the rate increases being sought were inordinately high and should be substantially pared down or denied altogether. There was an equally generally expressed view that water quality and service were good.

The Commission heard statements from the following customers: Elizabeth B. Glines, Toni Stevens, Ed Viera, Bill Buerger, Russell Unruhe, Harold A. Torsell, John Clausen, Isabel Kelly, and Dorothy Ward.

TABLE I
Citizens Utilities Company of California
Felton Water District
1981 Summary of Earnings

<u>Item</u>	<u>Applicant</u>	<u>At Issue</u>	<u>Staff</u>	<u>Adopted Revenues & Expenses</u>	<u>Adopted Rates</u>
Operating Revenues					
Metered	\$166,100	\$ -	\$166,100	\$166,100	\$303,800
Timber Sales	-	-	-	22,200	22,200
Private Fire Protection	1,300	-	1,300	1,300	1,300
Other	100	-	100	100	100
Total Operating Revenues	167,500	-	167,500	189,700	327,400
Operating Revenue Deductions					
Salaries and Wages	54,100	-	54,100	54,100	54,100
Materials, Serv. & Misc.	8,700	-	8,700	8,700	8,700
Purchased Power	9,200	-	9,200	9,200	9,200
Balancing Acct. (T.I.A.)	-	-	-	(4,200)	(4,200)
Customer Acct. & Misc.	9,100	2,900	6,200	6,200	6,200
Transportation Expense	5,100	-	5,100	5,100	5,100
Telephone and Telegraph	1,700	-	1,700	1,700	1,700
Banking Charges	-	(800)	800	-	-
Uncollectible Accounts	300	-	300	300	600
Administrative Office Exp.	26,500	1,300	25,200	26,500	26,500
Legal and Reg. Com. Exp.	5,700	3,000	2,700	5,700	5,700
Insurance	400	100	300	400	400
Injuries and Damages	4,000	2,100	1,900	4,000	4,000
Welfare and Pensions	14,100	2,800	11,300	14,100	14,100
Rents	100	-	100	100	100
Miscellaneous and Per Diem	200	-	200	200	200
Franchise Tax	-	-	-	-	-
Ad Valorem Tax	8,800	-	8,800	8,800	8,800
Payroll Tax	4,200	-	4,200	4,200	4,200
Depreciation Expense	23,300	-	23,300	23,300	23,300
Income Taxes	-	-	-	-	63,700
Total Oper. Rev. Deductions	175,500	11,400	164,100	168,400	232,400
Net Operating Revenues	(8,000)	(11,400)	3,400	21,300	95,000
Average Depr. Rate Base	802,000	27,600	774,400	788,800	788,800
Rate of Return	(1.00)%	(1.44)%	.44%	2.70%	12.04%

(Red Figure)

TABLE II
Citizens Utilities Company of California
Felton Water District
1982 Summary of Earnings

A.60285 ALJ/bw

<u>Item</u>	<u>Applicant</u>	<u>At Issue</u>	<u>Staff</u>	<u>Adopted Revenues & Expenses</u>	<u>Adopted Rates</u>
<u>Operating Revenues</u>					
Metered	\$168,700	\$ -	\$168,700	\$168,700	\$324,000
Timber Sales	-	-	-	22,200	22,200
Private Fire Protection	1,300	-	1,300	1,300	1,300
Other	100	-	100	100	100
Total Operating Revenues	170,100	-	170,100	192,300	347,600
<u>Operating Revenue Deductions</u>					
Salaries and Wages	60,600	-	60,600	60,600	60,600
Materials, Serv. & Miso.	9,400	-	9,400	9,400	9,400
Purchased Power	9,300	-	9,300	9,300	9,300
Balancing Acct. (T.I.A.)	-	-	-	(4,200)	(4,200)
Cust. Acct. & Miso.	9,800	3,200	6,600	6,600	6,600
Transportation Expense	5,700	-	5,700	5,700	5,700
Telephone and Telegraph	1,700	-	1,700	1,700	1,700
Banking Charges	-	(800)	800	-	-
Uncollectible Accounts	300	-	300	300	600
Admin. Office Expenses	28,900	1,400	27,500	28,900	28,900
Legal and Reg. Com. Expense	5,700	3,000	2,700	5,700	5,700
Insurance	500	-	500	500	500
Injuries and Damages	4,400	2,400	2,000	4,400	4,400
Welfare and Pensions	15,300	3,200	12,100	15,300	15,300
Rents	100	-	100	100	100
Miscellaneous and Per Diem	200	-	200	200	200
Franchise Tax	-	-	-	-	-
Ad Valorem Tax	11,100	-	11,100	11,100	11,100
Payroll Tax	4,700	-	4,700	4,700	4,700
Depreciation Expense	24,900	-	24,900	24,900	24,900
Income Taxes	-	-	-	-	62,000
Total Oper. Rev. Deductions	192,600	12,400	180,200	185,200	247,500
Net Operating Revenues	(22,500)	(12,400)	(10,100)	7,100	100,100
Average Depr. Rate Base	852,700	33,870	818,830	831,330	831,330
Rate of Return	(2.64)%	(1.41)%	(1.23)%	0.85%	12.04%

(Red Figure)

TABLE III

Citizens Utilities Company of California
Felton Water District
Rate Base

Test Year 1981

<u>Item</u>	<u>Applicant</u>	<u>At Issue</u>	<u>Staff</u>	<u>Adopted</u>
Utility Plant in Service	\$1,110,200	\$ -	\$1,110,200	
Depreciation Reserve	(195,500)	8,600	(204,100)	
Net Utility Plant in Service	914,700	8,600	906,100	\$906,100
Noninterest Bearing CWIP	-	-	-	
Materials and Supplies	6,500	-	6,500	6,500
Working Cash	22,100	19,000	3,100	19,200
Common Plant	6,400	-	6,400	6,400
Customers' Advances for Construction	(99,000)	-	(99,000)	(99,000)
Contributions in Aid of Construction	(21,900)	-	(21,900)	(21,900)
Reserve for Deferred Federal Income Tax	(26,800)	-	(26,800)	(28,500) ^{1/}
Total Average Depreciated Rate Base	802,000	27,600	774,400	788,800

(Red Figure)

^{1/} Effect of ERTA.

TABLE IV

Citizens Utilities Company of California
Felton Water District
Rate Base

Test Year 1982

<u>Item</u>	<u>Applicant</u>	<u>At Issue</u>	<u>Staff</u>	<u>Adopted</u>
Utility Plant in Service	\$1,184,100	\$11,500	\$1,172,600	
Depreciation Reserve	<u>(217,500)</u>	<u>3,370</u>	<u>(220,870)</u>	
Net Utility Plant in Service	966,600	14,870	951,730	\$951,730
Noninterest Bearing CWIP	-	-	-	
Materials and Supplies	7,000	-	7,000	7,000
Working Cash	22,100	19,000	3,100	13,600
Common Plant	6,300	-	6,300	6,300
Customers' Advances for Construction	(94,800)	-	(94,800)	(94,800)
Contribution in Aid of Construction	(21,400)	-	(21,400)	(21,400)
Reserve for Deferred Federal Income Tax	<u>(33,100)</u>	<u>-</u>	<u>(33,100)</u>	<u>(31,100)</u> ^{1/}
Total Average Depreciated Rate Base	852,700	33,870	818,830	831,330

(Red Figure)

1/ Effect of ERTA.

Process
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Revenues

No dispute exists between Felton and staff on estimated water sales in the test years. There is, however, disagreement as to the treatment of revenues derived from timber harvesting on Felton watershed lands.

Staff's testimony is that in late April 1981, subsequent to the filing of A.60285, it was learned from an alert ratepayer that recent timber harvest operations had been conducted in the vicinity of or upon Felton's lands. This information prompted staff investigation of land sales, assessors records, corporate files of Felton and of Citizens Resources Company (CRC), another wholly owned subsidiary of Citizens, and included discovery by audit and by deposition.

This investigation revealed that there was a timber harvest on Felton's public utility watershed lands in 1976 and 1978-79 which yielded gross receipts of \$278,000 and net receipts, exclusive of any applicable taxes, of \$266,549.

The fee ownership in the lands from which the timber was taken was acquired by Felton on January 16, 1962 when it merged with Felton Water Company. In September 1981, Felton had purchased the outstanding capital stock of the Felton Water Company and two parcels of land, not on the books of the seller, in one transaction for the unsegregated amount of \$225,920.

In the first rate proceeding following Felton's acquisition of the Felton Water Company properties, Citizens-California sought to include the two unbooked parcels of land in rate base at \$135,000, the difference between the gross sales price of \$225,920 and the net book value of the purchased utility's stock of \$90,920. Both Citizens-California and staff concurred that the purchased land was needed in the utility operations.

Although the two parcels were not carried on Felton Water Company's books, and Felton contended that they were not dedicated to public use until after the acquisition, the Commission found

convincing evidence of dedication by the selling entity at an earlier date. As the only evidence of value of the acres at the time of dedication was the staff's estimate of \$1,054, this sum was included in rate base. (D.66729, January 28, 1964, A.45164.)

This land is identified by nine separate parcel numbers in the record before us. For bookkeeping convenience, according to Felton, four of these parcels are carried on Felton's books as nonoperating properties. Five are carried on the books as operating properties.

Timber rights were severed from the fee ownership of seven of the nine parcels and transferred to CRC by deed recorded August 19, 1974. Commission authority was neither sought nor given for the transfer of these timber rights on public utility watershed property nor for the bookkeeping convenience by Felton of reclassifying watershed lands in rate base to nonoperating property.

At the hearing on this case, the record shows one of Felton's witnesses testified that 1979-80 ad valorem taxes on the lands classified as nonoperating by Felton were charged as nonoperating expense on the books. However, the workpaper submitted by Felton to the staff in support of Citizens-California's estimate of property taxes in the test years includes these taxes. It is not clear which entity of Citizens paid separately assessed taxes on timber rights, if any.

Citizens' expert forester was deposed by staff, and his deposition was admitted into evidence. It shows that Citizens' was exploring timber harvest potential on Felton lands prior to their acquisition in 1962, that a timber management contract was signed in 1974 and continues in force, and that the contract contemplates continuing tree farming activity on the Felton utility watershed. The contract states that the timber management and sales program will consist of a selective thinning or removal of approximately 40% of the merchantable timber volume, the intent being to maintain and protect the watershed and to leave the forest in an attractive and productive condition suitable for management as a sustained yield tree farm.

Some 2,305,000 board feet of lumber was removed and sold in 1976, 1978, and 1979, and harvesting cannot be renewed for at least 10 and perhaps 15 to 20 years from this first cutting. The staff therefore suggests 12 years forward as a reasonable amortization period for the net receipts of CRC's timber sales which it asks to be imputed to Felton.

Staff first argues that the arbitrary convenience bookkeeping used by Felton to reclassify several of the watershed parcels to the nonoperating property category without Commission or staff knowledge or approval should be disregarded in deciding this issue. We agree. It is clear that bookkeeping entries do not control over established facts. (D.66729, January 28, 1964, A.45164.)

Staff next submits that the transfers of timber rights from Felton to CRC without Commission authorization is void as the law provides that:

"No public utility...shall sell, lease, assign, mortgage, or otherwise dispose of...any part of its...line, plant, system, or other property necessary or useful in the performance of its duties to the public, or any franchise or permit or any right thereunder...without first having secured from the commission an order authorizing it so to do. Every such sale, lease, assignment, mortgage, disposition...made other than in accordance with the order of the commission authorizing it is void."
(Public Utilities (PU) Code § 851.)

Felton's brief does not contend that the pertinent watershed lands or the part consisting of timber rights are not necessary or useful in Felton's performance of its public utility duty to the public so as to obviate application of PU Code § 851. That such lands are necessary or useful was testified to by Felton's expert forester, admitted in Felton's contract with the forester, and testified to by staff. Further, Felton appeared before this Commission in 1962 and urged inclusion of all these lands in rate base at the full purchase price, including premium over book value paid for them. They were so included, and as such became dedicated public utility property. (D.66729, supra.)

An important issue of public utility regulation is at stake. Because of the protective umbrella of public utility regulation, regulated companies are able to pass many of their risks on to ratepayers. From the time an asset is dedicated to utility service and enters rate base, rates are computed to allow a reasonable return on the investment in that asset irrespective of fluctuations in its actual market value. If the asset becomes technically obsolete, suffers deterioration, or otherwise declines in value, the amount of investment nonetheless remains in rate base, earning a return and subject to gradual depreciation at ratepayer expense. This is the "quid" which ratepayers must pay for the "quo" of assets having been dedicated to utility service.

However, by the same token, ratepayers have a legal right to share in the appreciation in market value of assets which have been, but will no longer be, used in a public utility's regulated enterprise. Democratic Central Comm. v. Washington Metropolitan Area Transit Comm'n, 485 F.2d 786 (D.C. Cir. 1973), cert. den., 415 U.S. 935. Where ratepayers bear the financial burden associated with such assets and investors have been shielded from the risk of loss of their investment, the appreciation in market value over net book value must be credited to ratepayers in the ratemaking process. Id. at 806-11. See also New York Water Service Co. v. Public Service Comm'n, 208 N.Y.S. 2d 857 (N.Y. 1960); Detroit Edison Co., 14 P.U.R. 4th 223 (Mich. Pub. Serv. Comm'n 1978); Southern California Gas Co., 84 Cal. P.U.C. 405, 32 P.U.R. 4th 423 (Cal. Pub. Util. Comm'n 1978). If ratepayers have assumed "the expenses of ordinary maintenance and depreciation, and the risks of loss from casualty and obsolescence," combined with favorable accounting for investors of rate base, depreciation and tax items, then ratepayers are entitled to

all gains attributable to the removal from rate base of both depreciable and nondepreciable assets. Democratic Central Comm., supra, at 821.^{1/}

^{1/} Because we find the transfer of assets to CRC was void for lack of prior Commission approval, we need not measure the extent to which ratepayers have shielded investors from risk or the extent to which ratepayers should share in capital gain associated with these assets. We amortize timber sale revenues on the basis of the precedent established in D.92192, as the most practical means of treating this issue.

The parcels logged are used and useful as part of Felton's public utility operation; ratepayers pay a reasonable return to Felton on the parcels as part of Felton's rate base. The sale of timber and mineral rights to CRC is void since Commission approval to dispose of utility property was not obtained. The watershed, including timber and mineral rights, is dedicated to public utility service and, as such, to serve the public trust to be exercised by Felton, and this Commission, on behalf of ratepayers. Gains from the timber harvesting must be flowed through to ratepayers, otherwise Felton and its affiliated companies would unfairly enjoy the unique status of having someone else - ratepayers - pay the carrying cost on an investment but not share in periodic gains. Felton cannot enjoy the benefits of franchised monopoly status without the burdens of fair economic treatment to its captive ratepayers. This situation is similar to that addressed in 1975 when we found that gains from selling inventory fuel oil bought and dedicated to provide utility service accrue to ratepayers (San Diego Gas & Electric Co. (1975) 78 CPUC 485); thereafter, § 775 was added to the PU Code requiring such treatment.

We recently amortized timber sales revenues over a 10-year period in a water district where the watershed was farmed, as in the instant case (D.92192, September 3, 1980, A.58629). This is not a matter of first impression.

Felton states that D.92192 is not applicable to this proceeding in that: (1) there the utility was regularly farming while Felton is not and (2) there the timber sales were prospective while in Felton's case the sales were made before its prior rate case was heard. On the first point, Felton is incorrect that the timber sales were a once-only transaction; the contract with its forester admittedly contemplates ongoing tree farming on the watershed. On the second point, we would certainly have preferred that this issue would have come to us in the normal course of events, which would have occurred except for Felton's unilateral and unauthorized dealings with its watershed properties. Moreover, we cannot agree

with Citizens-California's contention that the Commission should have somehow ferreted out the timber sales by CRC in 1978, or earlier, so as to act prospectively in including them in gross revenues for ratemaking purposes.

Finally, Felton advances some related equity arguments. As it paid \$135,000 over book value for the watershed lands in 1962, and the Commission allowed only \$1,054, the historical cost, as rate base, Citizens should be allowed to keep the revenues. Or, Citizens should be allowed to keep the revenues because Felton earned a low return on rate base in the past. Or, if Citizens is not allowed to keep the revenues, the Commission should undo D.92192 and increase rate base by \$134,000 of the paid premium.

These contentions have no merit. Felton acquired the parcels as watershed for its utility operation knowing this Commission does not step up the rate base basis from historical cost when assets are transferred from one utility owner to another. The reason is that the ratepayers, captive within the particular service territory, pay reasonable rates to allow the opportunity to realize a return based on historical cost rate base; and just because the acquiring utility is willing to pay over historical cost does not mean ratepayers should have their rates adjusted upward. Our policy ensures continuity with respect to net plant or rate base investment for ratesetting purposes when there is a transfer; to do otherwise would put ratepayers at the peril of having cost of service based rates fluctuate due to vagaries of the marketplace or dealings between buyers and sellers. It should be noted that when utility plant is acquired for less than net book value, we do not adjust rate base downward for the acquiring utility entity. We understand why it is in Felton's interest to raise this contention, but it is a bootstrap argument.

Given the applicable sale dates of the timber, the staff recommends amortizing net proceeds over a 12-year period, using 15 years as the time span between harvests. We concur and will reduce Felton's revenue requirements by \$22,213 in each of the next 12 years.

The Relationship of CRC to Citizens-California
Water Systems

Absent attentive staff field investigation, the timber sales on Felton's watershed by CRC would not have come to light. The purported transfer is void as authority under PU Code § 851 was not obtained. We will, accordingly, direct Felton to take steps necessary to ensure that the recorded title for the parcels in question reflect that mineral and timber rights rest with Felton and not CRC.

We have no knowledge of what may have occurred between CRC and other Citizens-California water districts. Accordingly we will direct Citizens-California to make a compliance filing telling us, district by district, of all transfers of property and assets (including timber and mineral rights) between the districts and CRC since Citizens-California took over the districts, as well as any sales of the property and assets by CRC.

Tax Initiative Account (TIA)

Citizens-California's computation of the balance in its TIA as of December 31, 1980 is \$1,763. In accordance with our discussion in A.60132, Sacramento County Water District, we adopt the staff's computation in the amount of \$12,600 and amortize it over three years.

Attrition

As most of the attrition in the Felton expenses between the estimated years 1981 and 1982 is due to items for which an advice letter offset increase may be requested, no attrition allowance has been included for years 1983 and 1984.

Findings of Fact

1. The adopted estimates of operating revenues, operating expenses, rate base, and rate of return for test years 1981 and 1982 are reasonable.

2. A rate of return of 12.04% on the adopted rate base of \$788,800 for test year 1981 is reasonable.

3. A rate of return of 12.04% on the adopted rate base of \$831,330 for test year 1982 is reasonable.

4. Felton's earnings under present rates for test year 1981 would produce net operating revenues of \$21,300 on a rate base of \$788,800 based on the adopted results of operations, resulting in a rate of return of 2.20%.

5. Felton's earnings under present rates for test year 1982 would produce net operating revenues of \$7,100 on a rate base of \$831,330 based on the adopted results of operations, resulting in a rate of return of 0.85%.

6. The authorized increases in rates are expected to provide annual increases in revenues of \$137,700 in 1981 and \$18,300 in 1982.

7. Citizens-California's level of water service is adequate.

8. The increases in rates and charges authorized for the year 1982 in Appendix A are just and reasonable, and the present rates and charges insofar as they differ from those prescribed, are for the future unjust and unreasonable.

9. Increases in rates authorized for 1983 and 1984 in Appendix B are just and reasonable.

10. In order to lessen the immediate impact of large rate increases upon utility customers, we have adopted a policy of limiting increases to 50% of present rates in the first year after our decisions.

11. It is reasonable to authorize a revenue increase of \$84,000 or 50% of present rates in 1982 and to defer the balance of the authorized increase to 1983 and 1984 as shown in Appendix E.

12. Timber harvest revenues from Felton's watershed lands were \$266,549 for the years 1978-79.

13. Watershed lands from which timber was harvested are included in Citizens-California's rate base, and are necessary and useful to Felton's utility functions; Commission authorization to transfer timber and mineral rights to CRC was never obtained.

14. A reasonable estimate of the time remaining before further timber harvesting on the affected lands is feasible is 12 years.

15. Timber revenues should reasonably be imputed to Felton on a 12-year amortization basis.

Conclusions of Law

1. The application should be granted to the extent provided by the following order.
2. The transfer of timber and mineral rights from Felton to CRC is void.
3. Because of the immediate need for additional revenues, the following order should be effective on the date of signature.

O R D E R

IT IS ORDERED that:

1. Citizens Utilities Company of California's (Citizens-California) Felton Water District is authorized to file the revised schedules attached to this order as Appendix A and to concurrently cancel its present schedules for such service. This filing shall comply with General Order (GO) Series 96. The effective date of the revised schedules shall be 4 days after the date of filing. The revised schedules shall apply only to service rendered on and after their effective date.
2. On or after November 15, 1982 Citizens-California is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases attached to this order as Appendix B or to file a lesser increase which includes a uniform cents per 100 cubic feet of water adjustment from Appendix B in the event that the Felton Water District rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ended September 30, 1982, exceeds the lower of (a) the rate of return found reasonable by the Commission for Citizens-California during the corresponding period in the then most recent rate decision, or (b) 12.04%. Such filing shall comply with GO 96-A. The requested step rates shall be reviewed by the staff to determine their conformity with this order and shall go into effect upon the staff's determination of conformity. But the staff shall inform the Commission if it finds that the proposed step rates are not in accord with this decision, and the Commission may then

modify the increase. The effective date of the revised schedule shall be no earlier than January 1, 1983, or 30 days after the filing of the step rates, whichever is later.

3. On or after November 15, 1983 Citizens-California is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases attached to this order as Appendix B or to file a lesser increase which includes a uniform cents per 100 cubic feet of water adjustment from Appendix B in the event that the Felton Water District rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ended September 30, 1983, exceeds the lower of (a) the rate of return found reasonable by the Commission for Citizens-California during the corresponding period in the then most recent rate decision, or (b) 12.04%. Such filing shall comply with GO 96-A. The requested step rates shall be reviewed by the staff to determine their conformity with this order and shall go into effect upon the staff's determination of conformity. But the staff shall inform the Commission if it finds that the proposed step rates are not in accord with this decision, and the Commission may then modify the increase. The effective date of the revised schedule shall be no earlier than January 1, 1984, or 30 days after the filing of the step rate, whichever is later.

4. By June 30, 1982 Citizens-California shall send to its Felton Water District customers the bill insert set out in Appendix D.

5. Within 60 days from the effective date of this order Citizens-California shall file as a compliance filing in this proceeding a report listing the following, listed district by district.

- a. A list of all property and assets transferred between the particular district and Citizens Resource Company (CRC) going back to the date Citizens-California acquired the particular district. This list shall fully describe the assets or property and give the date of the purported transfer.

- b. A list of all property and assets transferred to CRC which was thereafter sold, transferred, harvested, or leased by CRC; the amount of any proceeds realized by CRC shall be listed on both a gross and net basis.

An original and 12 copies of the filing shall be tendered to the Docket Office and a copy served on the appearances in this proceeding.

6. The purported transfer of timber and mineral rights from Citizens-California's Felton Water District to CRC is void; and Citizens-California shall take all necessary steps to ensure that the recorded title on the parcels involved show these rights are its Felton Water District's.

This order is effective today.

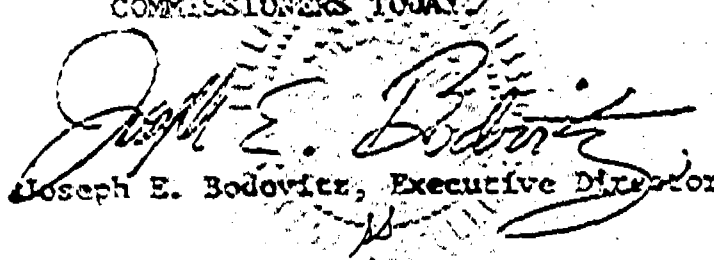
Dated May 4, 1982, at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

I concur but I would limit the notice on the effect of the Economic Tax Recovery Act to a single sentence indicating that an identified portion of the recent rate increase is due to the federal tax legislation of 1981.

/s/ JOHN E. BRYSON
Commissioner

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


Joseph E. Bodovitz, Executive Director

APPENDIX A
Page 1

Schedule No. FE-1

Felton Tariff AreaGENERAL METERED SERVICEAPPLICABILITY

Applicable to all metered water service.

TERRITORY

Felton and vicinity, Santa Cruz County.

RATES

Service Charge:

	Per Meter Per Month	
For 5/8 x 3/4-inch meter	\$ 5.00	(I)
For 3/4-inch meter	7.00	
For 1-inch meter	11.00	
For 1 1/4-inch meter	19.00	
For 2-inch meter	30.00	
For 3-inch meter	56.00	
For 4-inch meter	76.00	

Monthly Quantity Rates:

First 300 cu.ft., per 100 cu.ft.	\$ 0.82	
Over 300 cu.ft., per 100 cu.ft.	1.03	(I)

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. (T)
(T)

Service Reestablishment Charge:

For each reestablishment of water service \$ 4.10

SPECIAL CONDITIONS

1. The service reestablishment charge is in addition to the charges calculated in accordance with this schedule and will be made each time an account is reopened for a customer at the time water service is to be restored after discontinuance at that customer's request.

APPENDIX A
Page 2

Schedule No. FE-6M

Felton Tariff Area

ANNUAL METERED RESALE SERVICE

APPLICABILITY

Applicable to all metered water service furnished on an annual basis.

TERRITORY

Felton and vicinity, Santa Cruz County.

RATES

Annual Service Charge:	Per Meter Per Year	
For 5/8 x 3/4-inch meter	\$ 60.00	(I)
For 3/4-inch meter	84.00	
For 1-inch meter	132.00	
For 1 1/4-inch meter	228.00	
For 2-inch meter	360.00	
For 3-inch meter	672.00	
For 4-inch meter	912.00	

Monthly Quantity Rates:

First 300 cu.ft., per 100 cu.ft.	\$ 0.82	
Over 300 cu.ft., per 100 cu.ft.	1.03	(I)

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. (T)

Service Reestablishment Charge:

For each reestablishment of water service \$ 4.10

SPECIAL CONDITIONS

1. The opening bill for general metered service shall be the established annual service charge. Where initial service is established after the first day (continued on Cal. P.U.C. Sheet No. 963-W.)

(END OF APPENDIX A)

APPENDIX B

Each of the following increases in rates may be put into effect on the indicated date by filing a rate schedule which adds the appropriate increase to the rate which would otherwise be in effect on that date.

Service Charge:	Effective Dates	
	<u>1-1-83</u>	<u>1-1-84</u>
For 5/8 x 3/4-inch meter	\$ 2.00	-
For 3/4-inch meter	3.00	-
For 1-inch meter	3.00	-
For 1 1/4-inch meter	5.00	-
For 2-inch meter	8.00	-
For 3-inch meter	16.00	-
For 4-inch meter	22.00	-

Quantity Rates:

For the first 300 cu.ft., per 100 cu.ft.	0.34	-
For all over 300 cu.ft., per 100 cu.ft.	0.42	0.02

(END OF APPENDIX B)

APPENDIX C
Page 1ADOPTED QUANTITIES

Company: Citizens Utilities Company of California

District: Felton

	<u>1981</u>	<u>1982</u>		
	Ccf(1,000)	Ccf(1,000)		
1. <u>Water Production:</u>				
Fall Creek Intake	57,535	57,535		
Well	3,560.	3,560.		
Springs	-	-		
2. <u>Electric Power:</u>	kWh per Ccf	Supplier: PG&E	Date: 6/21/81	
kWh	125,500	127,400		
Cost	\$ 9,200	\$ 9,300		
Cost per kWh	\$0.07320 /kWh	\$0.07320 /kWh		
3. <u>Ad Valorem Taxes:</u>	\$ 8,800	\$ 11,100		
Tax Rate	1.045%	1.045%		
4. <u>Net-to-Gross Multiplier:</u>	2.0522			
5. <u>Uncollectible Rate:</u>	0.1806%			
6. <u>Number of Services:</u>				
	<u>No. of Services</u>		<u>Usage-KCcf</u>	<u>Avg. Usage-Ccf/Yr.</u>
	<u>1981</u>	<u>1982</u>	<u>1981</u>	<u>1982</u>
Commercial-Metered	1,308	1,328	165,940	168,480
Private Fire Prt.	7	7		
Public Fire Prt.	-	-		
Total	1,315	1,335		
7. <u>Number of Services (by meter size):</u>				
<u>Meter Size</u>	<u>1981</u>	<u>1982</u>		
5/8 x 3/4"	1,262 Services	1,279 Services		
3/4"	2	2		
1"	18	18		
1 1/2"	9	12		
2"	15	15		
3"	1	1		
4"	1	1		
Total	1,308	1,328		

* No water loss calculation because the springs water source is not metered.

APPENDIX C
Page 2INCOME TAX CALCULATION

Felton District

Item	1981	1982
------	------	------

State Franchise Tax

Operating Revenue	\$327,400	\$347,600
<u>Expenses</u>		
O&M, A&G, and Taxes Other Than Income	145,400	160,600
<u>Deductions and Adjustments</u>		
Clearing Accounts	(3,300)	(3,600)
Deductible Expense Capitalized	1,200	1,400
Interest	23,600	25,000
Subtotal - Deductions	21,500	22,800
State Tax Depreciation	44,900	55,500
Net Taxable Revenue	115,600	108,700
CCFT at 9.6%	11,100	10,400

Federal Income Tax

Operating Revenue	327,400	347,600
Expenses	145,400	160,600
Deductions	21,500	22,800
FIT Depreciation	30,100	36,000
CCFT	11,100	10,400
Taxable Income	119,300	117,800
Federal Income Tax at 46%	54,900	54,200
Graduated Tax Adjustment	(500)	(500)
Investment Tax Credit	(1,800)	(2,100)
FIT	52,600	51,600

(Red Figure)

(End of Appendix C)

APPENDIX D

Bill Insert for Felton Water District Customers

N O T I C E

\$6,000 of the recent rate increase granted to Citizens Utilities Company of California for its Felton District was made necessary by changes in tax laws proposed by the President and passed by Congress last year. This was the Economic Recovery Tax Act of 1981. Among its provisions was a requirement that utility ratepayers be charged for certain corporate taxes even though the utility does not have to pay them. This results from the way utilities may treat tax savings from depreciation on their plant and equipment. The savings can no longer be credited to the ratepayer, but must be left with the company and its shareholders.

For a more detailed explanation of this tax change, send a stamped self-addressed envelope to:

Consumer Affairs Branch
Public Utilities Commission
350 McAllister Street
San Francisco, CA 94102

(END OF APPENDIX D)

APPENDIX E

<u>1982</u>	<u>Adopted</u>	<u>Distribution</u>
	(Dollars in Thousands)	
Present	\$192.3	\$192.3
Adopted	347.6	276.3
Increase	155.3	(80.8%) 84.0

<u>1983</u>		
Present	347.6	276.3
Adopted	347.6 (27.0 ^{a/} + 2.4 ^{b/})	377.0
Increase	-	100.7

<u>1984</u>		
Present	347.6	377.0
Adopted	347.6 (26.5 ^{a/} + 5.6 ^{b/})	379.7
Increase	-	2.7

a/ Deferred amount \$155.3 - \$84.0 = \$71.3

For 9 months \$ 71.3 x $\frac{9}{12}$ = 53.5

Distribution \$ 27.0 in 1983
\$ 26.5 in 1984

b/ Interest

1982 \$ 27.0 x (12.04%) x $\frac{9}{12}$ = \$2.4

1983 \$ 26.5 x (12.04%) + \$26.5 x $\frac{9}{12}$ x (12.04%) = \$5.6

(END OF APPENDIX E)

Revenues

No dispute exists between Felton and staff on estimated water sales in the test years. There is, however, disagreement as to the treatment of revenues derived from timber harvesting on Felton watershed lands.

Staff's testimony is that in late April 1981, subsequent to the filing of A.60285, it was learned from a ~~company~~ ^{state newspaper} source that recent timber harvest operations had been conducted in the vicinity of or upon Felton's lands. This information prompted staff investigation of land sales, assessors records, corporate files of Felton and of Citizens Resources Company (CRC), another wholly owned subsidiary of Citizens, and included discovery by audit and by deposition. Ra

This investigation revealed that there was a timber harvest on Felton's public utility watershed lands in 1976 and 1978-79 which yielded gross receipts of \$278,000 and net receipts, exclusive of any applicable taxes, of \$266,549.

The fee ownership in the lands from which the timber was taken was acquired by Felton on January 16, 1962 when it merged with Felton Water Company. In September 1981, Felton had purchased the outstanding capital stock of the Felton Water Company and two parcels of land, not on the books of the seller, in one transaction for the unsegregated amount of \$225,920.

In the first rate proceeding following Felton's acquisition of the Felton Water Company properties, Citizens-California sought to include the two unbooked parcels of land in rate base at \$135,000, the difference between the gross sales price of \$225,920 and the net book value of the purchased utility's stock of \$90,920. Both Citizens-California and staff concurred that the purchased land was needed in the utility operations.

Although the two parcels were not carried on Felton Water Company's books, and Felton contended that they were not dedicated to public use until after the acquisition, the Commission found

An important issue of public utility regulation is at stake. Because of the protective umbrella of public utility regulation, regulated companies are able to pass many of their risks on to ratepayers. From the time an asset is dedicated to utility service and enters rate base, rates are computed to allow a reasonable return on the investment in that asset irrespective of fluctuations in its actual market value. If the asset becomes technically obsolete, suffers deterioration, or otherwise declines in value, the amount of investment nonetheless remains in rate base, earning a return and subject to gradual depreciation at ratepayer expense. This is the "quid" which ratepayers must pay for the "quo" of assets having been dedicated to utility service.

However, by the same token, ratepayers have a legal right to share in the appreciation in market value of assets which have been, but will no longer be, used in a public utility's regulated enterprise. Democratic Central Comm. v. Washington Metropolitan Area Transit Comm'n, 485 F.2d 786 (D.C. Cir. 1973), cert. den., 415 U.S. 935. Where ratepayers bear the financial burden associated with such assets and investors have been shielded from the risk of loss of their investment, the appreciation in market value over net book value must be credited to ratepayers in the ratemaking process. Id. at 806-11. See also New York Water Service Co. v. Public Service Comm'n, 208 N.Y.S. 2d 857 (N.Y. 1960); Detroit Edison Co., 14 P.U.R. 4th 223 (Mich. Pub. Serv. Comm'n 1978); Southern California Gas Co., 84 Cal. P.U.C. 405, 32 P.U.R. 4th 423 (Cal. Pub. Util. Comm'n 1978). If ratepayers have assumed "the expenses of ordinary maintenance and depreciation, and the risks of loss from casualty and obsolescence," combined with favorable accounting for investors of rate base, depreciation and tax items, then ratepayers are entitled to

- 176 -

all gains attributable to the removal from rate base of both depreciable and nondepreciable assets. Democratic Central Comm., supra, at 821.^{1/}

^{1/} Because we find the transfer of assets to CRC was void for lack of prior Commission approval, we need not measure the extent to which ratepayers have shielded investors from risk or the extent to which ratepayers should share in capital gain associated with these assets. We amortize timber sale revenues on the basis of the precedent established in D.92192, as the most practical means of treating this issue.

APPENDIX D

Bill Insert for Citizens Utilities Company of California's Felton Water District.

One item of expense in the rate increase recently granted to Citizens Utilities Company of California for its Felton Water District for the year 1982 by the Public Utilities Commission amounting to \$6,600 is attributable to President Reagan's Economic Recovery Tax Act of 1981, which requires the Public Utilities Commission to charge ratepayers for the expense of taxes which are not now being paid to the Federal Government and which may never be paid. This expense may increase in the future as a percent of your bill.

(END OF APPENDIX D)

- b. A list of all property and assets transferred to CRC which was thereafter sold, transferred, harvested, or leased by CRC; the amount of any proceeds realized by CRC shall be listed on both a gross and net basis.

An original and 12 copies of the filing shall be tendered to the Docket Office and a copy served on the appearances in this proceeding.

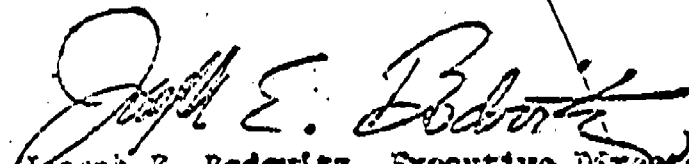
6. The purported transfer of timber and mineral rights from Citizens-California's Felton Water District to CRC is void; and Citizens-California shall take all necessary steps to ensure that the recorded title on the parcels involved show these rights are its Felton Water District's.

This order is effective today.

Dated MAY 4 1982, at San Francisco,
California.

JOHN E. BRYSON
President
RICHARD D. CRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. CREW
Commissioners

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


Joseph E. Rodovitz, Executive Director