

Decision No. 88079 NOV 8 1977

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application
of ROSSMOOR SANITATION, INC., for
an Order Authorizing a Raise in
Rates.

Application No. 56296
(Filed February 26, 1976;
amended March 11, 1977)

Rutan & Tucker, by Milford W. Dahl, Attorney at
Law, for applicant.
Martin E. Whelan, Jr., Attorney at Law, for
Professional Community Management, Inc.;
various mutual housing corporations inside
Leisure World; and Golden Rain Foundation of
Laguna Hills; protestants.
Jasper Williams, Attorney at Law, for the Commission
staff.

O P I N I O N

Rossmoor Sanitation, Inc. (Rossmoor), a California corporation, by its amended application seeks to increase rates for sewer service by \$207,870, an annual gross revenue increase of 20.5 percent for the test year 1976.

Notice of public hearing was published, posted, and mailed to each customer as required by the Rules of Practice and Procedure of this Commission. Hearings were held before Administrative Law Judge J. E. Thompson in Laguna Hills, California, on June 20, 21, 22, 23, and 24, 1977. The matter was taken under submission as of June 24, 1977.

On September 15, 1977, applicant filed a petition to set aside submission of this application, and that the Commission pending further hearing thereon authorize on an interim basis increased rates which may have been justified on the record as it currently stands. In justification for its petition, applicant points out that on

February 4, 1975, by Decision No. 84040 in Application No. 54129, the Commission established rates which were determined would provide applicant with a reasonable rate of return; according to the evidence presented herein for the test year 1976 applicant's earnings deteriorated to a rate of return of 4.45 percent according to applicant's computations, or 5.70 percent according to the Commission staff's figures; and it now finds for the 11 months ended August 31, 1977 it has had a net operating loss of \$58,350.

History and
Operations of Rossmoor

Rossmoor commenced its corporate existence July 31, 1963.

A certified copy of Rossmoor's Articles of Incorporation was filed as an attachment to its Application No. 53823, filed February 3, 1973.

When Rossmoor began providing sewer service in or about Laguna Hills, California, in 1963, the California Public Utilities Code did not provide for the regulation of sewer system corporations.

The California Public Utilities Code was amended to confer jurisdiction upon this Commission over sewer system corporations by 1970. As a result Rossmoor became a public utility subject to the jurisdiction of this Commission on July 1, 1972. Rossmoor is also subject to the jurisdiction of the California Regional Water Quality Control Board, Santa Ana Region; the Department of Health of the State of California; and the Orange County Health Department.

The service area of Rossmoor includes the Leisure World area, a large multiple-family residence senior citizen development, as well as other multiple-family residence, single-family residence, and commercial areas. Pursuant to Decision No. 84040 (Application No. 54129) Rossmoor prepared a study of classification of residential customers. A copy of that study was admitted into evidence as Exhibit 2 in this proceeding.

The service area is substantially developed and has required major expenditures for construction of sewer facilities since 1963. Developers have been required to contribute sewer plant constructed within specific projects and to pay a connection fee for each dwelling unit added to the system. These practices are utilized

throughout the industry by both publicly and privately owned systems and were examined at length in the prior hearing relating to Rossmoor's last request as set forth in Decision No. 84040 dated February 4, 1975 in Application No. 54129. The opinion and order in that matter provided for a continuation of that practice which Rossmoor appears to have employed without discrimination.

Rossmoor utilizes the employees of Rossmoor Water Company to perform necessary work. When these employees perform duties for Rossmoor, charges are assigned on a time card distribution basis.

The record reflects that Rossmoor operates a modern, efficient sewer system. The Commission staff reported that there had been no informal complaints filed with the Commission and that service is good. Protestants' attorney offered residents of Leisure World as witnesses who gave testimony as to general economic conditions in Leisure World; none of those appearing had any criticism of the service provided by Rossmoor.

Accounting, Rate of
Return, and Cost of Money

The staff witness (Mr. Nagao) testified about the contents of Exhibit 7 which was an examination of the accounting and financial records of Rossmoor.

In its amended application, Rossmoor has requested a 20.5 percent gross increase in existing rates to achieve a 9.4 percent return on its estimated average rate base of \$2,413,400 at proposed rates. Rossmoor did not present an exhibit or analysis of its cost of money or a return on common equity in connection with its requested rate of return on rate base.

The staff's rate of return witness (Mr. Quan) presented Exhibit 12 in support of his rate of return recommendation, which is a range of 8.85 percent to 9.15 percent. Based on the combined capital structure of Rossmoor and its affiliate, Rossmoor Water Company, the related earnings allowance for common equity would range from 9.98 percent to 10.70 percent.

The witness stated that combining the capital structure of the two affiliates eliminates the distortion in capital costs indicated by his analysis of their separate capital structures, particularly since both companies provide service to common customers within the same service area.

Exhibit 12 contains financial information related to trends in interest rates, various earnings comparisons, and a summary of returns authorized by this Commission for water utilities and sewer companies. Decisions rendered in connection with rate increases for sewer companies are relatively few because only several companies are regulated. With respect to Rossmoor, the Commission granted the company a 7.31 percent rate of return in Decision No. 84040 which provided for an allowance of 10 percent on common equity based on a capital structure consisting of about 71 percent debt and 29 percent common equity.

Among other things, Exhibit 12 shows that 69 percent of Rossmoor's investment has been obtained from external sources in the form of contributions in aid of construction; moreover, recorded earnings since 1972 have averaged about 4.00 percent on total capital.

The use of a combined capital structure would be consistent with methods adopted in previous Commission decisions involving subsidiaries. When considered together with other factors, a 9.00 percent rate of return would provide an allowance of 10.34 percent for common equity as summarized below:

	<u>Ratio</u>	<u>Cost</u>	<u>Weighted</u>
Long Term Debt	58.30%	8.04%	4.69%
Common Equity	<u>41.70</u>	10.34	<u>4.31</u>
Total	<u>100.00%</u>		<u>9.00%</u>

A 9.00 percent rate of return is reasonable and will be adopted in conjunction with the combined capital structure.

Results of Operations

Operating Revenues

Rossmoor submitted both its original and amended applications based on revenue estimates for the year 1976 using no recorded data. The staff prepared its report, Exhibit 8, one year later and had recorded data through September 30, 1976. At the hearing, Rossmoor stipulated that the staff estimate based on later recorded data was acceptable. The rate first proposed by Rossmoor in its application carried forward the differential of 50 cents between "Unrestricted Family Residences" and "Restricted Family Residences".^{1/} In the amended application, Rossmoor submitted a revised Schedule No. 1 which would yield the same gross revenue but would recognize a percentage differential between these two classes of service more closely reflecting the classification study submitted by Rossmoor in compliance with the Commission's order in the preceding rate matter.

Protestant's attorney introduced through its expert witness, a registered civil engineer, a classification study showing that a differential between the two classes of service under Rate Schedule No. 1 should be based on a percentage rather than a fixed amount. As set forth in Appendix A to this decision, we have adopted rates for unrestricted family residences which are 15 percent greater than the rates adopted for restricted family residences and when related to the average number of services for the year 1976 produce adopted revenues as shown in the summary of earnings tabulation on page 9. Rossmoor has only requested a rate increase for Schedule No. 1, General Residential Service.

Schedule No. 2, Commercial and Industrial Service and Schedule No. 3, Sale of Reclaimed Water should also be increased. Almost all of the reclaimed water sales are to Rossmoor for use on its Golf Course.

^{1/} Briefly, a "Restricted Family Residence" is one without children. A precise definition should be incorporated into applicant's tariff.

Operating Expenses

The staff estimated operating expenses for the year 1976 based on later data than used by Rossmoor in preparing its estimate. Rossmoor submitted as Exhibit 4 an addendum to its amended application which sets forth additional operating expenses for rental of an office which had taken place after the filing of its application but which had not been included by staff. Cross-examination of the staff engineer indicated that he had received the information too late to incorporate in his report and could not consider it at this time. We, therefore, adopt the staff estimates of Operation and Maintenance Expenses as well as the Administrative and General Expenses contained in Exhibit 8 and incorporated in the summary of earnings tabulation for purposes of this interim opinion.

Taxes

In the prior rate proceeding, this Commission ordered Rossmoor to make all reasonable efforts to obtain relief from the ad valorem taxes imposed by the county of Orange on contributed plant. The ad valorem taxes set out in Exhibit 3 show that although Rossmoor had initiated proceedings for such tax relief, it had not been granted as of January 1, 1976. Tax relief was granted and is reflected in both the staff report, Exhibit 8, and in Rossmoor's Exhibit 4 as the 1976-1977 tax statement with adjustments. Protestants' attorney cross-examined the witness for Rossmoor and the staff witness on methods used in determining the estimated reasonable ad valorem taxes for 1976. Protestants offered further testimony through their expert witness and Exhibit 11 to show that a further adjustment should be made to reflect a downward trend consistent with a correlation to rate base. We have reviewed the efforts of Rossmoor and find that its action has been effective in obtaining a substantial reduction in ad valorem taxes and that such a program of reviewing assessment records and tax code areas should be continued in the future. For rate-fixing purposes in this proceeding, we will adopt \$91,000 as the just and reasonable estimate of ad valorem taxes paid to the county of Orange in the year 1976. The staff estimate of \$19,100 for payroll taxes as

shown in Exhibit 8 is also adopted and will be included with taxes other than income in the following summary of earnings.

Income Taxes

For the purpose of ratefixing, we will adopt the staff adjusted income tax allowance of \$75,100 at proposed rates which gives recognition to the adopted changes including ad valorem taxes. We will not recognize the question raised by protestants regarding treatment of unrelated losses in the consolidated tax return because rates are set prospectively and we must also take cognizance of the recent Decision No. 87929 which authorized Rossmoor and Rossmoor Water Company to reorganize into subsidiaries of Laguna Hills Utility Company. The stock of Laguna Hills will then be distributed to Rossmoor's stockholders. Any future tax loss by the Rossmoor Corporation will not be available to reduce Laguna Hills taxable income.

Depreciation Expense and Rate Base

The staff had more recent information than that contained in Rossmorr's exhibits relating to depreciation expense and average depreciated rate base as estimated for the year 1976. Counsel for Rossmoor stated on the record that he would accept the staff's estimates. We, therefore, adopt the estimates of the staff as set forth in Exhibit 8 for depreciation expense and rate base.

Results of Operation and Summary of Earnings

The following tabulation is a summary of the estimated results of operation for the test year 1976, comparing the showing by Rossmoor, the staff, and the results adopted in this decision:

ESTIMATED RESULTS OF OPERATION
TEST YEAR 1976

Item	* Rossmoor:	** Staff:	Adopted:
	(Dollars in Thousands)		
<u>At Present Rates</u>			
Operating Revenues	\$1,016.4	\$1,041.8	\$1,041.8
<u>Operating Expenses</u>			
Operation & Maintenance	604.2	564.2	564.2
Administrative & General	133.9	123.6	123.6
Taxes, other than Income	106.1	135.2	110.1
Depreciation	64.6	77.7	77.7
Subtotal	908.8	900.7	875.6
Income Taxes	.2	2.8	8.0
Total Expenses	909.0	903.5	883.6
Net Revenue	107.4	138.3	158.2
Rate Base	2,413.4	2,426.8	2,426.8
Rate of Return	4.45%	5.70%	6.52%
<u>At Proposed and Authorized Rates</u>			
Operating Revenues	\$1,224.3	\$1,250.6	\$1,169.2
<u>Operating Expenses</u>			
Operation & Maintenance	604.2	564.2	564.2
Administrative & General	133.9	123.6	123.6
Taxes other than Income	106.1	135.2	110.1
Depreciation	64.6	77.7	77.7
Subtotal	908.8	900.7	875.6
Income Taxes	88.7	104.7	75.1
Total Expenses	997.5	1,005.4	950.7
Net Revenue	226.8	245.2	218.5
Rate Base	2,413.4	2,426.8	2,426.8
Rate of Return	9.40%	10.10%	9.0%

*Per Rossmoor's Exhibit No. 4

**Per Staff Exhibit No. 8

Findings of Fact

1. The adopted estimated results of operation for the test year 1976 set forth above, adjusted for taxes, are just and reasonable as related to revenues, expenses, and rate base for Rossmoor for ratemaking purposes.
2. A just and reasonable estimate of ad valorem taxes to be paid to the county of Orange for the test year 1976 for ratemaking purposes is \$91,000.
3. Adjusted income taxes based on the preceding findings are \$8,000 at present rates and \$75,100 at proposed rates which is the modification resulting from the adopted changes including ad valorem taxes.
4. Combining the capital structures of Rossmoor and its affiliate, Rossmoor Water Company, is appropriate for ratemaking purposes.
5. Except regarding the allocation of costs of transportation equipment, the allegations and statements by witness Nagao are adopted; and except for the item in paragraph 12(g), his accounting recommendations at pages 4, 5, and 8 of Exhibit 7 are adopted.
6. The operations of Rossmoor have been managed efficiently and prudently, and it has provided a good service to its customers.
7. A rate structure for "General Residential Service", as described in Schedule No. 1 of Rossmoor's tariff schedules, which will provide rates for Unrestricted Family Residences of not lower than 115 or greater than 117 percent of the rates for Restricted Family Residences will result in a just, reasonable, and nondiscriminatory rate structure.

Comparable increases have been included for Schedule No. 2 rates, Commercial and Industrial Service, and Schedule No. 3 rates, Sale of Reclaimed Water.
8. The increased rates for sewer service set forth in Appendix A, attached hereto, will provide Rossmoor with \$127,400 additional gross operating revenues, or an increase of 12.2 percent; and for a future rate year will provide Rossmoor with net earnings after income taxes of \$218,500 for a rate of return of 9.00 percent on a rate base

of \$2,426,800, and a return on common equity of 10.34 percent which earnings, returns, and rate base are reasonable.

9. The increases in rates resulting from the establishment of the rates and charges set forth in Appendix A are justified; and the present rates and charges, insofar as they differ from those set forth therein are, and for the future will be, unjust and unreasonable.

10. The Commission has considered applicant's petition for partial interim rate relief and concludes that the relief granted herein is reasonable and final for test year 1976.

Conclusions of Law

1. Rossmoor should be authorized to establish the increases in rates described herein.

2. Rossmoor should be ordered to implement the accounting recommendations specified in Finding 6.

3. Rossmoor should define "Unrestricted Family Residence" and "Restricted Family Residence" in its tariff.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, Rossmoor Sanitation, Inc. is authorized to file the revised rate schedules attached to this order as Appendix A and withdraw its presently effective Schedules Nos. 1, 2, and 3. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall be four days after the date of filing. The revised schedules shall apply only to service rendered on or after the effective date hereof.

2. Rossmoor Sanitation, Inc. shall effect the accounting recommendations contained in Exhibit 7 at pages 4, 5, and 8, except for the item in paragraph 12(g), relating to allocation of transportation equipment burden, within ninety days of the effective date of this order, and shall comply with Conclusion of Law No. 3.

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

Dated at San Francisco, California, this 8th day of NOVEMBER, 1977.

*I concur but would have made the order an Interim opinion
William Lyons, Jr.*

Robert B. ...
President

...
...

Commissioners

Schedule No. 1

GENERAL RESIDENTIAL SERVICE

Applicability

Applicable to General Residential Sewer Service.

Territory

El Toro, Laguna Hills, Rossmoor Leisure World and vicinity, Orange County.

Rates for Sewer Service

Unrestricted Family Residences \$5.69 per month, per residential dwelling unit (I)

Restricted Family Residences \$4.95 per month, per residential dwelling unit (I)

Terms of Payment

All sewer charges are payable in advance on the first day of the period for which the bill is rendered.

Associations, Apartments, Condominiums, and other Multiple Residences

When more than one residential dwelling unit is connected to the system of Rossmoor by service connections less in number than the number of residential dwelling units services, the rate per residential dwelling unit, as set forth above, shall be due and payable for each and every living or dwelling unit connected to the system.

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Schedule No. 2

COMMERCIAL AND INDUSTRIAL SERVICE

Applicability

Applicable to Commercial and Industrial service.

Territory

El Toro, Laguna Hills, Rossmoor Leisure World and vicinity, Orange County.

Service Charges to Commercial and Industrial Service

- (A) The service charge to commercial and industrial customers, hereinafter in this rule referred to as "customer", shall be based on the actual amount of sewage to be discharged into the Rossmoor Sanitation, Inc. system.
- (B) The basic service charge shall be \$0.71 per 1,000 gallons of sewage to be discharged. The minimum service charge shall be the amount equal to the charge for single family residences, as set forth in Tariff Sheet No. 1 of Rossmoor Sanitation, Inc. (I)
- (C) The actual amount of sewage so discharged shall be defined and determined by Rossmoor Sanitation, Inc. in accordance with one of the following methods:

Method 1:

By the application of a water use factor to the amount of metered domestic water use of the customer's establishment.

The customer's establishment shall be classified as to the ratio between the rate of sewage discharge and the actual metered rate of domestic water use. Said ratio shall be determined by Rossmoor Sanitation, Inc. and shall be termed "factor".

Example: Class 1 establishment

Metered water use by customer's establishment for a two-month billing period - 20,000 gallons - Factor 0.9.

Service charge for the two-month billing period equals $20 \times 0.9 \times \$0.71 = \12.78 (I)

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Schedule No. 3

SALE OF RECLAIMED WATER

General

Water delivered pursuant to this Schedule shall be chlorinated, but not filtered reclaimed water and may be delivered to any property located in Orange County, California.

All water delivered, pursuant to this rule, shall be provided only after the customer shall have entered into an agreement with the utility, which shall condition the sale of the water, among other things, as follows:

- (1) The availability of water.
- (2) Utility's responsibility for the quality of chlorinated, but not filtered, water shall be limited to the quality required by Governmental Agencies having jurisdiction over quality of water.
- (3) Except for the responsibility set forth in paragraph 2 above, Utility makes no other guarantees relating to the quality of water, and all express or implied guarantees and warranties are expressly disclaimed by Utility. Customer agrees to accept the water in its "AS IS" condition. Customer shall release and relinquish all claims, actions, and rights it may now or in the future have against Utility concerning expressed and implied guarantees and warranties relating to the quality of water except as provided in the first sentence of this Section. It is understood and agreed that Utility gives no warranty, express or implied, as to merchantability, fitness for purpose sold, description, quality (except as set forth in the first sentence of this section), productiveness, or any other manner, and will in no way be responsible for any use which customer shall make of the water.
- (4) Customer will indemnify Utility and their employees against and will hold and save them and each of them harmless from any and all actions, claims, damages to persons or property, penalties, obligations or liabilities that may be asserted or claimed by any person, firm, entity, corporation, political subdivision or other organization arising out of or in connection with the use of said reclaimed water in any manner by Customer, and Customer agrees to pay any costs, including attorney fees, which Utility may incur by reason of any such claims, actions or damages.
- (5) Customer shall comply with all rules, regulations and requirements relating to the use of said water, or otherwise, as established from time to time by the California State Department of Public Health, the Health Department of Orange County and the California Regional Water Quality Control Board.
- (6) The property upon which the water shall be used.

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Schedule No. 3

SALE OF RECLAIMED WATER

General - Contd.

(7) If, as a result of fire, earthquake, storm, rainfall, flood, Act of God, strikes, picketing, boycott, lockouts or other causes or conditions beyond the control of Utility, or because of damage or breakdown of any of Utility's facilities, Utility shall be released from its responsibility to deliver water during such periods of inability and shall have no liability to the customer during such period of time.

Customer's Election

Service to a customer will fall under this category when the customer desires to receive the water at such times during the day and week as the customer shall elect, providing other customers of this class of service have not already contracted for all of the supply available.

Reclaimed water, for this class of service, shall be sold at the rate of \$52.75 per acre-foot.

Utility's Election

Service to a customer will fall under this category when both of the following conditions are applicable:

(1) The customer will receive water at such times during the day and week as the Utility shall elect.

(2) The customer will use the same or a greater quantity of water each week* during the 9 months beginning October 1 and ending June 30, as that customer used during its week* of maximum consumption during the previous 3 months beginning July 1 and ending September 30.

There shall be no charge for water delivered under this class of service. There shall, however, be an annual contract renewal fee of \$100.00.

If at any time, Utility does not have enough water to supply all customers under this class of service, after providing all the water required by the "Customer Election", customers, the remaining supply shall be prorated between the customers under this class of service, in direct proportion to the total quantity of water each customer received during the previous 9 months beginning October 1 and ending June 30.

* Week is defined as beginning on Monday morning at 12:01 a.m. and ending on Sunday night at 12:00 p.m.