Decision No. 90714 AUG 28 1979

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the application of Thomas J. and Vicky K. Jernigan dba Bidwell Water Company for authority to execute a contract with the Department of Water Resources for a loan, and to increase rates for water services by means of a surcharge on existing rates to repay such loan.	Application No. 58617 (Filed January 22, 1979)

Richard H. Hargrove, Attorney at Law, and Thomas J. Jernigan, for Bidwell Water Company, applicant.
Daniel J. Corrigan, for Department of Water Resources; Susan Rovy, Attorney at Law, for Greenville Community Services District; Bill Wattenburg, for self; and Lloyd R. Hemzel, for State Department of Health Services; interested parties.
Philip Scott Weismehl, Attorney at Law, C. Frank Filice, and Ernst Knolle, for the Commission staff.

O P I N I O N

Thomas J. and Vicky K. Jernigan dba Bidwell Water Company provide water service to approximately 463 residential and commercial customers in the area of Greenville, California, an unincorporated community located between Lake Almanor and Quincy, Plumas County, California. Approximately one-half of the 463 connections are metered; flat rate service is provided for the remaining customers.

Water is obtained from Round Valley Lake and Buckeye Springs. Lake water is conveyed by gravity flow to Buckeye Springs and thence to distribution reservoirs through pipes, streams and a

ditch. The mixed water at Buckeye Springs is piped by gravity to two 150,000-gallon distribution reservoirs. The water is chlorinated at the inlet to the reservoirs. The treated water then moves by gravity flow through the distribution system.

Applicants allege that the present water system has many deficiencies including inadequate water storage facilities and old and deteriorated distribution mains which cause severe leakage problems. Filters are needed to improve treatment of water; the transmission ditch should be replaced with pipe to eliminate a contamination hazard. Also required is the addition of rocks to a low-level dam to prevent erosion and leakage, installation of a control valve on a spillway to regulate and conserve water, the replacement of existing diversion with permanent facilities to prevent loss of water and a control valve to regulate the water during high runoff. Finally, the existing dirt road to the treatment facilities should be improved to provide winter access, and the flat rate customers should be metered.

The California Safe Drinking Water Bond Act of 1976 (SDWBA) provides, among other things, that water utilities having systems which fail to meet California Health and Safety Code standards may, if they cannot otherwise finance necessary plant improvements, apply to the California Departments of Health Services (DHS) and Water Resources (DWR) for low interest rate loans. DHS is responsible for analyzing the public health issues, including a determination of the specific plant needed, while DWR analyzes the need for financial assistance and acts as the lending agency and fiscal administrator. Before the loan is granted, the applicants must demonstrate to DWR their ability to repay the loan, and must also show that they have instituted measures that will maximize

water conservation. Under the provisions of Sections 816 through 851 of the Public Utilities Code, public utility water companies must obtain authorization from the California Public Utilities Commission (Commission) to enter into any long-term loan. Section 454 of that Code requires Commission approval for rate increases.

By letter dated December 12, 1978, DWR informed applicants of their eligibility for a loan under the SDWBA. The DHS reviewed the loan proposal and set forth a summary of construction to be undertaken with the loan proceeds to meet the quality standards of Title 22, California Administrative Code, and quantity standards and pressure requirements of Title 17, California Administrative Code.

Applicants seek authority from the Commission to borrow $557,230 to finance construction of the needed plant improvements, and to increase rates by means of a surcharge on bills for water service to recover from customers the amounts needed to make periodic payments of principal and interest on the loan.

The items of construction and costs, as estimated in the application, are detailed as follows:

Items	Cost
Intake Structure	$ 10,000
211 Liner Feet 12" Ducticle Iron Pipe	4,200
4,000 Liner Feet 12" P.V.C.	40,000
Pressure Filters (Used or New)	100,000
Storage Tank (Used or New)	100,000
Control Building	15,000
700 Liner Feet 10" A.C. Pipe	10,500
2,400 Liner Feet 8" A.C. Pipe	28,800
1,000 Liner Feet 8" A.C. Pipe	8,000
9,300 Liner Feet 6" A.C. Pipe	93,000
300 Each Water Meters	45,000
Subtotal	$454,500
Construction Contingency	22,725
Engineering Design	31,915
Construction Inspection	22,770
Administrative and Legal Fees	9,090
DWR Administrative Fee Three Percent of Loan	16,230
Total Estimated Project Cost	$557,230

The loan from DWR will provide for a 35-year repayment schedule with equal semi-annual payments of principal and interest, at an interest rate of 5½ percent per annum. The annual charges for debt service will be approximately $36,200. Applicants propose that the amount of the yearly surcharge to repay principal and interest on the loan should be in direct proportion to the capacity of each customer's meter or service connection.

The applicants' repayment of principal and interest on the loan over a 35-year period would raise current water rates for the average metered customer by approximately $6.50 per month. For current flat rate residential service, pending metering, the current water rates would increase by $7.25 per customer per month. For nonresidential flat rate service, pending metering, the current water rates would increase, on a proportional basis, as shown in the Monthly Surcharge column of page 3 of 3, Appendix A.

The utility plant financed through the surcharge will be permanently excluded from rate base for ratemaking purposes, and the depreciation on this plant will be recorded for income tax purposes only.

Applicants' present rates were authorized by Commission Resolution No. W-1653, effective January 1, 1975. The estimated annual gross revenues for 1979, under present rates will be about $60,300. The $36,200 yearly increase thus would increase applicants' revenues by approximately 60 percent.

Applicants propose to establish a balancing account which would be credited with revenue collected through the surcharge and with investment tax credits arising out of the plant reconstruction program, as they are utilized. The balancing account would be charged with payments of interest and principal on the loan. The surcharge would be adjusted periodically to

reflect changes in the number of customer connections and resulting overages or shortages in the balancing account.

The surcharge proposed herein covers only the costs of the loan incurred to finance the added plant, not any additional operating expenses that may be incurred. It would not preclude the future rate increase requests to cover increased wages, property taxes, power bills, or other operating expenses that may be incurred in the future.

On February 7, 1979, staff members of the Commission's Finance Division conducted a public meeting in Greenville. Also participating in the meeting were representatives from DWR, DHS, the applicants, their engineer, and between 180 and 200 customers of applicants. The purpose of the meeting was to explain the plant reconstruction program to applicants' customers, to answer questions pertaining to the program and to obtain an indication of customer sentiment for or against the proposed program.

While the meeting produced general agreement that applicants' present water system is badly in need of repairs and replacement, significant opposition was evident at the public meeting; of the 70 customers expressing themselves in a show of hands 32 indicated their disapproval of the program.

Because of the strong public interest in this matter and the difficulty of resolving some of the issues raised on the basis of informal input from the meeting, it was decided to schedule a formal public hearing.

The hearing was held on May 10 and 11 before Commissioner Dedrick and Administrative Law Judge Gilman. Testimony and informal statements were presented by Mr. Jernigan, his attorney and engineer, a staff engineer representative of DHS and DWR, the local fire chief, a representative of the Community Services District, and numerous consumers participated by testimony or statements.

Summary

We have determined that there is no acceptable alternative to upgrading this system to meet DHS standards, and no acceptable alternative to the traditional SDWBA package to finance the improvements. We have also found that a previous rate increase in fact has not provided adequate revenue to support the costs of any added plant.

Rate Increase History

Soon after acquiring the system, applicants sought an advice letter rate increase, which was granted in 1975. This rate increase was intended by the Commission to provide enough extra revenue to cover then-current costs of ownership of health-related improvements similar to those now proposed. Those improvements were estimated to cost approximately $300,000 and would have been treated in a conventional manner, allowing the original cost to be included in rate base and to be depreciated. The rate increase was approved by the Commission on the recommendation of its Utilities Division without condition or restriction on the use of the extra revenue generated thereby. Applicants purchased some pipe, which is still retained; however, due to inadequate earnings, none of the improvements were installed.

During the informal meeting, several customers complained they were being asked twice to pay for the same plant; they wished to know how applicants had applied the extra revenue received after it was decided to delay installing additional plant.

Many of the customers at the informal meeting were concerned over the reliability of a regulatory staff which supported a rate increase for capital improvements without recommending any feedback procedure to determine whether the plant was actually installed and without any method to deal with overcollections in the event it was not.

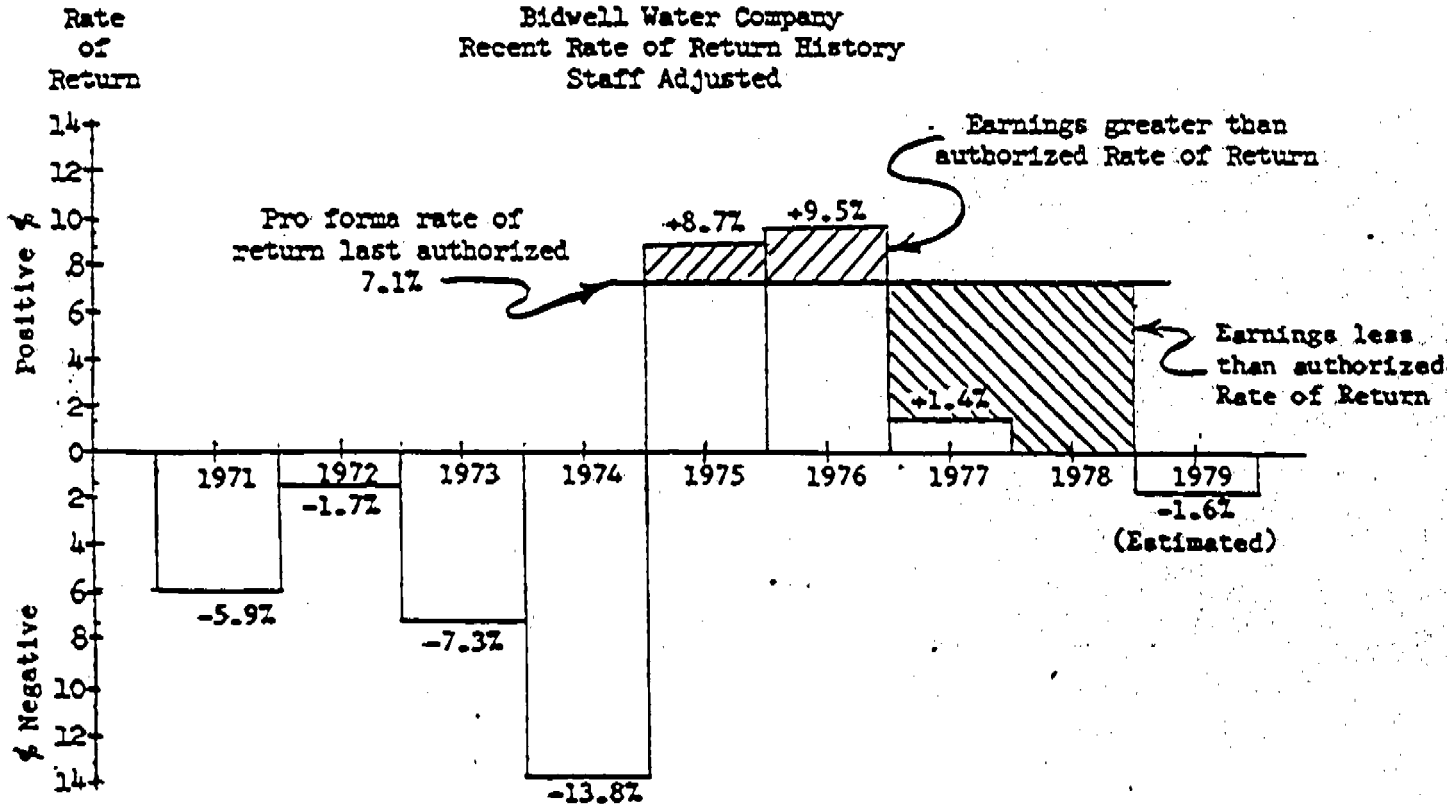
The staff witness who testified at the formal hearing indicated it was a departure from standard practice not to condition all or part of the increase on construction of the plant.

Our Utilities Division has now moved toward a policy of opposing construction-linked advice letter rate increases unless there is a device to insure that customers are not compelled to pay for nonexistent plant. The Division is also in the process of reexamining its review procedures to provide adequate feedback of the progress of non-SDWBA construction which is ordered by the Commission.[1/]

In this case, the omissions and oversights do not adversely affect ratepayers. As shown by staff-sponsored exhibit, the 1975 rates, even without the increased depreciation or return which the new plant would have generated, did not produce an excessive rate of return. In no single year since the increase was granted would the revenues have been sufficient to support even a fraction of the current costs of $300,000 worth of new plant. On the average, applicant has earned less than an adequate return on existing plant in the years since this rate increase was granted. Figure 1 below is taken from the staff exhibit.

1/ Here, as in all SDWBA-financed projects, DWR will monitor construction progress before releasing loan proceeds.

Figure 1



Note: Each one percent in rate of return represents roughly about $1,500 or 3% in gross revenues. The staff adjustments in the chart generally consist of changes to operating expenses to produce a uniform annual increase in proportion to customer growth and inflation.

Thus, in summary, it appears that the advice letter rate increase underestimated the full cost of running the enlarged system envisioned by applicant. The revenue produced was sufficient to produce approximately the intended rate of return only in the two years immediately following the increase. If applicants had installed substantial extra plant in 1975, they would now be in the position to claim depreciation plus a much higher rate of return on the total of both existing and added plant. Instead, the delay, while adding to the cost of upgrading the plant, has made it possible for applicants' customers to benefit from low-cost financing through a SDWBA loan.

The No-Project Alternative

The no-project alternative was not placed in issue at hearing. Apparently the community as a whole has recognized that the system must be upgraded in the near-term future.

Public Ownership

At the informal community meeting, there appeared to be substantial sentiment in favor of public ownership. Some members of the community believed that if the Greenville Community Services District were to condemn the water system, it would be able to finance both the acquisition and the needed improvements by means of a combination of low interest loans and grants, producing a total revenue requirement less than that required for a combination of private equity and a SDWBA loan. During the time which elapsed between the informal meeting and the hearing, the Community Services District (District) took a public survey to measure public support for acquisition of the system. The results showed that only a minority of those responding would support public ownership. The governing Board of the District thereupon took action indicating that the District did not plan to acquire the water system.

Since the Board has declared that public ownership is not a feasible alternative, no further discussion of the relative merits of public and private ownership is necessary. Since public grants are not available to privately owned systems, SDWBA financing is the only low-cost method of financing improvements presently available.

Impact on Fire Insurance Rates

The Chief of the Greenville Fire Department testified. He indicated that in 1976 a survey by the Insurance Services office had resulted in a reduction of the community's fire insurance rating from Class 6 to Class 7. Over 1,300 of the deficiency points found by the survey were attributable to various problems in the water system. He indicated that many of the proposed improvements in the system would tend to increase the amount and reliability of fireflow even though not intended for this purpose. He concluded that it was probable that completion of the system improvements even with no improvement in other aspects of the community's firefighting potential could reverse the down-rating.

He stated that if a Class 6 rating could be reestablished, local businesses should expect fire insurance savings in the range of 23 percent and homeowners could expect savings of as much as 15 percent of the straight fire insurance rates.[2/]

We have not adopted any findings on this topic for two reasons. First, the improvements were designed and presented without

2/ He cautioned that a substantial portion of the normal bill for a residential policy is for homeowners' protection and that there would be no change in this rate.

reference to this issue, which surfaced during the second day of hearing. We believe that the costs of the project are fully justified without reference to insurance savings and approval should be granted even if such savings were not likely.

Second, there was no opportunity to obtain direct input from Insurance Services Office or from any insurance company. Thus, we must recognize at least a possibility that some unexpected difficulty might intervene to prevent the expected savings.

Problems of Fixed-Income Consumers

Speakers at the hearing were concerned with the problems of the elderly and those on fixed incomes and the difficulties they would face in finding an additional five or six dollars per month for utility service.

We are likewise deeply concerned with this problem. Spreading the costs of the capital improvement between consumers on the basis of consumption will make it possible for each consumer to share in determining the portion of the increase he will bear. One who, for economic or other reasons, decides to conserve and limit himself primarily to domestic uses of water will pay a relatively small surcharge. On the other hand, a customer who can afford to consume large amounts of water for landscaping and other less essential uses will bear proportionally more of the increase. More substantial relief for those particularly vulnerable to inflation would require higher rates for the rest of the community. It would appear that deliberate shifting of the economic burdens of utility service now requires an evidentiary basis (Calif. Manufacturers' Association v P.U.C. (1979) 24 C 3d 263); we have no such evidence in this record.

A uniform cents per hundred cubic feet rate has been established as the preferred method for calculating SDWBA surcharges

if the system is, or will be metered. (Application of Quincy Water Co., D.88973, A.57406 (1978).) Since approximately one-half of the 463 connections are metered historical usage data is considered adequate to establish a uniform cents per hundred cubic feet for calculating SDWBA surcharges. The surcharge established at this time may, as additional metering is completed and new connections accomplished, be adjusted periodically as overages or shortages develop in the balancing account. Such adjustments shall be accomplished through an advice letter filing by the applicants. We will also establish an interim flat surcharge for residential or nonresidential flat rate service for use until individual flat rate service customers are metered.

Should New Customers Be Required to "Buy In"?

During the hearing, one consumer suggested a provision whereby future new customers would be required to pay a lump sum equivalent to that portion of existing customers' cumulative surcharge payments, excluding the amounts attributable to interest payments.

On the surface, such a provision appears appropriate to equalize the burden on new and old customers. A closer examination, however, discloses some flaws in that appearance. The principal defect stems from the fact that this added plant will depreciate; this depreciation can be estimated to occur evenly over a period which closely approximates the term of the loan. Consequently, a customer who was required to "buy in" at the end of 20 years would be required to pay a lump sum nearly equivalent to depreciation which accrued before service to him began. In total, he will pay as much to defray the principal of the loan as the customer who has enjoyed service over the full life span of the plant.

We think it makes better economic sense to view the amount paid to repay the loan principal in any year as being in

the nature of a current expense. Using that approach, it is logical to divide the expense between current customers only.

It should be noted that the added plant is the amount needed to serve present capacity; it is not sized to meet growth needs.

Other Issues

Some consumers were concerned that at the end of the 35 year period applicants would own, free and clear, plant which still possessed some useful life. At first glance, it might appear that consumers have, by paying off the loan at a rate faster than the plant depreciates, presented the utility with a modest windfall.

It should be recognized,however, that applicants are subject to restrictions which will prevent them, or any private purchaser, from reaping any economic benefit from this plant even after the loan is paid off. There are both legal and practical restrictions which would prevent any private owner from separating this plant from the remainder of the utility plant; in both a practical and a legal sense, it is permanently dedicated to the use of Greenville consumers. Preventing inclusion of this plant in rate base, will assure that neither applicants nor any private successor would be able to claim depreciation or return on this plant. Thus, the consumers can be assured that there will be no windfall or donation to any private utility owner arising from the slight mismatch between the term of the loan and the property's useful life.

Surprisingly, some of the opposition to the Safe Drinking Water Bond Act package seems to have been motivated by a feeling that consumers should not be expected, as part of the price of water, to pay for both principal and interest required to finance plant. This may stem from a failure to recognize any business, unless it is foredoomed to bankruptcy, will eventually collect all of the capital it employs from its consumers. Even government enterprises do

the same unless there is an opportunity to exact a subsidy from a segment of the public who does not benefit from the service provided. The principal difference between the SDWBA package and conventional utility financing is that here the annualized capital cost of particular items of plant are segregated and fully disclosed in advance, and the plant is in effect amortized rather than entering rate base.

Other customers were concerned that Mr. Jernigan might be able to inflate the costs of the project by doing the construction work himself.

There are two safeguards to ensure against inflated construction costs. First, DWR will require an outside contractor unless it is convinced that Mr. Jernigan will be able to do the work for less than competitive contractors.

Second, this decision is not a final decision on the reasonableness of the costs incurred in construction. If Mr. Jernigan does his own contracting, the reasonableness of his charges can be placed in issue in future rate proceedings.

Findings of Fact

1. The proposed water system improvements are needed to produce a healthful, reliable water supply. The plant reconstruction program will cost an estimated $557,230, including a 3 percent administrative charge by DWR.

2. The DWR loan provides the lowest cost capital for the needed water system improvements and is a prudent means of acquiring necessary capital. The proposed borrowing is for proper purposes and the money, property or labor to be procured or paid for by the issue of the loan authorized by this decision is reasonably required for the purposes specified, which, purposes are not, in whole or in part, reasonably chargeable to operating expenses or to income.

3. A rate surcharge should be established which provides in each six-month period, an amount of revenue approximately equal to the periodic loan payment. The increases in rates and charges by this decision are justified and are reasonable; and the present rates and charges, insofar as they differ from those prescribed by this decision, are for the future unjust and unreasonable.

4. The rate surcharge which is established to repay the DWR loan should last as long as the loan. The surcharge should not be intermingled with other utility charges. Special accounting requirements are necessary to ensure that there are no unintended windfalls to private utility owners.

5. This rate increase will increase applicants' annual gross revenues by approximately $36,200 per year.

6. The utility plant financed through this SDWBA loan should be permanently excluded from rate base.

7. New customers should not be required to match the amounts older customers have paid to reduce the principal on the loan.

8. Applicants' 1971 increase did not produce enough extra revenue to offset depreciation expenses or return on any significant amount of increased plant. On the average the revenues produced were not sufficient to cover reasonable expenses and provide a fair rate of return on existing investment.

9. There is insufficient data to fix a consumption based surcharge at the present time. A flat rate surcharge should be used until sufficient data has been collected.

Conclusion of Law

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

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, applicants are authorized to file the revised rate schedules attached to this order as Appendix A. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedule shall be five days after the date of filing. The revised schedule shall apply only to the service rendered on or after the effective date of the revised schedule.

2. Applicants are authorized to borrow $557,230 from the State Department of Water Resources, to execute the proposed loan contract, and to use the proceeds as specified in the application.

3. As a condition of the rate increase granted herein, applicants shall be responsible for refunding or applying on behalf of customers, any surplus accrued in the balancing account when ordered by the Commission.

4. Applicants shall establish and maintain a separate balancing account which shall include all billed surcharge revenue and the value of investment tax credits on the plant financed by the loan as utilized. The balancing account shall be reduced by payments of principal and interest to the State Department of Water Resources. The rate surcharge shall be separately identified on each customer's water bill issued by applicants.

5. **At such time as all existing flat rate customers have been metered applicants shall file an advice letter for the purpose of eliminating flat rate service tariff schedules.**

The authority granted by this order to issue an evidence of indebtedness and to execute a loan contract will become effective when applicants have paid the fee prescribed by Section 1904(b) of the Public Utilities Code, which fee is $1,116. In all other respects, the effective date of this order is the date hereof, omitting the usual 30-day delay in effectiveness is necessary to expedite construction.

Dated AUG 28 1979, at San Francisco, California.

President

Commissioners

Commissioner Claire T. Dedrick, being necessarily absent, did not participate in the disposition of this proceeding.

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
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By

Schedule No. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Greenville and vicinity, Plumas County.

RATES

	Per Meter Per Month	Surcharge Per 100 Cu.Ft.	
Quantity Rates:			
First 500 cu. ft. or less	$ 3.70	$ 0.26	
Next 1,000 cu. ft., per 100 cu. ft.	.50	0.26	
Next 3,500 cu. ft., per 100 cu. ft.	.40	0.26	
Next 5,000 cu. ft., per 100 cu. ft.	.30	0.26	
Over 10,000 cu. ft., per 100 cu. ft.	.16	0.26	(N)
Minimum Charge:			
For 5/8 x 3/4-inch meter	$ 3.70		
For 3/4-inch meter	5.00		
For 1-inch meter	7.00		
For 1½-inch meter	14.00		
For 2-inch meter	18.00		
For 3-inch meter	30.00		

(N)

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

Schedule No. 2R

RESIDENTIAL FLAT RATE SERVICE

APPLICABILITY

Applicable to all flat rate residential water service.

TERRITORY

Greenville and vicinity, Plumas County.

RATES

	Per Service Connection Per Month	Surcharge(N) Per Month	
For a single-family residential unit, including premises not exceeding 500 sq. ft. in area	$ 6.00	$7.25	
a. For each additional single-family residential unit on the same premises and served from the same service connection	5.50	6.75	(N)
b. For each 100 sq. ft. of premises in excess of 500 sq. ft.	.15		

SPECIAL CONDITIONS

1. The above flat rates apply to a service connection not larger than one inch in diameter.

2. If the utility so elects, a meter shall be installed and service provided under Schedule No. 1, Metered Service.

Schedule No. 2L

LIMITED FLAT RATE SERVICE

APPLICABILITY

Limited only to nonresidential customers presently receiving flat rate service.

TERRITORY

In the unincorporated town of Greenville and vicinity, Plumas County.

RATES

	Per Service Per Month	Surcharge Per Month	
Barbershops	$ 6.00	$ 7.25	(N)
Garages and Service Stations	15.00	18.00	
Drugstores, Soft Drink Parlor or Saloons	10.00	12.00	
Retail Stores	6.00	7.25	
Churches	6.00	7.25	(N)

SPECIAL CONDITIONS

1. The above flat rates apply only to nonresidential customers currently receiving flat rate service.

2. No new service will be provided under this schedule.

3. If the utility so elects, a meter shall be installed and service thereafter will be provided under Schedule No. 1, Metered Service.