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Decision No. 91324 FEB 13 1980

**ORIGINAL**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of )  
S. O. Patterson and Shirley R. )  
Patterson, doing business as Mira )  
Monte Water Co., for a certificate )  
of public convenience and necessity )  
to operate a public utility water )  
system near Red Bluff in Tehama )  
County and to establish rates for )  
service. )

Application No. 58147  
(Filed June 16, 1978)

S. O. Patterson, for himself, and  
Shirley R. Patterson, applicants.  
Elmer Siostrom, Attorney at Law,  
John Gibbons, and Eugene M. Lill,  
for the Commission staff.

O P I N I O N

This application by S. O. Patterson and Shirley R. Patterson, doing business as Mira Monte Water Co., seeks a certificate of public convenience and necessity under Section 1001 of the Public Utilities Code to operate a water system located in a subdivision named Mira Monte Estates approximately five miles west of Red Bluff. The subdivision includes 54 parcels with building lots ranging from 1.0 to 2.9 acres each. The subdivision is rural residential, having telephone and electrical services. However, no natural gas or central sewage services are planned. At the time of the application, virtually all of the construction of the water system had been completed, with the exception of service to three lots. The water supply comes from two wells. At the time of the application, only 13 of the services were metered. The plant allegedly conformed to General Order No. 103 standards when it was constructed in the spring of 1975. All mains

are, or are planned to be, 4 inches in diameter. As indicated by the application, this system was originally constructed and operated as a mutual water company under the name of Bayles Mutual Water Company (Mutual).

Applicants estimate that the total plant in-service as of January 1, 1978 cost \$34,435, including land, wells, pumping equipment, reservoir and tanks, water mains, services, and hydrants. Applicants plan, as soon as possible after issuance of this decision, to install meters on all of the residential services. The application proposed a metered rate and would include a monthly service charge of \$7.50 for a 5/8" x 3/4" meter and \$8.50 for a 3/4" meter with proportionally larger charges for larger meters. The first 300 cubic feet would be charged for at 20 cents per 100 cubic feet. All greater quantities would cost 30 cents per 100 cubic feet. The application also notes that the applicants own and operate two other public utility water systems in the vicinity.

Public hearing was held before Administrative Law Judge Gilman on October 25, 1978, in Red Bluff. During the hearing Mr. Patterson testified, as did the Commission's Finance Division witness and a staff engineer. Several customers participated by asking questions and making statements during the course of the hearing.

Mr. Patterson described briefly the history of his involvement in the water system, his efforts and investment to upgrade the physical plant, and his plans for operation.

The Finance Division witness indicated that the water system was installed by the developer of the subdivision, who presently resides in Red Bluff. The only other water system in the area is a 15-customer water system about three miles from Mira Monte. Mr. Patterson also operates the Las Flores (50 customers) and the Vista Grande (110 customers) water systems. Both are within 10 miles or less from Mira Monte and are public utility systems under the jurisdiction of this Commission. Mr. Patterson lives in Gerber, which is about 12 miles from Mira Monte.

The Finance Division witness asserted that Mutual was a bona fide mutual water company. In March 1975 the subdivider, the officers of Mutual, and Mr. Patterson entered into an agreement which provided that:

1. Mutual would sell all its assets to Mr. Patterson for \$1.
2. The subdivider would pay Mr. Patterson \$12,500 to construct additional plant facilities, including metering.
3. The subdivider would pay Mr. Patterson an additional \$1,000 per lot upon the sale of certain lots still owned by Mutual up to a maximum of \$25,000.
4. Mr. Patterson would provide and pay for all labor required to complete the additional construction.
5. Mr. Patterson would act to bring the water system under Commission jurisdiction.

This witness also indicated that there are no records of actual plant construction costs. He recommended that regardless of the adequacy of records, the original system plus any contributions from the subdivider should be excluded from rate base so that customers would not be required to pay either depreciation or earnings on investment which is ultimately traceable to the customers directly or indirectly (see Decision No. 83676 in Application No. 53003, San Gabriel Valley Water Company). The witness contended that the only item not properly treated as donated plant would be the labor needed to install the 3,600 feet of 4-inch main installed after the purchase. ✓ He estimated that labor for this installation should cost about \$2.50 per foot.

The Finance Division witness noted that the proposed flat rate schedule for the short period that it would be in effect would produce, on the average, \$15 per customer per month. He noted that it would be very difficult to estimate the changes in consumption

which would occur once the meters are installed. He therefore recommended that metered rates be established to be re-examined after a year or so of actual experience and adjusted to produce the desired level of revenue.

The Finance Division witness took exception to applicants' estimate of \$689 for depreciation expense since this was based on a rate base which included donated plant. He also noted that it was difficult to judge the reasonableness of the tax estimate of \$700 per year.

His written testimony concluded with the following statement:

"There is no ready solution to the problems posed by this water system. The customers are faced with relatively high rates and the probability that rates for some customers will be even higher in the future if the system is metered. The owner faces the prospect of limited compensation for his time, labor, or plant investment, either now or in the foreseeable future, because of the relatively high operating costs in relation to revenues. The Public Utilities Commission faces the prospect of another small, uneconomical water utility which it cannot effectively regulate, with the probability that any action it takes will be unpopular with both the customers and the owners.

"At the present time the customers are fortunate in that they have a responsible individual to operate the system. If he loses interest because of an absence of adequate profits, or if he becomes discouraged and sells the system, service is likely to deteriorate despite the relatively high rates.

"The only other course of action that we can suggest would be for the customers to consider reactivating the mutual water system and reacquiring the water system from the present owner. This will not

eliminate the basic problems, but it may result in some reduction in operating costs simply because there would be fewer records to be maintained, and mutual water companies often are operated largely with volunteer labor. On the other hand, unless there are qualified residents willing to maintain the system, service is likely to deteriorate in time."

The Finance Division witness concluded that no certificate is required because the system is already built and operating. He also concluded that, if the customers do not reacquire the water system, the Commission must find it to be a public utility water system and require the filing of tariffs. He recommended that the allowance to Mr. Patterson for managing and operating the system should reflect the additional risk arising out of the fact that much of the plant would be excluded from rate base.

The staff engineer's report largely confirmed the analysis and history presented by the Finance Division witness. He indicated that the water supply is potable and has a combined capacity with the two wells of 305 gallons per minute. He indicated that his estimate for the original cost for the total plant was approximately \$47,000. He believed that the operations to date would probably have accumulated a total depreciation reserve of \$9,918. However, if the Commission were to exclude donated plant from rate base, he would concur in the Finance Division's recommendation that the Commission should consider some additional salary allowance to the owner. He also supported the concept that the existing flat rates should be continued with minor modifications. He also suggested that the proposed metered schedule be authorized pending adequate analysis of actual results of operation once meters are installed.

Reviving the Mutual

The Commission has allowed several months to pass after submission of this proceeding to allow the residents to consider the offer made by Mr. Patterson by which applicants would resell the system to the customers in exchange for the additional amount they have invested in the system. It appears that the customers, by their silence, have collectively rejected that proposal and that reviving the mutual is not presently a feasible alternative course of action.

Rate Base and Owner's Compensation

The Commission has definitively established a policy that a mutual water system when purchased by a private individual or entity, who thereby becomes a public utility, should be valued at no more than the new owner's actual investment.<sup>1/</sup> This policy is no more than an application of a generally applicable ratemaking principle which has long been followed by this Commission. That rule requires that after a transfer, a utility's rate base must be valued at the lower of either depreciated original cost or purchase price.

The Commission recognizes that when a utility, particularly a comparatively small water system, is operated as a public utility, the owner must receive adequate compensation for the trouble and time required to manage the system properly and in compliance with our regulations, particularly those regarding accounting and reporting procedures. It realizes that any failure to provide such adequate compensation could encourage abandonment or the substitution of irresponsible for responsible ownership. We believe that the salary adopted herein (see page 8) meets that test. Nevertheless, without more

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<sup>1/</sup> Appl. of San Gabriel Valley Wtr. Co., Decision No. 83676, Application No. 53003 (1974).

information in the record concerning the owners' responsibilities to, and remuneration from, the other systems we must recognize that this is a rough and hence tentative approximation. Likewise, until we have information on all three systems in a single record, it would be premature to determine whether and to what extent rate of return should recognize the higher risk produced by a capital structure dominated by donated plant.

We would expect that in any further proceedings involving any of applicants' systems, the economic evidence will be presented on a consolidated basis.

#### Revenues and Rates

We would expect the installation of meters to reduce consumption significantly, particularly for irrigation purposes. Consequently, it is difficult to estimate applicants' gross revenues once meters are installed. The adopted results of operations set forth below constitute our best estimate of applicants' revenues and expenses once meters are installed.

Our determination of initial rate base is somewhat tentative because of the lack of a fully acceptable expert opinion on the labor costs involved. We have rejected the Finance Division witness' estimate of \$2.50 per foot and instead adopted a rate base of \$16,000 (allowing approximately \$4.50 per foot for labor).

We cannot simply adopt applicants' projected results of operation; they are based on a 1978, a 1983, and a 1988 test year. Our normal practice is to adopt a near future test year. We will apply that practice here, attempting to develop revenue and cost figures which would be experienced in 1980.

Since applicants have not formally withdrawn their offer to resell, it would be especially unfortunate to set initial rates at unrealistically low levels. The table below compares applicants' and the adopted projections. Customers should not expect that future utility bills will ever be set at a level significantly lower than fixed herein.

	<u>Applicants</u>		<u>Adopted</u>
	<u>1978</u>	<u>1983</u>	<u>1980</u>
Revenues	\$7,740	\$11,625	\$9,107
<u>Expenses</u>			
Salary	1,550	2,000	1,600
Other Operating Expenses	<u>3,775</u>	<u>5,450</u>	<u>4,955</u>
Subtotal	5,325	7,450	6,555
Depreciation	689	623	480
Taxes (including property and income)	<u>700*</u>	<u>800*</u>	<u>670</u>
Total Expenses	6,714	8,873	7,705
Net Revenue	1,026	2,752	1,402

\* Applicants may have mistakenly omitted income taxes on the net revenue.

The adopted rates are based on a rate base of \$16,000; applicants are projected to earn approximately 8.8 percent on that investment.

As indicated above, the application did not project either revenues or expenses for a near future test year. It is therefore impossible to make a direct comparison between the requested and the authorized rates or gross revenues. However, interpolating between applicants' two projections produces a figure approximating the gross revenues we expect the adopted rates to produce in a 1980 test year. The resulting estimated rate of return of 8.8 percent is slightly less than the requested 9.0 percent rate of return. Therefore, applicants have not been granted more than they asked for.



A comparison of requested and adopted rates is set forth below:

<u>Meter Size</u>	<u>Rates Requested</u>	<u>Rates Adopted</u>
5/8" x 3/4"	\$ 7.50	\$ 6.65
3/4"	8.50	7.30
1"	9.50	10.00
1 1/2"	15.00	13.30
2"	20.00	18.00

Quantity Rates:

First 300 cu. ft., per 100 cu. ft.	0.20	0.55
Over 300 cu. ft., per 100 cu. ft.	0.31	0.55

Flat Rate Service\*

Per Month

First residence	10.00	18.00
Second residence on same lot	8.00	-
For each 100 sq. ft. of irri- gation in excess of 4,000 sq. ft. per residence	.12	-

\* Since applicants plan to meter it is expected that these rates will be in use only on an interim basis.

Our rate structure differs from that proposed by applicants. We have decided that a greater proportion of the total revenue requirement should come from commodity charges, and relatively less from fixed charges. The purpose of this modification is to promote conservation. The structure adopted herein produces approximately the same total revenues as those sought by applicants on a near-term test year basis.

Problems of Transition

Applicants, since they have no tariffs on file, have experienced some difficulty in establishing the mutual rights and obligations of utility and customer. Applicants' witness apparently believed that the utility had no right or opportunity to establish tariff rates or rules until after a certificate had been issued by the Commission. That belief is incorrect.

Theoretically, applicants assumed all the rights and obligations of a public utility at the instant they became owners and operators of this system. Included was an obligation to have a tariff and to provide service and charge rates in conformity with that tariff. Applicants, however, apparently continued to utilize the rates established by the mutual operation. This mistake was clearly made in good faith and there can be no question that customers enjoyed a substantial bargain as a result thereof since the rates are, and apparently have been for some time, less than sufficient to provide an adequate return on investment.

Immediately upon issuance of this decision applicants will be furnished with a set of standard tariff pages which they may adopt<sup>2/</sup> and which will upon filing and effectiveness pursuant to General Order No. 96-A govern all subsequent transactions between applicants and their customers.

Applicants were concerned over the fact that certain customers have allegedly established second unauthorized connections to serve their lots. In at least two instances, the benefiting lot owners were paying nothing for the added service; applicants were unsure of their rights to abolish these connections or to charge for the additional service.

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<sup>2/</sup> In the case of Rule 15, Decision No. 84334, dated April 15, 1975, in Case No. 9263 requires adoption.

Rule 11.3.b of the standard tariff clauses gives the utility the right to install a meter on any service including an unauthorized one to prevent waste. Rule 11.5 authorizes discontinuance if a customer diverts water to an unauthorized use.

If applicants find that additional nonstandard rules are needed, they may adopt such using the procedures set forth in General Order No. 96-A.

Certification

There is a question as to whether a certificate of public convenience and necessity is required under the facts in this case, since the water company is already constructed and functioning. However, the problem need not be considered in this proceeding. The Pattersons have applied for a certificate and there is no opposition to granting such certificate. Under the circumstances there is no harm in granting their application.

Policy Considerations

This Commission has a well-established policy of denying certificate applications to construct new, very small public utility water systems; that policy is not, however, at issue here.

First, this is not a new system. The water system has been constructed and a number of families now rely on it to provide domestic water service. We cannot unring the bell. At most, we can explore alternative means to ensure that the already-constructed system is operated in a manner most likely to satisfy the interests of the customers involved. As indicated above, the cooperative ownership alternative has been rejected by Mutual's management which presumably speaks for all of the consumers. It therefore appears that in this case, there is no feasible alternative to public utility service.

Second, this transaction should be considered as the addition<sup>✓</sup> of a third, to two existing, public utility systems rather than the creation of a new, isolated, separately managed public utility.

If we were asked to consider the creation of a new multi-district public utility providing water service to 200 customers in three separate systems, we might very well conclude that the resulting entity would be too small to be economically viable. Here, however, all three systems are in existence and two of them are already part of our responsibility. The addition of approximately 50 more customers to the already existing public utility<sup>3/</sup> will make the resulting entity more viable and tend to protect all of its customers, old and new, from the economic and management problems which frequently plague small public utility water systems.

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<sup>3/</sup> Legally, the three Patterson systems constitute a single regulated entity. We believe, as a matter of practical regulation, however, that it is acceptable to recognize each system as a separate utility.

Third, this transaction will not add significantly to the cost and difficulty of regulating the relationship between applicants and the existing customers. In fact, since the merged system is larger and less likely to be vulnerable to the problems of the extremely small system, we actually anticipate a reduction in the per customer cost of regulation.

Applicants' customers can expect reasonably satisfactory service from applicants.

First, applicants consider their investment in these water systems as a permanent source of a return on their investment. Unlike other small water systems where the primary economic motivation for the investment is short-range profits on the sale of real estate, applicants' interest in preserving the value of their investment in many respects parallels the long-range interests of their customers.

Second, most of the outlay of money and labor necessary to upgrade the system to the level necessary to provide adequate domestic service has already been made. Applicants anticipate no difficulty in financing the further main replacements necessary to complete the improvement program so that all customers are served by looped 4-inch mains.<sup>4/</sup>

Third, applicants have the skills and equipment necessary to perform much of the labor necessary for constructing the additional plant necessary to loop the remaining portion of the system.

The evidence indicates that the service rendered in applicants' other systems is at least adequate and not unduly expensive.

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<sup>4/</sup> Mains of this size meet the standard imposed by the Commission's General Order No. 103 at the date when they were installed. The record leaves open the possibility that 4-inch mains would not provide all the fire flow required under General Order No. 103, as subsequently amended.

Thus, while the three systems combined are borderline in terms of size and long-range economic viability, these *their* characteristics cited in the preceding paragraphs indicate that the short-range prospects for both service and rates will be relatively favorable.

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#### Pressure Problems

The principal concern of the customers who participated in the hearing appeared to be inadequate pressure. Their comments indicated that this was a chronic problem, occurring principally during the summer months. The staff engineer also addressed himself to this problem.

His testimony indicates that when the system is totally metered and when continuous operation of both well pumps can be guaranteed, most of the pressure problems should vanish. The handful of houses on the single street not now served by a looped 4-inch main could possibly continue to have occasional pressure problems. Applicants have indicated, however, that they plan to upgrade this one remaining segment of the system. Thus, it is anticipated that the system will in the very near future be able to maintain adequate pressures year around throughout the system.

#### Findings of Fact

1. Applicants have offered to sell the Mira Monte system to consumers on fair terms. The offer has not been accepted.
2. The customers of this water system do not wish to own and operate it as a mutual water company.
3. Ownership and operation of this system as a mutual water company is not a feasible alternative to ownership and operation by applicants.

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4. In the past, consumers have experienced chronic low pressure. Once proper mains are installed, and metering is completed, this condition should no longer occur regularly or frequently.

5. If applicants own, operate, and manage this system in conjunction with other public utility water systems, none of which is large enough to be economically viable as an independent business, the customers of each system will be benefited.

6. Applicants recognize an obligation to bring all of the system up to the standards imposed by General Order No. 103 as it existed when the system was first constructed.

7. Applicants now have no tariff on file for the Mira Monte system.

8. The labor applicants expended in upgrading the system is worth \$16,000. This amount constitutes a reasonable rate base for the purpose of fixing applicants' initial rates. The estimates of expense and consumption and revenue set forth in the body of the opinion are reasonable.

9. The rates set forth in Appendix A are just and reasonable. After the effective date of this order any other rates will be unjust and unreasonable.

Conclusions of Law

1. A certificate of public convenience and necessity should be granted.

2. The rates adopted herein are the first rates found just and reasonable for public utility water service in this service area. They, thus, are the utility's initial, rather than increased, rates.

3. The fire-flow requirements of Paragraph VII, General Order No. 103, do not apply to mains in place prior to May 4, 1975 (Decision No. 84334 in Case No. 9263).

ORDER

IT IS HEREBY ORDERED that:

1. A certificate of public convenience and necessity to operate a public utility water company is hereby granted to applicants.
2. Applicants shall file and adopt a tariff which complies with the requirements of General Order No. 96-A.
3. All such filings shall be completed not later than ninety days after the effective date of this decision. Such rates and rules



shall govern service rendered on and after the date upon which the tariff sheets become effective. All such filings shall be in accordance with General Order No. 96-A.

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

Dated FEB 13 1980, at San Francisco, California.

John E. Sany  
President  
Vernon L. Sturgeon  
Richard D. Howell  
Clair J. Delaney  
James M. Spurr  
Commissioners

APPENDIX A

Schedule No. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Mira Monte Estates, a subdivision approximately five miles west of the City of Red Bluff, Tehama County.

RATES

	<u>Per Meter</u> <u>Per Month</u>
Service Charge:	
For 5/8 x 3/4-inch meter .....	\$ 6.65
For 3/4-inch meter .....	7.30
For 1-inch meter .....	10.00
For 1-1/2-inch meter .....	13.30
For 2-inch meter .....	18.00

Quantity Charge:

All water, per 100 cu.ft. .... \$ 0.55

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

Flat Rate Service:

All flat rate service, per month ..... \$18.00