

ORIGINALDecision No. 75876

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application
of the Southern California Water
Company for an order authorizing
it to increase the rates and
charges for water service in its
San Gabriel Valley District.

Application No. 50570
(Filed September 26, 1968)

O'Melveny & Myers, by Donn B. Miller, for
applicant.
David R. Larrouy, counsel, George A. Amaroli
and Edward C. Crawford, for the Com-
mission staff.

O P I N I O N

Applicant Southern California Water Company seeks authority to increase rates for water service in its San Gabriel Valley District.

Public hearing was held before Examiner Catey in El Monte on January 9, 1969 and in Los Angeles on March 18 and 19, 1969. Copies of the application had been served, notice of filing of the application published, and notice of hearing published and posted, in accordance with this Commission's rules of procedure. The matter was submitted on March 19, 1969.

Testimony on behalf of applicant ^{1/} was presented by its assistant to the president, its executive vice-president, its Rate and Valuation Department assistant manager, a consulting accountant and a consulting engineer. The Commission staff presentation was made through two accountants and two engineers.

1/ Testimony and exhibits relating to overall company operations had been presented by witnesses for applicant in Application No. 50460, the Simi Valley District rate proceeding. The testimony and exhibits were incorporated by reference in Application No. 50570.

Service Area and Water System

Applicant owns and operates water systems in seventeen districts and an electric system in one district, all in California. Its San Gabriel Valley District includes portions of the Cities of Arcadia, El Monte, Monrovia, Monterey Park, Rosemead, San Gabriel and Temple City and unincorporated areas of Los Angeles County adjacent to the cities. The service area slopes upward from the floor of the valley, ranging from approximately 300 feet to 600 feet above sea level. The customers are almost all in the residential or business category.

The water supply for this district is obtained from applicant's 19 wells and a connection to facilities of Upper San Gabriel Valley Municipal Water District (USGVMWD), a member agency of Metropolitan Water District of Southern California (MWD).

The distribution system includes about 100 miles of distribution mains, ranging in size up to 12-inch. There are about 10,800 metered services, 20 private fire protection services and 550 public fire hydrants. Three reservoirs and storage tanks, two hydropneumatic tanks, 17 well pumps connected directly to the distribution mains, and 6 booster pumps maintain system pressure and provide storage for the system. Three of the well pumps are driven by natural gas engines.

In 1962, applicant was authorized to consolidate the former South San Gabriel and South Arcadia Districts for accounting purposes. The local water supply for both areas is from the same underground basin and purchases of imported water in either area benefit both areas. Both areas now are operated as a single entity.

Service

Field investigations of applicant's operations, service and facilities in its San Gabriel Valley District were made by the

Commission staff. The plant was found to be in good condition, and good service was being provided. A staff engineer testified that no informal complaints regarding pressure or water quality have been registered with the Commission during the past three years.

Rates

Applicant's present tariffs include two separate schedules for general metered service in the South Arcadia and South San Gabriel portions of the San Gabriel Valley District, a schedule for private fire protection service, two separate schedules for public fire hydrant service, a schedule for construction flat rates, and a schedule for service to company employees. The South Arcadia rates became effective in 1960 and the South San Gabriel rates became effective in 1959.

Applicant proposes to increase and consolidate its rates for general metered service, to change from a minimum charge to a service charge form of rates, to increase the private fire protection rate and to consolidate the public fire hydrant service rates. The following Table I presents a comparison of applicant's present general metered service rates, those requested by applicant, and those authorized herein.

TABLE I
Comparison of Monthly Rates

General Metered Service	Present Rates		Entire District	
	So. Arcadia	So. S. Gabriel	Proposed#	Authorized
Minimum or Service Charge	\$1.70*	\$1.70*	\$1.45*	\$1.40*
First 800 cu.ft., per 100 cu.ft.	.00*	.00*	.133	.129
Next 1,200 cu.ft., per 100 cu.ft.	.14	.16	.133	.129
Next 3,000 cu.ft., per 100 cu.ft.	.12	.14	.133	.129
Next 5,000 cu.ft., per 100 cu.ft.	.10	.12	.123	.119
Over 10,000 cu.ft., per 100 cu.ft.	.08	.12	.103	.103

* Minimum charge or service charge for a 5/8 x 3/4-inch meter. A graduated scale of increased charges is provided for larger meters.

If the 10 percent surcharge to Federal income tax had not expired, bills computed under these rates were to have been increased by 2.08 percent.

For a typical commercial customer with average monthly consumption of 2,022 cubic feet through a 5/8 x 3/4-inch meter, the average monthly charge would increase 21 percent from \$3.41 in the South Arcadia area and 13 percent from \$3.65 in the South San Gabriel area under present rates to \$4.14 under the rates proposed by applicant. The operations of the present two tariff areas are now sufficiently integrated that separate rates are no longer warranted. The temporary surcharge would have added \$0.09 to this average monthly charge at proposed rates. Under the rates authorized herein, the average monthly charge for the typical commercial customer will increase 18 percent in the South Arcadia area and 10 percent in the South San Gabriel area to \$4.01.

Applicant's present "company-wide" private fire protection service schedule excludes six specific districts. In rate proceedings involving those districts, the Commission found that a monthly charge of \$2 per inch diameter of service was reasonable, rather than the \$1 per inch set forth in the "company-wide" schedule. Eventually, when all districts have had rate proceedings, the present "company-wide" schedule can be replaced with a revised schedule. In the meantime, as each district is covered by a rate proceeding, a separate increased schedule is authorized for that district.

Results of Operation

Witnesses for applicant and the Commission staff have analyzed and estimated applicant's operational results. Summarized in Table II, from applicant's Exhibit No. 1 and the staff's Exhibit No. 8, are the estimated results of operation for the test year 1969, under present rates and under those proposed by applicant, without considering any additional expenses and offsetting revenue requirement resulting from a 10 percent surcharge to Federal income tax. For comparison, this table also shows the corresponding results of operation modified as discussed hereinafter.

Table II
Estimated Results of Operation
Test Year 1969

<u>Item</u>	<u>Applicant</u>	<u>Staff</u>	<u>Modified</u>
<u>At Present Rates</u>			
Operating Revenues	\$ 482,000	\$ 482,000	\$ 482,000
<u>Deductions</u>			
Water Assessments	38,300	23,300	24,200
Power Purchased	42,300	40,700	40,700
District Operations Payroll	69,400	67,900	67,900
Cust. Acctg. Excl. Payroll & Central Billing	3,700	2,800	2,800
All Other Oper. & Maint. Expense	63,500	63,200	63,200
Regulatory Commission Expense	5,100	3,600	3,600
Other Direct Adm. & Gen'l. Expense	16,100	15,600	15,600
Other Allocated Adm. & Gen'l. Expense	23,600	22,100	23,300
Taxes, Excl. Franch. & Income Taxes	53,100	55,100	55,100
Depreciation	53,600	53,600	53,600
Subtotal	<u>368,700</u>	<u>347,900</u>	<u>350,000</u>
Local Franchise Taxes	9,500	9,500	9,500
Income Taxes	12,200	19,700	18,600
Total	<u>390,400</u>	<u>377,100</u>	<u>378,100</u>
Net Revenue	91,600	104,900	103,900
Rate Base	1,889,600	1,879,400	1,880,800
Rate of Return	4.85%	5.58%	5.52%
<u>At Rates Proposed by Applicant</u>			
Operating Revenues	577,700	577,900	577,900
<u>Deductions</u>			
Excl. Franch. & Income Taxes	368,700	347,900	350,000
Local Franchise Taxes	11,300	11,300	11,300
Income Taxes	60,700	68,400	67,200
Total	<u>440,700</u>	<u>427,600</u>	<u>428,500</u>
Net Revenue	137,000	150,300	149,400
Rate Base	1,889,600	1,879,400	1,880,800
Rate of Return	7.25%	8.00%	7.94%
<u>At Rates Authorized Herein</u>			
Operating Revenues	-	-	560,500
<u>Deductions</u>			
Excl. Franch. & Income Taxes	-	-	350,000
Local Franchise Taxes	-	-	10,900
Income Taxes	-	-	58,500
Total	<u>-</u>	<u>-</u>	<u>419,400</u>
Net Revenue	-	-	141,100
Rate Base	-	-	1,880,800
Rate of Return	-	-	7.50%

From Table II it can be determined that, exclusive of any temporary increase due to an income tax surcharge, the increase in operating revenues would be 20 percent under applicant's proposed rates and will be 16 percent under the rates authorized herein. ✓
✓

Water Assessments

All of the ground water produced by applicant in this district is subject to assessment by USGVMWD. The assessments currently include (1) a replenishment assessment on water producers in the area to provide funds for purchase of MWD water to recharge the Main San Gabriel Basin, and (2) a make-up assessment on certain producers, including applicant, to provide funds for purchase of MWD water to maintain a normal flow from the Main San Gabriel Basin to the Central Basin, pursuant to a court judgment.^{2/}

The assessments now are determined by multiplying the acre-feet of water produced during each half-year period by the applicable rates per acre-foot set by USGVMWD. There is considerable lag in setting the applicable rates so applicant, in its estimates for this proceeding, used projected rates estimated in 1967 by a consulting engineer retained by USGVMWD. In the two-year period since the engineer's previous estimate, changing factors beyond anyone's control and affecting the eventual assessment rates caused the engineer to revise his estimates downward after applicant's exhibits were already presented. The staff had available, in preparing its studies for the proceeding, the consulting engineer's revised estimates of assessment rates. For the year 1969, the staff used the consultant's

2/ Los Angeles County Superior Court Judgment 722647 and Stipulation Therefor, dated September 24, 1965, in City of Long Beach et al vs. San Gabriel Valley Water Company et al.

latest revised 1969-70 estimate of \$3.10 per acre-foot for the replenishment assessment, which is lower than the \$3.45 latest known rate, applicable to the fiscal year 1968-69. The staff used the latest known rate of \$0.75 per acre-foot for the make-up assessment, applicable to the calendar year 1967, which is lower than the consultant's latest revised 1969 estimate of \$1.57 per acre-foot. The total rate used by the staff for 1969 is thus the sum of an estimated replenishment assessment rate for a period partly in the future and an actual make-up assessment rate for a period in the past.

There is a further complication in attempting to estimate the water assessments which ultimately will be determined to be chargeable to each year's operations during the pendency of the water rates to be authorized herein. Applicant expects other litigation to be settled and a new plan to become effective within two years, which plan will result in higher assessment rates that will, however, apply only to water produced in excess of the producers' established water rights in the basin. This will affect applicant's total payments for water assessments but the direction and magnitude of the change cannot be determined now with any certainty. If applicant's adjusted rights are only 4,800 acre-feet per year, as estimated by applicant's consultant, the resultant assessment will be equivalent to about \$4.50 per acre-foot under the present combined assessment method.

There is an equitable long-range solution to the problem of indeterminate water assessments. We will set water rates in this proceeding as though the assessment rates will remain constant in the future at some assumed level. Applicant will be required to keep memorandum records showing accruals to a reserve for payment

of water assessments, with the accrual being based upon the assessment rate assumed in this proceeding. When the actual rates are established, the amount payable at those rates will be charged against the reserve, thus indicating any over- or under-accrual. Over a period of several years, if the over- and under-accruals do not appear to be balancing out, applicant may request revision of the rate to be used for subsequent accruals and, if appropriate, concurrent offsetting adjustment of its own water rate schedules. This is similar in principle to the remaining life depreciation method used to keep applicant's depreciation reserve from becoming excessively over- or under-accrued. It is also similar to but a little more direct than the plan effected for the El Monte Division of San Gabriel Valley Water Company by Decision No. 72498, dated May 23, 1967, in Application No. 49061. (67 CPUC 208)^{3/}

With the wide range possible in the actual future composite assessment rate, great precision in establishment of the initial accrual rate for the memorandum reserve account cannot be achieved. For the purpose of this proceeding, we will adopt \$4 per acre-foot, which is the staff's estimated rate rounded to the nearest dollar. That rate is reflected in the expenses adopted in Table II. Inasmuch as applicant's own increased water rates will be effective for only about half of the current year, the memorandum reserve account will apply to water produced after June 30, 1969.

Other Operation and Maintenance Expenses

The staff estimate of the cost of purchased power is based upon normalized water production, applied to power bills for each

^{3/} As we indicated in Decision No. 72498, change in the accrual rate to correct over- or under-accrual will not necessarily warrant a change in the future water rates to be paid by applicant's customers. A review of other possible changes in revenues, expenses and rate base must be made in each instance.

pumping plant. Applicant's estimate is based upon the same normalized production but reflects a projection of average costs for previous years. The staff's method appears to be inherently more accurate than that of applicant. The staff estimate is adopted in Table II.

The staff estimates of district operations payroll, customer accounting expense, direct administrative expenses, and taxes (other than on revenues and income) differ from applicant's primarily because the staff had more recent data on actual costs than were available when applicant's estimates were being prepared. The staff estimates are adopted in Table II.

For this district, with its relatively high customer saturation and limited prospects for future expansion, the staff's five-year spread of rate proceeding costs appears more reasonable than applicant's three-year spread of those costs. The staff's estimate of regulatory commission expense is adopted in Table II.

Electronic Data Processing

In 1963, applicant began conversion to the use of electronic data processing (EDP) equipment in lieu of certain former manual and machine billing and accounting procedures. In Decision No. 73827, dated March 12, 1968 in Application No. 49420, the Commission found unreasonable applicant's proposal to amortize approximately \$314,000 of conversion costs to future operating expense, and found that rate-payers should be credited with the profits derived from EDP work done by applicant for outside parties. In the current proceeding, applicant does not again request amortization of conversion costs but does request reconsideration of the previous finding regarding profits from outside EDP work.

In support of the position that profits from outside EDP work should be credited to operating expenses by including such profits in Account 611, Miscellaneous Service Revenue, a staff accountant testified that:

1. He doubted very much that the costs related to outside EDP work, as recorded in applicant's books, are correct.
2. Idle time of the EDP equipment is completely ignored in allocating costs between utility expenses and outside work.
3. The fact that applicant always seems to make money on its outside EDF work would indicate that it is either charging too much or putting too little into its costs for such work. Since there is competition for such work, applicant presumably is not charging too much and therefore must not be allocating enough expenses to that work.
4. In the transportation field, income from advertising placards and stickers on a bus is considered as operating income.

In further support of the position that profits from outside EDP work should be credited to operating expenses, a staff engineer testified that:

1. In applicant's operating expenses, the costs attributable to the EDP center were included 100 percent.
2. In reviewing applicant's work papers, he did not or could not determine that any expenses had been allocated to outside expenses at all but it had all been charged to various operating expenses.

3. The rent and all payroll for the data processing center were included 100 percent in applicant's operating expenses.

The staff accountant conceded that he had not made a specific investigation of applicant's EDP operations. He testified that the total EDP costs incurred by applicant are, in fact, partly charged to utility accounts and partly charged to outside work. The staff engineer conceded that the expense work papers which he reviewed may have included EDP costs after the outside work costs had already been deducted.

In opposition to the position that profits from outside EDP work should be credited to operating expenses, applicant:

1. Presented Exhibit No. 10 and related testimony, showing that applicant not only charges direct expenses involved in outside EDP work to that work but allocates other items, such as building and equipment rental, supervision expense and overheads, between utility work and outside work.
2. Contends that the amount of idle time is not only reduced by doing outside work, but the cost of idle time is spread ratably between utility work and outside work.
3. Contends that the outside EDP work thus benefits the customers and provides a means of recouping at least part of the substantial conversion expenses which have been disallowed as operating expense.

In the light of the additional testimony in this proceeding, we now find it to be reasonable for applicant to treat any profits

or losses from outside EDP work as non-operating profits or losses, as long as the expenses reasonably related to such work are not charged to utility operations. Although a detailed staff study, had it been made, might have resulted in suggestions for refinements in the allocation methods used by applicant, the record discloses no serious infirmities in applicant's present allocation procedures for EDP expenses. The staff adjustment of \$25,000 for total company (of which \$1,200 is allocated to the San Gabriel Valley District) is not included in deriving the administrative and general expenses adopted in Table II.

Income Taxes

The various differences between applicant's, the staff's and the adopted estimates of revenues and expenses affect the corresponding estimates of income taxes. Also, applicant used slightly lower depreciation rates than used by the staff in calculating the depreciation deduction for the income tax calculation.

The staff used the depreciation rates which applicant has used in the past for its income tax returns. Applicant used rates which it anticipates will apply to its 1969 tax returns. We are aware that determination of probable plant lives is not an exact science, as is evidenced by the periodic reviews which we require applicant to make of its book depreciation rates. It is reasonable to assume that the depreciation rates used for income tax purposes also must be reviewed periodically and revised to reflect mortality experience. Applicant did not, however, present any such study showing that the previous rates are no longer appropriate. The staff's estimate of depreciation deduction for tax purposes is adopted in determining the income taxes adopted in Table II.

Rate Base

The rate base estimates of applicant and staff differ in three components: working cash, advances for construction, and common plant allocated depreciation reserve. Applicant stipulated to the staff's lower working cash allowances, leaving only two issues regarding rate base.

Decision No. 74889 dated October 29, 1968, in Application No. 49861, discussed applicant's former practice of deferring collection of additional advances from subdividers when actual costs of extension exceed original amounts advanced. The decision placed applicant on notice that this was in violation of applicant's tariffs, so the practice presumably has been discontinued. There still is a carryover, however, of deferred advances from extensions completed prior to October, 1968. These eventually will be extinguished as the additional advances related to those extensions, which became due under the main extension rule, are offset against refunds related to those same extensions as those refunds become due under that rule. In the meantime, applicant's customers should not be penalized with a higher rate base due to applicant's failure to even attempt to collect advances due it under its tariffs. The staff adjustment reflects the advances which should have been collected and is included in the rate base adopted in Table II.

In developing estimates of common plant depreciation reserve, the staff credited the reserve with the estimated "net salvage" to be realized from the sale of applicant's former main office building. This approach appears reasonable, but the staff actually credited the gross salvage before taxes rather than the net salvage after taxes. The overall company effect was to understate

rate base by \$27,600. Of this total, \$1,400 is allocated to increase the staff's estimate for the San Gabriel Valley District in the rate base adopted in Table II.

Surcharge to Federal Income Tax

A 10 percent surcharge to Federal income taxes was imposed by the Revenue and Expenditure Control Act of 1968. The surcharge was retroactive for the full year 1968 and expired June 30, 1969. Applicant's Exhibit No. 1 indicates that a 2.08 percent surcharge on bills computed under the general metered service rates requested in the application would have been required to offset the effect of the income tax surcharge and produce the same net revenues indicated hereinbefore in Table II. If the surcharge is reinstated at some time in the near future, we would be receptive to a supplemental filing by applicant in this proceeding requesting appropriate additional rate relief. If the surcharge is reinstated at the previous 10 percent level, the corresponding surcharge on applicant's metered service rates will be 2.26 percent.

Rate of Return

In the recent rate proceedings involving applicant's Southwest and Barstow Districts, the Commission found that an average rate of return of 6.9 percent over the next two and one-half to three years was reasonable for applicant's operations. Applicant contends that a reasonable range of rate of return for its operations is from 7-1/4 to 8 percent. The staff recommends, as a reasonable average allowable rate of return for applicant's near future operations, 6.8 to 7.0 percent.

The chairman of applicant's board of directors testified in Application No. 50460 that maintenance of the present Class A

rating for applicant's mortgage bonds is an important objective from the standpoint of long-range financing. He stated that earnings of about three times the interest on those bonds is necessary to keep that rating.

The times coverage for bond interest at a given rate of return on rate base and a given bond interest rate is affected by the utility's capitalization ratio. Conversely, the capitalization ratio of the utility affects the level of return on rate base which would achieve a given multiple of coverage of bond interest. For example, to achieve three-times coverage, a utility with very little equity financing would require an astronomical return on equity, whereas, a utility with very little debt financing would require very little return to achieve the same three-times coverage of bond interest cost, with resulting minuscule return on equity.

Schedule 13 of applicant's Exhibit No. 1 in Application No. 50460 indicates that, for the period from 1967 through 1971, in order to maintain earnings of three times interest on debt, with capitalization percentages for debt ranging from 54 to 58 percent of total capital, returns of from 7.25 to 7.94 percent on rate base, with resultant returns of from 12 to 14 percent on equity, would be required. This is not a valid criterion, however, because not all of applicant's debt financing is by mortgage bonds. A recalculation using the pro forma 1969 year-end capitalization shown in Tables Nos. 2 and 8 of staff Exhibit No. 7 indicates a capitalization percentage of 48 percent mortgage debt with a composite interest rate of 4.3 percent, requiring only 6.2 percent return on rate base with resulting 9.1 percent return on equity to provide earnings equal to three times the interest on mortgage debt.

Issuance of additional mortgage debt would, of course, change these calculations, but the rate of return allowed herein will provide some cushion for future mortgage bond financing. Applicant's plans for the near future do not include such financing. The next major long-term financing planned by applicant is for issuance of preferred stock in 1971.

Applicant's Exhibit No. 1 in Application No. 50460 includes various financial statistics relating to applicant and to ten gas utilities, ten electric utilities and ten water utilities, all with roughly the same gross operating revenues of applicant. The statistics include such items as dividend rates, yields, price-earnings ratios, capitalization ratios, percent earnings on average total capital, and total earnings as a multiple of debt interest and of debt interest plus preferred stock dividends. The staff's Exhibit No. 1 in Application No. 50570 includes various financial statistics relating to applicant, and to ten other water utilities throughout the nation, and to ten other Class A California water utilities. The statistics include such items as common equity ratios, earnings on equity and earnings on total capital.

One of the yardsticks used in judging what is a reasonable rate of return to be allowed on rate base is a cost-of-money determination, wherein the various component parts of applicant's capital structure are assigned a percentage cost-of-money and a composite cost of capital is calculated.

The cost of equity determination is a judgment decision and is influenced by a multitude of factors, as is often expressed in Commission decisions, among which in this case are mentioned the continued need for construction funds, increasing debt costs, and the capital structure of applicant.

It must be borne in mind that, although this is a mathematical computation, the basis, as with all such computations, must be judgment. First, the embedded cost of long-term debt is determined as of the end of the last recorded period, and then a projection is made as to the effective cost of probable new issues to arrive at a near future effective interest rate. This projection into the future is, of course, a matter of judgment, based upon reasonably firm commitments or definite capital expenditure budgets.

There is a distinction between the earned rate of return that will be indicated by company records and the allowed or recommended rate of return. The rate of return recommendation is for the company's utility activities. It will be applied to a determined rate base for a single district, and such rate base will generally not include nonutility plant, acquisition adjustments relating to systems purchased rather than constructed, non-operative plant, and plant held for future use. To the extent that such items are a part of the plant values and capital structure of a company, the recorded and unadjusted earnings rates, particularly for common stock equity, will differ from the allowed or recommended rate, even if all of the rate case estimates, such as those for revenues, expenses, rate base and cost of debt, exactly equal the latter actual results.

A rate of return recommendation in the form of a range of return, rather than a single figure, is frequently made, as in the current proceeding. For example, in Decision No. 75873 issued July 1, 1969 in Application No. 49835 of General Telephone Company of California at page 42, the statement is made: "We have chosen a range of return rather than a specific percentage in order to provide the maximum incentives to the regulated company to achieve efficiency

and economy in operation; to recognize that we cannot predict the future with clarity and confidence; to acknowledge that the techniques employed in arriving at a fair rate of return are imprecise; and to lessen the prospect of another major rate case in the next few years."

In the cost-of-money determination, the capital structure and cost rates for debt and preferred stock are those for the total company. This is the only logical manner of consideration. Financing of any portion of the total operations is not usually accomplished separately. Customers in the districts are entitled to the benefits in capital costs, as well as all other allocable expenses, that may result from the system's being a part of a large, well-managed company. To attempt a cost-of-money determination in any other fashion would be impractical. The rate of return recommendation, however, is for the district concerned and the period concerned. It will have no bearing on the earnings of the other sixteen districts of the company, whose earnings rates may differ considerably. It is well established, however, that no single district should carry the load for, nor be subsidized by, any of the other districts.

The fact that the actual return on total company capitalization may not equal the return on rate base allowed for a single district does not invalidate the cost-of-money calculation, but merely serves to illustrate that the conclusions drawn therefrom must be tempered with judgment. As stated by the Supreme Court in the Hope Case, "Under the statutory standard of 'just and reasonable' it is the result reached not the method employed which is controlling".

The following Table III shows the cost of capital resulting from the ranges of rate of return recommended by applicant and the

staff, and from the rate of return found reasonable herein. Capital ratios and related cost factors are the pro forma 1969 year-end amounts developed by the staff in Exhibit No. 7.

TABLE III

Cost of Capital at Various Returns on Equity

<u>Item</u>	<u>Capital Ratio</u>	<u>Cost Factor</u>	<u>Weighted Cost</u>
Debt:			
Mortgage Debt Only	47.89%	4.30%	2.06%
Other Long-Term Debt	7.06	5.84	0.41
Bank Loans	2.50	6.50	0.16
Total Debt	57.45	4.58	2.63
Preferred Stock	6.91	4.54	0.31
Subtotal Excl. Common Equity	64.36	4.57	2.94
Common Equity:			
To Produce 6.80% *Total Return	35.64	10.83	3.86
7.00%+*Total Return	35.64	11.39	4.06
7.25% #Total Return	35.64	12.09	4.31
8.00% #Total Return	35.64	14.20	5.06

* Range recommended by staff.

Range recommended by applicant.

+ Return found reasonable herein.

The 6.9 percent return on rate base found reasonable in the last series of proceedings involving applicant was based, in part, on applicant's "cost of money" prior to the recent additional debt financing. This recent issue of convertible debentures is at an effective interest rate of 5.84 percent, as compared with its previous 4.30 percent imbedded cost of long-term debt. There is no significant change in any of the other factors, such as quality of service and efficiency of management, previously considered in determining a reasonable return. A 7.0 percent return on rate base now appears reasonable. Table III indicates an 11.39 percent return on common stock equity under the hypothetical conditions hereinbefore discussed.

Trend in Rate of Return

Applicant's estimates for the test years 1968 and 1969 indicate an annual decline of 0.64 percent in rate of return at proposed rates. The staff's estimates show an annual decline of 0.56 percent at proposed rates. Witnesses for both applicant and the staff testified, however, that they do not consider the trend from 1968 to 1969 to be indicative of the future trend in rate of return for the San Gabriel District. This is a little unusual, inasmuch as many of the adjustments made by the staff in its 1968 estimates were purportedly to eliminate distortions between the two years.

The comparative rates of return for two successive test years, or for a series of recorded years, are indicative of the future trend in rate of return only if the rates of change of major individual components of revenues, expenses and rate base in the test years, or recorded years, are reasonably indicative of the future trend of those items. Distortions caused by abnormal, non-recurring or sporadically recurring changes in revenues, expenses, or rate base items must be avoided to provide a valid basis for projection of the anticipated future trend in rate of return.

As an indication of the unreasonableness of the trend in rate of return derived from the test years 1968 and 1969, applicant prepared Exhibit No. 1-A, an analysis of the changes in estimated items of revenues, expenses and rate base between two successive future years. Applicant's investigation indicated to it that future annual increases in plant additions, with the related increases in ad valorem taxes and depreciation expenses, would not be as great as the increases between 1968 and 1969. This is due, to a large extent,

to the rather high saturation of the district's service area, limiting potential growth. Using a lower average annual increase for the plant and related items, based upon the 1964 through 1967 experience, which applicant considers more reasonable than the 1968-1969 experience, Exhibit No. 1-A indicates a future annual decline of 0.33 percent return on rate base. This is about half of the decline indicated by applicant's 1962-1969 estimates.

In Table 11-A of Exhibit No. 8 the staff made a similar study of the annual decline in rate of return which would result from anticipated future plant growth in lieu of the abnormal 1968-1969 growth, but assuming further that water assessments and MWD rates for purchased water are frozen at 1969 levels. On that basis, an annual decline of 0.19 percent is indicated.

The principal item of difference between the trend estimates of applicant and staff is the estimated trend in water assessments projected in applicant's estimates. With the memorandum reserve procedure outlined herein, it is not appropriate to compensate for the trend of this item in the rates to be established herein.

Cost of purchased water is not subject to as many uncertainties as are water assessments. MWD announces its future rates several years in advance, but the MWD rate increases are not necessarily uniform every year. For example, the rate will go up \$3 per acre-foot on July 1, 1969 but \$4 per acre-foot on July 1, 1970.

We pointed out, in Decision No. 74524, dated August 13, 1968, in Application No. 49938, applicant's Pomona Valley District rate proceeding, that the staff's estimate of probable future trend in rate of return was incorrect because "elimination of trend of wage

rates and cost of purchased water understates the attrition in rate of return". In Table 11-A of Exhibit No. 8, the staff has not eliminated the effect of wage trends but it has again eliminated the effect of continually increasing MWD rates. The staff does not contend that MWD rates will not continue to rise, nor that applicant should absorb the resulting increased costs. The staff suggests that relatively simple "offset" rate proceedings as MWD prices change would be preferable to reflecting some trend in MWD rates in the rates authorized for applicant in this proceeding. After careful consideration, we concur with the staff's suggestion. The rates authorized herein for applicant are those considered reasonable at MWD's July 1, 1969 to July 1, 1970 rates.

In analyzing the effect of annual changes in revenues, expenses and rate base, neither applicant nor the staff considered the effect on income taxes of the use of liberalized depreciation on the previous and incremental plant additions. Both analyses reflect the trend that would result if applicant used book depreciation as an income tax deduction. Comparing the change in depreciation expense for tax purposes from 1968 to 1969 on page 7-4 of staff Exhibit No. 8 with the corresponding change in book depreciation on page 9-1 of that exhibit shows that depreciation for income tax purposes is not increasing at as high a rate as is book depreciation. This anomaly was not explained but apparently, in this district, the higher income tax depreciation on incremental plant is more than offset by the declining income tax depreciation on existing plant, under the double-rate declining balance method.^{4/}

^{4/} The level of depreciation under the double-rate declining balance method remains higher than under straight-line even though the upward trend per year is less than under straight-line.

Had this effect been considered by the staff in its analysis of trend of rate of return, a total annual decline of 1/4 percent would have resulted, excluding the effect of any trends in water assessment rates and MWD water rates.

In most of the recent decisions in rate proceedings involving other districts of applicant, the apparent future trend in rate of return has been offset by the authorization of a level of rates to remain in effect for several years and designed to produce, on the average over that period, the rate of return found reasonable. That same approach is adopted for this proceeding, except that future changes in water assessment rates and MWD rates will be considered in future "offset" rate proceedings rather than in the current proceeding. With the annual "offset" proceedings resulting from this approach, and considering the relatively high saturation and low prospects for future expansion of the district, it is appropriate to project about four years into the future for the basic rates established herein.

The rate increase authorized herein will not be in effect for about the first half of the year 1969. With the indicated future trend in rate of return, the 7.5 percent return under the rates authorized herein for the test year 1969 should produce an average rate of return of 7 percent for a four-year period after the rates become effective, approximately 6-1/2 percent for the year 1969 (with about half of the year at the new rates), 7-1/4 percent for the year 1970, 7 percent for 1971, 6-3/4 percent for 1972, and 6-1/2 percent for 1973.

Accounting Changes

In Exhibit No. 8, the staff recommends that applicant make certain changes in its accounting procedures. These are in addition to the accounting for outside EDP work hereinbefore discussed. The additional staff suggestions are for applicant to:

1. Seek authorization for disposition of various acquisition adjustments which have been carried forward for several years.
2. Retire the recorded costs of EDP tapes and programs that are no longer used.
3. Retire from plant the cost of obtaining a certificate to construct a water system to serve an area near Moorpark, Ventura County.

In regard to the acquisition adjustments, applicant presented no justification for further delay in disposing of them. We will expect applicant in the near future to submit a plan for such disposition.

In regard to the EDP tapes and programs, a witness for applicant testified that none of them have yet become obsolete. When any of them do, they should be retired.

In regard to the Moorpark certificate, granted by Decision No. 70861, dated June 14, 1966, in Application No. 47745, applicant filed on May 14, 1967, revised tariff service area maps including that area, as authorized by the decision. Subsequent re-filing of applicant's maps have continued to show the Moorpark area as part of the territory which applicant is obligated to serve under its filed tariffs. The staff recommendation was based, at least in part, on the understanding that service to the area was being, or definitely would be, provided by a County Water District. This apparently is

not yet a certainty. If and when the area is served by a district, applicant should retire the intangible plant resulting from the cost of obtaining the certificate, and should request authority to file revised tariff service area maps which exclude the Moorpark area. In the meantime, of course, the intangible plant will be treated as non-operating property for rate-fixing purposes.

Findings and Conclusions

The Commission finds that:

1a. Applicant is in need of additional revenues.

b. The adopted estimates, previously discussed herein, of operating revenues, operating expenses and rate base for the test year 1969, and an annual decline of 0.25 percent in rate of return, reasonably indicate the probable range of results of applicant's operations for the near future.

c. An average rate of return of 7.0 percent on applicant's rate base for the next four years is reasonable.

d. The increases in rates and charges authorized herein are justified; the rates and charges authorized herein are reasonable; and the present rates and charges, insofar as they differ from those prescribed herein, are for the future unjust and unreasonable.

2a. Future rates for water assessments by USGVMWD are subject to considerable fluctuation.

b. The memorandum reserve account procedure discussed in the foregoing opinion and required by the order which follows provides a reasonable means of compensating for future changes in costs of water assessments.

The Commission concludes that the application should be granted in part and that applicant should be required to establish a memorandum reserve account for water assessments.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, applicant Southern California Water Company is authorized to file for its San Gabriel Valley District 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 schedules shall be four days after the date of filing. The revised schedules shall apply only to service rendered on and after the effective date thereof.

2a. Effective for water assessments by Upper San Gabriel Valley Municipal Water District applicable to water produced by applicant after June 30, 1969, applicant shall establish a memorandum reserve account as discussed in the foregoing opinion.

b. Until otherwise authorized by this Commission, the accrual rate for credits to this reserve shall be \$4 per acre-foot.

c. On or before August 1 of each year from 1970 through 1973, applicant shall file in this proceeding a summary showing all credits and debits to this reserve, and the derivation of the amounts of such entries.

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

Dated at San Francisco, California, this 8th day of JULY, 1969.

William Ferguson
President

Stephen M. Messier
Commissioner

[Signature]
Commissioners

Schedule No. SG-1
San Gabriel Valley Tariff Area (T)
METERED SERVICE (T)

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Portions of the cities of Arcadia, El Monte, Monrovia, Monterey (T)
Park, Rosemead, San Gabriel, Temple City and vicinity, Los Angeles (T)
County.

RATES

	<u>Per Meter</u> <u>Per Month</u>	
Quantity Rates:		
First 5,000 cubic feet, per 100 cubic feet....	\$ 0.129	
Next 5,000 cubic feet, per 100 cubic feet....	0.119	
Over 10,000 cubic feet, per 100 cubic feet....	0.103	
Service Charge:		
For 5/8 x 3/4-inch meter	\$ 1.40	
For 3/4-inch meter	1.55	
For 1-inch meter	2.25	
For 1 1/2-inch meter	3.15	
For 2-inch meter	4.35	
For 3-inch meter	8.70	
For 4-inch meter	13.00	
For 6-inch meter	24.25	
For 8-inch meter	34.00	

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

(N)

Schedule No. SG-4

San Gabriel Valley Tariff Area (T)

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service furnished to privately owned fire protection systems.

TERRITORY

Portions of the cities of Arcadia, El Monte, Monrovia, Monterey Park, Rosemead, San Gabriel, Temple City and vicinity, Los Angeles County. (T)
(T)

RATE

For each inch of diameter of service connection Per Month \$2.00 (I)

SPECIAL CONDITIONS

1. The fire protection service connection shall be installed by the utility and the cost paid by the applicant. Such payment shall not be subject to refund. (N)
2. The minimum diameter for fire protection service shall be four inches, and the maximum diameter shall be not more than the diameter of the main to which the service is connected.
3. If a distribution main of adequate size to serve a private fire protection system in addition to all other normal service does not exist in the street or alley adjacent to the premises to be served, then a service main from the nearest existing main of adequate capacity shall be installed by the utility and the cost paid by the applicant. Such payment shall not be subject to refund.
4. Service hereunder is for private fire protection systems to which no connections for other than fire protection purposes are allowed and which are regularly inspected by the underwriters having jurisdiction, are installed according to specifications of the utility, and are maintained to the satisfaction of the utility. The utility may install (N)

(Continued)

Schedule No. SG-4

San Gabriel Valley Tariff Area

(T)

PRIVATE FIRE PROTECTION SERVICE
(Continued)

SPECIAL CONDITIONS (Continued)

the standard detector type meter approved by the Board of Fire Underwriters for protection against theft, leakage or waste of water and the cost paid by the applicant. Such payment shall not be subject to refund.

(N)

5. The utility undertakes to supply only such water at such pressure as may be available at any time through the normal operation of its system.

(N)

Schedule No. SG-5

San Gabriel Valley Tariff Area

(T)

PUBLIC FIRE HYDRANT SERVICE

APPLICABILITY

Applicable to all public fire hydrant service.

TERRITORY

Portions of the cities of Arcadia, El Monte, Monrovia, Monterey Park, Rosemead, San Gabriel, Temple City and vicinity, Los Angeles County.

(T)
|
(T)

RATE

	<u>Per Month</u>	
For each hydrant	\$2.00	

(I)

SPECIAL CONDITIONS

1. Water delivered for purposes other than fire protection shall be charged for at the quantity rates in Schedule No. SG-1, Metered Service.

(N)

2. The cost of installation and maintenance of hydrants shall be borne by the utility.

3. The cost of relocation of any hydrant shall be paid by the party requesting relocation.

4. Hydrants shall be connected to the utility's system upon receipt of written request from a public authority. The written request shall designate the specific location of each hydrant and, where appropriate, the ownership, type and size.

5. The utility undertakes to supply only such water at such pressure as may be available at any time through the normal operation of its system.

(N)