

ORIGINAL

Decision No. 88125 NOV 22 1977

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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 Guernewood, Guernewood Park, Northwood, Monte Rio, Vacation Beach, River Meadows and vicinity in Sonoma County.

Application No. 55431  
(Filed January 7, 1975)

John H. Engel, Attorney at Law, for applicant.  
Mary Carlos, Attorney at Law, and James Barnes,  
for the Commission staff.

INTERIM OPINION

The Guerneville Water District of Citizens Utilities Company of California (Citizens California) requests an increase in rates for water service in the Guerneville area, designed to increase annual revenues in the test year by approximately \$154,800 over the rates now in effect.

Public hearings were held before Examiner Daly at San Francisco and Guerneville with the matter being submitted on concurrent briefs, which were filed on February 27, 1976. Copies of the application were served upon interested parties and notice of hearing was published, posted, and mailed in accordance with Commission Rules of Procedure.

On March 3, 1976, applicant filed a petition requesting an interim rate increase pending final determination of the application. The proposed preliminary rates are based upon staff's estimates and recommended rate of return.

The petition fails to state facts of an emergency nature justifying an interim increase. The petition for an interim increase is denied.

Citizens California has its principal office in Redding, California, and is a wholly owned subsidiary of Citizens Utilities Company, which has its administrative office in Stamford, Connecticut. Accounting, engineering, administrative, and other services are performed for the Guerneville Water District at the Redding and Stamford locations. Citizens California also has a plant at Sacramento, California, where administrative, engineering, and other services are performed for the Guerneville Water District.

Citizens California is a Class A telephone utility as well as a Class A water utility. Guerneville Water District, if considered independently of Citizens California, would be a Class B water utility.

Applicant serves the resort areas of Guerneville, Guerneville Park, El Bonita, Rio Nido, Vacation Beach, East Guerneville, Monte Rio, Villa Grande, and Monte Cristo. Water is obtained from numerous creek diversions and is supplemented by wells during peak periods. In addition to the pumps and wells, there are booster pumps in the system ranging from 1/4 HP to 15 HP and a total storage capacity of approximately 1,063,000 gallons in tanks that are located at different elevations throughout the distribution system.

As of December 31, 1973, the system consisted of approximately 413,000 feet of transmission and distribution mains and had 3,160 active metered services and 208 fire hydrant connections.

Applicant's Guerneville operations are conducted from its office in Guerneville.

#### Rates

Applicant proposes to increase rates as indicated by the following comparisons of present and proposed rates:

ANNUAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Guerneville, Rio Nido, East Guernewood, Guernewood Park, Northwood, Monte Rio, Vacation Beach, River Meadows, and vicinity, Sonoma County.

RATES

Quantity Rates:	<u>Per Meter Per Month</u>	
	<u>Present</u>	<u>Proposed</u>
Per 100 cu.ft. ....	\$ 0.27	\$ 0.44

Annual Service Charge:	<u>Per Meter Per Year</u>	
	<u>Present</u>	<u>Proposed</u>
For 5/8 x 3/4-inch meter .....	\$ 56.64	\$ 92.00
For 3/4-inch meter .....	75.00	122.00
For 1-inch meter .....	114.00	185.00
For 1-1/2-inch meter .....	204.00	330.00
For 2-inch meter .....	324.00	525.00
For 3-inch meter .....	640.00	1,037.00
For 4-inch meter .....	930.00	1,507.00

The Service Charge is applicable to all metered service. It is a readiness-to-serve charge to which is added the charge computed at the Quantity Rate for water used during the billing period.

Service Establishment Charge:

For each establishment or reestablishment of water service ..... \$4.00

PUBLIC FIRE HYDRANT SERVICE

APPLICABILITY

Applicable to all fire hydrant service furnished to duly organized or incorporated fire districts or other political subdivisions of the State.

TERRITORY

The unincorporated communities of Guerneville, Rio Nido, East Guerneville, Guerneville Park, Northwood, Monte Rio, Vacation Beach, River Meadows, and vicinity, Sonoma County.

RATES

	<u>Per Year</u>	
	<u>Present</u>	<u>Proposed</u>
Guerneville Fire District:		
Flat rate charge for		
3- 2-inch hydrants and		
16- 4-inch hydrants .....	\$747.00	\$1,210.00
Additional 2-inch hydrants, each .....	15.00	24.00
Additional 4-inch hydrants, each .....	36.00	58.00
Monte Rio Fire District:		
4-inch hydrants, each .....	36.00	58.00
2-inch hydrants (high pressure), each .	15.00	24.00
2-inch hydrants (low pressure), each ..	6.00	10.00
Rio Nido Fire District:		
4-inch hydrants, each .....	36.00	58.00
2-inch hydrants, each .....	15.00	24.00

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service rendered for private fire protection purposes.

(Continued)

PRIVATE FIRE PROTECTION SERVICE - Contd.

TERRITORY

The unincorporated communities of Guerneville, Rio Nido, East Guerneville, Guerneville Park, Northwood, Monte Rio, Vacation Beach, River Meadows, and vicinity, Sonoma County.

RATES

	<u>Per Year</u>	
	<u>Present</u>	<u>Proposed</u>
<b>Fire Hydrant Rates:</b>		
For each private hydrant .....	\$15.00	\$24.00
	<u>Per Month</u>	
	<u>Present</u>	<u>Proposed</u>
<b>Sprinkler Connection Rates:</b>		
For each 4-inch connection, or smaller	\$ 6.00	\$10.00
For each 6-inch connection .....	9.00	15.00
For each 8-inch connection .....	12.00	19.00
For each 10-inch connection .....	25.00	40.00
For each 12-inch connection .....	35.00	57.00

Service and Quality of Water

Twenty public witnesses testified, eight at San Francisco and twelve at Guerneville. In addition, representatives of the Guerneville Fire Department and the California Department of Health testified.

The public witness testimony related to complaints about dirty water, odor, water discoloration, bad tasting water, excessive chlorine, leaks in the system, stained washed clothes, and stained bathroom facilities. A significant number of complaints were directed toward a well in the Villa Grande area that produces water with a very high manganese and iron content, which affects its color and taste and also stains laundry when liquid chlorox is added.

A supervising engineer from the Water Sanitation Section of the California Department of Health introduced a report on the Guerneville system (Exhibit 21). The conclusions and recommendations in the report are as follows:

"Conclusions

- "A. The system does not meet California Department of Health Laws and Bacteriological Regulations as to water quality--specifically iron, manganese, color, bacteriology, and turbidity; nor water quality monitoring procedures--such as source water analyses and distribution system water analyses.
- "B. The use of surface stream water from unprotected water sheds without treatment other than disinfection does not provide adequate treatment.

"C. Most of the service facilities disinfection installations do not meet the California Department of Health's Reliability Standards for the Design and Operation of Water Supply Chlorination Facilities, dated July 1972.

"Recommendations

"It is recommended that the company:

- "1. Complete the chemical, trace elements, and general physical analyses required for all water sources. On completion of these analyses, the company should sample each source monthly and complete analyses made for those constituents found to be present in excess of allowable concentrations; such as iron, manganese, turbidity and color.
- "2. Comply with the California Department of Health's 'Reliability Standards for the Design and Operation of Water Supply Chlorinations Facilities,' dated July 1972 by:
  - "a. Installation of a duplicate chlorinator and an audible or visual alarm at each well subject to flooding.
  - "b. Installation of a duplicate chlorinator, an audible or visual alarm, a turbidity recorder, and a water supply turn-out for each of the surface water sources.
- "3. Rebuild the water distribution systems to meet California Department of Health Regulations on pipe size and length of run.
- "4. Install water treatment facilities for surface water sources including the processes of turbidity removal, iron and manganese removal and disinfection; or abandon the sources.

- "5. Install water treatment facilities at wells to remove excess iron and manganese from the water; or abandon the wells where water contains iron and manganese concentration above California Department of Health Standards.
- "6. Employ a Civil Engineer registered in the State of California who is knowledgeable in the field of water works design and operation for the purpose of preparing a master plan of improvements to the water systems to bring them in conformance with California Department of Health laws and regulations and the preceding recommendations."

The California Department of Health has directed applicant by letter (Exhibit 22) to prepare and submit a master plan of water treatment improvements and main replacements within ninety days of the date of the letter.

A summary of the bacteriological analyses of water samples indicates that those occasions which exceeded the allowable limits were taken during February 1975 when, according to applicant, some of the wells were under water as the result of flood conditions. Applicant also contends that several of the samples were taken inside structures, which could have been contaminated by inside pipes. Applicant claims that all of its tests during this period met the required standards.

Applicant contends that the cost of the recommended improvements would be approximately \$6.4 million and would result in a cost of more than \$875 per customer annually, over and above that of the proposed rates. The witness for the Department of Health testified that no consideration was given to the cost of the recommended improvements, but the recommended master plan was intended as a long-range program and applicant would not be expected to make all of the improvements immediately.



The staff, which supports the recommendations made by the California Department of Health, made the following recommendations:

1. Applicant be directed to make the following additions during 1976, all of which are included in staff's utility plant estimates for the 1976 test year:
  - 1,300 feet of 6-inch main - Monte Rio Vicinity
  - 200 feet of 8-inch main - Drake Road
  - 1,000 feet of 6-inch main - Moscow Road Intertie
  - 1,000 feet of 6-inch main - Center Way
2. Because the Guerneville water system lacks the capacity to meet the demands of a significant number of customers, which results from old, undersized mains and minimal treatment facilities, that applicant be directed to prepare a long-range improvement program with an annual level of additions considerably higher than the average annual additions made during the period from 1968 through 1975. Such plan should provide for specific projects amounting to at least \$75,000 covering the five-year period, 1977 through 1981. Each specific project description should include a statement as to how it relates to the overall plan, which should be submitted to the Commission for approval within ninety days after the date of the decision.
3. Upon completion of each year's specific additions for the period 1977 through 1981, applicant may request a supplemental order of the Commission authorizing the filing and charging of new rate schedules designed to compensate applicant for the additional expenses and to provide a reasonable rate of return on the additional investments.

The fire marshal for the Guerneville Fire Protection District testified that the proposed rate increase is unreasonable and unjustified; that the fire department was recently graded by the rating bureau of the Insurance Service Office; that its water supply

accounts for approximately 35 percent of the deficiency points on the grading schedule; and that many of the hydrants that are in service do not meet the minimum specifications of the Insurance Service Office. According to the witness, the fire department, because of its limited budget, could not afford the proposed increases, which he claims would be excessive considering the actual amount of water used each year. He suggested charging only for hydrants that meet minimum standards or charging on a "per-inch-per-foot" basis.

#### Rate Base

Applicant estimates rate base at \$1,162,400 and staff estimates it at \$1,012,300, resulting in a difference of \$150,100.

The following is a summary of applicant's and staff's estimates of average rate base for the test year 1976:

<u>Item</u>	<u>Applicant</u>	<u>Staff</u>	<u>Applicant Exceeds Staff</u>
	(Dollars in Thousands)		
Utility Plant in Service	\$1,530.3	\$1,519.0	\$111.3
Reserve for Depreciation	(419.2)	(399.4)	(19.8)
Net Plant in Service	<u>\$1,211.1</u>	<u>\$1,119.6</u>	<u>\$ 91.5</u>
Common Plant	8.5	8.5	-
Materials and Supplies	9.4	6.0	3.4
Working Cash	-	(33.7)	33.7
Minimum Bank Balance	16.6	-	16.6
Non-Interest Bearing C.V.I.I.P.	1.4	1.4	-
Advances for Construction	(53.1)	(53.1)	-
Contributions in Aid of Construction	(17.5)	(17.5)	-
Reserved for Differed Income Taxes	(14.0)	(18.9)	4.9
Average Rate Base	<u>\$1,162.4</u>	<u>\$1,012.3</u>	<u>\$150.1</u>

(Red Figure)

The main difference between the estimates of applicant and staff for utility plant in service results from the differences in their determinations of construction of utility plant for the year 1976.

When the application was filed applicant estimated construction of utility plant for 1976 at \$78,000. On the first day of hearing applicant revised its original estimate by raising it to \$175,000.

Staff's estimate of additions was based on a review of applicant's construction budgets, annual reports, the monthly construction reports filed under General Order No. 65-A, and contracts for construction expected to have been completed by the end of 1975. Staff rolled back to January 1, 1975 all nonrevenue producing and nonrecurring plant additions to be installed during the test period.

Included among applicant's proposed replacement projects, and with which staff is in full agreement, is the replacement of 1,800 feet of six-inch main in the Monte Rio vicinity, 200 feet of eight-inch main along Drake Road, 1,000 feet of six-inch main along the Moscow Road Intertie, and 1,000 feet of six-inch main along Center Way. Applicant's Exhibit 2 also proposed main replacement for six other projects in 1976, which staff did not include, because applicant originally indicated to staff, as evidenced by Exhibit 23, that these were contingent projects.

Plant additions for the years 1972, 1973, and 1974 were less than \$40,000 and applicant's estimates for 1977, 1978, and 1979 approximates \$40,000 a year. A graph introduced by staff depicts peaks of constructions during test years. Staff argues that applicant gives the greatest attention to increasing the figure for plant additions during test years, and the least attention to systematic planning and upgrading of the entire system.

Staff made allowance for the replacement of one vehicle, but excluded an additional vehicle because there was no evidence of its need.

Staff's estimate for plant in service is reasonable and will be accepted. Provision will be made in the ensuing findings and order for the so-called contingent projects if constructed in 1976.

Reserve for Depreciation

Staff's estimate of \$399,400 is \$19,800 less than applicant's estimate, which is attributable to the different estimates of plant additions.

Material and Supplies

Applicant's estimate of \$9,400 exceeds staff's estimate by \$3,400. The difference results from applicant's having an inventory of six- and eight-inch transit pipes which staff considered excessive. Staff adjusted the amount of the transit pipes and arrived at an inventory of \$5,380, which it then increased by 11.5 percent to account for inflation. Staff witness testified that the inventory of transit pipes, as of July 31, 1974, was perhaps higher than the company normally maintains.

Staff claims that there are at least two major suppliers within the area and pipes are readily available. Staff argues that because of the net to gross multiplier (2.1133) applicant must earn approximately 22 cents annually in gross revenues for each dollar's worth of excess transit pipe reflected in rate base as inventory. This far exceeds the discount savings applicant claims it realizes by purchasing pipe in large quantities.

Staff's estimate appears reasonable and will be accepted.

Working Cash

Applicant did not include an allowance for working cash in its estimate, whereas staff used a negative figure of \$(33,700).

Applicant has an annual service charge which is payable in advance, either annually or bimonthly. Seasonal users must pay annually and permanent residents have a choice between paying annually or bimonthly. Applicant, therefore, collects a large percentage of its total annual revenues in advance of providing service and during this time has the beneficial use of the money.

76996 dated March 24, 1970 in Application No. 48905 (Guerneville District), Decision No. 79915 dated April 4, 1972 in Application No. 52161 (Larkfield Water Company), and Decision No. 83610 dated October 16, 1974 in Application No. 54323 (Washington Water and Light Co). The Commission's prior position will be followed and no minimum bank balance will be included.

Reserve for Deferred Income Taxes

Applicant's estimate is \$(14,000) compared to staff's estimate of \$(18,900).

Applicant contends that staff, in rolling back all of the nonrevenue producing additions for 1975 and 1976 to January 1, 1975, substantially increases the tax depreciation, which has the effect of producing an artificial increase in the reserve for deferred income taxes. Applicant argues that income taxes should be calculated on an "as paid basis", and this rollback overstates the tax depreciation.

Staff contends that applicant rolled back nonrevenue producing plant in its determination of utility plant, but eliminated the effect of rollback in its determination of depreciation reserve. Exhibit 9, page 38, indicates that applicant showed \$387,400 as the recorded end-of-the-year depreciation reserve for 1974, but showed \$387,000 for the beginning of the year depreciation reserve for 1975. Exhibit 9 also shows that the pro forma end-of-the-year reserve for 1975 as \$411,000, whereas the beginning of the year reserve for 1976 is \$410,100. According to the footnote this was admittedly done to eliminate the prior year's effect of the rollback.

Applicant's approach appears inconsistent. When a rollback adjustment is made, the calculation must be carried through to all affected items, i.e., depreciation reserve, depreciation expense, and ad valorem taxes. Staff, however, contrary to Commission practice, used the 1975 and 1976 year end Reserve for Deferred Income Taxes instead of the average. The amount of \$10,300 is accepted for Reserve for Deferred Income Taxes. Such amount includes a correction for treatment of accelerated taxes discussed under Income Taxes, supra.

Rate base in the amount of \$1,020,900 is reasonable and will be adopted.

Operating Revenues

Applicant \$395,500, Staff \$405,400.

Applicant and staff agree on the number of customers, but differ on the average consumption per customer. Using the Modified Bean method, which is based on a correlation between rainfall, temperature, and historical consumption, the staff estimated consumption to be 69.2 Ccf and 72.1 Ccf for the years 1975 and 1976, respectively. Applicant took the average consumption per customer for the years 1958 to 1975 and estimated the average consumption to be 62.5 Ccf per customer for 1975 and 63 Ccf for 1976.

Applicant contends that the staff's estimate is too high as demonstrated by the fact that the actual consumption of 61.5 Ccf for 1975 was 7.7 lower than the 69.2 Ccf estimated by the staff and only 1.0 Ccf lower than the 62.5 estimated by applicant. According to applicant the highest consumption for any year in the period of 1965 through 1975 was 63.36 Ccf in 1973. Applicant is of the opinion that the Modified Bean projection was influenced by the increasing trend consumption that occurred prior to 1971, which reflected a change in the area from seasonal residents to permanent. This, applicant believes, is demonstrated by the fact that the average consumption per customer ranged from a low of 60.23 Ccf to a high of 63.36 Ccf.

The record demonstrates, not only by way of exhibits, but also by way of public witness testimony, that the Guerneville area is changing from a summer resort and vacation area to an area of permanent residency, which affects the annual consumption of water per customer. Although applicant may speculate that this change was completed in 1971, it was unable to indicate how many of its customers were year-round customers as opposed to permanent residents.

The Modified Bean method, which has a high coefficient of determination, indicated that the correlation between rainfall, temperature, and historical consumption was .93645.

The Commission is of the opinion that the Guerneville area is still in the process of change and that this change will continue to have an increasing effect upon the average annual consumption per customer. The staff's estimate of operating revenues will be accepted.

Operating and Maintenance Expense

The summary of earnings indicates a difference of \$3,700 in operation and maintenance expense estimated for 1976. The following tabulation sets forth the detailed estimates of applicant and staff:

<u>O &amp; M Expenses</u>	<u>Applicant</u>	<u>Staff</u>	<u>Applicant Exceeds Staff</u>
	(Dollars in Thousands)		
Salaries	\$ 58.7	\$ 54.9	\$ 3.8
Purchased Power	15.9	17.9	(2.0)
Materials & Misc.	13.0	13.0	-
Customer's Acctg. & Misc.	12.6	13.2	(.6)
Transportation	8.0	6.1	1.9
Telephone & Telegraph	2.6	2.0	.6
Uncollectible Accounts	<u>.8</u>	<u>.8</u>	<u>-</u>
Total	111.6	107.9	3.7

(Red Figure)

The difference of \$3,700 is primarily due to a difference in salary estimates. Staff annualized the August 1, 1975 Guerneville salaries for both 1975 and 1976, whereas applicant included salary and wage increases that it anticipates will occur in 1976. In addition thereto staff and applicant differed on the number of servicemen at Guerneville. The staff allowed salaries for 4-1/2 man years because one man, as the result of a disability, was working part time. Applicant claims that the staff made no allowance for an increase in salary for the local manager in the amount of \$1,088 effective January 1, 1976.

In conformity with Commission policy the staff, with the exception of the manager's salary, used the latest known salary rates to estimate salaries and wages for 1976. Staff's estimate will be accepted and an allowance for the manager's increase in salary will be made.

The \$2,000 difference in staff's estimates of \$17,900 and applicant's \$15,900 for purchased power is attributable to staff's higher estimate of water produced and to staff's use of the latest electric rates of Pacific Gas and Electric Company as authorized by Decision No. 84902 dated September 21, 1975.

Staff's estimate of \$6,100 for transportation is \$1,900 lower than applicant's \$8,000. Staff used the 1974 recorded transportation expense and increased it by 10 percent. Applicant's 1974 pro forma transportation expense was \$600 above 1974 recorded. Applicant then increased the pro forma figure by 20 percent. Applicant claims that the staff did not take into consideration a new vehicle that will be added in 1976. According to applicant's witness the 1975 transportation expense was actually 82 percent higher than 1974, but this included \$956 in damages to a truck that was hit by an uninsured motorist. In the staff's opinion this should be considered as an extraordinary nonrecurring expense and should not be considered for ratemaking purposes.

Applicant's estimate of \$2,600 for telephone and telegraph expenses is \$600 higher than the staff's estimate of \$2,000, which staff determined by using the average of 1973 and 1974 costs, with a 5 percent increase for the increase in rates granted Pacific Telephone and Telegraph by Decision No. 85287. Applicant claims that its 1975 telephone expense was up 25 percent over 1974, but provided no figures to support the increase.

Staff's estimates with an allowance for the manager's increase in salary appear reasonable and will be accepted.



Administrative and General Expenses  
(Dollars in Thousands)

<u>Item</u>	<u>Applicant</u>	<u>Staff</u>	<u>Applicant Exceeds Staff</u>
Administrative Office	\$24.4	\$13.7	\$10.7
Common Plant Expense	4.5	2.7	1.8
Legal & Regulatory Expense	4.9	.8	4.1
Insurance	.2	.2	-
Injuries & Damages	3.4	3.2	.2
Welfare & Pensions	13.9	9.9	4.0
Rent	1.4	1.4	-
Miscellaneous & Per Diem	<u>1.6</u>	<u>.9</u>	<u>.7</u>
Total	54.3	32.8	21.5

Citizens-Delaware both operates and/or has subsidiary utility companies providing gas, electric, telephone, water, and waste water service in more than 550 communities in the United States. Its headquarters is located at High Ridge Park, Stamford, Connecticut. It actively engages in the administrative direction of these companies performing administrative, accounting, financial, tax, engineering, and purchasing services for them. Services, including general management and supervision, engineering, accounting, financial, legal, and others, are performed in Stamford, Connecticut, by Citizens-Delaware for its subsidiaries. Certain management and supervising, accounting, billing, and other reporting services for Citizens California, and its California affiliates, including applicant, are performed at an administrative office in Redding, California. In addition, part of the Sacramento office of Citizens California is used for the common benefit of all water operations of said companies and affiliated companies in California.

These allocated expenses are covered in the first two items of Administrative and General Expenses, i.e., Administrative Office and Common Plant Expense. The allocation of these expenses was considered at length and determined in Decision No. 87609 dated July 19, 1977 in Application No. 55430 (Jackson Water Works, Inc.).

Per Decision No. 87609 the total allocation to all California operations of Redding and Stamford mutual service accounts was \$465,000 of which 2.94 percent or \$13,671 was allocated to applicant. The total allocation to all California operations of Sacramento common utility plant was \$33,400 of which 8.22 percent or \$2,746 was allocated to applicant.

All of the exhibits pertaining to the allocation of these expenses were introduced in the Jackson Water Works, Inc. proceeding and were also introduced and received in this proceeding. By stipulation all testimony introduced in the Jackson Water Works, Inc. proceeding relating to these exhibits was incorporated by reference in this proceeding.

We, therefore, adopt the estimate of \$13,671 for Administrative Office Expense and the estimate of \$2,746 for Common Plant Expense.

Staff's estimate of \$800 for legal and regulatory expenses is \$4,100 less than applicant's estimate of \$4,900. Because applicant used house counsel, the staff excluded all attorney's fees and salaries of Stamford, Redding, and Sacramento personnel who participated in the preparation of this proceeding. Staff considered those costs as part of the allocated expenses. Applicant's estimate included direct costs for such personnel, claiming it was in conformity with recommendations made by the Commission's Finance Division as set forth in Exhibit 15.

The recommendations, which relate to the allocation of Stamford, Redding, and Sacramento expenses, are intended for future proceedings. The purpose of those recommendations is to establish accounting procedures whereby accurate records will be available which will facilitate the future direct assignment of as many mutual service expenses as possible. These procedures are not presently in effect nor are accurate records for making direct assignments of cost presently available.

With regard to these accounting procedures recommended by the Commission's Finance Division, it should be noted that Ordering Paragraphs 3 and 4 of Decision No. 87609 dated July 19, 1977 (Jackson Water Works, Inc.) read as follows:

- "3. All cost accounting procedures of the administrative and office costs and expenses that are allocated by Citizens Utilities Company (Citizens-Delaware) to its California subsidiaries, including applicant herein, shall conform to the staff recommendations set forth in Exhibit 17.
- "4. Failure to conform to the staff recommendations set forth in Exhibit 17 will result in disallowance of all administrative and office expenses that are allocated to the California subsidiaries of Citizens-Delaware effective one year from the date of this order."

Applicant herein is clearly one of the California subsidiaries referred to and as such is put on notice that the above order is still operative and will be applied to this district by this order.

Staff allowed transcript, travel, and miscellaneous expenses in the amount of \$3,225, which it spread over four years. Staff excluded from its estimate \$2,000 for the last rate case, in which the Commission allowed \$1,600 a year for five years. This expense has been completely amortized.

Pursuant to an order issued by Commissioner Robert Batinovich, Citizens Utilities Company contracted for a management study the results of which were the subject of Decision No. 87608. Decision No. 87608, as amended by Decision No. 87776, authorized \$23,900, the cost of the study, to be allocated among the ten California subsidiaries of Citizens over a five-year period. Of the total cost, 8.54 percent or \$408 was allocated to applicant.

We, therefore, adopt the estimate of \$408 for the management study expense and have included it herein under legal and regulatory expenses.

Applicant's estimate of \$3,400 for injuries and damages is \$200 higher than the staff's because the staff witness did not use the latest known workers' compensation rate. Applicant's estimate will be accepted.

Applicant's estimate of \$9,900 for welfare and pension expenses is \$4,000 more than the staff's estimate. This is primarily attributable to the lower salary estimates on the part of staff for both Guerneville and the allocated salary expenses for Stamford, Redding, and Sacramento. It is also attributable to the fact that staff excluded expenses related to the Employee Efficiency Incentive Fund in accordance with Decision No. 76996 dated March 24, 1970 in Application No. 48905 (Guerneville District). Applicant points out that although this expense was excluded by Decision No. 76996 it was subsequently allowed in Decision No. 82361 dated January 22, 1974 in Application No. 53288 (Jackson Water Works, Inc.). Through inadvertence the staff failed to raise the issue in the last proceeding. We consider the incentive fund more in the nature of a bonus, the cost of which should be paid for by the stockholders rather than the consumers. Staff's estimate will be accepted.

Staff's estimate of \$900 for miscellaneous and per diem is \$700 less than applicant's figure. Both estimates were based on 5-year averages, which did not take into consideration the 1975 level of expenses. According to applicant the 1975 expenses were 200 percent higher than 1974 expenses, which applicant considered unusually low. The estimates being based on 5-year averages should compensate for an unusually high or low year. Staff's estimate appears to be reasonable and will be accepted.

Taxes Other Than Income

Applicant's estimate of \$39,300 for taxes other than income for 1976 is \$4,000 more than staff's estimate.

Applicant projected effective tax rates for the test years based on an analysis of the historic period 1970 through 1973. It based its estimate on the Sonoma County Assessor's method which gives equal weight to historical cost less depreciation and the capitalized income value in the derivation of the assessed value of property. Applicant, therefore, used proposed rates in reaching its estimate claiming that the increase in earnings due to the proposed rate increase would result in higher ad valorem taxes. Applicant argues that since rates are set for the future, the impact of the increased rates on ad valorem taxes should be reflected in the test year.

Staff used present rates to compute capitalized income valuation in accordance with the method used by the Sonoma County Assessor. Staff argues that since the ad valorem taxes for the 1976 test year will be computed using 1975 revenues and since the Commission has held that tax expense should reflect as nearly as possible the actual taxes paid during the test year, applicant's use of proposed rates is without merit and should be rejected (Decision No. 79915 dated April 4, 1972 in Application No. 52161, Larkfield Water Company). Also contributing to the difference is the difference in plant estimates.

We agree that ad valorem taxes should be determined on the basis of taxes actually paid during the test year and for this purpose present rates should be used. The staff's estimates are reasonable and will be accepted.

Depreciation

The difference between staff's estimate of \$31,700 and applicant's estimate of \$33,300 for depreciation results from differences in plant account balances, and differences in estimates of plant additions, retirements, and rollback adjustments. Both

estimated depreciation accruals by averaging the adjusted beginning and end-of-year balances for each depreciable plant account and by applying the accrual rates which were submitted to the Commission November 28, 1973.

Income Tax

Although the same method was used for estimating income taxes, staff's estimate of \$76,000 is \$24,700 higher than applicant's figure because of the difference in estimating expenses and revenues.

Both applicant and staff followed the same procedures for determining tax depreciation; straight-line for federal taxes, and liberalized on a flow-through basis for state taxes. Staff's estimate is \$5,015 higher because of the difference in the estimates for expenses and for taxes other than income.

The Commission has now issued its decision in the rehearing of Applications Nos. 51774 (The Pacific Telephone and Telegraph Company) and 51904 (General Telephone Company of California) relating to the ratemaking treatment of federal income tax depreciation and investment tax credit (Decision No. 87838 dated September 13, 1977). Among other things, the Commission found:



"Under the normalization method we are adopting for ratemaking purposes, tax depreciation expense for ratemaking purposes will be computed on a straight-line basis while federal taxes will be computed on an accelerated depreciation basis. The difference between the two tax computations will be accounted for in a deferred tax reserve. The average sum of the test year deferred tax reserve and the deferred tax reserve for the three next subsequent years shall be deducted from rate base in the test year. As a result of each of the deductions from rate base federal tax expense will be recomputed on the same basis in the test year for the test year and the three corresponding subsequent years, thus matching the estimated tax deferral amount for each period with the estimated federal tax expense for the same period. This method complies with Treasury Regulation 1.167(l) - (l) (h) (6) and is normalization accounting." (Mimeo. page 48.)

We, therefore, have made the appropriate adjustment and adopt \$10,300 as the estimate of deferred tax reserve.

Further, applicant is placed on notice that the treatment of tax depreciation and investment tax credit found reasonable in Decision No. 87838 will be applied in all future rate proceedings. for all subsidiaries and affiliates of Citizens Utilities Company.

Rate of Return

Applicant contends that a reasonable rate of return would be no less than 12 percent. The staff recommends a 9.00 percent to 9.30 percent rate of return, which would result in a 9.70 percent to 10.8 percent return on equity.<sup>1/</sup>

Rate of return is a judgment determination which the Commission must make in an impartial manner. In addition to the constitutional requirements consideration must be given to such factors as financial requirements for construction, the amount of funds available from advances and contributions for construction, applicant's status as a wholly owned subsidiary of Citizens-Delaware, the consolidated capital structure and related debt costs of Citizens-Delaware and its subsidiaries, the impact of high interest rates, earnings of other utilities; the effect upon consumers and investors, inflation, and service.

As of December 31, 1974 Citizens-Delaware and subsidiaries indicated a capital structure consisting of 40 percent debt and 60 percent common stock equity in the form of 4.1 million shares of Series A common and 1.4 million shares of Series B common. For the past 10 years the cash payment of dividends to holders of Series B common

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<sup>1/</sup> The rate of return exhibits received in the Jackson Water Works, Inc. proceeding (Application No. 55430) were also received in this proceeding. By stipulation all testimony relating to those exhibits was incorporated by reference in this proceeding.

has ranged between 16-1/2 to 21-1/2 percent of earnings available to common equity. In 1974 the company experienced earning rates of 16.10 percent on book value, which is a 10-year high mark.

The staff introduced comparisons for the five years, 1970 through 1974, relating to earning rates on average capital and common stock equity together with interest coverage for 10 combination utilities, 8 large regional water companies, and 9 Class A California water utilities. Citizens-Delaware and subsidiaries earned 12.57 percent on total capital, 16.76 percent on common equity, and interest on debt was earned 4.47 times, which was well above the average earned by the others.

Applicant points out that the staff's comparison fails to reflect whether the companies listed have sought, should, or would seek rate increases and therefore suggests that the earnings on average common equity as shown by the staff's exhibit may be low.

Applicant introduced Exhibit 14, which develops the earning requirements of the California subsidiaries of Citizens-Delaware based on the cost of debt and equity capital to Citizens-Delaware as of October 1975. According to the exhibit the cost of capital of Citizens-Delaware is over 12 percent and is broken down as follows:

<u>Item</u>	<u>Capital Ratio</u>	<u>Capital Cost Rate</u>	<u>Total Capital Cost</u>
<u>Current Capital Costs</u>			
Long-Term Debt	32.4%	9.50%	3.08%
Short-Term Debt	8.6	8.00	.69
Common Equity	<u>59.0</u>	15.00	<u>8.85</u>
Total Capitalization	100.0%		12.62%
<u>Embedded Cost of Debt</u>			
Long-Term Debt	32.4%	7.85%	2.54%
Short-Term Debt	8.6	8.00	.69
Common Equity	<u>59.0</u>	15.00	<u>8.85</u>
Total Capitalization	100.0%		12.08%

Applicant's rate of return expert testified that although Citizens-Delaware is not presently engaged in the issuance of long-term securities the current cost is approximately 9.25 percent and short-term prime cost is currently 7.50 percent; however, when effect is given to the noninterest bearing compensating bank balances the effective cost to Citizens-Delaware is 8.82 percent. He further testified that it was his opinion that no short-term borrowing would be necessary up to the end of 1976. In March 1975 Citizens-Delaware sold \$20 million of 30-year bonds at a cost of 9.05 percent, which was lower than the costs indicated for other double A utilities making debt offerings at that time. According to the witness this was possible because Citizens-Delaware is in a better financial position to issue debt than many other double A companies. It was his opinion that equity investors require anywhere from 3 to 6 percent more than the cost of debt, and for the past five years the earnings in common equity of Citizens-Delaware has averaged better than 15 percent.

As of August 1975 the earnings price ratio of Citizens-Delaware was 10, which was comparable to Moody's 125 Industrials. Its market price book value ratio of 1.5 was higher than the 1974 1.138 for Moody's 125 Industrials and the .562 for Moody's 24 Utilities. Applicant's rate of return witness gave no consideration to the operating results for other water utilities for comparison purposes because he considered the water utility industry as financially sick, and consequently not indicative of reasonable earnings.

The staff found that the embedded cost of debt for Citizens-Delaware is 7.84 percent. In making its determination it included certain REA mortgage notes of a subsidiary and certain other subsidiary obligations, which applicant excluded from its determinations of embedded cost. Applicant contends that this is improper because it tends to lower embedded debt costs. Applicant

argues that REA notes are available by statute only to the subsidiary Arizona corporation, and that the proceeds of the old pre-acquisition issues of the other subsidiaries are available only to the issuing companies. Applicant further argues that the proceeds of the lower cost debt issues are not available to the California subsidiaries and districts.

Applicant raised the same issue in a Writ of Review dated June 21, 1972 in Larkfield Water Company v CPUC, SF No. 22910. The Supreme Court denied review. The issue is moot. The staff by including all subsidiary debt used a reasonable approach.

In October 1974 the Commission in Decision No. 83610 used the consolidated capital structure in awarding an 8.50 percent rate of return to Washington Water and Light Co., which is wholly owned by Citizens-Delaware. The last authorized rate of return for applicant was 5.53 percent as determined by Decision No. 76996 dated March 24, 1970 in Application No. 48905.

The capital structure of Citizens-Delaware is less risky than most utilities in that its 60 percent equity ratio is well above the level of other utilities. Even in a competitively free regulated area it enjoys a return on equity comparable to industrial companies that are engaged in highly competitive fields where the higher risk justifies a higher return on equity.

The staff's recommended rate of return of 9 percent on the adopted rate base and a rate of return on common equity of 9.7 percent would be reasonable, if applicant were providing

an adequate level of water service and quality. However, the record in this proceeding clearly demonstrates that applicant's water quality and service are below minimum standards and inadequate. The quality of water distributed by applicant is especially poor in regard to color, taste, and odor and it contains considerable amounts of iron and manganese.

Applicant will thus be required to file a 5-year plan including associated costs and timetable for upgrading its system to provide an adequate level of service and water quality. The plan should set out a program of system improvements giving significant consideration to the staff's suggestions set forth in Exhibit 13 and to those suggested by the California Department of Health. The plan should include an annual expenditure of at least \$75,000 for replacement of distribution mains, construction of water treatment facilities, and installation of an additional storage tank. The plan must be approved by the Executive Director and once the plan is approved applicant will be required to implement all phases of the plan according to the timetable it establishes.

Until such time as all of the requirements contained in the plan have been completed, applicant's rate of return will be established at 7.2 percent. But for the fact that applicant's presently authorized rate of return is 5.53 percent established by a 1970 decision during a different era of utility regulation, there would be no reason to raise the rate of return at this point in time. An increase in present rates and charges consistent with a rate of return of 7.2 percent is reasonable so long as applicant proceeds in a timely manner to upgrade the present water quality and service to an adequate level in accordance with the to-be-approved plan and timetable.

If applicant should fail to submit a reasonable plan as ordered herein or fail to implement the approved plan according to its time schedule, then applicant's rates and charges will be reduced to their present levels.

Upon certification by the Executive Director that a stage of improvement, that is, a phase of the approved plan, has been completed, applicant may submit a tariff filing to revise its rate schedules to reflect the existing authorized rate of return (7.2%) on the previously approved costs for such completed phase.

Completion of the entire plan should raise applicant's water quality and service to an adequate level at which time staff's recommended rate of return of 9.0 percent will be reasonable. Thus, upon certification by the Executive Director that all improvements required by the plan have been completed, applicant may submit a tariff filing to revise its rate schedules to reflect a rate of return of 9.0 percent. Such tariff filing must be approved by the Commission prior to becoming effective.

Adopted Results

A summary of the earnings as computed and adopted for test year 1976 is as follows:

SUMMARY OF EARNINGS 1976  
(Dollars in Thousands)

Item	Applicant		Staff		Adopted
	Present*	Proposed	Present*	Proposed	
	Rates	Rates	Rates	Rates	
Operating Revenues	\$243.7	\$ 395.5	\$251.1	\$ 405.4	\$ 304.7
<u>Operating Expenses</u>					
Oper. & Main.	116.4	111.6	107.0	107.9	109.0
Admin. & Gen.	48.3	54.3	31.7	32.8	33.2
Depreciation	30.9	33.3	31.7	31.7	31.7
Taxes --Except Income	37.5	39.3	34.6	35.3	35.3
Income Taxes	-	51.3	(3.3)	76.0	21.9
Total Expenses	233.1	289.8	201.7	283.7	231.1
Net Operating Revenue	10.6	105.7	49.4	121.7	73.6
Average Rate Base	993.5	1,162.4	981.4	1,012.3	1,020.9
Rate of Return	1.07%	9.09%	5.03%	12.02%	7.2%

(Red Figure)

\*Present Rates reflect expense estimates and  
rate base at time application was filed.

On the first day of hearing, applicant introduced a number of exhibits revising many of its original estimates. Applicant claims this was necessary to reflect increases in costs and expenses during the one-year period from January 7, 1975, the date of filing, to the date of hearing.

Findings

1. The proposed order will be entered on an interim basis. Upon certification by the Executive Director to the Commission that he has approved a plan for improvements to applicant's system including associated costs and timetable, this interim order will become final without further order of the Commission.



2. The estimates of operating revenues, operating expenses, and rate base adopted herein for test year 1976 are reasonable.

3. A rate of return of 9.0 percent on the adopted rate base would be reasonable if applicant were providing an adequate level of service and water quality.

4. Applicant's level of service and water quality is inadequate because the water being distributed by applicant is poor in regard to color, taste, and odor, and it contains considerable amounts of iron and manganese.

5. Applicant will be required to file a 5-year plan, including associated costs and timetable, for upgrading its system to provide an adequate level of water quality and service, giving significant consideration to the staff's suggestions set forth in Exhibit 13 and to those suggested by the California Department of Health. The plan should include an annual expenditure of at least \$75,000 for replacement of distribution mains, construction of water treatment facilities, and installation of an additional storage tank.

6. Upon approval of a plan and timetable by the Executive Director, applicant will be required to implement all phases of the plan according to the established timetable.

7. Until such time as all of the requirements set forth in the approved plan have been completed, applicant's rate of return will be 7.2 percent, which is reasonable under the circumstances.

8. Upon certification by the Executive Director that a stage of improvement, that is, a phase of the approved plan, has been completed, applicant may submit a tariff filing to revise its rate schedules to reflect the existing authorized rate of return on the previously approved costs for such completed improvements.

9. The increase in rates and charges are authorized herein totaling \$53,600 are justified and reasonable so long as applicant is proceeding in a timely fashion to upgrade its present service and water quality to an acceptable level.

10. If applicant fails to upgrade its level of water quality and service as ordered herein, then the present rates and charges are reasonable and the rates and charges ordered herein would be excessive and unreasonable. At such time, the Commission will reduce applicant's rates and charges to the present level.

11. Completion of all improvements required by the approved plan should raise applicant's water quality and service to an adequate level at which time a 9.0 percent rate of return will be reasonable.

12. Upon certification by the Executive Director that all improvements required by the approved plan have been completed, applicant may submit a tariff filing to revise its rate schedules to reflect a rate of return of 9.0 percent. Such tariff filing must be approved by the Commission prior to becoming effective.

13. All cost accounting procedures of administrative and office costs and expenses that are allocated by Citizens Utilities to its California subsidiaries, including applicant herein, shall conform to the staff recommendations set forth in the proceedings on Jackson Water Works, Inc. in Application No. 55430 (Exhibit 17) as previously ordered in Decision No. 87609. Failure to do so will result in disallowance of all administrative and office expenses that are allocated to the California subsidiaries of Citizens-Delaware effective July 19, 1978.

Conclusion

The application should be granted to the extent hereinafter set forth in the following order.

INTERIM ORDER

IT IS ORDERED that:

1. Citizens Utilities Company of California - Guerneville District is authorized to file the revised schedules of general metered service attached to this order as Appendix A, and concurrently to cancel its present schedule for general metered service.

Such filings shall comply with General Order No. 96-A. The effective date of the new and revised tariff schedules shall be four days after the date of filing. The new and revised schedules shall apply only to service rendered on and after the effective date thereof.

2. Within one hundred twenty days after the effective date hereof applicant shall file with the Commission a plan of system improvements, giving significant consideration to the staff suggestions set forth in Exhibit 13 and to those suggested by the California Department of Health, that will require the expenditure of at least \$75,000 a year.

3. Upon approval of the plan and in accordance with the timetable established therein, applicant shall make the necessary improvements.

4. Upon certification by the Executive Director that a phase of improvement has been completed, applicant may submit a tariff filing to revise its rate schedules to reflect the existing authorized rate of return on the previously approved costs for such completed phase of improvement.

5. Upon certification by the Executive Director that all improvements required in the approved plan have been completed, applicant may submit a tariff filing to revise its rate schedules to reflect a rate of return of 9.0 percent. Such tariff filing must be approved by the Commission before becoming effective.

6. If applicant fails to file or implement a plan within one hundred twenty days of the effective date of this order or fails to implement the plan for improvements in accordance with its approved timetable, the Executive Director shall immediately certify this failure to the Commission for action consistent with this decision.

7. Applicant's petition for an interim rate increase is denied.

8. This order will be entered on an interim basis. Upon certification by the Executive Director to the Commission that he has approved a plan for improvements to applicant's system including associated costs and timetable, this interim order will become final without further order of the Commission.

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

Dated at San Francisco, California, this 22nd day of NOVEMBER, 1977.

I will file a dissent.  
William Sycuro, Jr.

Robert Bateman  
President

Verona L. Sturgeon  
Richard D. Givale  
Clair T. DeBrie  
Commissioners

APPENDIX A  
Page 1 of 3

Schedule No. GU-1A

ANNUAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Guerneville, Rio Nido, East Guernewood, Guernewood Park, Northwood, Monte Rio, Vacation Beach, River Meadows, and vicinity, Sonoma County.

RATES

Quantity Rates:	<u>Per Meter Per Month</u>	
For the first 300 cu.-ft., per 100 cu.-ft. ....	50.270	(I)
For all over 300 cu.-ft., per 100 cu.-ft. ....	0.424	(I)
Annual Service Charge:	<u>Per Meter Per Year</u>	
For 5/8 x 3/4-inch meter .....	\$ 63.00	(I)
For 3/4-inch meter .....	90.00	} (I)
For 1-inch meter .....	138.00	
For 1 1/2-inch meter .....	247.20	
For 2-inch meter .....	392.40	
For 3-inch meter .....	775.20	
For 4-inch meter .....	1,128.00	

The Service Charge is applicable to all metered service. It is a readiness-to-serve charge to which is added the charge computed at the Quantity Rate for water used during the billing period.

Service Establishment Charge:

For each establishment or reestablishment of water service. .... \$4.00

APPENDIX A  
Page 2 of 3

Schedule No. GU-4

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service rendered for private fire protection purposes.

TERRITORY

The unincorporated communities of Guerneville, Rio Nido, East Guerneville, Guerneville Park, Northwood, Monte Rio, Vacation Beach, River Meadows, and vicinity, Sonoma County.

RATES

	<u>Per Year</u>	
Fire Hydrant Rates:		
For each private hydrant .....	\$19.00	(I)
Sprinkler Connection Rates:		
For each 4-inch connection, or smaller .....	\$ 7.30	(I)
For each 6-inch connection .....	10.90	
For each 8-inch connection .....	14.55	
For each 10-inch connection .....	30.30	
For each 12-inch connection .....	42.40	(I)

## Schedule GU-5

PUBLIC FIRE HYDRANT SERVICEAPPLICABILITY

Applicable to all fire hydrant service furnished to duly organized or incorporated fire districts or other political subdivisions of the State.

TERRITORY

The unincorporated communities of Guerneville, Rio Nido, East Guerneville, Guerneville Park, Northwood, Monte Rio, Vacation Beach, River Meadows, and vicinity, Sonoma County.

RATES

	<u>Per Year</u>	
Guerneville Fire District:		
Flat rate charge for		
3- 2-inch hydrants and		
16- 4-inch hydrants .....	\$906.00	(I)
Additional 2-inch hydrants, each .....	18.00	
Additional 4-inch hydrants, each .....	43.80	
Monte Rio Fire District:		
4-inch hydrants, each .....	43.80	
2-inch hydrants (high pressure), each .....	18.00	
2-inch hydrants (low pressure), each .....	7.30	
Rio Nido Fire District:		
4-inch hydrants, each .....	43.80	
2-inch hydrants, each .....	18.00	(I)