

ORIGINAL

Decision No. 92796 MAR 17 1981

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Ernest & Louise Pierson, doing business as Freshwater Valley Estates Water Co., request authority to abandon the water system in Humboldt County.

Application No. 59523
(Filed March 14, 1980)

In the matter of Freshwater Valley Estates Water Company's Advice Letter filed January 2, 1980 to increase rates by \$3,388 or about 260 percent.

Application No. 59530
(Filed March 21, 1980)

- Ernest Pierson, for Freshwater Valley Estates Water Company, applicant.
- Jon H. Lyons, Attorney at Law, for Freshwater Valley Estates Homeowners Association, and for himself; Irene V. Gates, for herself and husband, Humboldt B. Gates;
- Colleen C. Heber, for Homeowners Association;
- Roland Giampaolo and Marie Giampaolo, for residents; Ken Merideth, for residents; and Colette Van Fleet, Charles C. McCulloch, John Arnett and Barbara Arnett, Leslie P. Youngs, and Melvin Wahlund and Sarah Wahlund, for themselves, protestants.
- Robert H. Bennett, for the Commission staff.

O P I N I O N

I. Introduction

Freshwater Valley Estates Water Company (Freshwater) provides water service to 11 customers on the outskirts of Eureka in Humboldt County. By A.59523 Ernest Pierson and Louise Pierson (applicants), doing business as Freshwater, request authority to abandon the water system. By A.59530 applicants request authority

to increase water rates by \$3,388, approximately 260 percent. These matters were combined for hearing before Administrative Law Judge Patrick J. Power in Eureka on August 21, 1980. Every customer appeared and participated in the hearing or in a public meeting held the night before, protesting the applications. Applicants offered the testimony of Ernest Pierson as owner of Freshwater and his son, Henry Pierson, general manager. Henry Pierson is also a customer of Freshwater. The Commission staff offered the testimony of Arthur Choy, assistant utilities engineer. Three customers: William Van Fleet, Irene V. Gates, and John Arnett offered sworn testimony. The matter was submitted upon written briefs filed by applicants, staff, and Jon Lyons, on behalf of protestants.

These pending matters need to be addressed in the context of the origins of this utility. Freshwater was found to be a public utility by D.69698 in C.7953, dated September 21, 1965. The following excerpts are relevant to understanding the current situation:

"Defendant Ernest Pierson testified that commencing with the first lot sale in 1955 defendants planned on a mutual water system and that until there would be enough people there to be able to have them absorb the cost, they were furnishing water as an interim or temporary measure until the mutual water system was formed. . . .

"The intent of defendants was that this property would be perpetually devoted to water service for residents of the subdivision. Although only seven families were being served at the time of the hearing, more were expected; indeed, defendants deferred implementation of the mutual water company plan for the claimed reason that there were not yet sufficient customers to make it economic. . . .

"Defendants argue that, since their operation is too small to be economic, we should not rule that it is a regulated public utility. Such a consideration would have been relevant in a proceeding to determine whether or not public convenience and necessity required construction of the system in the first

place, but it has no bearing on the legal status of utility property constructed without a certificate of public convenience and necessity. Moreover, small water companies often are not profitable in the developmental stages and it is not uncommon for the owners to accept such losses during the initial period of operation; this is especially true where, as here, the owners of the utility are also the owners or developers of the land served by the utility."

Fifteen years later the anticipated development has not occurred. The county will not issue permits for any more septic tanks in the area. A major portion of the original subdivision is zoned as a Timber Protection Zone and not subject to development. There is no potential for growth in the system, at least in terms of any reasonable future test period.

II. Abandonment

Applicants request "one of the following:

- "1. Abandonment.
- "2. Increased rate and surcharge so bills can be paid."

Applicants have contacted the Humboldt Community Service District (District) and determined at least preliminary interest on the District's part in taking over Freshwater. To facilitate such a transfer applicants offer "to pay the indebtedness of the water company of approximately three thousand dollars, and also to pay up to \$2,500 of costs involved in making the transfer." The customers oppose such a transfer.

The opposition to the District is summarized in the testimony of Mr. Van Fleet:

"If the Community Services District came in, I think it would only be a matter of time, with the coming of water and sewer to the whole area there, that then the lots that are undeveloped until now on both sides of the Freshwater Road would then be open to development, plus a shopping center down at Three Corners.

"And the character that we have now of the fields with horses is quite a difference. This is why we purchased the property out there, for this kind of an environment.

"And to compare that with the typical subdivision and shopping centers is entirely a different character I wouldn't care to see."

Mr. Van Fleet also opposes the requested rate increase.

The alternative form of abandonment would lead to the formation of a mutual water company. In A.59523 applicants state:

"We propose to negotiate a mutual water company where the system improvements would be maintained by the users until a public utility district was formed in the area or another utility provided service. We would pay the delinquent bills. An unspecified right-of-way would be given to access the improvements via the existing road, or any future road, terminating at the time service to the subdivision is taken over by another utility.

". . . If (a) mutual is established, one of the residents is a 'water treatment plant operator, Grade 2' which qualifies him to operate the system."

Henry Pierson is the "operator".

As indicated above, a mutual water company was originally intended as the serving vehicle. The original deeds referred to the pending mutual water company and a nonprofit corporation was formed, Freshwater. However, the mutual water company was never perfected and the transfer of the water company to the corporation never occurred. Thus Freshwater remains the property of applicants.

The mutual water company remedy is also opposed by the customers, apparently on the basis that applicants have a legal and moral obligation to continue providing water service. Mrs. Gates and Mr. Arnett indicated that some increase in the present rates would be reasonable, however.

Staff states that it is:

"...concerned about the future possibility of a reluctant owner and/or poor water service... "

"If the request to abandon the water system is denied, the staff foresees a crisis-type situation that will need to be straightened out at some later date. The staff believes that a reasonable alternative to the continuation as a regulated public utility can and should be worked out between the customers and the utility's owners."

Accordingly, staff recommends that:

"In the absence of an authorized transfer or sale, the water company should be required to remain in operation as a public utility for a period of about one year from date of decision in order to permit the customers sufficient time to obtain water from alternate sources. Applicants should then be permitted to discontinue water service and be relieved of its public utility obligations in connection with the utility system unless relieved earlier by other actions."

This is in addition to the staff's recommended rate increase, discussed below.

Based on the applicants' request for either authority to abandon service or a rate increase, we conclude that abandonment should not be permitted at this time. We find that the rate increase granted by this decision is adequate to sustain the utility for a period sufficient for the customers to face up to their alternatives.

It is important that the customers understand that regulation is not the solution. By Resolution No. M-4708, adopted August 28, 1980, this Commission stated:

"WHEREAS: The Commission finds that Class D water company operations tend to be inadequate for both owners and customers, the lack of economies of scale often results in a limited return on the owner's investment and poor service to the customer. Now, therefore, be it resolved that the Commission will:"

* * *

"(d) support and promote the conversion of unviable or marginal water utilities to

public ownership or their mergers with more viable entities when opportunities arise and customer service is more likely to improve through such change than without it; ..."

That policy is appropriately applied in this proceeding.

The immediate signal is provided by the substantial rate increase supported by the record and authorized by this decision. The customers' objection to the District is apparently based on lifestyle considerations that are wholly beyond the purview of this Commission. They are willing to pay more for water to sustain that lifestyle, but are they willing to pay enough to adequately support the utility? Whatever their sense of moral obligation, the law is clear:

"The state has no power to compel the continued operation of a public utility at a loss, where the owner of that utility is willing to and does in fact abandon to the public all its property that has been devoted to public use." (Lyon & Hoag v Railroad Comm. (1920) 183 Cal 145.)

Our experience with utilities of this size indicates that abandonment is more a matter of "when" rather than "if". Staff's point regarding deteriorating service provided by a reluctant owner is well-taken, and the customers would be well-advised to arrange for an orderly transition.

Nevertheless, we decline to go as far as proposed by staff and set a deadline for the resolution of this matter. We are not prepared to presume that abandonment will be appropriate at any particular time without further proceedings. We will entertain a future filing for abandonment that provides for the transition to a mutual, a district, a homeowners association, or some other alternative to a regulated public utility.

III. Rate Relief

The water system is described in this excerpt from the staff report:

"The water system obtains its water from one well. In 1979 a new 3 hp submerged pump producing 26 gpm was set at 100 feet deep in the 128 feet

deep, eight-inch in diameter well. The well was drilled 20 feet deeper, because the water table was too shallow. There is no shelter over the well and the top of the well casing extends about 3 feet above the ground.

"A chlorinator is located near the well. It has a shelter, but it is not completely enclosed to protect the equipment.

"There are two water storage tanks on the distribution system with a total capacity of 18,200 gallons. The redwood tank holds 4,700 gallons. A missing section of screen on the top side of the wooden tank was not replaced. Two wooden steps of the ladder were weakened and cracked. The utility's manager responded that he will take care of them right away. The other, a steel tank, holds 13,500 gallons, and it is rusty around the outside.

"The distribution mains consist of 8,765 feet of standard screw, cement-asbestos, plastic and copper in sizes ranging from 2" to 4" in diameter."

Service is provided to Henry Pierson on a flat rate basis and to the other 10 customers on a metered schedule.

By A.59530 applicants request an increase in rates of \$3,388 annually. Staff reviewed the application and proposes a number of ratemaking adjustments. Based on staff's calculations applicants' requested relief would yield a 21.4 percent rate of return. Staff recommends that a 10 percent rate of return be applied.

Protestants argue in their brief that the rate increase should be denied. In support of their position they assert that: "A. Applicant's present operations are discriminatory thus precluding the proposed increase in rates.... B. Applicant's customers should not have to play a part in Applicant-Developer's business risks.... C. Applicant has failed to carry its burden of proof for the proposed rate increase." However, they "do not oppose a fair, equitable and reasonable rate increase." We find that the staff showing provides a reasonable basis for the rate relief and adopt it with slight modification.

While applicants' own showing is minimal, the staff has discharged its responsibility to the Commission, the public, and to the utility. As stated in staff's brief:

"Many of the small water utilities under jurisdiction of the Commission do not have the expertise to thoroughly understand rate-making theory. These utilities depend upon the Commission staff to assist them in their requests for a rate increase. ... It is advantageous to all parties that the utility receives revenues that are just, reasonable and sufficient to cover reasonable operating expenses and to provide a return on its investment as provided under Section No. 728 of the Public Utilities Code."

We agree.

The discrimination issue arises from the relationship between Freshwater and Henry Pierson, general manager. The practice in the past has been to compensate Mr. Pierson for his services by way of a preferential water rate - the only flat rate on the system. Because Mr. Pierson apparently uses substantial volumes of water to operate his ranch and stables, the customers argue that there is undue discrimination, thereby "precluding" the proposed rate increase and contributing a "major part" in applicants' financial difficulties.

Staff resolves this problem by billing the general manager for water consumption on the meter rate schedule, while including a "fair and reasonable allowance for management salaries to compensate the manager for time spent on maintenance work." Staff appears to have reasonably calculated the amount of water used by Mr. Pierson for test year purposes. Its recommendation is adopted.

Staff has also responded to protestants' point regarding the business risks undertaken by applicants and the economic hardship resulting from the inability to sell out the subdivision. Staff recommends a 40 percent "saturation adjustment" in order to "reduce the utility's original built plant to the equivalent needs of the present customers." The saturation adjustment recognizes that only 11 of the 31 lots originally intended to be developed

are in use, but that the original facilities were built to serve the entire subdivision. The rate base is reduced accordingly. We find this adjustment reasonable.

The adopted results of operations are shown in Table I. The adopted figures are based on the staff showing, including the staff estimate of operating and maintenance expense. The major differences between applicants and staff are the following:

purchased power - staff's estimate is higher (\$118), based on higher electric rates.

contract work - staff's estimate is lower (\$2,041), based on an apportionment between plant additions and expenses, and 5-year amortization of a portion of the expenses.

management salary - staff allowed \$500 to recognize Henry Pierson's contribution as general manager.

insurance - staff's estimate reflects the 40 percent saturation adjustment.

retire loan - staff deleted this item as not recoverable.

Operating revenues are based on staff's sales estimates, including its proposed metering of the general manager. The rates are calculated to yield a 10 percent rate of return. Income taxes are based on applicants' status as individuals, rather than the illusory corporation.

TABLE I
SUMMARY OF EARNINGS
(Estimated Year 1980)

FRESHWATER VALLEY ESTATES WATER COMPANY

Item	Utility-Estimated		Staff-Estimated		Adopted
	Present Rates	Proposed Rates	Present Rates	Proposed Rates	
<u>Operating Revenues</u>					
Flat Rate Revenue	\$ 180	\$ 300	\$ -	\$ -	\$ -
Meter Revenue	<u>1,932</u>	<u>5,200</u>	<u>2,740</u>	<u>7,200</u>	<u>4,300</u>
Total	\$2,112	\$5,500	\$2,740	\$7,200	\$4,300
<u>Operating Expenses</u>					
Purchased Power	\$ 735	\$ 432	\$ 550	\$ 550	\$ 550
Management Salary	-	-	500	500	500
Other O&M	3,576	4,053	1,300	1,300	1,300
Depreciation	-	-	340	340	340
Taxes Other Than Income	-	-	-	-	-
Subtotal	4,311	4,485	2,690	2,690	2,690
Taxes on Income	<u>200</u>	<u>200</u>	<u>200</u>	<u>1,120</u>	<u>20</u>
Total Oper. Expenses	\$4,511	\$4,685	\$2,890	\$3,810	\$2,710
Net Oper. Revenue	(2,399)	815	(150)	3,390	1,590
Depreciated Rate Base	-	-	15,870	15,870	15,870
Rate of Return	Loss	-	Loss	21.4%	10.0%

(Red Figure)

Freshwater's presently effective rates contain three blocks - 0-300 cf, 300-800 cf, and over 800 cf - and are inverted. Staff proposes to retain the current balance between service charges and quantity rates, but to consolidate the existing three blocks into two blocks - 0-300 cf, and over 300 cf. There is no opposition. Staff's proposal is adopted.

Protestants request that this Commission:

"Direct, as a condition of any rate increase, the establishment of a reserve account to meet future financial obligations.

"Direct, as a condition of any rate increase, the periodic testing of meters."

These conditions are opposed by applicants and staff.

Staff responds on a theoretical level:

"Since the utility does not have service deficiencies, the staff questions the need for the utility owners to deposit a quantity of money each year into a reserve account. The utility owners can set up a reserve account from available net revenues to cover future major repairs and system improvements as a part of prudent management."

Applicants respond in more practical terms: "You cannot have a reserve for depreciation without excess money. The bills come first." Both points are well taken.

Regarding the periodic testing of meters, staff states:

"The periodic testing of water meters is covered by Section VI, 6. of General Order No. 103. No evidence was introduced at the hearing to indicate that there is a problem with the accuracy of the utility's meters."

In this circumstance we see no basis for imposing an additional obligation on this utility.

Findings of Fact

1. Freshwater was founded by Ernest and Louise Pierson to provide water service to a subdivision of 31 parcels in the vicinity of Eureka, in Humboldt County.
2. Upon completion of the subdivision Freshwater was intended to be operated as a mutual water company.
3. The mutual water company has never been perfected.
4. Freshwater was found to be a public utility by D.69698 in C.7953, dated September 21, 1965.
5. Service is provided to 11 customers.
6. Further development in the subdivision is unlikely without sewer service.
7. By A.59523 Ernest and Louise Pierson seek authority to abandon Freshwater.
8. Applicants have offered to pay outstanding debts and other costs involved in arranging a transfer of Freshwater to the District.
9. The District has expressed some interest in possibly taking over Freshwater.
10. The customers of Freshwater oppose the transfer of Freshwater to the District, in part because of the possibility that sewer service would be provided and development would occur.
11. Applicants have offered to facilitate the formation of a mutual water company.
12. One of the customers - Harry Pierson is a qualified water treatment plant operator able to operate a mutual water company. Mr. Pierson is the son of applicants and the general manager of Freshwater.
13. The customers generally oppose formation of a mutual water company.
14. Freshwater has lost money in the past and is at best a marginally profitable utility company that has little prospect for improvement.

15. Service is provided to 10 of the customers on a metered basis and to Mr. Pierson on a flat rate basis.

16. Mr. Pierson is served on a flat rate as a means of providing compensation for his services as general manager.

17. Mr. Pierson should be served on a metered basis and separately compensated for his services as recommended by staff.

18. Staff has reasonably estimated the test year volumes of water used.

19. Staff has reasonably estimated the utility's test year operating and maintenance expenses.

20. Staff's 40 percent saturation adjustment reasonably recognizes the reduced requirements of the utility.

21. The rates are reasonably set to yield a 10 percent return based on staff's estimates of sales, expenses, and rate base. The resulting annual rate increase is \$1,560.

22. The existing relationship between service charges and commodity rates is reasonably maintained.

23. A two-block commodity rate adequately recognizes lifeline requirements.

24. Service is adequate.

25. There is no evidence that meters are unreliable.

26. The chlorinator has a shelter, but it is not completely enclosed to protect the equipment.

27. There is no shelter over the well and the top of the well casing extends about 3 feet above the ground.

28. There is a need for immediate rate relief in light of the precarious financial condition of the utility.

29. The increase in rates and charges authorized by this order is justified and reasonable; the present rates and charges, insofar as they differ from those prescribed by this decision, are for the future unjust and unreasonable.

Conclusions of Law

1. Abandonment is not appropriate.

2. Freshwater should be authorized to increase its water rates as set forth in Appendix A.

3. The general manager should be charged on a metered schedule basis.

4. The effective date of this decision should be the date hereof since there is an immediate need for rate relief.

O R D E R

IT IS ORDERED that:

1. Ernest and Louise Pierson operating Freshwater Valley Estates Water Company are authorized to file the revised tariff schedules attached to this order as Appendix A and cancel the presently effective tariffs. The revised tariffs shall become effective five days after filing.

2. Freshwater Valley Estates Water Company shall bill all of its customers at the appropriate meter rate.

3. Freshwater Valley Estates Water Company shall:
 - a. Enclose the chlorinator to protect the equipment in a lockable shed.
 - b. Provide a concrete slab around the top of the well casing.
4. The relief requested in Application No. 59523 is denied. The effective date of this order is the date hereof.

Dated MAR 17 1981, at San Francisco, California.

John E. Geyson
President
William D. ...
...
...

Commissioners

APPENDIX A

Schedule No. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

In Freshwater Valley Estates, near Eureka, Humboldt County.

RATES

	<u>Per Meter</u> <u>Per Month</u>	
Service Charge:		
For 5/8 x 3/4-inch meter	\$14.00	(I)
For 3/4-inch meter	16.00	I
For 1-inch meter	22.00	(I)
Quantity Rates:		
First 300 cu.ft., per 100 cu.ft.	\$ 0.75	(I)
Over 300 cu.ft., per 100 cu.ft.	1.11	(I)

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

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