

ORIGINAL

Decision No. 86552

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of Santa Clarita Water Company for Authority to increase its rates and charges for water service in Bouquet Canyon and vicinity near Saugus in the northeastern portion of Los Angeles County.

Application No. 56053
(Filed November 6, 1975;
amended March 23, 1976)

- William G. Fleckles, Attorney at Law, for applicant.
- Morris Wright, for Friendly Village Community Association #3, Inc.;
- Ira F. Knight, for Friendly Village Community Association #4; Edward G. Lorenz, for Friendly Village Community Association #5; Robert Silverstein, for Friendly Valley Recreation, Inc.;
- Henry Vollack, Attorney at Law, for Friendly Valley; Marjorie L. Delaney, Geri Fethke, and Marilyn Ludford, for themselves; protestants.
- Connie Schmidt, Rita A. Fox, and R. E. Delaney, for themselves; and Gunter A. Redlin, for California Department of Health; interested parties.
- James D. Squeri, Attorney at Law, Ernst G. Knolle, and I. B. Nagao, for the Commission staff.

O P I N I O N

The original application filed by Santa Clarita Water Company (SC) sought authority to increase its water quantity charge from .193 cents to .270 cents per hundred cubic feet of water with no increase in its flat rate charges since flat rate service

was gradually being eliminated. The purpose was to provide rates which would allow SC to earn the 9.6 percent rate of return authorized in D.84566 dated June 17, 1975. SC represents that based on its current level of rates and expenses it anticipates earning only 5.54 percent on rate base during 1976. The amended application seeks an additional increase in the water quantity charge to .359 cents per ccf because of increases in labor costs, real estate taxes, power and insurance costs, and other costs not anticipated in the original application. The amendment raised the requested revenue increase from \$250,600 to about \$549,200, based upon SC's presently authorized rates, or a 49 percent revenue increase.^{1/} D.84566 authorized step rates, the earliest of which became effective on July 1, 1976. The applicant is not requesting such rates here, and we shall eliminate the second step increase due July 1, 1977.

D.84883 dated September 10, 1975 allowed SC to issue promissory notes in the aggregate sum of \$460,000 for the following purposes: (1) The purchase of a 6,000 square foot steel warehouse with two and one-half acres of storage yard for the sum of \$110,000 with a down payment of \$25,000, the balance to be paid in monthly installments of \$850, including interest at 10 percent per annum, to be secured by a deed of trust. This purchase was accomplished at the end of 1975 and is reflected in all subsequent discussions. (2) In order to acquire new office facilities SC condemned two and one-half acres of land owned by an affiliate a short distance away from its present offices for an office building

^{1/} Revenues at presently authorized rates are estimated at \$1,122,500. The requested revenues are \$1,671,700.

site. The cost is \$110,000 with no down payment, the entire sum to be paid with the issuance of a promissory note payable in monthly installments of \$1,363 including interest at the rate of 10 percent per year. (3) The estimated cost of the office building of 6,000 square feet to be built on the above site is \$225,000, which SC proposed to obtain by borrowing from the Bank of America via a promissory note secured by a deed of trust, repayable in monthly installments of \$2,500 including interest at the rate of 10½ percent per year. At the conclusion of hearings a final price had not yet been agreed upon by the contractor though bids have been taken by the architect. Present cost estimate for this construction is \$294,000. The cost of the office building and site have been reflected in projected rate base by the applicant and the staff.

Before the hearings commenced applicant had filed a petition for interim relief in conjunction with the financing of four new one million gallon steel storage tanks at a rental cost of \$77,400 per year for 15 years, or \$6,450 per month. This petition was consolidated for hearing with this application. Public hearings were held before Examiner Phillip E. Blecher in Saugus on May 5, 6, and 7 and in Los Angeles on May 13 and 14 and was submitted on the latter date after final oral arguments.

Background

SC is a public utility water company which has 9,000 shares of outstanding common stock, owned about 55 percent by the Bonelli Cattle Company and 45 percent among 19 Bonelli family members. Benjamin Bonelli is president of SC and Robert Bonelli is vice-president and secretary. Each is now drawing \$1,600 per month salary. Benjamin Bonelli lives in northern California. He allegedly spends two or three days a week in SC's service area and

at least another day or two a week on other business of the applicant conducted elsewhere. Robert Bonelli lives in Phoenix, Arizona and claims substantially the same time spent on the job as the vice-president. Applicant's service area lies generally northeast of Saugus in Los Angeles County and is spread out over 70 square miles. It has approximately 10,000 customers. It is presently delinquent in the payment of 1972 and 1973 Los Angeles County real property taxes and is also delinquent in main extension contract refunds.

Protestants

Friendly Village is an adult retirement-oriented development in SC's service area. Its recreational association and several of its community associations have protested the requested rate increase on the grounds that it is unreasonable, unjustifiable, and that the utility has not complied with Decision No. 84566. These protestants have generally adopted the recommendations of the Finance and Accounts Division (F&A) of the staff. They also object to SC's "double billing" because the units are on a flat rate and the common areas of their community are metered. Thus, they in effect pay two monthly service charges. In Decision No. 84566 special consideration was given to these customers because of this inequity. The flat rate services are gradually being metered at SC's expense. Because the problem was primarily created by the developer of the project in the layout of the water system and because applicant is not seeking a flat rate increase it is not inequitable to increase the water quantity charge. No other appropriate relief can be granted to Friendly Village under the existing circumstances as it would result in a discriminatory rate structure to SC's other customers, essentially subsidizing the residents of Friendly Village.

The Senior Sanitary Engineer (SSE) of the California Department of Health testified that a domestic water permit has never been granted to applicant and that a field survey made in March 1976 principally found that applicant has not corrected any of the well construction defects previously documented in the department's letter of April 29, 1975 despite an agreement (dated June 15, 1975) to so do. This witness sponsored Exhibit 11 which indicated there are 11 major deficiencies to be investigated and/or corrected. (The remaining deficiencies consist of routine maintenance matters and other matters involving long-term commitments.) He estimated that each of these 11 major deficiencies could be corrected for about \$3,000. SC's permit application has been pending since April 1974. SC's general manager indicated in a letter admitted as Exhibit 23 that it would take approximately 30 months to correct these items and that the major items would cost approximately \$45,000 to \$50,000. Though the SSE indicated that these deficiencies might cause potential health problems there have been no complaints about the quality of the water. The applicant is in violation of Section 4011 of the California Health and Safety Code but the department has not taken any corrective action because of the financial problems represented to it by the utility.

I. Results of Operation-Test Year 1976

Results of operation projected by the company, the staff,^{2/} and as adopted are contained in Table 1, infra, page 15. The staff's estimates are based on the two following reasonable assumptions (which we have adopted for the purpose of setting rates here):

- (1) The recorded 1975 metered consumption of 351.6 ccf per customer.
- (2) The number of metered customers is 9,247.

^{2/} The staff refers to the Utilities Division.

A. Operation and Maintenance Expenses-Miscellaneous Expenses

1. Purchased Energy. The staff used a 10 percent increase in estimated metered consumption to cover flat rate consumption and losses to determine total water production. It used the latest gas and electricity rates to the production figure to obtain the purchased energy expenses. This is a more reasonable approach than the flat increase of 20 percent over 1975 recorded expenses used by SC.

2. The miscellaneous expenses of the staff projected at \$74,800 are being increased by \$18,000 which is the rental for the present offices of SC.^{3/} (This includes the lease of four one million gallon storage tanks as discussed later.)

3. Payroll Expense. The staff's payroll expense of \$348,200 is more accurate than the applicant's estimate of \$302,100 because it includes provision for additional employees as required by the applicant for its data processing and bookkeeping operations and reflects the capitalized 15 percent of the total payroll. The balance is spread to Accounts 711 through 791.

4. Uncollectibles are not accounted for in the staff process because they are contained in its revenue adjustment factor.

5. We are adopting the staff's 1976 operation and maintenance expense of \$490,000 as reasonable.

B. Administrative and General Expenses

Except for insurance we are adopting the staff's estimates as reasonable. The testimony regarding SC's insurance showed that its current annualized costs exceed the staff estimate by \$12,000. We are thus increasing insurance expense by that sum and are adopting the sum of \$195,100 as reasonable administrative and general expenses.

^{3/} See discussion respecting the new office building and site in III, infra.

C. New Storage Tanks

In the summer of 1975 SC lost a 500,000-gallon rubberized water tank due to vandalism. In January 1976 it also lost a 210,000-gallon bolted steel tank which burst for unknown reasons. A recent inspection has disclosed that one additional 210,000-gallon steel tank and one 500,000-gallon steel tank are corroded to the point where it is unsafe to maintain water levels at more than 50 percent capacity. SC's evidence indicates that had these tanks been fully operable, the company's water storage capacity would still be below par and would dip into the fire-flow protection. SC believes it prudent from an engineering and service viewpoint to replace these tanks with four one-million gallon steel tanks which meet AWWA standards. We agree with this conclusion.

SC originally proposed obtaining these tanks under a 15-year lease with the Bank of America but during this proceeding brought forth a new lease agreement, Exhibit 19, with GATX leasing Corporation, which does not require a personal guaranty by the officers and does not provide an option to purchase the tanks at the end of the lease term. The total installed cost is \$550,000 and the payments will be \$77,400 a year or \$6,450 a month. F&A prepared Exhibit 18 showing that the true interest rate for the lease period for the Bank of America agreement would be 11.22 percent using the stated assumptions. This exhibit also compared costs under two assumed purchase arrangements (Fn 4, p.8). F&A concluded that the total cost to the ratepayers over the entire estimated life (30 years) of the tanks would be less under the lease arrangement while the present value cost would be most under the lease arrangement, and vice versa under the assumed purchase arrangements. F&A concludes that the leasing of tanks is less favorable to the ratepayer than purchasing. We generally agree with this conclusion but because the assumed purchase arrangements^{4/} are not feasible for

^{4/} Table II Purchase assumes 100 percent debt financing. Table III Purchase assumes 50 percent equity and 50 percent debt financing.

SC in its existing financial condition, we believe that the lease arrangement is the desirable choice, on balance. We will approve the lease as proposed in Exhibit 19 with two modifications:

(1) Paragraph 10 of Exhibit 19 regarding accelerated depreciation being used by the lessor must be deleted. (2) A provision for purchase of the tanks at the end of the 15 year lease term at net salvage value must be included. We have reflected a five-year amortization of the investment tax credit allowed on these tanks in the appropriate areas in our adopted results of operations.

D. Computer Equipment

In late 1975 SC obtained an IBM System 32 computer and related equipment under an agreement with IBM (Exhibit 13). This agreement is a lease with option to purchase. SC indicates that it intends to exercise this option under the terms of the agreement. The lease term is 36 months. SC should have obtained authority under Code Section 818 to enter into this agreement, but it failed to do so. SC has capitalized this agreement on its books and believes that this system will allow more efficient and accurate recordkeeping and data compilation in compliance with the previous Commission order. It will allow streamlining and simplification of overall operations. We do not deny the potential benefits that may accrue to both the company and its ratepayers as a result of this equipment but we admonish the company for its failure to obtain

approval from this Commission. Should this happen again SC may be penalized. We will belatedly authorize this agreement (Exhibit 13) and will by this order approve SC's capitalization of this equipment in the sum of \$49,876.96.

II. Accounting Recommendations

F&A made a detailed study of SC's operations and accounting methods. F&A noted (a) many areas in which the applicant could improve its record and bookkeeping, (b) many areas in which it has not completely complied or not complied at all with General Order No. 103 and the Uniform System of Accounts required of public utilities, (c) discrepancies between the annual report and the results of operations summary attached to this application, and (d) other areas of contention between F&A and the applicant as to the treatment of various items of expense and related matters.

In Decision No. 84566 we ordered accounting changes. We will reiterate those areas which require attention. Again, the company is skirting a contempt action. The accounts, expenses, and other bookkeeping entries should be made in accordance with the recommendations of the F&A division as contained in Exhibit 15 herein and in compliance with General Order No. 103. Notably, these include:

- (1) The general ledger account should be brought into complete balance with the annual report;
- (2) Meter records should be kept for at least five years (including meters in storage) so that each meter may be located instantly;

- (3) A reserve for uncollectible accounts should be created and bad debt expense should be accrued on a monthly basis;
- (4) Year-end adjustments and closing entries should be timely posted and charged to the proper calendar year;
- (5) Timely retirements should be made when utility plant is removed from service;
- (6) The items reflected in Account 220, Notes Payable, to Mary P. Bonelli, \$6,500 and W. G. Bonelli Trust, \$32,500 should be transferred to Account 223, Payable to Associated Companies; and
- (7) The amounts in accounts payable of \$27,359.03 payable to Rodeo Land Company should be transferred from this account to Account 223.

F&A also recommends reducing the monthly salary of each of the officers to \$500 because it alleges each works only eight days per month. This is not substantiated by the evidence. This salary is presently \$1,600 a month each or a total of \$3,200 a month for both officers working what they assert to be four-day weeks. We shall not reduce these salaries at this time, but we are notifying the officers that we shall not allow an increase in this amount, for ratemaking purposes, for at least three years from the effective date of this order unless the State Department of Health permit is obtained and all other recommendations and orders contained herein are fully complied with, while the service remains at least as satisfactory as at the present time.

III. Rate Base

The staff adjusted the company's recorded plant in service and depreciation by deducting an adjustment of \$40,336 for retirement of storage tanks. The staff also transferred the following items from material and supplies inventory to utility plant in service:

<u>Item</u>	<u>Account</u>
Meters	\$13,079
Gas engines and accessories	23,494
Electric motors (net)	<u>1,275</u>
Total	<u>37,848</u>

These transfers were made to comply with our accounting procedures. The staff also removed \$8,140 worth of automobiles from the plant. The total of the staff's adjustments results in a net reduction from plant of \$10,634.

In D. 84883 we authorized the utility to issue debt of \$100,000 to \$150,000 for the office building site and \$225,000 for the proposed office building. An appraiser testified that the value of the site is \$265,000. SC paid \$110,000 to an affiliated company for the land. We have no quarrel with the appraisal. However, SC has the burden of proving that this property is necessary and useful in its utility operations to warrant its inclusion in rate base. The evidence on this subject may be summarized as follows:

The payments for the land of \$1,363 a month and for the building (at \$225,000) of \$2,500 a month, total \$3,863 a month, or \$46,356 a year. SC has already completed the purchase of a 6,000-square foot warehouse with 2-1/2 acres of adjoining storage yard. SC's present office site is an older home of just under 3,000

square feet. There is a wooden shed behind this building which is presently used for storage. SC's general manager indicated that there would be a more efficient flow of work and use of space in a building specially designed for use as an office building. He does not believe that there is space available for the new employees necessary to handle the computer services. There is no conference room. The place is noisy. There is no room for the telemetering equipment or lab testing equipment. The lavatory facilities are inadequate. No studies were made regarding the adaptation or expansion of the existing facilities. He said it could be done but it would be very expensive.

F&A believes the present building is adequate from an auditor's viewpoint.

The staff indicated that a new office building might be of some benefit and possibly add to efficiency.

At the request of SC's counsel, the presiding examiner and staff counsel made a tour of the company's existing office building and environs, the proposed office building site, and the newly acquired warehouse and abutting acreage. The examiner agrees that the existing office building is not an ideal facility and additional space would improve working conditions and possibly, efficiency. However, it was also his opinion that the warehouse facility is under-utilized and contains more than adequate room for telemetering and lab testing equipment and other nonoffice functions without in any way impairing the primary purpose of the warehouse building and adjacent land and that the present building is adequate, if not ideal.

There was no evidence regarding the use of the warehouse facility for any of the above purposes, nor was any evidence adduced on the use of the existing area around the present building and the wooden shed, nor was there any evidence indicating the cost and feasibility of expanding the present building.

SC is seeking to include the proposed office building and site in rate base to recover the costs from its customers. Here is a utility which is delinquent in its contractual obligations, its property tax payments, and funds required to comply with the state health department requirements for a domestic water company. Moreover, in the time since its last rate increase in June 1975, the company has had storage tank problems requiring new storage capacity, acquired expensive (for this size utility) computer equipment, and purchased a large warehouse and adjacent acreage, all of which have been included in its cost of service. SC desires a lease to acquire storage capacity because of its inability to obtain reasonable financing (which we are approving here).

Under these circumstances, we believe it indefensible to include the proposed office building and land in cost of service at this time. We have no doubt that the proposal would be beneficial to the utility, but we are charged with the duty of balancing the interests of the utility and its ratepayers. For SC and its ratepayers, the proposed building is a luxury which neither can afford, considering SC's financial and operational problems discussed above. In addition, its burden of proof regarding the usefulness and reasonableness has not been sustained. No alternatives were analyzed or even considered, nor has the necessity of the new building been considered in light of the new warehouse.

The evidence indicated the site cost of \$110,000 and building cost of \$294,000 has been included in both company and staff rate base projections. We have excluded this total of \$404,000 (less allowable depreciation) from our adopted rate base.

IV. Rate of Return

The presently authorized rate of return is 9.6 percent. The utility in its amended application is seeking an 11.53 percent rate of return. F&A has recommended reducing the rate of return to 9.12 percent as a penalty because of SC's failure (a) to comply with the accounting recommendations made in D.84566; (b) to follow the Uniform System of Accounts; (c) to comply with General Order No. 103; and (d) to properly supervise and manage the general operations and inventories. We do not believe it prudent to levy a penalty against the utility for accounting shortcomings since it has represented that the newly installed computer system will be able to cure all the bookkeeping, accounting, and recordkeeping shortcomings and errors that have previously existed. We shall allow the utility to retain its presently authorized rate of return of 9.6 percent, but put SC on notice that in the event the accounting, recordkeeping, and bookkeeping omissions, errors, and shortcomings are not corrected by the time it next applies for rate relief, we shall take that fact into consideration in determining just and reasonable rates. The rate of return requested by the utility we consider to be excessive and not warranted under the circumstances. We think the presently authorized rate of return is reasonable for the future and shall set rates based upon that return. The rate of return on equity will be 9.96 percent.

The company's request, the staff's estimated results, and the adopted results of operations are all contained in Table 1, below.

TABLE 1
Results of Operations

Item	Authorized Rates (Test Year 1976)		
	Company Proposed	Staff Proposed	Adopted*
(Dollars in Thousands)			
Operating Revenues	\$1,671.7	\$1,711.1	\$1,465.6
<u>Operating Expenses</u>			
Operation and Maintenance	538.2	490.0	490.0
Administrative and General	207.6	183.1	195.1
Miscellaneous	100.7	74.8	92.8
Depreciation	152.1	138.0	130.7
Taxes Other than Income	160.3	201.9	188.8
Income Taxes	179.6	221.7	108.6
Total Expenses	1,338.5	1,309.5	1,206.0
Net Operating Revenues	333.2	401.6	259.6
Average Rate Base	2,891.1	2,995.5 ^{5/}	2,704.5
Rate of Return	11.53%	13.41%	9.6%

* At rates authorized herein.

Findings

1. Applicant is in need of additional gross revenues for test year 1976 in the amount of \$309,900.
2. The results of operation adopted herein reasonably represent the estimated results of the utility's future operations.
3. A rate of return of 9.6 percent on the adopted rate base is fair and reasonable for the future.

^{5/} At the hearing the staff increased its proposed rate base to \$3,100. Table 1 is derived from the staff's exhibit.

4. The increases in rates and charges authorized herein are justified and are reasonable and the present rates and charges insofar as they differ from those prescribed herein are for the future unjust and unreasonable. The step rate authorized by D.84566 to be effective July 1, 1977 is eliminated.

5. Applicant is given authority to enter into a lease with option to purchase for the computer and related equipment under the terms and conditions described in Exhibit 13. In the event applicant does not purchase the equipment within the prescribed time limitations the cost of this equipment shall be deducted from rate base and rates shall be adjusted accordingly, on the Commission's own motion.

6. The following recommendations of F&A are reasonable and should be adopted:

- (a) The general ledger account should be brought into complete balance with the annual report;
- (b) Meter records should be kept for at least five years (including meters in storage) so that each meter may be located instantly;
- (c) A reserve for uncollectible accounts should be created and bad debt expense should be accrued on a monthly basis;
- (d) Year-end adjustments and closing entries should be timely posted and charged to the proper calendar year;
- (e) Timely retirements should be made when utility plant is removed from service;
- (f) The items reflected in Account 220, Notes Payable, to Mary P. Bonelli, \$6,500 and W. G. Bonelli Trust, \$32,500 should be transferred to Account 223, Payable to Associated Companies; and
- (g) The amounts in accounts payable of \$27,359.03 payable to Rodeo Land Company should be transferred from this account to Account 223.

7. Applicant must comply with the State Department of Public Health requirements under Section 4011 of the California Health and Safety Code at the earliest possible time. No increase in officers' salaries shall be permitted for ratemaking purposes until such time as SC obtains a domestic water permit from the California Department of Health or three years from the effective date of this order, whichever is sooner.

8. Applicant is authorized to enter into a lease for four one million gallon welded steel tanks meeting AWWA standards under the terms set forth in Exhibit 19 herein except: (a) Paragraph 10 of Exhibit 19 must be deleted to allow SC the right of accelerated depreciation, and (b) a provision for purchase of the tanks at the end of the 15 year lease term at net salvage value must be included. An executed copy of the lease agreement must be filed with the Commission.

Conclusions

1. The application should be granted to the extent authorized in the order below.
2. In all other respects the application should be denied.
3. The leases for the computer equipment described in Exhibit 13 and for the storage tanks described in Exhibit 19 are evidences of indebtedness of the utility.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, applicant Santa Clarita Water Company is authorized to file the revised rate schedules attached to this order as Appendix A. Such filing shall comply with General Order No. 96-A. The effective date of the

revised schedules shall be five 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.

2. Applicant shall determine accruals for depreciation by dividing the original cost of the utility plant, less estimated future net salvage, less depreciation reserve, by the estimated remaining life of the plant. Applicant shall review the accruals when major changes in utility composition occurs and at intervals of not more than three years. Results of these reviews shall be submitted to this Commission.

3. Applicant shall establish a work order system in conformance with the Uniform System of Accounts.

4. Applicant shall comply in all respects with General Order No. 103.

5. Applicant shall comply with all accounting recommendations set forth in Finding 6 above.

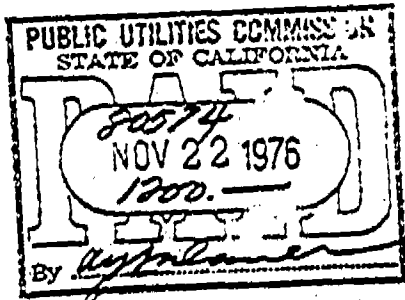
6. For the purpose specified in this proceeding applicant may issue evidence of indebtedness by executing the lease and purchase option agreement for the computer equipment described in Exhibit 13 for a principal amount not exceeding \$50,000 in accordance with and in substantially the same form as Exhibit 13.

7. On and after the effective date of this order and on or before December 31, 1976, for the purposes specified in this proceeding, applicant may issue evidence of indebtedness by executing a lease for a principal amount not exceeding \$550,000 in accordance with Finding 8 above.

The authority granted by this order to execute the leases herein above described will become effective when the issuer has paid the fee prescribed by Section 1904(b) of the Public Utilities Code which fee is \$1,200. In other respects the effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 26th day of OCTOBER, 1976.

[Signature] President
William J. [Signature]
[Signature]
[Signature]
Ralut Botwin Commissioners



APPENDIX A

Schedule No. 1

GENERAL METERED SERVICEAPPLICABILITY

Applicable to all metered water service.

TERRITORY

Bouquet Canyon and vicinity, near Saugus, Los Angeles County.

RATES

Service Charge:	<u>Per Meter</u> <u>Per Month</u>
For 5/8 x 3/4-inch meter	\$ 3.85
For 3/4-inch meter	4.20
For 1-inch meter	5.70
For 1 1/2-inch meter	8.10
For 2-inch meter	10.40
For 3-inch meter	19.10
For 4-inch meter	25.80
For 6-inch meter	45.60
For 8-inch meter	62.75
For 10-inch meter	77.00

Quantity Rates:

For all water delivered, per 100 cu.ft. .. \$ 0.274 (I)

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