

ORIGINAL

Decision No. 87872 SEP 20 1977

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
CALIFORNIA WATER SERVICE COMPANY, a)
corporation, for an order)
authorizing it to consolidate its)
Hamilton City district with its)
Chico district for all purposes)
and for an order authorizing it to)
increase rates charged for water)
service in the new consolidated)
district, including the Chico area)
and the Hamilton City area.)

Application No. 56186
(Filed January 9, 1976)

McCutchen, Doyle, Brown & Enersen,
by Crawford Greene, Attorney at
Law, for applicant.
Katie L. Richardson, for herself,
interested party.
Lionel B. Wilson, Attorney at Law,
and Jasjit Sekhon, for the
Commission staff.

FINAL OPINION

Decision No. 87335 issued on May 17, 1977 disposed of all the issues, save one, raised by applicant and the staff in this proceeding. The decision reserved the question of the reasonableness of applicant's executive salaries. The staff assigned to this proceeding had raised this issue pursuant to a recently established staff policy applicable to all general rate increase applications by major California utilities.

At the time of the submission of all other issues in this application, the staff had commenced, but not yet completed, such a study applicable to applicant's personnel. The staff studies and applicant's response were presented at a hearing held before Administrative Law Judge Gilman in San Francisco on November 30 and December 2 and 3, 1976. The adjustment proposed by the staff would have a minimal impact on the rates authorized by Decision No. 87335. Staff and applicant, therefore, stipulated that it would not be reasonable to delay establishing permanent rates to allow careful review by the Commission of the evidence on this issue. Applicant stipulated that the maximum staff adjustment should be reflected in the adopted results of operation as if the adjustment had been found reasonable by the Commission. Even in the event that some portion or all of the adjustment was later found unsupported, applicant offered to forego recovering any additional revenue for salaries until such time as it sought rate relief to offset other categories of expense. If the Commission finds that the staff adjustment is unjustified, applicant will recover part of the associated revenues prospectively only, by tacking it on to any offset advice letter filing which may be applicable to this district.

The proposed staff adjustment consists of two elements. The first element, amounting to \$35,000 per year, is the disallowance of the consulting fee paid to applicant's recently retired chief executive. The second element is the disallowance of \$21,000 of the \$71,000 per year now paid to applicant's chief executive.

In order to evaluate the importance of this issue, it should be noted that the proposed staff adjustment would reduce applicant's allowed expenses by approximately \$2,000 per year for this district. The total population in the Chico-Hamilton City district is approximately 35,000. The total annual gross revenues at the rates adopted by Decision No. 87335 are estimated to be \$1.509 million for the combined district.

The same disposition was used in five other district cases filed and submitted contemporaneously, as indicated below. The recommended company-wide disallowance, \$46,000, would be allocated as follows:

| <u>District</u> | <u>Application/ Decision</u> | <u>Amount</u> |
|---------------------|----------------------------------|---------------|
| East Los Angeles | D.87333 A.56134 | \$ 4,812 |
| Palos Verdes | D.87334 A.56159 | 4,591 |
| Chico/Hamilton City | D.87335 A.56186 | 1,638 |
| Livermore | D.87336 A.56208 | 1,828 |
| San Carlos | D.87337 A.56225 | 1,449 |
| Other Districts* | | <u>31,862</u> |
| | | 46,000 |

*Rates in these districts are not presently affected by the staff disallowance.

Consulting Fee

Prior to November 1, 1976 the bylaws of California Water Service Company (CWS) provided that the chairman of the board should also be the chief executive officer of the corporation; the combined positions carried a salary of \$79,000 per year. The bylaws also provided for a president who served primarily as the chief operating officer; the salary for this position was \$66,000.

On November 1, 1976 the chief executive officer reached the mandatory retirement age and retired as such, but consented to continue to serve as chairman of the board and as a consultant on general corporate matters. The fees for consultation are to be \$35,000 annually. At the same time, the incumbent president also assumed the office of chief executive officer with full responsibility for the operations and affairs of the company at an increase in salary to \$71,000 per year.

The staff witness recommended that the entire amount of the consulting fee be disallowed for the following reasons: the individual concerned, as a director of the corporation should be expected to give the benefit of his experience and expertise to the company without extra compensation; the other corporate officers have sufficient experience to conduct the business of the utility without consultation; and CWS retains well-known firms of attorneys, accountants, and financial advisors and should be able to function without any additional consultation.

The witness also noted that the individual concerned still draws a full salary from another California water utility as board member and as an executive officer, that he is still an active member of his law firm, is a university trustee, and serves as a member of the board of directors of two major non-utility conglomerates.

The company contended that the chairman of the board was requested to continue to serve by the compensation committee of the board and that the size of the fee was determined by that committee. He is assertedly expected to be available on a day-to-day basis, whereas the other directors are required only to attend the regular monthly directors' meetings. The individual concerned has extraordinary experience since he served CWS for

approximately 25 years, including a long period as general counsel. He has further experience as a director of two major national firms and as a director and chairman of the executive committee of another major California water utility. In one particular instance the individual spent a considerable amount of time meeting with the bond-rating agencies in New York City. Those rating agencies appeared to be particularly impressed by the company's ability to employ persons with a national reputation as directors; and as a result, a major refinancing was achieved at very favorable rates.

We note that the individual in question is a director and chairman of the board; as such, he continues to have a fiduciary relationship to the corporation. He also continues as an active working partner in the law firm which is on retainer to CWS. This position also places him in a fiduciary relationship to the corporation.

This individual will draw a substantial pension. His pension is calculated under the same formula used to calculate the pensions of all other CWS employees. Since the principal elements are longevity and life-time average salary, it is possible to estimate that his pension could be as much as four or five times that of a hourly-paid worker who had the same length of service. As a pensioner, this individual must be assumed to have a strong personal stake in the company's continued prosperity and success.

Applicant's showing has not convinced us that applicant's needs for expertise and experience cannot be adequately met by the company's full-time employees and the prestigious firms it has on retainer. The company's showing has not convinced us that the compensation will produce services in addition to those it could reasonably expect to receive from one who has both a substantial stake in, and a fiduciary duty to, the corporation. Nor has it convinced us that the amount of the compensation was arrived at

by means of an arm's length bargain. We are especially concerned by the fact that this individual continues to hold what would normally be considered a full-time position with another major California water utility in addition to his duties as an active member of a large law firm and as a member of the boards of three other large institutions.

We will, therefore, disallow the consulting fee in its entirety.

Chief Executive's Salary

According to the company's bylaws, the salaries of CWS's officers are to be set by a committee of the board of directors which is composed of three outside directors. Theoretically, this determination is made on the basis of the company's surveys of executives' salaries in utility and non-utility businesses. The recommendations of the committee are to be submitted to the board for approval and become effective on March 1 of each year. However, the committee has for a number of years simply recommended that the percentage increase granted to union employees also be granted to all officers. For 1976 and 1977 the increases were 9.5 percent and 7.7 percent, respectively.

The staff witness recommended that \$21,000 of the chief executive's \$71,000 salary be disallowed for ratemaking purposes.

Each party introduced one potentially useful set of comparisons. Applicant showed that its \$71,000 salary was well in line with the salaries paid to the handful of comparable water utilities throughout the nation. This comparison was supported, to a limited extent, by data from other types of privately owned utilities. Staff's exhibit, on the other hand, showed that comparable publicly owned enterprises can attract numbers of apparently qualified candidates for chief executive positions at a salary of approximately \$50,000 per year.

Applicant's showing was flawed since it made no attempt to explain the other companies' methods of establishing salaries. We cannot tell whether the compared utilities establish their chief executives' salaries by reference to subordinate executives' salaries within the company or whether there is an attempt to relate it to the market for chief executive talent or some other external condition. It is at least conceivable that the process was based on purely subjective criteria. Since we have no information concerning the mechanism by which these salaries are set, the information is of limited probative value.

The staff showing suffered from an inadequate sample. Further, at least half of the examples used might have been classed as transactions in the market for city managers rather than the market for utility executives. Based on this record, we cannot verify or rebut our belief that public-sector utility executives and city managers are not likely to compete for each other's jobs. Because of these difficulties, the \$50,000 estimate is not well supported.

Applicant attempted to demonstrate that chief executives of privately owned utilities need additional skills to deal with problems not encountered by publicly owned enterprises such as regulation and taxation.

However, it appears that CWS, like many other utilities, follows the practice of employing well-paid specialists to devise and implement regulatory and tax strategies. We find it difficult to believe that an otherwise well-qualified individual would be disqualified as a private utility chief executive solely because he lacked special skills in these areas. We are not convinced that an individual who has successfully operated a publicly owned utility enterprise could not transfer his skills to a privately owned company. In our opinion, a comparison with salaries of executives of comparable publicly owned enterprises is relevant.

The company claims that the chief executive was personally responsible for a program which will save approximately \$700,000 per year in property taxes; these savings will be reflected in full in applicant's next general rate proceeding, thus benefiting consumers. It would seem plausible that a proven track record in achieving cost savings could have an impact on the market value of an executive's compensation. Nevertheless, neither party suggested an acceptable way to deal with this element. It would appear, however, that the staff estimate overlooked this factor.

We believe that the ultimate question to be answered here is: What is the least amount the utility could pay to obtain the skills necessary to satisfy the consumer's need for economical, reliable service?

Each presentation supports a significantly different answer. Each is flawed, and there is no apparent acceptable method of reconciling the difference.

Rather than pursue the issue further in this proceeding, we will call on both parties for improved presentations in applicant's next round of general rate cases.

We find:

1. The consulting fees paid to applicant's chairman of the board have not been shown to produce services of value to consumers.
2. The services of applicant's chief executive have a market value of between \$50,000 and \$71,000. The value of such services to consumers is estimated to be at least \$61,000 for the purpose of resolving pending applications.

We conclude that applicant should be authorized to increase its rates to produce additional revenues in each district as set forth in the order which correspond to an allowance of \$61,000 for the chief executive's salary. We further conclude that the consulting fees should be disallowed.

FINAL ORDER

IT IS ORDERED that when applicant files its next offset advice letter increase in each of the below listed districts, it is authorized to include in such filings sufficient additional revenue to offset the amount of compensation costs listed.

| | |
|---------------------|---------|
| East Los Angeles | \$1,150 |
| Palos Verdes | 1,098 |
| Chico/Hamilton City | 392 |
| Livermore | 437 |
| San Carlos | 346 |
| Visalia | 393 |

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

Dated at San Francisco, California, this 20th day of SEPTEMBER, 1977.

Ruben Batmang
President
William S. S. S.
Yegor S. S. S.
Robert D. S. S.
W. S. S. S.
Commissioners