

**ORIGINAL**Decision 82 07 019 JUL 7 - 1982

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of KERNVILLE DOMESTIC )  
 WATER COMPANY to increase water )  
 rates by approximately 33.2% with )  
 a 1982 test year. )

Application 61021  
 (Filed November 2, 1981;  
 amended February 17, 1982)

Gibson, Dunn & Crutcher, by Raymond L. Curran, Attorney at Law, for applicant.  
James M. Windsor and Gunter Redlin, for the State Department of Health Services, Sanitary Engineering Branch, interested party.  
Jasjit S. Sekhon, for the Commission staff.

INTERIM OPINIONBackground

In late September 1981 Kernville Domestic Water Company (Kernville or applicant) filed a draft advice letter with the Commission requesting a rate increase to offset the effect of inflation on its cost of service. At about the same time it sent a notice of proposed increase to each customer stating that Kernville had requested authority to increase gross revenue by 33.2% in 1982. No dollar amount was mentioned in the notice. The Commission, upon receiving more than 200 letters of protest, converted the draft advice letter rate increase request into a regular application for a rate increase on November 2, 1981. It was docketed as Application (A.) 61021.

On February 17, 1982 Kernville filed a first amendment to A.61021. A notice of this amendment was sent to all customers on February 18, 1982 informing them that the request was for \$36,846, or 43.08% (see Reference Item F).

Kernville is a Class C water company which is a subsidiary of Antelope Valley Water Company which, in turn, is a subsidiary of Dominguez Water Company (Dominguez). Kernville's last general rate increase was authorized by the Commission in March 1976. We found an 8.5% rate of return on rate base to be reasonable at that time. Since then, there was one offset rate increase in late 1980.

Summary

This decision authorizes Kernville a 23.4% increase in revenues, which gives it the opportunity to realize an 8.5% return on rate base. If service is improved to adequate levels, we will authorize Kernville an 11% return. It requested a revenue increase of 43.0% and an 11.49% return. If rates are not increased Kernville will barely break even or operate at a loss; and if Kernville is operating at a loss, customers' service may very likely not improve. We are offering Kernville an incentive to improve its service, which is, in our opinion, the most constructive approach in the interest of Kernville's ratepayers. ✓

Public Witness Testimony

A hearing was held in Kernville before Administrative Law Judge Colgan on April 27, 1982. Statements and testimony were heard. The hearing continued in Los Angeles on April 28, 29, and 30, when it was submitted, pending receipt of three late-filed exhibits.

The public witness testimony covered several hours. More than 20 local ratepayers spoke. In addition, we have received over 200 letters of complaint. The comments and letters addressed the following service problems:

1. Poor water quality - samples of murky tap water were offered in illustration. This, it was claimed, ruins laundry and plumbing fixtures;
2. Insufficient water supplies for fire-fighting - this from a former fire chief. One ratepayer testified that because of inadequate water supplies for fire fighting, his insurance company would not insure his Kernville property;
3. Outages on holiday weekends and unannounced shutdowns for repairs on various occasions;
4. Especially numerous outages in the "Pasco Tract" located on a hill above the main community;
5. Maintenance which has been irregular and deferred for years thereby exacerbating present breakdown problems;
6. Surging and aeration causing plumbing fixtures to be blown off walls;
7. Putrid smell after shutdowns - sometimes accompanied by filth entering fixtures in homes;
8. Depressed real estate market due to applicant's failure to meet water quality and quantity requirements of the California Department of Health Services (DHS) which, consequently, placed a moratorium on future water service connections;
9. Overchlorination;
10. Inoperative fire hydrants last summer; and
11. A general consensus that a company providing such inadequate service should not be rewarded with a rate increase unless it is accompanied by assurances of improvement.

In addition there were numerous statements, mostly from retired persons on fixed incomes, about the difficulty of absorbing any further increases in the cost of basic necessities, including water, in these difficult economic times.

Testimony of the Parties

Presentation of DHS

When the public comment had all been received, the formal hearing commenced. It began with the out-of-order presentation by two representatives from the DHS, an interested party. The presentation is fairly well summarized in Exhibit 1.

DHS witnesses testified that Kernville is failing to meet water quantity and quality standards mandated by law. Specifically iron, manganese, and, to a lesser extent, fluoride are present in quantities far in excess of acceptable levels; chlorination of all water sources and fluoride blending at some wells is necessary; and approximately 200 gallons per minute of additional source capacity with 125,000 gallons of additional storage capacity are needed. A program to replace inadequate distribution mains with ones meeting Kern County's fire-flow requirements is also needed.

As an alternative to removal of iron and manganese, DHS suggested substitution of Kern River water through purchase of downstream rights or negotiating exchange agreements with downstream users.

Noting that applicant is third on the Department of Water Resources' (DWR) loan priority list, DHS witnesses suggested that Kernville should be required to apply immediately for a Safe Drinking Water Bond Act loan from the DWR or demonstrate alternative financing sufficient to fund these improvements which, according to DHS, should cost \$250,000 to \$300,000.

Finally, the DHS recommended that the Commission support the present service connection moratorium (imposed by DHS) until the water quantity improvements are made.

Applicant's Showing

Applicant presented its showing through three witnesses, its vice president for finance, its construction manager, and the operations manager for the parent company, Dominguez. The vice president for finance addressed all the finance-related issues. The construction manager described engineering problems associated with well drilling and treatment plants and problems associated with high mineralization. The operations manager, who is responsible for the maintenance of pumping storage and transmission facilities, explained recent malfunctions, how they were remedied, and future plans for notification of customers prior to line flushing. He also stated he would look into the question of obtaining Kern River water. The construction manager disputed DHS's cost estimate for the work it claims needs to be done. He believed it much too low, but offered only an unexplained rough estimate of \$971,000. Otherwise, these witnesses offered little to contradict the concerns expressed by customers or DHS.

Staff's Showing

Staff's showing was made by the project manager. He indicated substantial agreement with the data and conclusions of Kernville. He testified that an 11% return on rate base would be reasonable and that the proposed rate design is appropriate in that it reflects the Hydraulic Branch's model rate structure program. That is, it embodies a service charge (rather than a minimum charge), a lifeline rate for up to 300 cubic feet per month, and a second block inverted rate which is not more than 50% higher than the lifeline block.

Staff also concluded that the service improvements recommended by DHS were necessary.

Revenue Requirement

The summary of earnings attached to the amended application indicates that applicant expected this requested increase would lead to a rate of return on rate base of 9.75%, whereas the summary attached to the initial draft advice letter indicated an expected 11.49% return on rate base.

At the hearing applicant's vice president for finance, Harry Brand, Jr., explained that applicant had decided to accept the lower return on rate base rather than to make necessary amendments because it was believed that it would be disadvantageous to delay the hearing and chance the decision not being in effect in time for the summer months - the months in which Kernville's water usage and revenue are the greatest.

Brand pointed out, however, that applicant's strategy did not proceed as planned since the hearing was postponed anyway. Brand stated that Kernville still contends that an increase sufficient to produce a rate of return of 11.49% is just and reasonable and should be granted by the Commission.

Unfortunately, the record in this matter was confused considerably because, as staff pointed out, the operating revenue figure for estimated year 1982 which Kernville relied upon in its application (and in Exhibit 2) was inaccurate. This error was compounded by both applicant's and staff's use of a projected increase in number of customers which was rendered inaccurate when the DHS instituted a water service connection moratorium in the community because of water problems.

Kernville acquiesced to the accuracy of staff's 1982 operating revenue figure of \$99,822 (rather than Kernville's \$85,520) based on 481 customers. However, it is clear that the actual number of customers in 1982 cannot exceed 456 because of the service connection moratorium imposed by DHS. Therefore, the proper 1982 operating revenue figure (which we will adopt though it was used by neither applicant nor staff) is based on 456 customers. Table 1, which follows, sets forth the adopted operating results for test year 1982 based on staff's estimates modified as described. These figures reflect conventional normalization for applying the Economic Recovery Tax Act of 1981 (ERTA) as adopted in our Decision (D.) 93848.<sup>1/</sup>

Exhibit 9 was prepared during the course of the hearing to correct the revenue figure discrepancy, but only Column C of that exhibit uses the figure of 456 customers.

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<sup>1/</sup> ERTA is a federally mandated provision which causes an increase in income tax expense for ratemaking purposes due to elimination of the full flow-through to ratepayers of the benefits from accelerated depreciation and investment tax credit on utility plant additions placed in service after December 31, 1980.

Table 1

KERNVILLE DOMESTIC WATER COMPANY  
(A Subsidiary of Dominguez Water Company)

Summary of Earnings  
Estimated Results of Operations  
Test Year 1982

Item	Present Rates			Authorized:
	:Applicant <sup>a/</sup>	: Staff	: Adopted	: Rates
Operating Revenues	\$ 85,520	\$ 99,822	\$ 94,724	\$116,900
Deductions:				
Purchased Power	20,303	20,303	19,248	19,248
Payroll	15,500	15,500	15,500	15,500
Other O&M Expenses	25,400	25,400	25,400	25,400
Admin. & Gen.	20,333	20,333	20,333	20,333
Subtotal	81,536	81,536	80,481	80,481
Depreciation Expense	8,424	8,328	8,328	8,328
Taxes Other Than on Inc.	4,067	4,067	4,067	4,067
Balancing Account Adj.	1,738	1,738	1,738	1,738
Income Taxes	100	200	200	6,658
Total Deductions	104,665 <sup>b/</sup>	95,869	94,814	101,272
Net Operating Revenue	(19,145)	3,953	(90)	15,628
Depreciated Rate Base	183,990	183,860	183,860	183,860
Rate of Return	Loss	2.15%	Loss	8.5%

(Red Figure)

a/ Applicant's original proposal.

b/ Applicant inadvertently included \$8,800 interest expense in this total.



Extrapolation from the figures in Exhibits 8 and 9 shows that an increase of \$36,846, as requested, would amount to only a 38.9% increase, not a 43.08% increase as customers were told. However, such an increase would lead to a rate of return of about 15%. In this proceeding Kernville asked for a rate of return of 9.75% while contending that 11.49% would be reasonable. Staff testified that 11%, or 11.1%, would be reasonable.

Using the proper base of 456 customers, the parties agreed that a rate of return of 9.75% could be achieved with an increase in gross operating revenues to \$117,991, which is an increase of \$23,267, or 24.6%.

Using the same data, a rate of return of 11% could be achieved with revenues of \$122,644, which is an increase of \$29,775, or 31.4%.

Likewise, a rate of return of 11.49% could be achieved with revenues of \$124,579, which is an increase of \$29,855, or 31.5%.

Each of these figures is less than the \$36,846, or 43.08%, requested.

In 1976 we found a rate of return on rate base of 8.5% to be reasonable for this utility. Economic conditions today do not justify a lower return; however, Kernville's quality of service at this point certainly does not warrant increasing it. The evidence establishes that, at currently authorized rates, applicant could expect no better than 2.15% return on rate base (see Exhibit 8). The evidence supports staff's conclusion that an 11% return would be reasonable if service was adequate. However, the serious nature of the service problems, as illustrated by the testimony of DHS and staff, along with the concerns expressed by customers, convinces

us that such an increase is only warranted if these long-neglected issues are resolved by Kernville. Therefore, we will restrict our immediate authorization to an increase which would result in an 8.5% rate of return on adopted rate base.

Service Improvements

In order to attain the basic water quality and quantity criteria the law requires and its customers deserve, we will also direct Kernville to:

1. Prepare a plan for regular main replacement,
2. Go forward with the drilling of the three planned test wells or develop other sources,
3. Erect and connect the unassembled storage tank it owns,
4. Install an iron and manganese removal treatment facility or exchange the water for Kern River water,
5. Begin blending water from Well 2 to lower the fluoride level,
6. Establish a reliable and predictable means of disinfecting all water,
7. Pursue the feasibility of obtaining Kern River water rights, and
8. Develop a procedure for notifying customers prior to flushing lines.

When we are satisfied that these goals are being diligently and reasonably pursued, we will authorize rates to produce an additional 2.5% rate of return on rate base for a total of an 11% rate of return. The promise of a higher rate of return will give applicant an incentive to improve service.

Some of these improvements qualify for Department of Water Resources (DWR) funding, which is less costly than the loan offered to Kernville by its parent company, Dominguez, for well drilling. We urge Kernville to use DWR loan money if that option can be exercised without delaying the work.

Findings of Fact

1. Neither water quality nor service of Kernville is satisfactory.

2. The estimates of operating revenues, operating expenses, and rate base in the preceding Table 1 reasonably indicate the probable results of Kernville's 1982 operations.

3. The information shown in Table 1 regarding the impact of ERTA on net revenues and rate base properly reflects the consequences of ERTA and our decision in Order Instituting Investigation 24 (D.93848).

4. A compilation of adopted quantities and the adopted tax calculations are contained in Appendix B to this decision.

5. An increase of 23.4%, or \$22,176, would afford Kernville an opportunity to earn a return on rate base of 8.5%. An additional increase of 9.7%, or \$11,320, for a total increase of 35.4%, or \$33,496, will afford Kernville an opportunity to earn a total return on rate base of 11%.

Conclusions of Law

1. The rates shown in Appendix A are just, reasonable, nondiscriminatory, and should be adopted.

2. A basic revenue increase of \$22,176, or 23.4%, is just and reasonable for 1982. A total increase of \$33,496, or 35.4%, is just and reasonable if Kernville takes the steps required below to improve service deficiencies.

3. The application should be granted on an interim basis as provided by the following order.

4. Because of the immediate need for additional revenue, the interim order should be effective today.

INTERIM ORDER

IT IS ORDERED that:

1. Kernville Domestic Water Company (Kernville) is authorized to file, effective today, the revised rate schedules in Appendix A. The filing shall comply with General Order 96-A. The revised schedules shall apply only to service rendered on and after their effective date.

2. In order to bring its level of service and water quality into conformity with the needs of its customers and statutory requirements, Kernville shall take the following actions:

- a. Establish and file with staff, within 180 days, a written plan for regular main replacement adequate to bring the system up to the fire-flow requirements set forth in Section VIII of General Order 103.
- b. Proceed immediately with plans to drill three test wells. This work shall be completed within one year. If sources capable of producing at least 200 gallons per minute additional water are developed prior to all three wells being drilled, the obligation to continue shall cease. In the event no water is obtained from these or other sources within one year, Kernville shall immediately attempt to procure Kern River water and, within 15 months, present staff with a written description of the action taken.
- c. Within one year, erect and connect the 300,000-gallon storage tank which is presently on site but unassembled.

- d. Within one year, install a centralized iron and manganese removal treatment facility connected to all wells. The facility must be capable of lowering the concentration of these minerals to statutorily permissible levels. In the alternative, Kernville may demonstrate the existence of contractual authority to exchange Kern River water for water from these sources.
- e. Within one year, initiate a means of blending water from Well 2 with water from another source or sources in such manner as to assure that the statutorily permissible levels of fluoride are not exceeded.
- f. Within one year, demonstrate that a means of disinfecting sufficient to assure conformity with statutory requirements for bacterial contamination has been achieved as to each water source.
- g. Within six months, file a report with staff outlining the results of an investigation into the feasibility of obtaining rights to Kern River water.
- h. Submit a written plan to staff within three months outlining a procedure which will henceforth be followed to assure that affected customers are notified in advance of any line flushing or service discontinuance unless it is of an emergency nature and cannot be reasonably anticipated.

3. Kernville will be authorized a rate increase to produce an additional 2.5% rate of return if and when it can demonstrate (1) within nine months that all the improvements ordered above have been accomplished; or (2) that Items a, g, and h have been accomplished, that Item b has been commenced, and that applicant has a commitment or the reasonable expectation of a commitment for funds at a cost no more financially burdensome to the ratepayers than those of the DWR Safe Drinking Water Bond

Act loan, for the expeditious completion of these items. This does not preclude applicant from receiving a loan of up to \$45,000 as already planned from the parent company, Dominguez Water Company, for the implementation of Item 2, the well drilling. However, we discourage applicant from taking the full amount and strongly urge that the drilling be funded primarily with DWR loan money if that option can be exercised without delaying the work.

4. When Kernville has met the conditions set out in Ordering Paragraph 3, it may make a compliance filing, as a pleading in this proceeding filed with the Docket Office and served on all appearances, detailing its compliance. We will keep this proceeding open to review Kernville's compliance with this order and to evaluate whether rates should be authorized to produce an 11% return on rate base.

5. Within 45 days, applicant shall mail to all its customers a bill insert notice as shown in Appendix C.

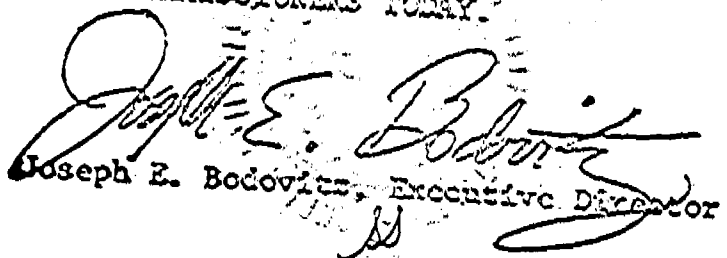
This order is effective today.

Dated     JUL 7 1982    , at San Francisco,  
California.

RICHARD D. GRAVELLE  
LEONARD M. CRIMES, JR.  
VICTOR CALVO  
PRISCILLA C. GREW  
Commissioners

Commissioner John E. Bryson,  
being necessarily absent, did  
not participate.

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

  
Joseph E. Bodovitz, Executive Director

APPENDIX A

Schedule 1

METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Kernville and vicinity, Kern County.

RATES

Quantity Rates:<sup>a/</sup>

	<u>Per Meter</u> <u>Per Month</u>	
First 300 cu.ft., per 100 cu.ft. ....	\$ 0.800	(C)
Over 300 cu.ft., per 100 cu.ft. ....	1.074	(C)

Service Charge:

For 5/8 x 3/4-inch meter .....	\$ 6.50	(C)
For 3/4-inch meter .....	7.15	
For 1-inch meter .....	9.75	
For 1-1/2-inch meter .....	13.00	
For 2-inch meter .....	17.55	
For 3-inch meter .....	32.50	
For 4-inch meter .....	44.20	

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. (C)

<sup>a/</sup> These rates include amortization factor of \$0.022 per Ccf for purchased power to amortize undercollections of \$3,475 over 24 months.

APPENDIX B  
Page 1

KERNVILLE DOMESTIC WATER COMPANY  
Adopted Quantities for the Test Year 1982  
(Page 1)

1. <u>Water Production:</u>		
Wells		93,845 Ccf
2. <u>Electric Power:</u>		
(Supplier: Edison 1/1/82)		
Kilowatt-hour (kWh)		221,302 kWh
Cost		\$19,248
Cost per kWh		\$0.0870/kWh
3. <u>Ad Valorem Taxes:</u>		
Amount		\$ 2,500
Effective Tax Rate		1.297%
4. <u>Net-to-Gross Multiplier:</u>		2.0588
5. <u>Uncollectible Rate:</u>		.86%
6. <u>Metered Water Sales Used to Design Rates:</u>		
	<u>Range - Ccf</u>	
Block 1	0-3	14,100 Ccf
Block 2	Over 3	<u>64,104 Ccf</u>
Total Usage		78,204 Ccf



APPENDIX B  
Page 2

KERNVILLE DOMESTIC WATER COMPANY  
Adopted Quantities for the Test Year 1982  
(Page 2)

7.	<u>Number of Services:</u>	No. of <u>Services</u>	Usage <u>Ccf</u>	Avg. Usage <u>Ccf/Yr.</u>
	Commercial	456	78,204	171.5
	Unaccounted Water (20%)		<u>15,641</u>	
	Total Water Produced		93,845	
8.	<u>Number of Services (by Meter Size):</u>			
	<u>Meter Size</u>			
	5/8 x 3/4-inch	439		
	3/4-inch	-		
	1-inch	12		
	1-1/2-inch	2		
	2-inch	2		
	3-inch	1		
	4-inch	-		
		<u>456</u>		
9.	<u>Rates Excluding Balancing Account Amortization:</u>			
	<u>Range - Ccf</u>			
	0-3, per 100 cu.ft.	\$0.778		
	Over 3, per 100 cu.ft.	1.052		
10.	<u>Balancing Account Amortization:</u>			
	Purchased Power	\$0.022/Ccf		

APPENDIX B  
Page 3KERNVILLE DOMESTIC WATER COMPANY  
Income Tax Calculation on Consolidated Basis  
at Authorized Rates for the Test Year 1982  
(Page 3)

<u>Item</u>	
Operating Revenues	\$116,900
Deductions:	
Oper. & Maint. Expenses	61,886
Admin. & Gen. Expenses	20,333
Taxes Other Than on Income	4,067
Interest	<u>8,800</u>
Subtotal	95,086
State Taxable Income Before Depreciation	21,814
State Tax Depreciation	8,328
State Taxable Income	13,486
State Tax @ 9.6%	1,295
Federal Tax Depreciation	8,328
Federal Taxable Income	12,190
Tax on Consolidated Basis @ 46%	5,607
Credit for Less Than \$100,000	<u>(244)</u>
Consolidated FIT	5,363
Total Taxes on Income	6,658

(Red Figure)

(END OF APPENDIX B)

APPENDIX C

N O T I C E

\$1,055 of the recent rate increase granted to Kernville Domestic Water Company 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 C)

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