State of California

M e m o r a n d u m

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To: The Commission
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File No:

Subject: POLICY FOR HANDLING WATER COMPANY SERVICE PROBLEMS

RECOMMENDATION: The Water Management Committee recommends the Commission should adopt the following proposed policy in order to clearly define the responsibility of all water companies to provide acceptable service and to establish credible and consistent penalties for failure to do so. The keys to this proposed policy are the following: (1) staff recommendations to improve service should represent the minimum needed to provide acceptable service and should be realistic and feasible, (2) improvement projects likely to result in substantial rate impacts should not be undertaken without public disclosure and customer opportunity for comment, and (3) rate increases granted to water companies should be subject to partial or possibly total cancellation and refund in the event of non-compliance with Commission orders for service improvements.

BACKGROUND: Water company service problems can become issues in a variety of Commission proceedings, including those for rate increases, complaint cases and transfer and sale of utility stock and assets. While the majority of service problems exist at small companies suffering from inadequate plant, large companies occasionally do have districts which provide unacceptable service. The proposed policy, therefore, should apply to all regulated water companies.

Currently there is no consistent Commission approach toward non-compliance with its orders. At one extreme the Commission ordered a cancellation and refund of an entire rate increase for Meadowbrook Water Company, Inc., in W-4708, dated September 8, 1978. At the other extreme it ordered Antelope Water Company, in R-2891, dated October 8, 1981, to initiate and complete a system improvement plan within the following five years but provided no penalties if it failed to perform. Most general rate increase resolutions for companies found to provide poor service contain orders for

them to correct designated service problems by a specified time or to face a reduction of rates. Decisions authorizing rate increases, however, usually do not contain provisions for penalties for failure to perform. An example of this is Decision 82-08-019 issued August 4, 1982, which ordered Santa Clarita Water Company to make improvements but provided for no penalties if it didn't comply.

In cases with severe problems and extensive customer protest, the Commission has reduced the rate of return until service has been improved, such as with Citizens Utilities Companies, for it Montara District, in D.88128, issued on November 22, 1977.

The goal of this memo is to develop consistent policy and implementation procedures which will apply to all the proceedings in which service is an issue.

DISCUSSION:

Commission Ordered Service Improvements

It cannot be overemphasized that the level of ordered improvements must be feasible. A determination of the costs and financing of the proposed improvements and their probable rate impact must be part of staff's analysis, even if it is only a preliminary estimate. Although it may be desirable to have water companies with deteriorated or poorly designed plant overhauled to meet GO 103 standards, this may simply be impossible due to the size of the utility, the lack of financing, inflation, etc. An exception to this policy would occur when the customers ask for or otherwise indicate willingness to pay for a more extensive project (say to provide for increased fire protection).

Customer Awareness of Improvement Plans

Water company bills, in many areas, are catching up to gas and electric bills. Public disclosure and opportunity for ratepayer comment about planned large improvement projects financed through private sources should become routine practice (as it is now for projects financed through the Safe Drinking Water Bond Act Loan Program). A recent case which points to this need is A.60254, filed on February 10, 1981, for the Montara District of Citizens Utilities Company, serving 1,300 customers. The adopted rate base in its last rate case in 1977, was $818,400. A.60254 indicated an expenditure of $897,000 since 1977, of which $256,000 represented a Commission ordered and approved construction plan; the balance represented utility initiated expenditure. The case contained no evidence detailing the necessity for, or the reasonableness and prudency of, these additional expenditures. Although not all of this routine plant was adopted in the decision, due to the timing of its completion, the effect is still $35.00 to $40.00 monthly bills for average water use. The large volume of customer complaints indicates no appreciation of the service improvements being bought.

What this memo proposes is a requirement that total yearly construction budgets which exceed the adopted test year or recorded year rate base by 10% for A & B companies and 25% for C & D companies be submitted to the affected public and the Commission for comment before implementation. If proposed improvements are not essential for health reasons and the customers prefer to have inferior service and to pay lower rates, their views should be considered.

Penalties for Non-Compliance

Over the past five years the Commission has made rate increases subject to automatic reduction for eight water companies. The rate increases were granted conditionally; if the utilities failed to perform as ordered they were subject to losing all or part of their rate increase without further hearing. The advantage of this rate reduction policy is that it provides an incentive for the utility to comply and it simplifies follow-up and compliance work by the staff. From the outset the burden is on the utility to perform. Without this

approach the opposite has usually been the case – if the utility ignored our orders, the burden of proof was on the Commission, via an OII or a contempt proceeding, to prove that the utility didn't comply and that it should comply, a process which usually takes years.

This approach may make a rate increase more palatable for ratepayers of systems providing poor service but needing additional revenues to continue operation and to improve service. It tells ratepayers that they will not be providing a profit indefinitely to a utility providing poor service.

In consideration of these advantages the proposed policy, therefore, adopts this approach for all utilities; to give them rate increases sufficient to keep them operational but to make part or all of the rate increase subject to cancellation, and possibly refund, in the event of non-compliance with Commission orders. An additional penalty may be imposed on large companies that have current outstanding Commission service improvement orders; the authorized conditional rate increase would reflect a reduced rate of return until the conditional rate increase would reflect a reduced rate of return until the utility complies. This is to compensate ratepayers who have paid for, but not yet received, these improvements.

This policy does not preclude the use of other recourse, such as fines, when the Commission believes it is appropriate. It establishes the rate reduction policy as the standard procedure to apply to all utilities to accomplish the Commission's goal of achieving system improvements with a minimum of ratepayer dissatisfaction and Commission hearing time, etc.

The attached appendix contains suggested internal procedures for partial implementation of the proposed policy in rate increase proceedings. It also establishes notice requirements of utility improvement plans between rate cases. Rules for complaint cases and applications for transfer and sale of utilities will be developed at a later date.

APPENDIX (To Service Improvement Memo)

A. CUSTOMER NOTICE OF CAPITAL IMPROVEMENTS BETWEEN RATE CASES
(These rules apply to capital improvements, not maintenance.)

1. WHEN REQUIRED

a. Class A & B

If the total improvements for the year will increase rate base (as shown in the last Annual Report or more recent rate decision) by more than 10%, there must be notice to the customers and the Staff.

b. Class C & D

If the total improvements for the year will increase rate base (as shown in the last Annual Report of more recent rate decision) by more than 25% there must be notice to the customers and the staff.

c. Exceptions

This notice requirement shall not apply to emergency repairs or other conditions, such as system failure, water outage, or sudden contamination.

II. MANNER OF THE NOTICE

1. The notice could accompany the normal billing or be a separate mailing. It must be sent to the same address and person responsible for payment of the water bill. A copy of the notice must also be sent to staff at the same time.

III. CONTENTS OF THE NOTICE

a. The notice must identify the intended system improvements, the problems they will help solve, the estimated total cost, the effect on customer rates (increase of ____%), and likely result if improvements are not made.

b. The notice must ask the ratepayers to write to the utility within 20 days if they wish to comment on the proposal. Any comments must be sent to staff by the utility. If no comments are received the utility must notify staff of this fact.

IV. STAFF ANALYSIS

Staff will determine that the proposed improvements represent the appropriate means to solve the problem addressed, or if there is a less costly alternative which would meet the appropriate level of service.

V. CUSTOMER COMMENTS

The utility shall not proceed with the improvements for 20 days after mailing the customer's reaction to the Staff. This will permit Staff review of customer's comments. If there is substantial customer resistance Staff will schedule a public meeting in or near the utility service area so that the utility can further explain the need for the improvements. Staff will present any alternatives to provide the appropriate level of service. The utility shall be responsible for arranging for the meeting place and notification of the meeting to all customers.

VI. CUSTOMER REJECTION

If the consensus of customer reaction is a desire to retain poor quality (but not unsafe) service rather than pay for improvements, the utility is on notice that the proposed improvements may not be permitted into ratebase. In this instance a formal application should be filed seeking Commission authorization for the disputed improvements.

B. <u>DEVELOPMENT OF UTILITY OBLIGATIONS TO CORRECT SERVICE PROBLEMS IDENTIFIED DURING GENERAL RATE CASE ADVICE LETTER & APPLICATION PROCEEDINGS</u>

I. ADVICE LETTER

a. The service improvement need is identified by utility or staff.

b. The proposal for corrections (utility's and/or staff's) is reviewed in terms of:

1. Alternative solutions
2. Costs
3. Financing possibilities
4. Impact on rates
5. Schedule for making improvements

c. Staff sends a letter of confirmation to the utility that includes:

1. A description of staff recommendations for improvements including a proposed schedule for completion.

2. A statement of Commission compliance policy, including potential penalties for non-compliance and the utility obligation to meet requirements accepted by the filing of tariffs.

3. A statement of the utility right to request a hearing if it cannot meet construction deadline. This letter request is to be filed for staff consideration six weeks before the final construction deadline. If hearing is granted the reasonableness of ordered improvements shall not be at

issue and the burden would be on the utility to convince the Commission that the increased rates should not be cancelled.

4. A request for the utility's acknowledgement of staff's recommendations and Commission policy.

d. Upon receipt of the response from the utility staff determines the need for a hearing (if the utility disagrees with the proposed plan or with the Commission compliance policy).

e. The customers are notified, via customer letter, of the proposed improvements (if threshold test for rate-base impact met), including a description of the problem, the proposed plan, its probable cost and impact on rates.

f. Staff analyzes the customer response to determine if a public meeting/hearing is indicated.

II APPLICATION

a. Staff or the utility identifies service improvement need and discusses this at customer meeting if issues are well enough developed.

b. Staff reviews proposal for improvements, including:

1. Alternative
2. Cost
3. Impact on rates

c. Customers are notified by letter from the utility (if ratebase threshold test met), which provides a brief description of the source problem, the improvement plan, its probable cost & impact on rates. They are informed of their right to participate in upcoming hearing and are directed to send responses to the utility.

d. The utility notifies staff of customer reaction.

e. Staff testimony at the hearing must include recommendations regarding the improvement plan, an estimate of the cost and rate effects of the proposal, benchmark construction goals and a reporting plan. It also includes the potential penalties to be applied in the event of utility non-compliance with the Commission order. It states the utility right to request a hearing if it believes, six weeks before the final construction date, that it cannot meet the deadline. Staff must state that if a hearing is granted, the reasonableness of the service improvement order shall not be at issue and that the burden is on utility to convince Commission that increased rates should not be cancelled.

C. IMPLEMENTATION OF POLICY IN DECISIONS AND RESOLUTIONS

1. Findings of Fact

   a. Include finding of the need for and feasibility of proposed improvements or other actions.

   b. Include finding of the cost, effect on rates and the proposed construction date of the proposed plan.

2. Ordering Paragraphs

   a. Order utility to make specific improvements or take other actions to correct service problems.

   b. Specify timeframe for implementation of plan, including (if relevant) breakdown into verifiable segments to which utility must conform.

   c. State that filing of rate increase tariffs is acceptance by utility of its obligation to meet requirements.

   d. Direct utility to notify staff of completion date of each phase of project.

   e. Make all or part of the rate increase conditioned upon utility completion of ordered improvements, or other actions, on time.

      - Any part of the rate increase earmarked to finance a specific improvement project will be subject to both cancellation and refund.

      - The portion of a general rate increase providing the return on equity will be reduced to zero.

   f. In addition may authorize a reduced rate of return for a large utility having an outstanding Commission order for service improvements, to be effective until it complies.

   g. Make step rates conditioned upon compliance with the order.

   h. May authorize a ratebase offset by advice letter for specific improvement items(s) not included in adopted results.

   i. Contain an appendix showing the effective date of the reduced rates.