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Decision No. 88128 NOV 22 1977

ORIGINAL

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 Montara, Marine View, Farallone City, Moss Beach and adjacent territory in San Mateo County.

Application No. 55538
(Filed March 6, 1975)

Investigation on the Commission's own motion into the operations, practices, service, equipment, facilities, rules, regulations, contracts and water supply of CITIZENS UTILITIES COMPANY OF CALIFORNIA, Montara District, serving the areas of Montara, Marine View, Farallone City, Moss Beach and adjacent territory in San Mateo County.

Case No. 10093
(Filed May 4, 1976)

John H. Engel, Attorney at Law, for Citizens Utilities Company of California, applicant in A.55538 and respondent in C.10093.

Joanne Rabin, Deputy Attorney General, for the Department of Health; and James C. Parks and Cecilia S. Goldthorpe, for themselves; interested parties.

Mary Carlos, Attorney at Law, and James Barnes, for the Commission staff.

O P I N I O N

Citizens Utilities Company of California (Citizens-California), Montara District, a wholly owned subsidiary of Citizens Utilities Company (Citizens-Delaware), requests an increase in rates for water service to increase annual revenues in the test year by approximately \$92,800 over the rates now in effect.

The above Commission investigation was consolidated with the application for rate increase. Public hearings were held before Examiner Daly at Montara on June 1, 2, 3, and 4, 1976 with the matters being submitted on concurrent briefs, which were filed on September 3, 1976. By Decision No. 86193 dated August 3, 1976 the Commission issued an interim order requiring respondent to (a) acquire new sources of water for its Montara service area capable of producing at least 200 gallons of water per minute; (b) file a water management plan giving priority to the conservation of water and to the continuity of service in an emergency; (c) make no new connections until a sufficient water supply has been demonstrated; and (d) conduct a well-testing program under the supervision of a registered engineer.

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. Its headquarters is located in High Ridge Park, Stamford, Connecticut. It actively engages in administrative direction of applicant performing administrative, accounting, financial, tax, engineering, and purchasing services for it.

Citizens-California, which has its principal office in Redding, California, is a Class A telephone utility as well as a Class A water utility. The Montara Water District of Citizens-California serves the communities of Montara, Marine View, Farallone City, Moss Beach, and the adjacent areas all located in San Mateo County. Water is obtained from both spring diversions and wells. Three of the wells are located in the northern part of the system and two near the airport in the southern section. As of December 31, 1974 there were approximately 121,000 feet of distribution main ranging from 1½ to 8 inches in diameter included in the system. As of the same date the district had 968 active metered service connections, 2 private fire connections, and 47 public fire hydrant

connections. Operations within the district are conducted from an office in Montara. In addition to a division manager, whose office is located in Los Altos, a local representative, two servicemen, and a clerk operate out of the Montara office.

Rates

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

METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Montara, Farallone City, Moss Beach and Marine View, and vicinity, San Mateo County.

RATES

	<u>Per Meter</u>	<u>Per Month</u>
	<u>Present</u>	<u>Proposed</u>
Quantity Rates:		
First 500 cu.ft. or less	\$ 9.20	\$ 13.15
Next 4,000 cu.ft., per 100 cu.ft. ..	.85	1.22
Over 5,000 cu.ft., per 100 cu.ft. ..	.50	.72
Minimum Charge:		
For 5/8 x 3/4-inch meter	\$ 9.20	\$ 13.15
For 3/4-inch meter	13.00	18.60
For 1-inch meter	16.25	23.25
For 1-1/2-inch meter	30.00	42.90
For 2-inch meter	42.00	60.05
For 3-inch meter	85.00	121.55
For 4-inch meter	130.00	185.90

The Minimum Charge will entitle the customer to the quantity of water which that minimum charge will purchase at the Quantity Rates.

PRIVATE FIRE HYDRANT SERVICE

APPLICABILITY

Applicable to all fire hydrant service furnished for private fire hydrants.

TERRITORY

The unincorporated communities of Montara, Farallone City, Moss Beach and Marine View, and vicinity, San Mateo County.

RATE

	Per Month	
	<u>Present</u>	<u>Proposed</u>
For each hydrant	\$2.00	\$2.85

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

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

TERRITORY

The unincorporated communities of Montara, Farallone City, Moss Beach and Marine View, and vicinity, San Mateo County.

RATES

	Per Month	
	<u>Present</u>	<u>Proposed</u>
For each 4-inch connection or smaller ..	\$ 6.00	\$ 8.60
For each 6-inch connection	9.00	12.85
For each 8-inch connection	12.00	17.15
For each 10-inch connection	25.00	35.75
For each 12-inch connection	35.00	50.05

PUBLIC FIRE HYDRANT SERVICE

APPLICABILITY

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

TERRITORY

The unincorporated communities of Montara, Farallone City, Moss Beach and Marine View, and vicinity, San Mateo County.

RATES

	Per Hydrant Per Month					
	Utility Owned Utility Maintained		Utility Owned Customer Maintained		Customer Owned Customer Maintained	
	<u>Present</u>	<u>Proposed</u>	<u>Present</u>	<u>Proposed</u>	<u>Present</u>	<u>Proposed</u>
Served by mains smaller than 6-inch	\$3.00	\$4.30	\$1.75	\$2.50	\$1.00	\$1.45
Served by mains 6-inch or larger	4.25	6.10	3.00	4.30	1.00	1.45

Service and Quality of Water

Twenty-four public witnesses testified. The majority were critical of intermittent water outages, which were covered in detail in Decision No. 86193.

There were several complaints about low pressure, two of which were checked by applicant. One was found to range between 95 and 110 pounds with a flow of 15 gallons per minute at the front hose bib. In the case of service to another witness the pressure check was adequate, but the flow at the meter was somewhat below normal, and applicant's general manager directed that the service from the main be replaced.

Two witnesses testified that a number of customers had been receiving water through their neighbors' homes. According to applicant this resulted from a dispute between several contractors about the payment for a main extension in accordance with the Extension Rule, which has since been resolved.

The owner of a rehabilitation hospital complained of debris in the water, hard water, and lack of pressure. Because of poor service and asserted indifference on the part of applicant, she contends that she was forced to install a water softener at a cost of \$5,000 and water tanks at a cost of \$8,000.

These complaints apparently had been the subject of a complaint proceeding brought by this witness in 1970.

Another complaint expressed by certain witnesses was the difficulty experienced in contacting a representative of applicant during an emergency or even for the purpose of obtaining information. The problem is more acute when the office closes for the day. At the present time a call placed to applicant after 5:00 p.m. is answered by a recording which provides the home telephone number of a service man.

According to applicant an answering service was used several years ago but was discontinued because it was not reliable. Applicant claims that it attempted to have the local fire department accept after-hour emergency calls, but the department was hesitant to do so because of possible liability. Applicant has used call diverters but contends that the diverter is no more effective than a recording giving an emergency number to call.

Rate Base

Applicant estimates rate base at \$913,400 and the staff estimates it at \$818,400, resulting in a difference of \$95,000.

The following is a summary of applicant's and the 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	\$1,199.5	\$1,112.3	\$87.2
Reserve for Depreciation	(186.8)	(180.6)	(6.2)
Net Utility Plant in Service	1,012.7	931.7	81.0
Common Plant	3.9	3.8	.1
Materials and Supplies	6.0	3.7	2.3
Working Cash	21.0	16.3	4.7
Minimum Bank Balances	12.2	-	12.2
Noninterest-Bearing CWIP	4.6	3.6	1.0
Advances for Construction	(117.3)	(106.9)	(10.4)
Contributions in Aid of Construction	(14.4)	(15.1)	.7
Reserve for Deferred Taxes	(15.3)	(18.7)	3.4
Average Rate Base	913.4	818.4	95.0

(Red Figure)

1. Utility Plant in Service. The main difference between the estimates of applicant and the staff for utility plant in service results from the difference in their determination of construction of utility plant for the year 1976. Staff allows \$222,400 of 1976 plant additions whereas applicant's revised construction budget projects plant additions in the amount of \$294,200.

Staff rolled back to 1975 certain projects scheduled for construction. The rolled-back projects are a 450,000-gallon storage tank, \$96,100; a pressure sand filter, \$22,400; and a booster pump, \$6,600. Staff estimated other additions to be installed during 1976 to total \$97,300, which is the average of all plant additions for the five-year period 1971 through 1975. Staff's estimates for concurrent retirements is \$7,500, which is the average for all retirements for the same five-year period.

Although staff recognized that many of applicant's proposed projects are important to the upgrading of the water system, it believes that the installation schedule and cost estimates for these projects are uncertain. Staff, therefore, recommends that additional rate relief based on the actual capitalized costs of these projects over and above the staff's allowance of \$97,300 be granted to applicant if and when it completes all projects contained in its revised 1976 construction budget.

Applicant argues that there is no uncertainty relating to the scheduling and cost of the proposed projects. According to applicant it has already expended or committed, by issued purchase order or other writing, to spend \$241,843 for the proposed projects.

We note in this proceeding, as we have recently noted in affiliated rate proceedings, a proposed program of long-needed system improvements that applicant has conveniently timed for a rate relief test year. The public deserves better consideration.

The difference between applicant and the staff in the reserve for depreciation is attributable to the different estimates of utility plant in service.

We adopt staff's estimate and recommendation.

2. Materials and Supplies. Applicant's estimate for materials and supplies is \$6,000, whereas the staff's estimate is \$3,700.

Applicant's estimate reflects 35 percent of the three-year average of the materials and supplies inventory held at the district office of applicant's affiliate, North Los Altos Water Company, which is also used by that company and the Felton District. The percentage of allocation was determined on the basis used for allocating other expenses such as salaries, transportation, etc., and upon the respective number of customers.

Applicant's original estimate for this expense was zero, apparently because the entire account was carried, unallocated at Los Altos. Applicant provided no work papers to substantiate the use of 35 percent of \$17,000 for the North Los Altos inventory.

Staff's estimate appears reasonable and will be accepted.

3. Working Cash. Applicant estimates working cash at \$21,000 and the staff's estimate is \$16,300.

Applicant's estimate is based upon a lead-lag study which it contends is more detailed and therefore a more accurate method of determining working cash than that used by the staff. Staff based its estimate on the simplified method as provided by the staff's Standard Practice U-16, which is the same method that it has used in all of the affiliated rate proceedings. 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.).

Applicant included \$12,200 for minimum bank balances which the staff completely excluded. This represents a portion of the amount of minimum bank balances Citizens-Delaware is required to keep with banks in order to acquire short-term financing at the prime rate.

Applicant argues that the effect of maintaining such compensatory bank balances is that the borrower pays interest on the total amount of a particular loan, but actually has the use of a lesser amount, the balance being maintained in its account with the bank. According to applicant their compensatory bank balances carry a legitimate cost, and since they are not included in the working cash compensations, nor in the cost of capital, it is necessary to make allowances for them in rate base.

Applicant does not itself make any short-term borrowings. The balances are not directly related to the day-to-day activities of the applicant. The same disallowances were applied in Decision No. 76996 dated March 24, 1970 in Application No. 48905 (Guerneville District) and Decision No. 79919 dated April 4, 1972 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.

4. Noninterest-Bearing CWIP. Applicant's estimate of \$4,600 for noninterest-bearing CWIP is \$1,000 more than the staff's and applicant's estimate of (\$15,300) for reserve for deferred taxes where the staff's estimate is (\$18,700). In both instances the differences result from the staff's use of a lower level of construction.

Staff's estimate of average rate base in the amount of \$818,400 is reasonable and will be adopted.

Operating Revenues

Applicant estimated operating revenues at present rates to be \$186,300. The staff estimate is \$204,200. Both staff and applicant estimated the average metered sales per commercial customer by use of a multiple regression analysis based on time, rainfall, temperature, and recorded historical consumption. Based on statistics from the Half Moon Bay Weather Station the staff's estimated average annual use per customer for 1975 was 111.9 Ccf. and 113.9 Ccf. for 1976 as compared to applicant's figures of 113.4 Ccf. and 115.7 Ccf. The difference is primarily due to the differences in the average number of average commercial customers and the average annual use per customer. Staff's estimate of customer growth includes 12 additional customers that applicant admits are the approximate number of unauthorized connections.

Staff's estimate appears reasonable and will be accepted.

Operation and Maintenance Expenses

The summary of earnings indicates a difference of \$26,500 in operation and maintenance expense estimates for 1976. The following tabulation sets forth the detailed estimates of applicant and staff:

<u>Item</u>	<u>Applicant</u>	<u>Staff</u>	<u>Applicant Exceeds Staff</u>
	(Dollars in Thousands)		
<u>Operation and Maintenance Expenses</u>			
Salaries	\$39.9	\$34.9	\$ 5.0
Purchased Power	11.5	9.3	2.2
Ground Water Charges	13.8	-	13.8
Materials, Service, & Miscellaneous	11.3	9.0	2.3
Customer Accounting	4.0	3.8	.2
Transportation	6.7	5.8	.9
Telephone	1.6	1.6	-
Uncollectible Accounts	<u>3.3</u>	<u>1.2</u>	<u>2.1</u>
Total Operation and Maintenance	92.1	65.6	26.5

1. Salaries. The difference in salaries results from discrepancies in the use of a wage rate for one employee, the number of hours estimated for the part-time employee, the amount of overtime paid another employee, and estimated amounts to be charged to construction. The wage rate difference amounts to approximately \$1,000 resulting from applicant's inadvertently furnishing an incorrect wage rate. The overtime issue amounts to approximately \$500. The difference in the number of hours for the part-time employee is approximately 85 hours. The remaining difference is attributable to the staff's use of 16 percent as the charges to construction. Applicant claims that the charges to construction indicate a downward trend from 24.62 percent in 1972 to 8.05 percent in 1975.

Staff's estimate for charges to construction appear reasonable when considered in the light of the system improvements that are presently required. Staff estimated salaries will be increased \$1,500 for the wage rate and overtime items.

2. Purchased Power. As originally set forth in Exhibits 10 and 20 applicant estimated purchased power at \$11,500 and the staff at \$11,900. By late-filed Exhibit 24 the staff reduced its estimate to \$9,300. According to Exhibit 24 the staff's revision was based upon information contained in pumping plant tests conducted by Pacific Gas and Electric Company (PG&E) in 1974 and which was produced by applicant at the staff's request in the last day of hearing. Applicant argues that it is not valid to base the purchased power costs on the PG&E tests because they show the situation on a single occasion over two years ago and cannot solely be relied upon to determine the efficiency of the wells.

Staff argues that applicant is negligent in not maintaining its plant and allowing it to deteriorate. According to the staff this deterioration of plant caused the pumps to operate at a lower than normal efficiency at a higher than normal cost, and therefore the cost thereof should not be forced upon the ratepayers.

Staff's estimate will be accepted with an additional \$2,800 to offset the increased cost of purchase power effected by Commission Decision No. 86281 dated August 27, 1976.

3. Ground Water Charges. Applicant included \$13,800 for payments to the county of San Mateo pursuant to a stipulated judgment issued by the Superior Court of San Mateo County on May 12, 1976. The amount also includes \$5,000 for amortization of the legal expenses related to the litigation.

The judgment resulted from a civil action brought by the county of San Mateo against applicant and requires applicant to pay to the county the sum of \$40 per acre foot of water pumped from the north and south airport wells. The order also provides that in the event applicant appeals from the judgment it may post a bond in the sum of \$25,000 in lieu of making immediate payment to the county.

Applicant's witness testified that he did not know whether any payment had been paid to the county as a ground charge. On August 12, 1976 applicant filed a Notice of Appeal.

No allowance for ground charges will be made until such time as the appeal has been determined or until payments have been actually made. The matter of extraordinary legal expense should be developed at a subsequent rate proceeding.

4. Materials, Services, and Miscellaneous. Applicant estimated accounts in the materials, services, and miscellaneous category by increasing the six-year averages for each account by 20 percent to 25 percent to arrive at the 1974 figure and then increasing these amounts by 15 percent to 20 percent for each year 1975 and 1976. Staff estimated these accounts by separating the chemical and filtering material expenses and then estimating the cost per customer for the remaining accounts. Chemical and filtering material expenses were estimated by the staff on a cost per hundred cubic feet produced in 1975 and then increased by 15 percent for 1976. The 15 percent was the increase in the wholesale price index for the period October 1974 to October 1975. Applicant contends that the staff's estimate does not truly reflect current or future conditions.

Staff's estimate appears reasonable and will be accepted.

5. Customer Accounting. Applicant estimated customer accounting on a per-customer basis and then added twenty cents per customer for each year from 1974 through 1976. Staff, on the other hand, trended the cost per customer for the last five years. Staff's estimate is higher due to the use of the 1974 and 1975 recorded figures and the higher estimate of customers.

6. Transportation. Applicant estimated transportation expenses by annualizing the first 11 months of 1974 recorded expenses and increasing these by 20 percent per year for 1975 and 1976. Staff trended expenses for the last five years, including 1975 recorded.

Staff's estimates for customer accounting and transportation are reasonable and will be accepted.

7. Uncollectible Accounts. Applicant originally estimated uncollectible accounts at \$1,100 at proposed rates for the test year. Applicant revised this estimate to \$3,300 claiming that it correctly reflects the uncollectibles experience for the years 1974 and 1975. Staff omitted the last two years' uncollectible accounts in making its estimate because both years increased by a factor of 400 percent over the amount uncollectible in 1973. Staff contends that since no explanation was given for the extraordinary rise the trend of applicant's experience prior to 1974 should be followed.

Staff's estimate of \$1,200 will be accepted.

Administrative and General Expenses

<u>Item</u>	<u>Applicant</u>	<u>Staff</u>	<u>Applicant Exceeds Staff</u>
	(Dollars in Thousands)		
Administrative Office Expenses	\$11.8	\$ 6.0	\$ 5.8
Common Plant Expenses	2.1	1.2	.9
Legal and Regulatory Expenses	4.5	.8	3.7
Insurance	.2	.1	.1
Injuries and Damages	2.1	2.0	.1
Welfare and Pension	8.9	6.9	2.0
Rent	1.0	1.0	-
Miscellaneous and Per Diem	<u>.1</u>	<u>.1</u>	<u>-</u>
Total	30.7	18.1	12.6

1. Administrative Office and Common Plant Expenses. 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-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 allocations of \$465,000 to all California operations of the Redding and Stamford mutual service accounts. Of that amount 1.30 percent or \$6,045 was allocated to applicant. In the same proceeding the Commission adopted \$33,400 as the total allocation to all California operations of the Sacramento common utility plant of which 3.63 percent or \$1,212 was allocated to applicant.

We, therefore, adopt the estimate of \$6,000 for Administrative Office Expense and the estimate of \$1,200 for Common Plant Expense.

2. Legal and Regulatory Expenses. Staff's estimate of \$800 for legal and regulatory expenses is \$3,700 less than applicant's estimate of \$4,500. Because applicant used house counsel the staff excluded all attorneys' fees and salaries of Stamford, Redding, and Sacramento personnel who participated in the preparations 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 16. The recommendations, relating to the allocation of Stamford, Redding, are intended for future proceedings whereby accurate records will be available which will facilitate the future direct assignments 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, which it spread over four years.

In addition to the expense for this proceeding, applicant included an amount of \$1,400 per year for three years to amortize the cost of a prior rate case. In Decision No. 77212 dated March 24, 1970 in Application No. 49023, the Commission allowed \$660 per year for legal and regulatory expenses based on a five-year amortization of an adjusted total allowance. The past expense has been fully amortized.

Staff's estimate of \$800 will be accepted.

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 5.42 percent or \$259 was allocated to applicant.

We, therefore, adopt the estimate of \$259 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 an adjustment would delay this matter further. However, the amount will be offset against a recalculated deferred tax account as discussed below under Income Taxes.

3. Insurance, Injuries, and Damages. Initially applicant and the staff estimated insurance at \$100. Applicant revised its estimate to \$200 based upon recorded 1975 costs. Applicant's estimate will be accepted.

The difference of \$100 between the staff and applicant in the injuries and damages account is due to the difference between them in salaries and amounts capitalized. Staff's estimate of \$2,000 is accepted.

4. Welfare and Pension. Applicant's estimate of \$8,900 for welfare and pension expenses is \$2,000 more than the staff's estimate. This is primarily attributable to the lower salary estimates on the part of the staff for Montara and the allocated salary expenses for Stamford, Redding, and Sacramento. It is also attributable to the fact that the 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 by the consumer. Staff's estimate will be accepted.

Taxes Other Than Income Taxes

Applicant's estimate of \$23,200 for ad valorem taxes for 1976 is \$4,100 more than staff's estimate.

Both applicant and the staff used a tax rate of \$11.04 per \$100 of assessed valuation, but they differ on the assessed valuation to which the rate is applied. Staff applied it to the assessed valuation for the 1975-1976 tax year and to its estimate for the 1976-1977 tax year and took half of each as the ad valorem tax expense for 1976. Applicant applied the rate to its estimate of the assessed valuation for the 1976-1977 tax year.

Staff's method is consistent with past Commission practices and its estimate will be accepted.

Applicant's estimate of payroll taxes is \$200 more than the staff's estimate of \$3,100. Payroll taxes are dependent upon the total salaries and the difference is due to the difference in their respective estimates of salaries.

Depreciation

Applicant's estimate of \$27,800 is \$3,900 higher than the staff's estimate of \$23,900. The difference is primarily due to the staff's lower estimate of construction for the test year.

Income Taxes

Both applicant and staff followed the same procedure for estimating income taxes; staff's estimate of \$61,000 is \$27,900 higher than applicant's figure of \$33,200 because of the difference in estimating expenses and revenues.

The procedures for determining tax depreciation (straight-line for federal taxes, and liberalized on a flow through basis for state taxes) are the same as those used for other rate applications of Citizens-Delaware considered by the Commission since Decision No. 83610 dated October 16, 1974 in Application No. 54323 (Washington Water and Light Co.). During these proceedings the Commission, by order of the Supreme Court of the State of California in S.F. No. 23215, S.F. No. 23237, and S.F. No. 23257, was rehearing the ratemaking treatment of federal income tax depreciation in Applications Nos. 51774 (The Pacific

Telephone and Telegraph Company) and 51904 (General Telephone Company of California). The staff, thus recommended that pending the outcome of those hearings, applicant be ordered to maintain its customers' records as may be appropriate to implement customer refunds in the event this Commission should in its final determination prescribe a method other than that now followed.

However, the Commission has now issued its decision in those matters (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 based 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 because 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 \$259 for the management study expense discussed, supra.

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-Delaware.

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.^{1/}

Rate of return is a judgment determination which the Commission must make in a 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 cost of Citizens-Delaware and its subsidiaries; the impact of high interest rates; the 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 4.4 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 has ranged between 16-1/2 to 21-1/2 percent. 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

^{1/} 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.

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 9.50 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 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 determination 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, S.F. No. 22910. The Supreme Court denied review. The issue has been decided. 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 7.2 percent as determined by Decision No. 77212 dated May 12, 1970 in Application No. 49023.

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 9.3 percent would be reasonable for applicant if applicant was providing an adequate level of water quality and service. The record in this proceeding clearly demonstrates that applicant's water quality and service are below minimum standards and inadequate. Applicant's water facilities are deficient as found in Decision No. 86193.

Applicant will thus be required to file a two-year plan including associated costs for upgrading its system to provide an adequate level of water service and quality. The plan should set out a program of system improvements consistent with the recommendations of staff and the California Department of Health and the findings in Decision No. 86193. The plan should also include a better method of

communication between applicant and its customers for the purpose of reporting emergency situations as well as providing information and adequate notice to customers when possible, particularly before water is shut off. Special consideration should be given to a method by which customers can communicate with a representative of applicant during the time the office is closed. 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 remain at 7.2 percent. The present rates and charges which are consistent with a rate of return of 7.2 percent are 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.

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 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:

Item	Applicant		Staff		Adopted
	Present Rates	Proposed Rates	Present Rates	Proposed Rates	
Operating Revenues	\$186.3	\$279.1	\$204.2	\$292.4	\$204.2
(Dollars in Thousands)					
<u>Operating Expenses</u>					
Operation and Maintenance	64.5	92.1	65.3	65.6	68.1
Administration and General	24.9	30.7	18.1	18.1	18.1
Taxes Other Than Income	18.5	26.5	22.2	22.2	22.2
Depreciation	26.1	27.8	23.9	23.9	23.9
Income Taxes	4.5	33.2	14.8	61.1	13.3
Total Expenses	138.5	210.3	144.3	190.9	145.6
Net Operating Expenses	47.8	68.8	59.9	101.5	58.6
Rate Base	812.6	913.4	818.4	818.4	818.4
Rate of Return	5.88%	7.53%	7.32%	12.4%	7.2%

Findings

1. The estimates of operating revenues, operating expenses, and rate base adopted herein for test year 1976 are reasonable.
2. A rate of return of 9.0 percent on the adopted rate base would be reasonable if applicant was providing an adequate level of water service and quality.
3. Applicant's level of water service and quality is inadequate because applicant's existing water facilities are deficient as found in Decision No. 86193.
4. Applicant will be required to file a two-year plan including associated costs for upgrading its system to provide an adequate level of water quality and service, giving significant consideration to the suggestions of staff and the California Department of Health and the findings in Decision No. 86193. The plan should include a better method of communications for the purpose of reporting emergency situations as well as providing information and adequate notice to customers when possible, particularly before water is shut off. Special consideration

should be given to a method of communicating with a representative of applicant during the time that the office is closed.

5. 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.

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

7. 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 percent) on the previously approved costs for such completed improvements.

8. No increase in rates is required at this time since applicant's present level of revenues are earning a rate of return approximately equal to that presently authorized.

9. 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.

10. 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.

11. All cost accounting procedures of administrative and office costs and expenses that are allocated by Citizens-Delaware 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.

O R D E R

IT IS ORDERED that:

1. Within ninety days after the effective date hereof Citizens Utilities Company of California, Montara District, shall file with the Commission a two-year plan including associated costs of system improvements, giving significant considerations to the recommendations of staff and the California State Department of Health and the findings in Decision No. 86193.
2. Upon approval of the plan and in accordance with the timetable established therein, applicant shall make the necessary improvements.
3. 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.
4. 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 must be approved by the Commission before becoming effective.

5. All cost accounting procedures of administrative and office costs and expenses that are allocated by Citizens-Delaware 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.

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

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.

Robert Batimianis
President

Vernon L. Sturgeon
Clayton W. Swank
Charles L. Deibel
Commissioners

● I will file a dissent.
William Snow, Jr.