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Decision No. 89496 OCT 3 1978 ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of LAKE GREGORY WATER COMPANY, a California corporation, for authority to increase its public utility water rates.	Application No. 57146 (Filed March 11, 1977)

Rutan & Tucker, by Milfred W. Dahl, Attorney at Law, for applicant.
Richard Finnstrom, for the Commission staff.

O P I N I O N

Lake Gregory Water Company (LGWC) seeks authority by this application to increase its metered and flat rate water rates in addition to changing its rate structure so as to increase annual revenues by a total of $64,000, or 31.1 percent. LGWC proposes to obtain such increases by changing from its current minimum charge-type tariff to a service charge-type tariff of $6 per month for a 5/8 x 3/4-inch meter, plus a commodity charge of $1.45 per 100 cubic feet (Ccf) for all purchased water as opposed to its current minimum charge of $8 per month, which entitles the customer to the first 1,200 cubic feet or less per quarter, plus a commodity charge of $.83 per Ccf thereafter. It also proposes to increase its residential flat service rates from $28.50 per quarter for single-family residential units to $38.55 per quarter.

LGWC provides public utility water service in a service area located in the San Bernardino mountains adjacent to the Lake Gregory and Crestline resort areas. The area has been primarily a weekend and vacation resort although there has been a trend toward year-round residence. LGWC was formed by its majority stockholder, Lake Gregory Land and Water Company (LGLWC), to facilitate land sales in the area. Both LGLWC and LGWC have been beset with management, financial, and physical plant problems in recent years, and have experienced net income losses in the years 1975, 1976, and 1977. Recently, the major stock of LGLWC and LGWC has been placed into a trust whose trustee is designated as executor in managing the financial affairs of the two companies. LGWC's service area consists of approximately 4,720 lots with a total of 1,621 active service connections as of December 31, 1977. Of these, 1,292 accounts are metered connections while 329 accounts are on a flat rate service.

After notice, which was published, mailed to customers, and posted in accordance with this Commission's Rules of Practice and Procedure, a public hearing was held before Administrative Law Judge William A. Turkish in San Bernardino on May 17 and 18, 1978. The matter was submitted subject to the filing and receipt of concurrent briefs or upon the filing of the transcript, whichever was later. Post hearing, the matter was reopened by the Administrative Law Judge for the receipt of late-filed Exhibits 5 and 6 upon stipulation by LGWC and the staff. The matter is deemed submitted as of August 2, 1978.

Testimony on behalf of LGWC was presented by its general manager, Mr. James Midgley, and by an industrial accounting consultant, Mr. William Carter, who was formerly the controller of LGWC. Four customers testified questioning the need for the rate increase in view of the poor quality of water and the level of service offered by LGWC. Mr. Willem Van Lier, a senior utilities engineer, testified for the Commission staff. Testimony was also received from Mr. Chester Anderson, a registered civil engineer and district engineer of the State Department of Health.

Initially, LGWC derived all its domestic water needs from its own wells and springs. However, in the past decade, the State Department of Health has systematically ordered closure of a number of wells because of health considerations, and in 1977 only four wells remained in use. The abandonment of its wells caused LGWC to purchase most of its water from other water agencies. Its main water supplier presently is the Crestline-Lake Arrowhead Water Agency (CLAWA). Charges for water have been at a rate of $250 per acre-foot, but CLAWA recently notified LGWC that it was increasing its charge for water to $325 per acre-foot effective July 1, 1978. Upon stipulation of LGWC and the staff, the previously submitted summary of earnings has been updated to reflect this increase in purchased water.

LGWC's operations and earnings were most recently reviewed in a general rate increase Application No. 53870, which resulted in Decision No. 82216 issued December 4, 1973. In that decision, the Commission ordered LGWC to initiate and place into effect a program for systematically converting all flat rate services to metered service within a three-year period so as to reduce operating costs by reducing and preventing consumer wastage of water. LGWC began a meter conversion program but this became stalled in 1977 due to severe cash-flow problems and LGWC's inability to purchase meters on a cash basis. LGWC has recently located some meter suppliers who will accept purchases on a deferred payment basis and LGWC has again reactivated its program of meter conversion subject to its available cash. It hopes to complete its meter conversion program by the end of

1978 although this appears unlikely at this late time of the year. This Commission has long been of the opinion that measured service is the only proper one. By this means, charges are equitably distributed among consumers according to actual usage, extravagance in use is reduced, and water is thus conserved. There is no doubt that flat rate service encourages extravagant water consumption. For these reasons, the order that follows will require LGWC to actively resume its meter conversion program and complete full conversion by the end of 1979.

At the present time, LGWC has an application for a loan on file with the California Department of Water Resources (CDWR) under the California Safe Drinking Water Bond Law of 1976. The loan calls for a proposed funding of $484,000 at 6 percent interest over a 25-year period. The loan is expected to be used for main and transmission system replacements, for recoating of tank interiors, for meter conversions, and for other purchases. The loan application is not considered in this opinion.

Rates

Present and proposed rates for service are as follows:

METERED SERVICE
Quarterly Quantity Rates

Present		Proposed	
First 1,200 cu.ft. or less	$24.00	All water delivered, per 100 cu.ft.	$1.45
Over 1,200 cu.ft., per 100 cu.ft.	.83		
Quarterly Minimum Charge 1/		Quarterly Service Charge 2/	
For 5/8 x 3/4-inch meter	$24.00		$18.00
For 1-inch meter	31.50		24.00
For 1-1/2-inch meter	42.00		66.00
For 2-inch meter	63.00		84.00

1/ The Quarterly Minimum Charge will entitle the customer to the quantity of water each quarter which the Quarterly Minimum Charge will purchase at the Quarterly Quantity Rates.

2/ The Service Charge is applicable to all metered service. It is a readiness-to-serve charge to which is added the quantity charges for water used during the quarter.

RESIDENTIAL FLAT RATE SERVICE
Per Service Connection Per Quarter

	Present	Proposed
For a single-family residential unit	$28.50 3/	$38.55 3/

3/ The above flat rates apply to service connections not larger than 5/8-inch in diameter.

At the proposed rates, metered customers with an average consumption of approximately 5 Ccf per month will receive a 50 percent increase in annual billing from $105.96 at present minimum charge rates to $159 at proposed service charge and quantity rates. A single-family residence on flat rate service will have an annual increase in billing from $114 to $154.20, reflecting a 35.3 percent increase.

Results of Operation

Witnesses for LGWC and the Commission staff have analyzed and estimated LGWC's operational results. Summarized in the following Table I are the estimated results of operation taken from LGWC's Exhibits 3 and 5, and the staff's Exhibit 4 for test year 1978 under present water rates and those proposed by LGWC. For comparison, this table also shows the results of operation at rates authorized herein.

Table I

ESTIMATED RESULTS OF OPERATION
(Test Year 1978)

Item	Present Rates		Proposed Rates		Authorized Rates
	Applicant	Staff	Applicant	Staff	Adopted Results
	(a)	(b)	(c)	(d)	(e)
	(Dollars in Thousands)				
Operating Revenues	$196.2	$206.2	$278.3	$270.3	$259.0
Operating Expenses					
Oper. & Maintenance	175.4	166.9 1/	231.2 1/	166.9 1/	174.4 1/
Depreciation	18.0	19.0	18.0	19.0	19.0
Taxes, Except Income	21.9	15.0	21.9	15.0	16.8
Income Taxes	.2	.2	22.4	21.1	5.6
Total Oper. Expenses	$215.5	$201.1	$293.5	$222.0	$215.8
Net Operating Revenues	(19.3)	5.1	(15.2)	48.3	43.2
Average Rate Base	500.7	472.3	500.7	472.3	472.3
Rate of Return	(3.87%)	1.08%	(3.03%)	10.2%	9.15%

1/ Reflects increased cost for purchased water by LGWC.

The LGWC application was filed in March 1977 and the recorded data used therein was for the year 1975. The summary of earnings contained therein reflects the estimated summary of earnings at present and proposed rates for 1976 and the years 1977 through 1979 at proposed rates. The staff study (Exhibit 4) was based on later information including the 1977 annual report. The staff stressed the fact that LGWC did not provide the staff with any working papers with which to support its figures contained in its summary of earnings. At the hearing, LGWC submitted a revised summary of earnings for the years 1975, 1976, and 1977 recorded and for 1977 and 1978 estimated at proposed rates (Exhibit 3). A late-filed exhibit includes the summary of earnings for 1978 estimated at present rates (Exhibit 5). Because LGWC provided no working papers to justify its figures, we adopt the staff's showing modified slightly to accommodate some allowances in operating expenses, due to recent organizational changes. The differences between the staff's study and LGWC's figures will be discussed below.

Operating Revenues

The difference in revenue estimates between LGWC and the staff is due to differences in the estimated number of customers as well as the consumption of water per customer for the two test years of 1977 and 1978. Neither LGWC nor the staff used the Modified Bean Method, rainfall consideration, or temperature factors in estimating usage as LGWC has both resort-oriented seasonal usage along with many year-round customers. Both LGWC and the staff estimated future consumption from an analysis of metered water use and projection of continued conversion of flat rate to metered service, with all new services metered. No lifeline amounts were included in LGWC's requested rates. LGWC's revised estimated water sales were based on the

1977 recorded year and the estimated average number of customers for test year 1978. The staff's estimated water sales are based on the recorded average number of customers and estimated water use for the year 1977, and the estimated average number of customers and estimated average water use for the year 1978. The staff allowed a 15 percent amount for unaccounted-for water.

Operating Expenses

As stated above, LGWC did not have or submit a file of its working papers to the staff in support of its estimated expenses contained in the summary of earnings (Exhibit 3). Since no working papers were available to compare each account on an individual basis, the staff made its estimates on the information contained in the application, the utility's accounting records, and from the recorded annual reports for the years 1973 through 1977. The method used by the staff consisted of reviewing each expense account as recorded. The payroll expense portion of that account was then segregated out and adjusted upward for inflation. With payroll expense segregated out of the account, the remainder was then inspected to determine those amounts not deemed relevant to utility operations. These were then deleted and the account then reviewed for reasonableness. Nonrecurring expenses were amortized and excessive costs not considered fair for a reasonable operation were adjusted. The net expenses were then either trended or averaged and adjusted to reflect inflationary conditions. The major operating expense differences between LGWC and the staff are to be found in the purchased water costs and the water consumption amounts. Other differences are found in four O & M accounts and in payroll.

Purchased Water Expense

In its revised summary of earnings, LGWC submitted its 1978 estimated purchased water costs at $73,579 based on its cost of $250 per acre-foot. However, effective July 1, 1978, the cost of water from its major supplier, CLAWA, was increased to $325 per acre-foot. The staff stipulates to this increased cost and the results of operation herein reflect purchased water at this cost. LGWC estimates its 1978 purchased water costs at $325 per acre-foot to be $129,350. The staff is of the opinion that only $92,862 should be allowed for purchased water costs since a great deal of this purchased water is being lost through leaks in the system, which is far in excess of normal quantities of water loss. LGWC's transmission and distribution mains were installed approximately 30 years ago and are of inferior quality. As a consequence of both age and quality and an inadequate maintenance system over the years, the system has begun leaking at an alarming rate, and the leaks are increasing steadily in number with the resultant loss of expensive water. Although we are aware of and share the concern of present management with respect to its leak problem and recognize its herculean efforts being expended toward eliminating or at least significantly reducing the leakage, we see no early solution to this problem given the serious cash-flow condition of LGWC and its financial inability to replace the entire transmission and distribution system, which is called for, rather than the day-to-day patchwork of its system, which is eating up a great deal of cash as well as man-hours. Approval of the loan application by the CDWR or possible sale of LGWC to a more financially sound buyer appears to be the only solution to the plaguing water loss problem of LGWC. However we may sympathize with its plight, we cannot allow water being lost over and above a reasonable amount to be considered for ratemaking purposes. If we were to include the wasted water in the ratemaking process, we would in effect be rewarding poor management and years of neglect of system maintenance and condoning continuation of such practice in the future. There is no justification for the customer to bear the cost of such practices. The costs of poor management and neglect properly are the risks of the shareholders.

The staff arrived at the estimated purchased water by allowing 15 percent water loss to the total water consumption. An estimated 3 percent to account for the approximate amount of water derived from LGWC's well production was included. Total water consumption in turn was estimated on the basis of the past five years recorded average of metered water consumption multiplied by the estimated average number of metered customers and estimated average number of flat rate customers' consumption, (estimated 40 percent more than metered consumption), multiplied by the estimated number of flat rate customers. This total was then multiplied by the cost of water purchased by LGWC to arrive at the total purchased water cost. We adopt the staff's estimate of $92,862 for purchased water as reasonable.

Payroll

In its revised summary of earnings, LGWC estimates $63,429 for 1978 expensed payroll after capitalizing $14,084 based upon historical costs. The total projected payroll was calculated upon the current salaries of seven employees, five of whom devoted part of their time to LGWC and part of their time to LGLWC activities during January and February 1978, but who thereafter devoted all their time to LGWC activities. The figure also includes estimated overtime for one full-time serviceman and the services of a part-time serviceman. The staff's estimate for expensed payroll is lower than LGWC's revised figures by $5,375 and is based on what it considers reasonable amounts paid currently to employees. The staff's estimate of 1978 expensed payroll is $51,365 after capitalization of $9,935, which was based on a three-year average. In its computation, the staff allocated part of payroll expense to LGLWC on its premise that the duties performed by some employees were split between LGLWC and LGWC. LGWC testified that it expects to lay off one clerk when it implements a computerized accounting operation. LGWC's general manager also testified that with the system improvements it hopes to make with the DWR loan, LGWC will be able to eliminate one of the serviceman employee positions. Since the intended improvements are largely the replacement of mains and transmission lines to eliminate the leak problem, it is obvious that the expenditure of the serviceman's time is primarily devoted in the repairing of the excessively high number of leaks. As we stated previously, it is unreasonable to require the water consumers to bear the cost of prior neglect of the water system. We accept LGWC's contention that the employees' duties are no longer split between LGLWC and LGWC and will allow the full amount of current salaries being paid, but we will also delete the salary of one clerk and 50 percent of the salary of one serviceman as urged by the staff. In addition, we accept the staff's capitalization of $9,935, which was averaged over three years, as being reasonable.

Other Operating Expenses

LGWC's revised summary of earnings shows operating expenses, excluding expensed payroll and purchased water, of $36,564 with no underlying justification or segregation of accounts making up these amounts shown other than its 1977 annual report (Exhibit 2). The 1977 annual report merely shows total expense for each account, but does not break each account down to indicate each item expenditure. The staff's estimate of operating expenses, other than purchased water and payroll, is $23,523 - a difference of $13,041. The major difference is found in Account 758 (Maintenance, Structures, and Plant). LGWC shows a total of $21,591.41 expended in this account without any underlying basis for such expenditure. The staff allowed only $860 for this account after removing the expensed payroll which was included in the LGWC figures, miscellaneous nonrelevant amounts of $200 and $1,990 for the rental costs of a compressor used in the repair of leaks. The total amount allowed by the staff represents the expense of repairing 60 leaks per year which the staff considers reasonable in light of the leak experience of similar but reasonably operated water utilities, which experience in the order of 30-40 leaks per year. The staff examined the years 1973 through 1977 and arrived at an average cost of $13.40 per leak, which it then multiplied by 60 leaks plus an additional 7 percent added for inflation to arrive at its allowance for this account. The staff deleted the $1,990 cost of the compressor rental as being excessive, maintaining that LGWC should have purchased its own compressor, which in turn could have been amortized. While we agree that it would appear more advantageous for LGWC to have purchased its own compressor, it is not an unreasonable management decision in light of its severe cash-flow and precarious financial condition to opt for leasing equipment rather than outright purchase of same. We consider the staff's position that the ratepayer be required to bear the cost of repairing only a reasonable number of leaks consistent with an efficiently operated water system to be a proper one. For this reason, we find the staff's allowance of the cost of repairing only 60 leaks per year to be reasonable. With respect to the cost of the compressor, we think that allowing the rental costs is proper. However, we will allow only the amount of rental costs as would be incurred for the 60 leaks per year, which we deemed reasonable, to be borne by the ratepayers. We increased this account from $860 to $1,450. In Account 797 (Regulatory Commission Expense), LGWC shows an expense cost of $3,800 while the staff report shows an amortized amount of $1,500 for the expenses relating to the current case. LGWC included the amount of $1,590.02 in this account which relates to the Commission expenses incurred in connection with its previous Application No. 53870 filed in 1973. The staff representative testified that the regulatory Commission expenses in connection with Application No. 53870 were fully amortized in 1977 and should not be included in this account. In the absence of rebuttal, we accept the staff's expense for this account as reasonable. The other difference between LGWC and the staff occurs in Account 798 (Miscellaneous Other General Operation Expenses). LGWC shows an expense of $5,565.86 in this account. The staff excluded $3,907.08 from this account, which was incurred for professional fees to set up a trust by the major stockholders of LGLWC and LGWC on the premise that this expense should be borne by the stockholders rather than the ratepayers since it is a benefit for the stockholders only. We agree with the staff's position.

Utility Plant, Depreciation, and Rate Base

Significant increases in the utility plant account from 1972 to 1978 were mainly attributed to transmission and distribution main replacements, meter, and service additions. The staff has rolled back all LGWC's net plant additions to the beginning-of-year and has generally accepted LGWC's estimated additions and retirements. The staff also excluded any plant disallowed in

Decision No. 77891 and Decision No. 82216. In several accounts, LGWC failed to produce complete cost breakdowns, and the staff made an estimate in those cases upon the information available.

The differences between LGWC's and the staff's estimate of rate base are due to differences in estimates of utility plant, depreciation reserve, materials and supplies, advances for construction, and contributions to plant. In determining depreciation, the staff used the 1977 annual report recorded figures as a start-off point and adjusted it for the year 1978 estimated. LGWC did not use the straight-line-remaining-life depreciation method in its annual reports. LGWC's rate base includes landed property of abandoned wells, which are not useful to the ratepayer, anticipated complete metering of its system in 1978, which is not considered by the staff as realistic, and overstated plant additions for new service, meters, and labor. We adopt the staff's average rate base as more reasonable.

The rates proposed in LGWC's revised results of operation indicate a rate of return of approximately 8.10 percent based on test year 1978 estimated. However, the recent increase in purchased water cost, which is reflected in LGWC's estimated summary of earnings in Table I, reduces the rate of return to a negative 3.03 percent. In this proceeding, the Commission staff made no recommendations concerning rate of return, but we adopt a rate of return of 9.15 percent as reasonable. As LGWC has a negative equity balance, no rate of return on equity can be determined. The Commission staff recommended that LGWC's requested change from minimum charge tariff to service charge tariff be authorized.

We deem this reasonable since the customer expects water when he turns on his tap, and there are certain costs involved in maintaining a readiness-to-serve system, whether the customer uses water or not, which should be borne by the customer.

Findings

1. LGWC is in need of additional revenue, but the proposed rates set forth in the application are excessive.

2. The adopted estimates, previously discussed herein of operating revenues, operating expenses, and rate base for test year 1978, reasonably indicate the probable results of LGWC's operation for the near future.

3. A rate of return of 9.15 percent on the adopted rate base is reasonable. This Results In A $53 M. Rate Increase.

4. The rates authorized herein are based on the staff recommended rate design. That design is appropriate and proper.

5. The increases in rates and charges authorized herein are justified, and the present rates and charges, insofar as they differ from those prescribed herein, are for the future unjust and unreasonable. The current financial instability of LGWC makes immediate rate relief imperative.

6. The meter conversion system ordered in Decision No. 53870 should be reactivated and accelerated.

7. Abandonment of minimum charge rates for service charge rates, plus commodity charge rates, is reasonable for this utility as the trend is toward year-round residence in the area.

8. Lifeline rates are unsuitable and unnecessary for a water utility with LGWC's customer mix of weekend residents, vacation residents, and full-time residents, and in view of the low average of 5 Ccf per month water consumption by its customers.

9. The record developed in this proceeding did not include consideration of Article XIII-A to the Constitution of the State of California. Pursuant to Commission OII No. 19, June 27, 1978, LGWC is required to establish a Tax Initiative Account.

10. The increase in rates authorized herein is subject to the filing of an advice letter by LGWC within sixty days after the effective date of this order, requesting a rate reduction based upon the estimated or actual reduction in ad valorem taxes on the utility's property as of July 1, 1978.

11. In the absence of the filing required by Finding 10, the rate increase authorized herein should automatically terminate sixty days after the effective date of this order, and the rates in effect immediately prior to the increase ordered herein should apply thereafter; and LGWC should immediately file appropriate rate schedules in compliance with General Order No. 96-A.

The Commission concludes that the application should be granted to the extent set forth in the order which follows.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, Lake Gregory Water Company (LGWC) is authorized to file the revised rate schedules attached to this order as Appendix A, subject to Findings 2, 9, 10, and 11 herein. Such filing shall comply with General Order No. 96-A. The effective date of the revised tariff schedules shall be five days after the date of filing. The revised schedules shall apply only to service rendered on and after the effective date thereof.

2. After the effective date of this order, LGWC shall reinstitute and put into effect the meter conversion program ordered by Decision No. 82216 on an accelerated basis so as to complete such conversion program by the end of 1979.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 3rd day of OCTOBER, 1978.

Robert Batinovich
President
William Symons Jr.
Vernon L. Sturgeon
Richard D. Gravelle
Claire T. Dedrick
Commissioners

Schedule No. 1 (C)

METERED SERVICE (C)

APPLICABILITY (C)

Applicable to all metered water service.

TERRITORY

Lake Gregory and vicinity, San Bernardino County.

RATES

	Per Meter Per Quarter	
Service Charge:		
For 5/8 x 3/4-inch meter	$18.00	(I)
For 1-inch meter	27.00	
For 1-1/2-inch meter	36.00	
For 2-inch meter	48.00	(I)
Quantity Rates:		
For all water delivered, per 100 cu.ft.	1.34	(I)

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

SPECIAL CONDITIONS

1. The quarterly service charge applies to service during the three-month period and is due in advance. (C)
(C)

(Continued)

Schedule No. 1 (C)

METERED SERVICE

SPECIAL CONDITIONS - Contd.

2. The opening bill for metered service, except upon conversion from flat rate service, shall be the established quarterly service charge for the service. Where initial service is established after the first day of any quarter, the portion of such quarterly charge applicable to the current quarter shall be determined by multiplying the quarterly charge by one ninety-first (1/91) of the number of days remaining in the quarter. The balance of the payment of the initial quarterly charge shall be credited against the charges for the succeeding quarter. If service is not continued for at least one quarter after the date of initial service, no refund of the initial charges shall be due the customer.

3. Meters will be read on or about the last day of March, June, September, and December. Meters may be read and quantity charges billed during the winter season at intervals greater than three months. (C)

Schedule No. 2R (C)

RESIDENTIAL FLAT RATE SERVICE (C)

APPLICABILITY

Applicable to all flat rate residential water service. (C)

TERRITORY

Lake Gregory and vicinity, San Bernardino County.

RATES	Per Service Connection Per Quarter	
For a single-family residential unit, including premises	$38.50	(C) (I)
		(D)

SPECIAL CONDITIONS

1. The above flat rate applies to a service connection not larger than 5/8-inch in diameter. (C)

2. For service covered by the above classification, if the utility so elects, a meter shall be installed and service provided under Schedule No. 1, Metered Service, effective as of the first day of the following calendar month. Where the flat rate charge for a period has been paid in advance, refund of the prorated difference between such flat rate payment and the minimum meter charge for the same period shall be made on or before that day. (C)

3. The flat rate charge applies to service during each quarter of the calendar year and is due in advance. Flat rates shall be payable after the beginning of the quarter and shall become delinquent 30 days after the beginning of the quarter. (C)

(Continued)

Schedule No. 2R

RESIDENTIAL FLAT RATE SERVICE

SPECIAL CONDITIONS - Contd.

4. Where initial service is established after the first day of any quarter, the portion of such quarterly charge applicable to the current quarter shall be determined by multiplying the quarterly charge by one ninety-first (1/91) of the number of days remaining in the quarter. If service is not continued for at least one quarter after the date of initial service, no refund of the initial charges shall be due the customer. (C)

(C)