

(Decision No. 73381)

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

* * *

IN THE MATTER OF THE APPLICATION OF THE
CASCADE TOWN COMPANY AND CASCADE PUBLIC
SERVICE COMPANY FOR A DETERMINATION FOR
RATE MAKING PURPOSES OF THE REASONABLE
VALUE OF THEIR PROPERTIES DEVOTED TO
PUBLIC USE, THE FAIR RATE OF RETURN
THEREON, THE GROSS REVENUES TO WHICH
APPLICANTS MAY BE ENTITLED, AND RULES
AND REGULATIONS GOVERNING SUCH SERVICE.

APPLICATION NO. 23705

RECOMMENDED DECISION

of
William D. Mitchell
Examiner

IN THE MATTER OF THE APPLICATION OF THE
CASCADE TOWN COMPANY, A CORPORATION,
P. O. BOX 111, CASCADE, COLORADO, FOR
AUTHORITY TO TRANSFER A PORTION OF ITS
ASSETS AND LIABILITIES TO CASCADE PUBLIC
SERVICE COMPANY, A CORPORATION, CASCADE,
COLORADO.

APPLICATION NO. 23706

RECOMMENDED DECISION

of
William D. Mitchell
Examiner

August 20, 1969

Appearances: John P. Thompson, Esq., Denver, Colorado,
for Applicants.
Erle Blakeney, Cascade, Colorado;
Jack Power, Cascade, Colorado;
John F. Brady, Cascade, Colorado;
Byron Church, Colorado Springs,
Colorado; Fern Johnson, Cascade,
Colorado; Glenn H. Main, Cascade,
Colorado; Thomas H. Jones, Cascade,
Colorado; and Richard G. Steward,
Cascade, Colorado, Protestants.
Girts Krumins, Esq., Denver, Colorado,
for the Staff of the Commission.

PROCEDURE AND RECORD

The above-entitled applications were filed by The Cascade Town Company and Cascade Public Service Company (Applicants) on April 25, 1969. Upon due and proper notice, the said applications were set down for hearing on July 22, 1969, at 10:00 o'clock A.M., in the County Commissioners' Conference Room, 27 E. Vermijo, Colorado Springs, Colorado. On July 18, 1969, the Commission appointed William D. Mitchell, an employee of the Commission admitted to the practice of law in the State of Colorado, Examiner

in these proceedings. The matters were consolidated for hearing and were duly heard by said Examiner at the time and place stated above. A Protest to the applications was duly filed by a group of twelve (12) customers of Cascade Town Company, eight (8) of which appeared at the hearing. Exhibits 1 through 15, 17, 19 and 20 were received into evidence. Exhibit 18 was offered by Protestants but not admitted. Exhibit 16 was offered and rejected then allowed to be filed after corrections as a late-filed Exhibit by stipulation of the parties. Official notice was taken of the Annual Reports to the Commission by Cascade Town Company for the years 1960 through 1968 and of Commission Decision No. 57371.

The eight (8) appearing Protestants were ruled to be parties to the proceeding. At the conclusion of the hearing on July 23, 1969, the matter was taken under advisement.

The Examiner transmits herewith the record and exhibits in the above-captioned matters together with his Recommended Decision and Recommended Order herein.

FINDINGS OF FACT

From the record herein, your Examiner finds as fact, that:

1. Cascade Town Company is a public utility providing water service in the unincorporated community of Cascade, Colorado, subject to the jurisdiction of this Commission, and the Commission has jurisdiction over the subject matter of the applications herein.
2. By its application herein, Cascade Town Company proposes to transfer its water utility business and assets connected therewith, except water rights, to Cascade Public Service Company, a newly formed corporation.
3. Cascade Public Service Company, if approval of the transfer mentioned in Finding No. 2 is granted, will become a public utility under the jurisdiction of the Commission and The Cascade Town Company will retain only non-utility business and cease to operate under Commission jurisdiction.

4. For rate-making purposes in the within application, the calendar year 1968 is a proper test year.

5. The reasonable value of Applicants' properties devoted to public use (rate base) as of the end of the test year 1968 is \$67,963.82.

6. Approximately \$200.00 included in the rate base above consists of repairs and improvements on non-utility plant and is allowed as working capital. The working capital requirements of the utility are minor, as its rates are billed for a year in advance.

7. The fair rate of return on the rate base as stated in Finding No. 5 is eight (8%) percent.

8. Applying the fair rate of return as found herein to Applicants' rate base, a return requirement of \$5,437.11 is determined and such return is and will be necessary and adequate to compensate Applicants for capital costs applicable to the water utility business, and will provide for service on necessary debt, preserve the financial integrity of the utility and provide for reasonable and necessary return to the equity owners so as to prevent confiscation of property.

9. As of the end of the test year, Applicants' liabilities included notes payable of approximately \$15,000.00 bearing 8% interest. Total annualized interest cost of \$1,200.00 is included in the return allowance above, leaving allowable net income of \$4,237.11.

10. The State and Federal Income Taxes necessary to provide such net income are \$1,480.98.

11. Applicants' actual cash expense attributable to water operations of \$19,978.89 during the year 1968 must be adjusted for the purposes of rate making by subtracting therefrom expenses attributable to prior years and extraordinary and non-recurring expenses, and by including therein amortization of rate case expense to the extent it was not paid in 1968, as follows:

Subtract: Regulatory Commission Expenses	\$4,759.49
Subtract: Interest Expense	<u>483.74</u>
Total Subtractions	\$5,243.23

Add: Reasonable Expenses for outside services and Regulatory Commission Expenses	\$2,000.00
Add: Rate Case Expenses (\$2,800.00, amortized over a period of four (4) years)	<u>700.00</u>
Total Additions	\$2,700.00

12. The necessary, proper and allowable expenses of operating the water utility for the test year as adjusted, were \$17,435.66 in addition to the income taxes and return as found above.

13. The total revenue requirements based on the test year operations of Applicants are \$24,353.75. The actual utility revenue for the test year was \$17,170.09, resulting in deficiency in revenues of \$7,183.66.

14. The computation of the return allowance herein contemplates that Applicants will provide reasonably good water utility service. A substantially reduced return allowance would be proper if improved service were not contemplated.

15. Certain improvements to the water system are necessary to provide reasonably good water utility service as stated in Finding No. 14. Such improvements do not necessarily consist of an installation of water storage tank as proposed in engineering study introduced as Exhibit No. 4. The construction of such a tank would improve the pressure conditions as well as allow an expansion of the system. To provide adequate pressure conditions for existing customers, it may be necessary to do no more than repair the larger leaks in the system, repair the pressure reducing valve and perhaps make some improvements to the pump operation, eliminate potential blockages in the system and provide additional pressure reducing valves, all as discussed in the engineering study (Exhibit No. 4).

16. The proposed transfer of assets to Cascade Public Service Company resulting in a separation of utility and non-utility business is not inconsistent with the public interest, provided that the water rights retained by The Cascade Town Company are permanently available to the

Cascade Public Service Company for the benefit of the public it serves. Reasonable safeguards that these water rights will not be lost or alienated in the future are necessary. Such safeguards can be adequately provided for by an agreement between the two companies which would preclude The Town Company from selling, conveying, leasing or otherwise encumbering or alienating such water rights to anyone except Cascade Public Service Company or by specific approval of this Commission, which Agreement should be recorded to create a lien on such water rights.

17. The public interest requires further safeguards against unnecessary increases in utility rates solely by virtue of the transfer proposed by Applicants. Such safeguards may be provided by a condition upon the transfer that the rates of the Cascade Public Service Company shall not, at any time, include an expense connected with the supply of water in excess of the actual costs of providing such water by either or both Applicants herein; and that, in any future case, Cascade Public Service Company shall have the burden of proof to show that Cascade Town Company has incurred any costs in the supply of water over and above the necessary return and associated income taxes on the original cost of such water rights (hereby determined to be \$6,833.33), and no consideration will be given to the actual cash payment to Cascade Town Company pursuant to the Water Supply Agreement (Exhibit No. 6).

DISCUSSION AND COMMENTS

Rate Base. The rate base submitted by Applicants herein includes approximately \$200 in non-utility property. This has not been corrected, and the said amount is allowed in lieu of working capital. In other respects Applicants' rate base follows the pattern of a previous case before this Commission.

Operating Expenses. The Cascade Town Company has both utility and non-utility operations and, therefore, some allocation of operating expenses between the two categories must be made. Such allocation is always subject to judgment, and while an argument as to minor adjustments of utility operating expenses can be made, such amounts would not be substantial.

Consequently, Applicants' figures with respect to operating expenses, except an item entitled "Regulatory Commission Expense," have been accepted. Income taxes will be discussed below. With respect to the item entitled "Regulatory Commission Expense," it is noted that Applicants' figures in this account include mostly expenditures that are more properly included in "outside services." The fact of misclassification is not in itself too important, except that Applicants should adhere to the Uniform System of Accounts as prescribed by the Commission. The amounts included in this account, however, are not representative of the test year, since certain expenses applicable to a past period and some extraordinary and non-recurring legal expenses are present. Likewise, this account as presented by Applicants includes some, but not all, of the rate case expense. An examination of Applicant's annual reports from 1961 to 1967 indicates that the amounts charged to Regulatory Commission Expense in these years varied from a low of \$830 to a high of \$1,735. Consequently, it is the finding that the sum of \$2,000 is a reasonable and necessary expense applicable to the test year and appropriate adjustment has been made. Rate Case Expense, as indicated in the record herein, is a total of \$2,800; amortizing this amount over a period of four years, in line with the agreed schedule of payments to Applicants' attorney, results in a proper rate case expense applicable to the proceeding of \$700 a year.

Applicant has included interest costs in its operating expenses. This is a so-called below-the-line expense that should not be included in operating expenses to arrive at net operating income. It should be noted that Applicants' exhibit does show net income rather than net operating income. The adjustment for interest is made in order to arrive at net operating income.

Return. Applicant submits that a rate of return of 8, 9, or 10% may be applicable. The finding that 8% is a reasonable and necessary rate of return is based somewhat on the fact that improvements to the water system are contemplated. Utility property that is inadequate or unserviceable to the extent that service to customers is impaired would otherwise not be entitled to the full return allowance. The requirements for improve-

ment in service that are implied in the return allowance will be discussed below.

Income Taxes. Income taxes directly associated with the return on rate base is the amount for income taxes that must be paid in order to obtain the net operating income allowed. To arrive at the proper income tax figure, the Examiner has first deducted an annualized interest cost of \$1,200. Interest is, of course, deductible for income tax purposes. The income tax has then been refigured on the basis of the taxable income required to produce the net operating income allowed as return. It should be noted that Applicants' exhibits computed income taxes using the return allowance as the taxable income. This method would, of course, result in a lesser net operating income, as the income taxes should be figured on the taxable income which is net income plus the taxes.

Quality of Service. Both Applicants and Protestants state that improvements to the system are necessary to provide adequate service. There are, of course, apparent differences of opinion between the parties in this regard. Nevertheless, it is evident from the record that service must be improved. As a matter of fact, Applicants' request for rate relief is based in a great measure on the fact that expenditures must be made to provide proper service. An examination of the Engineering Study submitted in the record by Applicant indicates, however, that proposed improvements would do more than improve service to existing customers, in that such proposed improvements would also provide for expansion. It is, of course, not so much the concern of the Protestants, nor of the Commission, that additional service can be provided, but rather that the service to existing customers meet the requirements of the Rules of the Commission. It clearly appears that service could be improved by relatively minor improvements to the system; such as repair of leaks, repair of pressure reducing valves, improved pump operation, together with a planned program of flushing dead ends and making pressure surveys. These matters are provided for in the Rules of the Commission Regulating the Service of Water Utilities. Likewise, there appears to be some complaint that the customers have not been informed

where to direct complaints, requests for service, etc., since the Applicant no longer maintains a resident agent in Cascade. This matter can easily be taken care of by properly advising customers at the time the new rates are put into effect and the bills are mailed, and Applicants should do so in accordance with Rule 9 of the Commission's Rules Regulating the Service of Water Utilities.

Applicants appear to suggest that even with the proposed rate increase they would not be able to provide all of the necessary and desirable improvements to the system, and that the Commission should devise a method whereby the customers would be assessed additional charges to pay for such improvements. It is, of course, true that ultimately the customers pay for the entire cost of operating a utility. The observation must be made, however, that management of the utility business rests with the Applicants and it is they who have the duty to plan for, make investment in, and provide the facilities necessary for good service. The regulatory responsibility in this regard is discharged when rates are allowed that provide adequate return in addition to necessary operating expenses. Furthermore, such return can be provided only on investment already made, not on some future and speculative need. This is really not unlike other investments and other businesses, where investment always must be made first and charges made for service provided only afterwards.

Transfer of Assets to Cascade Public Service Company. The separation of utility and non-utility operations in this instance is in the public interest. The only problem that arises is with respect to water supply and the cost of raw water to the utility company, particularly since the two entities will be owned and controlled by the same interests. This transfer should be no occasion for increased costs to the utility rate payers because of inflating the cost of water to the Public Service Company beyond that which is necessary on the basis of cost to the Town Company. Similarly, the water rights must be preserved for the use and benefit of the Cascade Public Service Company and its customers. This can be accomplished by properly encumbering the water rights owned by Cascade Town Company, and such encumbrance

should be subject to Commission approval before the final transfer is made.

It is the conclusion of the Examiner that on the basis of the test year a rate increase of \$7,183.66 annually should be granted and that the Order below should be entered.

RECOMMENDED ORDER

1. That Applicants, or either of them, be, and hereby are, authorized to file a new schedule of rates which, when applied to the conditions of the test year 1968, would produce gross revenues for water service of \$24,353.75. Such rates may be filed to become effective upon thirty (30) days notice and prorated to customers then existing for the balance of the current year of service.

2. That Applicants, or either of them, shall perform such maintenance or system improvements as are necessary to provide the minimum adequate service in terms of pressure and water supply as required by the rules of the Commission. Such program of maintenance and improvement shall be completed not later than June 1, 1970, unless otherwise ordered by the Commission, and Applicant shall file with the Commission written progress reports in this matter every ninety (90) days from and after the effective date of this Order, until concluded.

3. That Applicants, or either of them, shall continue to operate in accordance with the rules of the Commission regarding service, operation, construction, maintenance and accounting.

4. That the transfer of such assets of the Cascade Town Company to Cascade Public Service Company as proposed herein be, and hereby is, authorized and approved; provided, however, the water supply agreement between the two Applicants be modified in accordance with the Findings herein and, when modified, such agreement be submitted to and approved by the Commission.

5. That the above mentioned authorization for transfer of assets is, further, made expressly upon the condition that Cascade Public Service Company shall not include in its operating expenses any amounts paid to the Cascade Town Company, or its successors, in excess of the actual cost of

providing the water supply by the Cascade Town Company to the Cascade Public Service Company in accordance with the Findings herein.

6. The accounting practices for Applicant's utility operations shall be brought into accord with the uniform system of accounts prescribed by this Commission and in the future, Applicant shall keep its books in accordance with the uniform system of accounts.

7. That within sixty (60) days of the transfer of assets to the Cascade Public Service Company by the Cascade Town Company a report of the journal entries effecting such transfer and the balance sheet for Cascade Public Service Company resulting therefrom shall be made to this Commission.

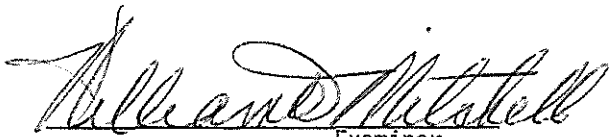
8. That within sixty (60) days of the transfer of assets to Cascade Public Service Company, a final report to this Commission will be made for the operations of the Cascade Town Company ending as of the last day it operates as a public utility on an annual report form supplied by this Commission.

9. That the authorization to transfer assets herein granted shall become null and void in the event such transfer is not accomplished in accordance with the provisions hereof by July 1, 1970.

As provided by Section 115-6-9 (2), CRS 1963, as amended, copies of this Examiner's Recommended Decision shall be served upon the parties, who may file exceptions thereto; but if no exceptions are filed within twenty days after service upon the parties or within such extended period of time as the Commission may authorize in writing (copies of any such extension to be served upon the parties), or unless such Decision is stayed within such time by the Commission upon its own motion, such Recommended

Decision shall become the Decision of the Commission and subject to the provisions of Section 115-6-14, CRS 1963, as amended.

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO


Examiner
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