

Decision No. 87608 JUL 19 1977

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of JACKSON WATER WORKS, INC., to increase its rates and charges for its water system serving the City of Jackson and adjacent territory in Amador County.

Application No. 55430
(Filed January 7, 1975)

Application of CITIZENS UTILITIES COMPANY OF CALIFORNIA for authority to increase its rates and charges for its water system serving the areas of Guerneville, Rio Nido, East Guerneville, Guerneville Park, Northwood, Monte Rio, Vacation Beach, River Meadows and vicinity in Sonoma County.

Application No. 55431
(Filed January 7, 1975)

Application of LARKFIELD WATER COMPANY for authority to increase its rates and charges for its water system serving the unincorporated area of Larkfield and vicinity north of Santa Rosa in Sonoma County.

Application No. 55453
(Filed January 22, 1975)

Application of NORTH LOS ALTOS WATER COMPANY to increase its rates and charges for its water system serving portions of the Cities of Los Altos and Mountain View in Santa Clara County.

Application No. 55471
(Filed January 30, 1975)

Application of CITIZENS UTILITIES COMPANY OF CALIFORNIA for authority to increase its rates and charges for its water system serving the areas of Montara, Marine View, Farallone City, Moss Beach and adjacent territory in San Mateo County.

Application No. 55538
(Filed March 6, 1975)

Application of INVERNESS WATER
COMPANY to increase its rates and
charges for its water system serving
the unincorporated communities of
Inverness, Seahaven Subdivision
No. 1, and vicinity in Marin County.

Application No. 56285
(Filed February 23, 1976)

Jeremiah F. Hallisey, Attorney at Law, for Citizens
Utilities Company, applicant.
Charles R. Farrar, Jr., Attorney at Law, for
Arthur Young and Company; Randall Wilkes, Attorney
at Law, for Wikiup Larkfield; Richard J. Massa,
Attorney at Law, for Inverness Water Committee;
Joseph Garcia, Attorney at Law, for California
Department of Consumer Affairs; and Kristine
Gazadd, Attorney at Law, for City of Jackson;
Interested parties.
Mary Carlos, Attorney at Law, James Barnes, and
K. K. Chew, for the Commission staff.

SUPPLEMENTAL OPINION IN APPLICATIONS
NOS. 55430, 55431, 55453, 55471, and 55538
AND INTERIM OPINION IN APPLICATION NO. 56285

On February 10, 1976, Commissioner Robert Batinovich issued an order directing Citizens Utilities Company (Citizens) to submit within thirty days the proposals of five management consulting firms to conduct a study to determine whether (1) the utility is properly managed and (2) whether the need for the rate increases in the instant proceedings result from circumstances beyond the control of management. In compliance with the order the firm of Arthur Young and Company was selected. In accordance with accepted practice a first draft was submitted for review to Citizens Delaware on August 17, 1976. Although certain changes were made, the record clearly demonstrates that Arthur Young and Company exercised final and independent judgment with respect to the contents of the final draft which was completed on September 28, 1976.

The study was received in evidence as Exhibit 1-A at a public hearing held before Commissioner Batinovich and Examiner Daly at San Francisco on November 22, 23, and 24, 1976 and December 16 and 17, 1976.

The study methodology consisted of seven basic components consisting of (1) a detailed work plan, (2) use of experienced senior management consultants, (3) extensive on-site inspection and review of each utility including the Sacramento and Redding facilities, (4) interviews of the full-time company personnel at each location, (5) review of all available written information at each location, (6) use of a market research company to conduct a customer attitude survey in the communities served by the six water companies, and (7) all data gathered and indexed as well as information obtained through the Commission's staff, Citizens' management, and other sources.

With respect to the two questions raised by Commissioner Batinovich's order the report concluded as follows:

"A. Is the Utility Properly Managed?

"The answer to this question must be divided into two segments:

- "1. In the financial, accounting, and short-term budgeting areas the company is closely controlled and utilizes sound and smooth running systems and procedures. We concluded that Citizens is well managed in these areas.
- "2. Second, with respect to the performance of operations and maintenance, personnel practices, systems documentation and customer relations, these utilities generally operate in a responsive mode. This results in a relatively short-range, day-to-day approach to managing these activities. When situations deteriorate sufficiently to demand and get attention, corporate management becomes involved and its resources are brought to bear on the problem.

"It is the responsibility of corporate management to provide the direction and attendant procedures and controls to direct local operations in these areas. Consequently, with respect to these areas of operations and maintenance, we found that the utilities lack the consistency, clear procedures, and anticipation of problems which is found in the company's financial operations.

"B. Does the Need For Rate Increases Result From Circumstances Beyond the Control of Management?

"We address this question by examining three categories of cost:

- "1. Costs outside management's control such as purchased water, purchased power, and taxes are uncontrollable and must be passed through to the customer if the utility is to earn a fair return.
- "2. Costs related to the size of operations such as the cost of capital and depreciation associated with a main replacement program or a new storage tank are usually significant on a per customer basis in these relatively small systems. These systems are unable to achieve economies of scale outside of the present centralized accounting, general administrative and billing activities.
- "3. Costs within the control of management are those which result from significant capital expenditures to improve water quality and costs related to field operating practices and procedures.

"Overall, we estimate that the cost increases that form the primary basis for the current rate increase applications are the result of largely uncontrollable cost increases including significant levels of needed capital investment in most of the utilities."

As a result of the customer survey the report found that:

- "1. The customers surveyed are materially more satisfied with their electric, gas, and telephone service than with their water service.
- "2. The majority of customers believe their overall water service is satisfactory, good, or excellent; but more than one-third believe the service is poor or very poor.
- "3. More than two-thirds of the customers would not be willing to pay any more for 'perfect' water."

In areas where the findings of the report identified deficiencies or opportunities for improvement, specific recommendations were made and are summarized as follows:

"A. Planning Methodologies and Systems

"Specific three to five year construction and capital improvement plans should be prepared and monitored for each utility based on a two-phase analysis:

- "1. A comprehensive review and documentation of the supply, demand and storage capacities, and trends of the system.
- "2. A complete review and documentation of the age, condition, and estimated remaining service life of major capital equipment.

"The estimated new construction, repair, and replacement requirements anticipated during each year of the planning period should be identified.

"B. System Documentation

"The documentation of both the equipment and facilities located in each system, and the maintenance work should be improved. This should augment the local staff's ability to perform the planning function and efficiently maintain the system. Current system maps and maintenance history files should be used as the basis for improved documentation.

"C. Operating Practices and Procedures

"The company should refine and further develop the following:

- "1. Practices and procedures that apply to all utilities such as preventive maintenance, and operating and record-keeping practices that apply to all or most water utilities.
- "2. Practices and procedures which apply to specific utilities such as filter plant or valve maintenance procedures and schedules.

"D. Staffing Guidelines

"Staffing guidelines for each utility should be established based on the number of customers, overall system condition, current operating and maintenance requirements, and the availability of additional personnel from other Citizens' utilities in the area. These guidelines should be developed nationally, based upon the company's collective knowledge and from historical data from water utilities operated by Citizens and others.

"E. Classification and Salary Structure

"Accurate and up-to-date job descriptions should be developed for all positions below the District Manager level. These descriptions should cover common or related jobs in Citizens' California water utilities. Consistent with company policy, pay grades and salary ranges and steps should then be assigned to each classification based on competitive market conditions, and the cost of living in each area.

"F. Field Personnel Training

"A minimum amount of standardized 'classroom' instruction should be provided to all new employees to complement current on-the-job training. A recommended course of instruction is identified on page VI-7 of the report.

"G. Hiring Policies and Procedures

"Improvement in the policies and procedures governing the hiring of new employees should help reduce costly turnover. We recommend that the following improvements be made:

"New Servicemen and Local Representatives should have prior experience with other water utilities or closely related businesses, if at all possible.

"For each prospective employee under serious consideration, the company should contact at least one prior employer to evaluate the applicant's experience and past performance.

"Prospective employees should be provided with a description of duties, working hours, and working conditions associated with the position for which they are applying.

"Selective notification of open positions in other Citizens' utilities should be provided to employees in other locations to allow these employees to move within the company rather than resigning to relocate to another area.

"H. Performance Evaluation

"A formalized, written performance evaluation program should be developed and implemented based on evaluation criteria specifically related to the assigned duties and responsibilities of each job classification. The evaluation criteria should be explained to each employee when he or she accepts a position.

"I. Customer Relations

"We recommend that the company augment its customer relations program by utilizing inexpensive bill inserts and advertisements, or articles in local newspapers to inform customers of the following types of activities:

"Changes or improvements which are being made to their system to improve service and/or water quality and supply.

"New personnel, promotions, or significant accomplishments by employees in the company or community.

"Notification of expected service interruption or inconvenience due to planned construction or maintenance activities.

"J. Customer Complaint Documentation and Prioritization

"We recommend that the following three steps be taken in the utilities to document and prioritize customer complaints:

"Citizens should establish and enforce a uniform complaint and inquiry documentation practice. This should include revision of the currently used Customer Service Report to better facilitate categorization and ultimate tabulation of contacts.

"Priorities should be established and documented, based upon the company's customer service objectives, for handling various types of complaints.

"Each type of complaint or problem should be assigned a response time objective. If repair work cannot be initiated within the targeted time, consideration should be given to bringing in additional help and the customer should be contacted with an explanation for the delay.

"K. Accounting System

"The general ledger and financial reporting for each water utility should be implemented on the company's new computer as soon as practical. This would eliminate the need for manual records for these applications and for the time-sharing system used to prepare the Results of Operations and Statistics Report.

"L. Data Processing

"The data processing cost allocation procedures should be improved. Systems analyst and programmer personnel costs should be allocated on a time reporting basis rather than accumulated with computer operations costs for allocation. This method would

"provide a more equitable cost allocation because these personnel costs do not necessarily correspond to computer operations costs. This could be accomplished through the time reporting system already in use by the company.

"M. Intercompany Communications

"District Managers and Local Representatives should be kept well informed of planned changes and improvement within their utilities. From the customer's perspective, these employees are the company, and they should be knowledgeable about any planned changes in their area so that they can properly respond to questions or inform customers of future improvements being considered."

Several witnesses, including a member of the faculty of the University of California, Graduate School of Business, and a representative of the California Department of Consumer Affairs, were critical of the methodology employed in the preparation of the report particularly the customer survey portion, which was conducted by telephone. It was the opinion of the professor that any formulas employed to establish the size of sample required to get a 95 percent level of confidence become irrelevant as soon as you start to conduct telephone surveys where there is a substantial rate of nonresponse which distorts the random character of the survey.

Although the survey is helpful we are more persuaded by the testimony of the 100 public witnesses who testified in these proceedings.

Mr. Ishier Jacobson, who is president of Citizens and Citizens Utilities Company of California, testified for the purpose of stating the position of Citizens and its subsidiaries in relation to the management study. His testimony is summarized as follows:

He received Commissioner Batinovich's order on February 17, 1976 and thereafter submitted requests for proposals to 22 firms. Twenty firms responded, but nine of them declined to submit proposals.

Citizens submitted to the Commission proposals from: (1) Arthur Anderson and Co.; (2) Arthur Young and Co.; (3) Middle West Service Company; (4) Peat, Marwick, Mitchell and Co.; and (5) Stone and Webster Management Consultants. Commissioner Batinovich selected Arthur Young and Co. and the selection was thereafter confirmed by the Commission.

He met with Mr. Crown and his associates from Arthur Young and Co. on May 11, 1976 and July 20, 1976, and provided them with all necessary materials. He received and saw a draft of the report on August 18, 1976, and although he discussed the contents with representatives from Arthur Young and Co., the contents of the final report, which he received on October 4, 1976, were in the final analysis decided upon by Arthur Young and Co. Citizens agrees with the final conclusions of the report that its utility is reasonably well managed and that any increase is a result of circumstances beyond the control of management.

It is the position of Citizens that because 60 percent of the total cost of service relates to physical facilities it is absolutely essential that neither new facilities nor improvements be made before they are necessary in order to keep the utilities' rates at the lowest reasonable level. Citizens believes that improvements should be made when needed and not before. To do otherwise would result in prematurely higher revenue requirements.

With respect to the report's finding that the area of customer relations and local operations have not received sufficient emphasis and follow-up, Citizens takes the position that the work force for each utility considered is small, varying from one to a maximum of eight. Since most of the work forces are operating personnel, who have little time and frequently have little interest or capacity to participate in customer relations activities, additional staffing to perform those functions would be required, which would substantially increase existing expenses. In the opinion of Citizens such expenses are not cost justifiable because the cost to the customer would outweigh the benefit to the customer.

Although financial controls are reasonably subject to standardization, local operations of small water companies are not. The men who operate these systems are not great readers and they essentially learn their occupation by doing. As a consequence corporate management spends more of its time and resources on financial controls than in the area of local operations. Citizens does not agree that work manuals should be prepared for servicemen. According to a company survey of 25 California water utilities, both investor-owned companies and districts, only two have manuals for fixing leaks and only six have manuals for flushing.

Citizens does not agree with the report's recommendation for job classifications. While this recommendation might have some degree of validity for a large work force having a wide range of types of employees, it is not applicable to the small work force of these six water utilities, which have a total of 21 employees, including 2 managers, 15 servicemen, 4 full-time clerks, and 1 part-time clerk. All of the related water companies in California have a total of only 64 employees.

Citizens does not believe that the report's recommendation for complete and detailed maps is cost justified. Citizens recently received proposals on the cost of printing such maps for the Inverness and Guerneville systems. The estimate for Inverness is \$14,000 and the estimates for Guerneville range from \$40,000 to \$162,000. Although such maps would be esthetically attractive and might be most helpful, the additional cost to the customer would far exceed their benefits.

Although Citizens presently conducts on-going reviews of the trends of the supply, demand and storage capacities of its various systems it does not agree with the extensive reviews recommended by the report. A complete review of a system would require that mains be dug up for the purpose of determining their condition, which would be not only a foolish expense, but uninformative because one cannot determine the service life of a pipe by its age and appearance.

The recommendation relating to estimated construction, repairs, and replacement requirements anticipated during each year of the three to five year planning periods is impracticable when applied to replacement projects,

because these projects are not of long duration and usually take a week to complete. With respect to construction of wells, tanks, and treatment facilities, which are projects requiring long periods to construct, Citizens has always conducted long-range planning.

Citizens lacks neither the ability nor the desire to make improvements. Since acquiring the six water systems considered Citizens has spent \$1,287,932 on construction in North Los Altos, \$681,553 in Jackson, \$954,337 in Montara, \$462,803 in Inverness, \$636,158 in Guerneville, and \$556,842 in Larkfield. As a matter of company policy improvements relating to health and safety are made immediately and esthetic improvements relating to the quality of water are made if desired by the customer and approved by the Commission.

Without adequate rates neither Citizens nor any utility can long provide adequate service. It is not possible for any utility to make improvements in small systems where it either operates at a loss or at less than one could get in terms of putting capital in the bank. Citizens' objective remains, and will always remain, good service at reasonable rates, with all factors considered.

Citizens' management has done its best to minimize machinery failure and human error; it is not perfect, but it continues to try and this is confirmed by the Arthur Young and Co. report.

Citizens believes that the report has been helpful in indicating that Citizens' past efforts in informing consumers of the costs and alternatives in the esthetic treatment of water have been inadequate. Although the company has attempted in various ways to inform its customers of the direct correlation between the cost of water treatment and rates, it admittedly has not been successful. In order to communicate more effectively it has recently engaged the consulting firm of Braun and Company.

During the course of hearing Citizens introduced Exhibit 29-A which relates to the cost of the Management Study proceeding. Exhibit 29-A was amended by late-filed Exhibit 42-A. Citizens believes that these costs should be allocated between the six water companies and amortized over a three-year period.

The staff by late-filed Exhibit 41-A made two recommendations for the allowance of costs of the study. One was made by the Utilities Division of the Commission and the other was made by the Commission's Finance and Accounts Division and the Legal Division. Both recommendations provide for an allocation between the ten California water companies of Citizens; however, the Utilities Division and the Finance and Accounts Division recommend that the allocations be amortized over a five-year period whereas the Legal Division recommends a ten-year period.

A comparison of Citizens' request and the staff's recommendations is summarized as follows: ✓

| <u>Item</u> | <u>Company Proposed</u> | <u>Utilities Div. Recommended</u> | <u>F&A and Legal Div. Recommended</u> | <u>Adopted</u> |
|---------------------|-------------------------|-----------------------------------|---|-----------------|
| Arthur Young Report | \$17,000 | \$17,000 | \$17,000 | \$17,000 |
| Drossler Report | 4,200 | 4,200 | - | - |
| Braun & Co. | 12,200 | - | - | - |
| O'Brien & Hallisey | 12,500 | 12,500 | - | - |
| Direct Salaries | 8,400 | - | - | - |
| Travel and Per Diem | 4,600 | 4,600 | - | 4,600 |
| Miscellaneous | 2,300 | 2,300 | 1,900 | 2,300 |
| | <u>\$61,200</u> | <u>\$40,600</u> | <u>\$18,900</u> | <u>\$23,900</u> |

The staff contends that the expenses for Braun and Company should be disallowed because these expenses are for public relations work which is a form of institutional advertising that is disallowed as an operating expense by Decision No. 83162 dated July 23, 1974 (The Pacific Telephone and Telegraph Company). The staff also recommends disallowance of expenses for direct salaries inasmuch as these salaries are already included in the test year estimates as charges from Stamford administrative office.

In addition the Finance and Accounts Division and the Legal Division recommend disallowance of the legal and travel expenses as well as the cost of the Drossler Report. They argue that Citizens could have used the same in-house attorney who participated in the

rate hearings for five of the six water districts and that the travel and per diem expenses were incurred because Citizens chooses to maintain its corporate offices in Connecticut, which is a convenience to the company and confers no benefit to the California ratepayers. They further argue that the cost of the customer attitude survey made by the Drossler Company should be disallowed because it exceeds not only the amount, but the scope of the estimate and proposal as originally submitted by Arthur Young and Company; and as approved by the Commission.

We agree with the staff that Braun & Company as well as direct salaries expenses should be excluded. We are further convinced by the Finance and Accounts and Legal Divisions' arguments that the Drossler survey and legal expenses are unreasonable and will be disallowed. We find that the travel expenses incurred in the preparation and presentation of the Management Study are reasonable. The Utilities Division recommended figure for miscellaneous expense is adopted. We are also of the opinion that these costs should be allocated among the 10 California water companies of Citizens and amortized over a period of five years. ✓

The allocation will be as follows:

| <u>System</u> | <u>Allocation Factor</u> | <u>5-Year Allocation</u> |
|------------------------|--------------------------|--------------------------|
| <u>Citizens</u> | | |
| Felton | 4.24% | \$ 183 |
| Guerneville | 8.54 | 369 |
| Montara | 5.42 | 234 |
| Sacramento | 43.85 | 1,895 |
| Francis Land and Water | 2.14 | 92 |
| Inverness | 1.63 | 70 |
| Jackson | 4.83 | 209 |
| Larkfield | 2.45 | 106 |
| North Los Altos | 6.23 | 269 |
| Wash. Water and Light | 20.67 | 893 |
| | <u>100.00%</u> | <u>\$4,320</u> |

4-1 ✓

In order to facilitate the adoption of the recommendations made by the Arthur Young and Company report, specific provisions will be included in the rate case decisions for each of the various districts.

SUPPLEMENTAL ORDER IN APPLICATIONS
NOS. 55430, 55431, 55453, 55471, AND 55538
AND INTERIM OPINION IN APPLICATION NO. 56285

IT IS ORDERED that the petition filed January 7, 1977 and all petitions and motions not heretofore ruled upon in these proceedings are denied.

The effective date of this order shall be twenty days after the date hereof.

Dated at San Francisco, California, this 19th day of JULY, 1977.

I dissent.
William Squors, Jr.

I abstain
Vernon L. Sturgeon

Robert B. Berman
President

Robert D. Howell
Carle D. DeWitt
Commissioners