

Decision No. SS126 NOV 22 1977

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

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

Application No. 55453  
(Filed January 22, 1975)

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

INTERIM OPINION

Larkfield Water Company, a wholly owned subsidiary of Citizens Utilities Company (Citizens-Delaware), requests an increase in rates for water service designed to increase annual revenues in the test year by \$70,300 over the rates now in effect.

Public hearing was held before Examiner Daly at Santa Rosa on November 24, 25, 26, 1975, and January 5, 1976, at San Francisco. The matter was submitted on concurrent briefs since filed and considered. Copies of the application were served upon interested parties and notice of hearing was published, posted, and mailed in accordance with the Commission's Rules of Practice and Procedure.

Citizens-Delaware both operates and/or has subsidiary utility companies providing gas, electric, telephone, water, and waste water services in more than 500 communities in the United States. 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 Utilities Company of California (Citizens-California), and its California affiliates, including applicant, are performed at an administrative office in Redding, California. In addition, certain plants in the Sacramento office of Citizens-California are used for the common benefit of all water operations of affiliated water companies in California.

Applicant provides water service to an unincorporated portion of Sonoma County about four miles north of the city of Santa Rosa. The service area which is divided into three parts including two subdivisions (Larkfield and Wikiup) and the unincorporated community of Fulton, is served by one interconnecting distribution system. The Larkfield subdivision and the community of Fulton are located on relatively flat terrain, while the Wikiup subdivision rises sharply to the north. These areas vary in elevation from approximately 150 feet to 550 feet. Water is supplied to the service area by three wells located in the Larkfield subdivision and from a connection to the Sonoma County Water Agency's aqueduct. The distribution system consists of approximately 71,000 feet of mains, ranging in size from 2 inches to 12 inches. The system is composed of about 90 percent cement asbestos and 10 percent cast-iron water mains. As of December 31, 1973, applicant was serving 708 metered customers, two private fire connections, and 48 public fire hydrants.

Rates

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

METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Larkfield Estates and vicinity, located approximately three miles northerly of the City of Santa Rosa, Sonoma County.

RATES

		<u>Per Meter Per Month</u>	
		<u>Present</u>	<u>Proposed</u>
		<u>Rates</u>	<u>Rates</u>
Service Charge:			
For	5/8 x 3/4-inch meter .....	\$ 3.75	\$ 5.70
For	3/4-inch meter .....	4.10	6.20
For	1-inch meter .....	5.65	8.60
For	1-1/2-inch meter .....	7.90	12.00
For	2-inch meter .....	10.25	15.60
For	3-inch meter .....	19.00	28.90
For	4-inch meter .....	26.00	39.50
For	6-inch meter .....	41.00	62.30

Quantity Rates:

For the first 50,000 cu.ft., per 100 cu.ft.	.352	.535
For all over 50,000 cu.ft., per 100 cu.ft.	.307	.467

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

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service furnished for privately owned fire protection systems.

TERRITORY

The unincorporated subdivision known as Larkfield Estates and vicinity, located adjacent to U.S. Highway 101, approximately three miles north of the City of Santa Rosa, Sonoma County.

RATES

		<u>Per Month</u>	
		<u>Present</u>	<u>Proposed</u>
		<u>Rates</u>	<u>Rates</u>
For each inch of diameter of service connection		\$1.25	\$1.90

PUBLIC FIRE HYDRANT SERVICE

APPLICABILITY

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

TERRITORY

The unincorporated subdivision known as Larkfield Estates, and vicinity, located adjacent to U.S. Highway 101, approximately three miles north of the City of Santa Rosa, Sonoma County.

RATE

	<u>Per Month</u>	
	<u>Present Rates</u>	<u>Proposed Rates</u>
For each hydrant .....	\$2.50	\$3.80

Service and Quality of Water

There were two informal complaints registered with the Commission in 1974 and four informal complaints filed through October 1, 1975.

Complaints filed in applicant's office are indicated as follows:

<u>Type of Complaint</u>	<u>1974</u>	<u>1/1 to 10/1/75</u>
Main Leaks	5	5
Dirt, Sand, Smell	8	5
No Water	2	1
Low Pressure	14	14
High Pressure	1	-
Miscellaneous	<u>25</u>	<u>5</u>
Total	55	30

Subsequent to the filing of the instant application the Commission received 224 form letters from the Greater Larkfield Civic Association listing the following complaints.

Inadequate Fire Protection	5
Low Pressure	98
Insufficient Water	69
Water Quality	145
Odor	12
Dirt	15
Iron and Manganese	29
Expected High Cost	13
Miscellaneous	<u>4</u>
Total	390

In addition to the increased rates, a major complaint of the Wikiup Home Owners' Association was the low pressure at the higher altitudes and the inadequate fire flow. As a result of a meeting held in June 1975, between applicant, representatives of the home owners' association and a member of the staff, steps were taken to improve pressure for nine customers in the closed pressure zone.

Twenty-four public witnesses testified. Several were of the opinion that the cost of water was too high at the present rates and resulted in restrictive use for gardening. Others complained of low pressure and many complained of dirty water that discolored kitchen and bathroom facilities and stained dishes and clothes. Several testified that it was necessary to use an acid compound to clean kitchen and bathroom facilities. A doctor, who is a pathologist and president of the Sonoma Medical Association, testified that the high content of manganese in the water constitutes a potential health problem. A representative of the California Department of Health, who was presented by the staff, testified that tests of Wells Nos. 1, 3, and 4, made on November 17, 1975, indicated high iron and manganese contents. He recommended that the iron and manganese be removed by effective treatment so as to conform with maximum limits established by the State of California. It was his estimate that separate treatment plants at each well would cost approximately \$235,000.

The Fire Chief of the district testified that he was particularly concerned with the hydrant flow at Los Altos Court and Vista Grande, which drops to 290 gallons per minute when 500 gallons per minute is the minimum required. Lack of notice of shutoffs was also a problem expressed by many of the other public witnesses. On three occasions during the period of 1974 and 1975 the Sonoma County Water Agency turned off the water without notification until some time after the shutoff. Although applicant, with the help of some of the residents, attempted to notify customers by use of a sound truck, spot radio and television announcements, and distribution of handbills, many customers were uninformed.

Another problem frequently mentioned was the difficulty experienced in reporting leaks or service problems and in obtaining information by telephone. In most cases no one was available to

answer the telephone. According to applicant this problem has been corrected by a new telephone number, which will permit customers to call the utility office in Guerneville without charge. During nonbusiness hours a call diverter will automatically transfer calls to a serviceman.

The staff recommends that an additional storage tank be installed at the lower storage and pump station and that increased booster pump capacity be installed at the upper pump station in order to provide an adequate quantity of water to the upper pressure zone during periods of maximum demand. The staff further recommends that applicant investigate a better method of treating the well water production in order to improve the quality of water. It was the staff's estimate that a treatment plant to improve the water quality would require an additional investment of approximately \$200,000 for filtration equipment, which would require approximately \$60 per customer per year in additional revenue at the staff's recommended rate of return of 9.0 percent.

Rate Base

The following tabulation sets forth a comparison of applicant and the staff rate base components for the estimated year 1976, which includes applicant's estimates at the time the application was filed on January 22, 1975, and its revised estimates filed during the course of hearing in Exhibit 11.

	<u>Applicant Date of Filing</u>	<u>Applicant Exh. 11</u>	<u>Staff</u>	<u>Applicant Exceeds Staff</u>
Utility Plant in Service	\$982,000	\$945,700	\$838,100	\$107,600
Reserve for Depreciation	<u>(165,000)</u>	<u>(162,400)</u>	<u>(155,800)</u>	<u>(6,600)</u>
Net Plant In Service	\$817,000	\$783,300	\$682,300	\$101,000
Common Plant	2,900	2,900	2,900	-
Materials and Supplies	5,500	5,500	3,700	1,800
Working Cash	12,700	12,700	11,000	1,700
Minimum Bank Balances	6,900	6,900	-	6,900
Non-Interest Bearing C.W.I.P.	5,700	1,700	2,600	(900)
Advances for Construction	(259,000)	(218,900)	(218,900)	-
Contributions in Aid of Construction	(20,800)	(22,000)	(22,000)	-
Reserve for Deferred Income				
Taxes	<u>(18,800)</u>	<u>(12,200)</u>	<u>(15,500)</u>	<u>3,300</u>
Average Rate Base	\$552,100	\$559,900	\$446,100	\$113,800

(Red Figure)



The difference between staff and applicant is primarily due to staff's (1) allowance of \$24,000 for 1976 plant additions, (2) elimination of Well No. 2 from rate base, and (3) adjustment for 12-inch main.

Applicant revised its estimated construction of utility plant for 1976 to provide for the following:

<u>Item</u>	
Line extensions and replacements under \$1,000	\$ 6,000
Line extensions and replacements over \$1,000	6,000
Meters and Services	4,000
Storage Tank at Wikiup Drive	80,300
2,000 gal. Chemical Storage Tank at Well #3	2,500
Chlorine and Treatment Equipment at Well #4	5,000
Total	<u>\$103,800</u>

Staff introduced a graph of applicant's plant additions (Exhibit 24) which it contends shows a predictable pattern of peak construction prior to or during applications for increases and valleys of minimal construction during other years. In support of its contention staff points out that applicant shows construction of \$108,000 and \$103,000 for the years 1975 and 1976 and estimates construction at less than \$20,000 a year for the years 1977, 1978, and 1979.

The staff excluded Well No. 2 because in a prior proceeding the Commission found that "...Well No. 2 is producing turbid water at an inadequate rate after the failure of its casing." Since the construction of Well No. 4 in 1975, Well No. 2 has been maintained on a standby basis for Well No. 3; however, it has not been used since the new well has been placed in operation.

Staff also excluded a portion of the cost of the 12-inch main to the Sonoma County aqueduct, because the Commission in the

prior proceeding (Decision No. 79915, supra) found that applicant's 12-inch main was oversized.

Staff recommends installation of the storage tank, but it takes the position that no allowance should be made until the tank is actually constructed. Although the tank was originally scheduled for completion in the summer of 1974 no work had been performed as of late 1975. Applicant claims that construction of the tank was delayed because of a delay in construction of Well No. 4, but that a work order has been issued and construction will be completed in May 1976.

Staff's estimate for reserve for depreciation is lower than applicant's because its estimate of plant additions is lower.

Applicant and the staff computed working cash by using the simplified basis prescribed by staff Practice U-16. The minor difference in working cash is due to the different estimates of expense. The staff did not include additional amounts for minimum bank balances in conformity with Decision No. 83610 dated October 16, 1974 in Application No. 54323 (Washington Water and Light Co.).

Staff's estimate of materials and supplies is \$1,800 less than applicant's. Both used weighted averages supplied from figures in applicant's work papers covering the years 1970-1974. Staff, however, in reaching its determination also used the year-end amount of \$2,416 for 1974, which was taken from applicant's annual report and is less than the \$5,100 weighted average. Staff takes the position that its estimate is reasonably close to applicant's actual inventory as of July 31, 1974. Staff also takes the position and we agree that the amount of \$3,700 is ample for materials and supplies particularly in an area close to Santa Rosa where supplies are readily available when needed.

Staff's estimated rate base in the amount of \$446,100 is reasonable and will be accepted.

Operating Revenue

The staff reviewed applicant's method of estimating water consumption and revenue and made an independent estimate of the quantities. The staff estimated the annual metered sales per commercial customer by use of a multiple regression analysis based on time, rainfall, temperature, and recorded historical consumption. Based on the Santa Rosa weather station, an annual average use per customer of 239.1 Ccf per customer was determined. Due to the close approximation to applicant's estimate of 240 Ccf per customer, the staff adopted applicant's estimate of \$135,400 under present rates as reasonable.

Operation and Maintenance Expense

The summary of earnings indicate a difference of \$1,800 in operation and maintenance expense estimates 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	\$12.7	\$11.8	\$ .9
Purchased Power	13.5	12.6	.9
Purchased Water	13.6	13.6	-
Materials, Services & Misc.	8.6	8.6	-
Customers Accounting & Misc.	1.9	1.9	-
Transportation	2.0	2.0	-
Telephone and Telegraph	.6	.6	-
Uncollectible Accounts	.3	.3	-
Total	<u>\$53.2</u>	<u>\$51.4</u>	<u>\$1.8</u>

The difference in salaries is attributable to the staff's using current known salary levels as of August 1, 1975, whereas applicant used a projected wage level for 1976 when wage contracts are renegotiated. It is the staff's contention that known wage levels should be used instead of speculative wage levels. Applicant believes that this is unrealistic because it fails to reflect all of the charges that will take place during the test year. It is suggested by the staff that within the provisions prescribed by the Commission such expenses as they become a reality can be offset by the filing of an advice letter. Applicant argues that such procedure results in a continuous series of local advice letter filings and requires applicant to absorb the increased expenses during the lag periods. In weighing the equities between having the consumer absorb anticipated salary expenses and applicant absorbing lag period expenses we are more persuaded by the interests of the consumer.

In the case of purchased power the staff's estimate was based on the power rates placed in effect by PG&E, effective September 17, 1975. Applicant contends that it priced the last 12 months power bills at the current PG&E rates and developed an average cost of 2.97 cents per kwh for pumping and a cost of 3.3 cents per kwh for boosting, which when applied to the required kwhs estimated by the staff results in a total cost of \$13,500, which is \$900 higher than that estimated by the staff. Staff attempted to reconstruct applicant's work paper for the 12 months ending October 31, by requesting the amount of water pumped. In attempting to check the data applicant informed the staff that all the data was not completely available. Staff's estimate will be accepted.

Administrative and General Expenses

A summary of administrative and general expenses is as follows:

<u>Item</u>	<u>Applicant</u>	<u>Staff</u>	<u>Applicant Exceeds Staff</u>
	(Dollars in Thousands)		
Administrative Office Exp.	\$ 8.3	\$ 4.7	\$ 3.6
Common Plant Expense	1.5	1.0	.5
Legal & Regulatory Expense	5.9	3.6	2.3
Insurance	.1	.1	-
Injuries and Damages	.8	.8	-
Welfare and Pensions	3.3	2.9	.4
Miscellaneous & Per Diem	<u>.1</u>	<u>.1</u>	<u>-</u>
Total Adm. & Gen.	\$20.0	\$13.2	\$ 6.8

General office expenses are from two sources, Stamford, Connecticut, and Redding, California. 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 supervisory, accounting, billing, and other reporting services for Citizens Utilities Company of California (Citizens-California), and its California affiliates, including applicant, are performed at an administrative office in Redding, California. In addition, certain plant in the Sacramento office of Citizens-California is used for the benefit of all water operations of that company and affiliate water companies in California.

A thorough presentation on the allocation of these costs to California for the year 1976 was presented by applicant and the staff in the application of Jackson Water Works, Inc. (Application No. 55430). By stipulation the testimony of witnesses appearing on behalf of the applicant and the staff relating to those allocated costs was received in this proceeding by reference. By Decision No. 87609 dated July 19, 1977 in Application No. 55430, the Commission set forth the total allocation of \$465,000 to all California

operations of Redding and Stamford mutual service accounts. Of that amount, 1.02 percent or \$4,743 was allocated to applicant.

In the same proceeding, the Commission adopted \$33,400 as the total allocation to all California operations of Sacramento common utility plant of which 2.85 percent of \$952 was allocated to applicant. We, therefore, adopt the estimate of \$4,743 for administrative office expense and the estimate of \$952 for common plant expense.

Staff and applicant differ by \$2,300 for legal and regulatory expenses. The difference is primarily attributable to applicant's including an amount of \$2,200 to amortize a prior rate case where the Commission allowed \$1,330 by Decision No. 79915, dated April 4, 1972 in Application No. 52161 (Larkfield Water Company). Applicant also included direct salary charges to Larkfield for services performed by Stamford personnel, which it claims is consistent with recommendations made by the Commission's Finance Division. These recommendations relate to future procedures and when put into effect will provide the necessary records to support direct charges. In any event applicant was unable to substantiate the direct charges with time records or other data.

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.

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 for the cost of the study to be allocated among the ten California subsidiaries of Citizens-Delaware over five years. Of the total cost, 2.45 percent of \$117 was allocated to applicant. We, therefore, adopt the estimate of \$117 for the management study expense.

No adjustment has been made in the previous tables to the required revenues in this proceeding since the amount is small and the time involved in making such adjustments would delay this matter further. However, the amount will be offset against a recalculated deferred tax account as discussed below under Income Taxes.

The staff excluded \$400 from welfare and pensions, because it represents expenses for the Employees' Efficiency Incentive Fund, which the Commission has held to be more in the nature of sharing of profits than a necessary expense of doing business. (Decision No. 76996 dated March 24, 1970 in Application No. 48905, Guerneville District, Citizens Utilities Company.)

Income Taxes

The differences in taxes are mainly due to the different estimates of expenses.

Citizens-Delaware, which includes applicant in its consolidated income tax returns, applied liberalized depreciation to the 1971 plant additions in the 1971 consolidated income tax returns, and similarly to the 1972, 1973, and 1974 plant additions. In computing state income tax, the staff computed depreciation on a straight-line basis for plant constructed before January 1, 1971, and used liberalized depreciation for qualifying additions in 1971, 1972,

1973, 1974, 1975, and 1976. Both applicant and the staff followed this method, which was adopted by the Commission in Decision No. 83610 dated October 16, 1974 in Application No. 54322 (Washington Water and Light Co.). Each computed investment credit on the 1971, 1972, and 1973 plant additions and deducted 3.5 percent (spread over 28 years) of this credit as an annual amount from the federal income tax.

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(1) - (1) (h) (6) and is normalization accounting." (Mimeo. page 48.)

No adjustment has been made in the deferred tax reserve or in the required revenues in this proceeding since the amount involved would be small and the time involved in making such adjustments would delay this matter further. The amount by which revenues would



be decreased due to a recalculation is made even smaller by an offset of \$117 for the management study expense discussed, supra.

Applicant is placed on notice, however, 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.

Depreciation Expenses and Reserve

Both applicant and the staff computed the depreciation expense by the straight-line remaining life method and applied depreciation rates by accounts. Each applied these rates by accounts to the average of adjusted beginning and end-of-year depreciable plant balances. The differences in the estimates of the depreciation expenses and reserves are due to different estimates of plant additions.

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.

Rate of return is a judgment determination which the Commission must make in an informed and impartial manner. In addition to the constitutional requirements, consideration must also 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 payout ratio of dividends to holders of Series B common has ranged between 16-1/2 to 21-1/2 percent of total 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-year period 1970 through 1974 relating to earning rates on average capital and average 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 4.47 times interest on debt, which were well above the averages earned by the others.

Applicant points out that the staff's comparison fails to reflect whether the companies listed have, 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. In its comparison study of return on equity in which it determined that Citizens-Delaware was entitled to at least a 15 percent rate of return, applicant's rate of return witness admitted that he did not include any water utilities, because he considers them a financially sick industry and to include them would only distort the results.

Applicant introduced Exhibit 12, which develops the earning requirements of the California subsidiaries of 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>So-Called Current Capital Costs</u>			
Long-Term Debt	32.4%	9.50%	3.08%
Short-Term Debt	8.6%	8.00%	.69%
Common Equity	59.0%	15.00%	8.85%
Total Capitalization	<u>100.0%</u>		<u>12.62%</u>
<u>Using Embedded Cost of Debt</u>			
Long-Term Debt	32.4%	7.85%	2.54%
Short-Term Debt	8.6%	8.00%	.69%
Common Equity	59.0%	15.00%	8.85%
Total Capitalization	<u>100.0%</u>		<u>12.08%</u>

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 rate 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 in his estimate Citizens-Delaware would require no short-term borrowing up to the end of 1976. In March 1975 Citizens-Delaware sold \$20 million of 30-year bonds at a cost of 9.50 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 on common equity of Citizens-Delaware have 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 and its market price-book value ratio was 1.5, which was higher than the 1.138 estimated in 1974 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 considers the water industry as financially sick, and consequently not indicative of reasonable earnings.

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 as improper because they tend to lower embedded debt costs. Applicant argues that REA notes are available by statute only to a 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 filed 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 Company, which is wholly owned by Citizens-Delaware. The last authorized rate of return for applicant was 7.7 percent as determined by Decision No. 79915 dated April 4, 1972 in Application No. 52161.

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.

The staff's recommended rate of return of 9 percent on the adopted rate base and a rate of return on common equity of 9.70 percent would be reasonable for applicant if applicant were providing an adequate level of service and water 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 taste and odor, and it contains considerable amount of iron and manganese which cause staining of clothes, dishes, and appliances.

Applicant will thus be required to file a 3-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 recommendations of the staff and the California Department of Health relating to a central treatment plant or to individual plants for each well and to the installation of a new storage tank. The plan should also give serious consideration to improving hydrant pressure at Los Altos Court and Vista Grande and improving pressure at higher elevations including the Wikiup Area. Further, the plan should provide for a better method of communication between applicant and customers for the purpose of providing adequate notice, when possible, to customers before water is shut off. The plan must be approved by the Executive Director

and when approved applicant will be required to implement all phases of the plan according to the approved timetables. Because of the inadequate level of service and water quality, and until such time as all of the requirements contained in the plan have been completed, applicant's rate of return will remain at 7.7 percent, which is reasonable under existing circumstances. An increase in present rates and charges consistent with a rate of return of 7.7 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 (7.7%) 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 follow:

Item	Applicant		Staff		Adopted
	Present Rates	Proposed Rates	Present Rates	Proposed Rates	
Operating Revenues	\$135.4	\$205.7	\$135.4	\$205.7	\$140.9
(Dollars in Thousands)					
<u>Operating Expenses</u>					
Operation & Maintenance	56.6	53.2	51.3	51.4	51.3
Administrative General	16.7	20.0	13.2	13.2	13.2
Taxes Other than Income	19.6	28.7	18.7	18.7	18.7
Depreciation	18.9	17.8	14.4	14.4	14.4
Income Taxes	-	32.2	6.0	43.0	8.9
Total Expenses	\$111.8	\$151.9	\$103.6	\$140.7	\$106.5
Net Operating Revenue	23.6	53.8	31.8	65.0	34.4
Rate Base	552.1	559.9	446.1	446.1	446.1
Rate of Return	4.27%	9.61%	7.13%	14.57%	7.7%

(Red Figure)

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 shall 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 water service and quality is inadequate because the water being distributed by applicant is poor in regard to taste and odor, and contains considerable amounts of iron and manganese which cause staining of clothes, dishes, and appliances and the numbers and intensity of customer complaints is significant.

5. Applicant will be required to file a 3-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 recommendations of the staff and the California Department of Health relating to a central treatment plant or to individual plants for each well and to the installation of a new storage tank. The plan should also give consideration to improving hydrant pressure at Los Altos Court and Vista Grande and improving pressure at higher elevations including the Wikiup area. Further, the plan should provide for a better method of communication between applicant and customers for the purpose of providing adequate notice, when possible, to customers before water is shut off.

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 7.7 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 authorized herein totaling \$5,500 is 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 being 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 D. 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. After the effective date of this order, Larkfield Water Company is authorized to file the revised rate schedules attached to this order as Appendix A and concurrently to cancel the present rate schedules. Such filings shall comply with General Order

No. 96-A. The effective date of the new and revised tariff sheets 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, including associated costs and timetable for upgrading its system to provide an adequate level of water quality and service, giving significant consideration to the recommendations of the staff and the California Department of Health relating to a central treatment plant or individual plant for Wells Nos. 1, 3, and 4, and to the installation of a new storage tank. The plan shall also give consideration to improving hydrant pressure at Los Altos Court and Vista Grande and improving pressure at higher elevations including the Wikiup area. The plan shall also provide for a better method of communication between applicant and its customers for the purpose of reporting service problems and, in particular, adequate and sufficient notice to customers before water is shut off. ✓  
✓  
✓

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 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 based 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 will become effective upon Commission approval.

6. If applicant fails to submit a plan within 120 days of the effective date of this order or if applicant fails to implement the plan for improvements in accordance with its approved timetable, the Executive Director shall immediately certify this failure to the Commission and to applicant for action consistent with this decision.

7. 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 D. 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.

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

A-55453 fc

associated costs and timetable, this interim order shall 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.

*Luillika dissent  
William Szymon, Jr*

*Robert B. ...*  
President

*Vernon L. Sturgeon*  
*Stephen D. ...*  
*Clare L. ...*  
Commissioners

APPENDIX A  
Page 1 of 3

Schedule No. 1

METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Larkfield Estates and vicinity, located approximately three miles northerly of the City of Santa Rosa, Sonoma County.

RATES

	<u>Per Meter Per Month</u>
Service Charge:	
For 5/8 x 3/4-inch meter .....	\$ 3.75
For 3/4-inch meter .....	4.10
For 1-inch meter .....	5.90
For 1-1/2-inch meter .....	8.20
For 2-inch meter .....	10.70
For 3-inch meter .....	19.80
For 4-inch meter .....	27.00
For 6-inch meter .....	43.00

Quantity Rate:

Per 100 cu.ft. ....	\$ .371
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(I)  
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(I)

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

Schedule No. 4

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service furnished for privately owned fire protection systems.

TERRITORY

The unincorporated subdivision known as Larkfield Estates and vicinity located adjacent to U.S. Highway 101, approximately three miles north of the City of Santa Rosa, Sonoma County.

RATES

	<u>Per Month</u>	
For each inch of diameter of service connection .....	\$1.30	(I)

SPECIAL CONDITIONS

1. The fire protection service will be installed by the utility at the cost of the applicant. Such cost shall not be subject to refund.
2. If a distribution main of adequate size to serve a private fire protection system in addition to all other normal service does not exist in the street or alley adjacent to the premises to be served, then a service main from the nearest existing main of adequate capacity will be installed by the utility at the cost of the applicant. Such cost shall not be subject to refund.
3. Service hereunder is for private fire protection systems to which no connections for other than fire protection purposes are allowed and which are regularly inspected by the underwriters having jurisdiction, are installed according to specifications of the utility, and are maintained to the satisfaction of the utility. The utility may install the standard detector type meter approved by the Board of Fire Underwriters for protection against theft, leakage or waste of water.
4. For water delivered for other than fire protection purposes, charges will be made therefor under Schedule No. 1, General Metered Service.
5. The utility will supply only such water at such pressure as may be available from time to time as a result of its normal operation of the system.

Schedule No. 5

PUBLIC FIRE HYDRANT SERVICE

APPLICABILITY

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

TERRITORY

The unincorporated subdivision known as Larkfield Estates, and vicinity, located adjacent to U.S. Highway 101, approximately three miles north of the City of Santa Rosa, Sonoma County.

RATE

Per Month

For each hydrant ..... \$2.60 (I)

SPECIAL CONDITIONS

1. For water delivered for other than fire protection purposes, charges will be made at the quantity rates under Schedule No. 1, General Metered Service.
2. The cost of installation and maintenance of hydrants will be borne by the utility.
3. Relocation of any hydrant shall be at the expense of the party requesting relocation.
4. The utility will supply only such water at such pressure as may be available from time to time as the result of its normal operation of the system.