SW/ltc **

ORIGINAL

Decision No. 84378

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHWEST WATER COMPANY, a California corporation, for Authority to Increase its Rates Charged for Water Service in its La Mirada and Etiwanda Districts.	Application No. 54787 (Filed April 5, 1974; amended September 16, 1974)

Clayson, Stark, Rothrock & Mann, by George G. Grover, Attorney at Law, and Walker Hannon, for applicant.
Alexander Googooian, Attorney at Law, for City of La Mirada, protestant.
Kenneth Dodd, for Park Water Co., interested party.
Freda Abbott, Attorney at Law, Andrew Tokmakoff, and Ichiro Nagao, for the Commission staff.

OPINION

Southwest Water Company (Southwest) requests authority to increase its rates for water service in its two separate districts, La Mirada and Etiwanda. The La Mirada District provides service to approximately 12,000 customers located in the city of La Mirada and vicinity, in Los Angeles and Orange counties. The Etiwanda District supplies water to approximately 400 customers in or near the community of Etiwanda, in San Bernardino County.

The rates proposed by this application, as amended, would, according to Southwest's estimates, increase annual gross revenues by approximately $862,000, for the La Mirada District by 55.66 percent and for the Etiwanda District by 96.00 percent.

The present and proposed La Mirada general metered service rates are set forth below in abbreviated form:

	Per Meter Present*	Per Month Proposed
Quantity Rates:		
For all water delivered, per 100 cu.ft. .	$ 0.214	$ 0.325
Service Charge:		
For 5/8 x 3/4-inch meter	3.15	5.20
For 3/4-inch meter	3.30	5.70
For 1-inch meter	4.30	7.80
For 1½-inch meter	8.80	10.40
For 2-inch meter	11.00	14.00
For 3-inch meter	16.00	26.00
For 4-inch meter	22.00	35.40
For 6-inch meter	33.00	58.75
For 8-inch meter	55.00	87.40

The service charge is applicable to all metered service. It is a readiness-to-serve charge to which is added the charge, computed at the Quantity Rates, for water used during the month.

*Rates in effect before September 16, 1974, on which date the quantity rate of $0.214 was increased to $0.219.

The present and proposed Etiwanda general metered service rates are set forth below in abbreviated form:

	Per Meter Present*	Per Month Proposed
Quantity Rates:		
For all water delivered, per 100 cu.ft. ..	$ 0.27	$ 0.515
Service Charge:		
For 5/8 x 3/4-inch meter	4.00	8.40
For 3/4-inch meter	4.50	9.25
For 1-inch meter	6.00	12.60
For 1½-inch meter	8.50	16.80
For 2-inch meter	11.00	22.70
For 3-inch meter	20.00	42.00
For 4-inch meter	27.00	57.10
For 6-inch meter	45.00	94.90
For 8-inch meter	67.00	141.10

The service charge is applicable to all metered service. It is a readiness-to-serve charge to which is added the charge, computed at the Quantity Rates, for water used during the month.

*Rates in effect on September 16, 1974.

Public hearing in this matter was held November 6 in Etiwanda,[1/] November 7 in La Mirada, and November 8, 26, and 27, and December 9 and 10, 1974 in Los Angeles before Examiner Main. Notice of the hearing was provided to customers by bill insert or direct mailing, publication in newspapers of general circulation in Southwest's service areas, and posting in Southwest's business offices. Many of Southwest's customers wrote to the

---

1/ Implicit in the issuance of this decision is the denial of a petition by Etiwanda residents requesting an additional hearing be held in Etiwanda and assigned to a different examiner.

Commission expressing concern and dismay at the size of the rate increases proposed by Southwest. Twenty-two customers testified at the hearings held in Etiwanda and La Mirada.

Service

Approximately 15 customers testified either to possible errors in billing or to such service matters as poor water quality, low water pressure, delays in repairing leaks, or irregularities in meter reading. Southwest was directed to investigate the customer complaints and report the results. Those results were reported in Exhibits 24 and 25, which upon review have disclosed a reasonable treatment of these limited service matters.

In Exhibit 5 the staff reported on Southwest's service as follows:

"During the period between January 1972 through October 1974 seven informal complaints were filed with the Commission, two were from the Etiwanda District and five were from La Mirada. All seven were protesting the amount of the bills and have been resolved. Applicant maintains a log of Service Complaints in its office and checks out each one usually the same day. The following tabulation summarizes applicant's Service Calls during 1972, 1973 and 1974 through September.

Service Complaints

	Nature of Complaint	1972	1973	9 Months 1974
(1)	No Water	2	4	0
(2)	Low Pressure	49	42	31
(3)	Taste or Odor	10	16	16
(4)	Colored Water	38	17	12
(5)	Noise	49	46	34
(6)	Total	148	125	93

"The tabulation indicates a downward trend in the number of service complaints from year to year. However, applicant should pay particular attention to taste and odor complaints. In general the overall service provided by applicant to its customers appears to be adequate."

<u>Accounting</u>

Southwest's accounting records are audited annually by Haskins & Sells, a firm of certified public accountants.

For this proceeding the staff of the Commission's Finance and Accounts Division (F&A) examined Southwest's books and records for the period December 1, 1971 through June 30, 1974, with emphasis on rate base items, operating revenues and expenses, and the sale of the La Sierra District. The results of this examination are set forth in Exhibit 4.

The staff found that Southwest's accounting records generally are maintained as prescribed by this Commission. Exceptions to this general result are focused upon in the following three-part staff recommendation which appeared at page 13 of Exhibit 4 and which would require Southwest to:

> "a. Amortize the deferred income tax relating to those already invested involuntary conversions and future conversions, if any, with the composite depreciation rate.
>
> "b. Not to charge operating expenses with expenses related to sale of plant, (e.g., write-off of uncollectible accounts of sold districts) and nonrecurring arbitrary expenses, (e.g., termination pay of officers).
>
> "c. Not to include nonutility operating taxes with utility operating taxes."

Southwest has concurred in this recommendation. Its purpose is to make the accounting treatment of the several items more closely conform to the ratemaking treatment.

In contrast to its parts (b) and (c), which appear to be self-explanatory, part (a) requires some elaboration. Involuntary conversions occur when a taxpayer sells its properties as a result of a threat of condemnation by a public agency and acquires replacement properties of an amount equal to or greater than the proceeds received from the sale. Under the Internal Revenue Code, the tax basis of the replacement property is its cost less the amount of any gain not recognized. That basis results, to the extent of the deduction for the gain, in lower future depreciation charges allowable for tax purposes which in turn results in higher future income tax expense.

Southwest has reinvested in utility plant the proceeds from three condemnations. That utility plant is subject to the foregoing tax basis, which avoids immediate recognition of taxable gains and instead spreads tax consequences over the service life of the depreciable plant. The capital gains tax Southwest has elected in this way not to recognize amounts to $56,815 and has been entered as other reserves on its balance sheet. That amount is made up as follows from the three condemnations:

City of Ontario	$26,267
Cucamonga Water District	3,659
City of Santa Fe Springs	26,889
Total	$56,815

The F&A staff "recommends starting with December 31, 1972, the amortization of this deferred tax of $56,815 using the composite depreciation rate for straight-line remaining life. This amortization should be used to reduce income tax expense so as to minimize the difference in future higher income tax as a result of Southwest electing not to immediately recognize their capital gains." The composite depreciation rate is 2.074 percent.

The recommended amortization would bring the accounting into closer alignment with the treatment used in ratemaking. In ratemaking, the tax basis of the replacement property is simply its cost, i.e., cost without reduction by the amount of the gain not recognized. This basis results in higher depreciation charges than actually allowable for tax purposes and, accordingly, in lower income tax expense. Treated in this way, a nonutility tax burden is excluded from operating taxes, i.e., it is not flowed through to the ratepayer but confined to the utility.

The staff's three-part accounting recommendation will be adopted.

Rate of Return

A fair and reasonable rate of return applied to an appropriately derived rate base quantifies the earnings opportunity available to the utility after recovery of operating expenses, depreciation allowances, and taxes. The return or earnings on invested capital provide for the interest payable by the company on its debt, the dividends on preferred stock, and the earnings on common equity.

The rate of return witness for the Commission staff recommended that a rate of return in the range of 8.50 percent to 8.80 percent be applied to the rate base determined in this proceeding. Tabulated below are estimated capital ratios as of December 31, 1974, together with cost factors for long-term debt and preferred stock, and the earnings allowance for common stock equity of from 10.19 percent to 10.68 percent corresponding to that recommendation:

Item	Capital Ratios	Cost Factors	Earnings Allowance for Common Stock Equity: 10.19%	10.35%	10.52%	10.68%
			Weighted Cost Totals			
Long-Term Debt	3.97%	6.29%	.25%	.25%	.25%	.25%
Preferred Stock	34.41	5.72	1.97	1.97	1.97	1.97
Common Equity	61.62		6.28	6.38	6.48	6.58
Totals	100.00%		8.50%	8.60%	8.70%	8.80%

He testified that his allowance for earnings on common stock equity was necessarily a judgment based on many considerations, some of which were: (a) comparative earnings of other water utilities; (b) recently authorized rates of return; (c) capital structure and imbedded costs; (d) financial requirements for construction and other purposes; (e) the amount of funds available from advances, contributions, and other sources; and (f) balancing of consumer interests with the benefits accruing to the investors in the company because it is essential that the rate of return be equitable for consumers as well as investors.

Southwest's rate of return witness, a financial consultant and advisor, rendered an opinion that the return on Southwest's common equity should be no less than 14.38 percent. The corresponding rate of return on total capital, as structured on December 31, 1973, would be 10.93 percent.

He testified that the 14.38 percent level was determined in relation to the yield and risk of United States Treasury Bonds. The yield used was simply the listed yield, for the September 15, 1974 asked price of the 6-3/8 percent coupon bonds maturing in 1984, converted to monthly compounding. The risk factor, a multiplier of 1.75 applied to the bond effective yield of 7.72 percent, was another matter. Although the witness stated that mathematical techniques and judgmental considerations were involved in the factor's determination, the record is far from clear as to what the critical inputs were. Evaluation of risk, we note, is more susceptible to error than is the evaluation of other important factors considered in determining a reasonable rate of return.

The 14.38 percent level is supported, he further testified, by conduct of common stock investors in the open market. In August 1974 the average price earnings ratio of the 75 utilities in the Lehman Brothers Index was 6.96. That ratio through its reciprocal yields an average rate of return on common equity of 14.37 percent. He also contended the rise in the consumer price index (with a 1967 base) to 250.4, which according to his testimony translates to an effective yield of over 12.5 percent for the 80 months ended August 17, 1974, provides further support for his opinion on return.

In essence, this witness has offered his judgment as to the terms under which a new investor might devote his funds to the business. Stated another way, it is his judgment an investor would not purchase Southwest's common stock at book value, under prevailing investment opportunities, unless earnings were expected to be at the level he recommends. His approach would be better suited, it seems to us, for use in setting offering prices on new security issues, especially those of debt or preferred stock.

If not for other reasons, his approach has limited value in the determination of a reasonable return on common equity for ratemaking, simply because of the marked sensitivity to changes in United States Treasury Bond yields. For example, by the end of February 1975 the yield on the bonds relied upon by this witness, viz., the 1984 maturing 6-3/8 percent coupon treasury bonds, had declined to 6.86 percent (Wall Street Journal, Monday, March 3, 1975). Moreover, the corresponding effective yield in terms of monthly compounding according to his testimony on that subject would be something less than that 6.86 percent. Thus, if the 1.75 multiplier remains constant--and we gather from the record it probably would--the required return on common equity would shift from the 14.38 percent determined by this witness to about 12.5 percent.

The most serious shortcoming of his approach, however, is the result it has yielded. A 14.38 percent return on common stock equity, where the ratio of common equity to total capital is over 60 percent, where there is no interest coverage problem, and where there is no substantial requirement for external financing, is patently excessive.

Southwest's capital structure, which contains 96 percent equity (34.4 percent preferred stock, 61.6 percent common equity) and 4 percent debt, has disadvantages for the ratepayer in that impact from earnings on equity capital nearly doubles when income taxes are considered. Consumer burden, as measured by return plus federal income taxes at 48 percent on weighted costs of preferred and common stocks as return components, would reach 16.69 percent at the top of the staff recommended range for rate of return.

In our opinion an 8.65 percent rate of return, which lies at the midpoint of the staff recommended range, would tend to strike a proper balance of the interests of the ratepayer and the investor and, based on all of the evidence, is the fair rate of return for Southwest. The corresponding return on common equity is 10.44 percent.

Results of Operation

Witnesses for Southwest and the staff have examined and analyzed Southwest's operating results. Their respective estimates of results of operation for test year 1974 are set forth in Exhibits 2 and 5, and a detailed comparison of the differences in their estimates appears in Exhibit 12.

Summarized in Table 1 on the next page are their estimates, as finalized in Exhibit 12, for the La Mirada District and for the Etiwanda District. Also shown in Table 1 are the adopted operating results by district and for the total company.

A. 54787 - IB/ltc *

Table 1

Estimated Results of Operation
Under Present Rates
Test Year 1974

(Thousands of Dollars)

Item	La Mirada District Southwest	La Mirada District Staff	La Mirada District Adopted	Etiwanda District Southwest	Etiwanda District Staff	Etiwanda District Adopted	Total Co. Adopted
Operating Revenues	$ 1,444.0	$ 1,456.1	$ 1,456.1	$ 61.2	$ 62.0	$ 62.0	$ 1,518.1
Operating Expenses:							
Oper. and Maint. Exp.							
Replenishment Tax	32.2	32.2	32.2	-	-	-	32.2
Purchased Water	303.9	277.3	307.0	7.7	7.3	7.3	314.3
Power for Pumping	103.3	103.3	103.3	0.8	0.9	0.9	104.2
Payroll	85.8	85.8	85.8	10.5	10.5	10.5	96.3
Uncollectibles	5.1	5.0	5.0	0.6	0.6	0.6	5.6
Other Exp.	105.0	98.3	105.0	7.3	6.0	6.3	111.3
Subtotal	$ 635.3	$ 601.9	$ 638.3	$ 26.9	$ 25.3	$ 25.6	$ 663.9
Adm. and Gen. Exp.							
Payroll	$ 140.6	$ 128.7	$ 128.7	$ 6.2	$ 5.6	$ 5.6	$ 134.3
Regulatory Comm. Exp.	17.7	14.1	14.1	0.8	0.6	0.6	14.7
Franchise Requirements	21.5	21.8	21.8	1.4	1.4	1.4	23.2
Outside Services	23.2	19.2	22.0	1.0	1.0	1.0	23.0
Misc. Exp.	20.9	15.0	17.7	0.9	0.7	0.8	18.5
Exp. Transferred	(27.3)	(28.6)	(28.6)	(1.2)	(1.3)	(1.3)	(29.9)
Other Exp.	130.0	117.5	122.1	5.7	5.3	5.5	127.6
Subtotal	$ 326.6	$ 287.7	$ 297.8	$ 14.8	$ 13.3	$ 13.6	$ 311.4
Depreciation	$ 143.9	$ 141.7	$ 141.7	$ 5.9	$ 5.7	$ 5.7	$ 147.4
Taxes Other than on Income	163.6	163.6	163.6	5.2	5.2	5.2	168.8
Income Taxes	59.5	103.5	79.0	3.1	4.6	4.2	83.2
Total Operating Exp.	$ 1,328.9	$ 1,298.4	$ 1,320.4	$ 55.9	$ 54.1	$ 54.3	$ 1,374.7
Net Revenue	$ 115.1	$ 157.7	$ 135.7	$ 5.3	$ 7.9	$ 7.7	$ 143.4
Rate Base	$ 4,107.5	$ 4,099.5	$ 4,099.5	$ 262.1	$ 259.5	$ 259.5	$ 4,359.0
Rate of Return	2.80%	3.85%	3.31%	2.02%	3.04%	2.97%	3.29%

( ) Denotes Red Figure

Revenues

The revenue estimates made by Southwest and those prepared by the staff clearly are not far apart. In normalizing domestic water use per customer both Southwest and the staff used the same data and a multiple correlation analysis under the Modified Bean Method. They reached, however, somewhat different results.

For the La Mirada District $9,000 of the $12,100 difference in revenue estimates is attributable to the staff's estimated domestic consumption of 229.3 ccf per customer per year exceeding Southwest's estimate by 3.5 ccf. The remaining difference is in industrial sales. In that category the staff estimated sales of 222,000 ccf in contrast to Southwest's estimate of 211,500 ccf.

For the Etiwanda District, the staff estimated $800 more in operating revenues. The staff's estimate exceeded Southwest's by $100, $300, and $400, respectively, in domestic, commercial, and public authority water sales. The normalized domestic water use per customer was estimated by the staff to be 271.6 ccf which exceeded Southwest's estimate by 1.6 ccf.

The revenue estimates presented by Southwest and the slightly higher estimates made by the staff are within the range of reasonableness. For this proceeding we will adopt the staff's revenue estimates.

Operation & Maintenance Expense

For the La Mirada District there are three principal elements of difference between the company and staff in the estimates of O & M expenses. Those elements are (1) water requirements including losses and unaccounted for; (2) water availability by sources of supply; and (3) anticipated price levels for materials and services during 1974. Water requirements and availability by sources affect purchased water costs.

The adopted level of those costs, $307,000, exceeds both the company and staff estimates. It reflects, as will be brought out shortly, a substantial increase in rates for water purchased from Suburban Water Systems. The third element affects Other O & M Expense, which was estimated as $105,000 by the company and $98,300 by the staff.

The water requirements we have adopted are 4,606,900 ccf, which is 60,100 ccf higher than the staff estimate and 27,000 ccf lower than the company estimate. The adopted requirements are the sum of the staff estimated water sales of 4,006,000 ccf, consistent with adopted revenues, and losses and unaccounted for water of 600,900 ccf, equivalent to 15 percent of sales.

The latter, the level of unaccounted for water properly includable in test year adopted operating results, was a contested issue. Such losses in recent years have been running at about 17 percent of sales, a level rejected as excessive by the staff. The staff allowed an arbitrary judgment figure of 13.5 percent of sales for this item.

Through exercising closer control of losses and unaccounted for there is potential for significant cost savings. For example, each one percent of sales, as losses and unaccounted for, costs nearly $6,000 in purchased water based on Central Basin rates of $65 per acre-foot. Accordingly, Southwest's management should focus on this potential and see to it that the necessary studies are undertaken to determine for this district an optimum reasonable range for losses and unaccounted for. If by the next proceeding on this district Southwest's management has not had that optimum range developed, an even larger adjustment on unaccounted for water, than that represented in the above adopted basis of 15 percent of sales, can then reasonably be expected.

The point in dispute concerning water supply by sources is the quantity of water available to Southwest from Suburban Water Systems (Suburban), since Southwest and the staff essentially agree on the amounts of water that can be pumped from the basin by Southwest and purchased by Southwest from California Domestic Water Company.

Because of its lower price and better quality, Southwest purchases Suburban water in preference to supplies from the other remaining source, Central Basin Municipal Water District. Southwest, in formulating its estimate, has trended the water purchased from Suburban over a five-year period, whereas the staff fixed the supply available from Suburban at the same level experienced in 1973, a wet year. The results were: Southwest estimated 2,089 acre-feet in purchases from Suburban; the staff estimated 577 acre-feet more, or 2,666 acre-feet.

The amount of water which can be purchased from Suburban is a function of Suburban's own water availability and the requirements of its customers, i.e., Suburban has water available for Southwest only after the requirements of its own customers are satisfied. Neither Southwest nor the staff forecasted the supply available to Southwest from Suburban on this basis.

Absent an estimate developed on that more precise basis we deem it reasonable to use an intermediate level. The purchases by Southwest from Suburban which we adopt for the test year are 2,275 acre-feet at a cost of $109,000, based on a new Suburban rate of $47.92 per acre-foot, or $0.11 per ccf. (See Decision No. 83920, Appendix A, page 5 of 5.) That rate is $5.28 higher per acre-foot than the former rate of $42.64 per acre-foot which, according to Table 7 of Exhibit 12, was used by Southwest and the staff.

The third area of difference, as noted earlier, is in estimating the extent the cost of materials and services in Other O & M Expense would increase over 1973 in 1974. The staff folded into its estimate a projected 5 percent increase in contrast to the company's estimated increase of 15 percent. Exhibit 21, which through a series of graphs depicts the increases which have occurred during 1974, is persuasive in support of the company's estimate, which is adopted.

For the Etiwanda District the company's estimate of operation and maintenance expenses of $26,900 exceeds the staff's estimate by $1,600 and our adopted estimate by $1,300. These differences occur, as can be seen in Table 1, in the estimates for Purchased Water and Other O & M Expenses only, there being agreement on the expense levels for Power for Pumping, Payroll, and Uncollectibles.

For Purchased Water the staff's $7,300 estimate reflects water requirements of 173,300 ccf including 28,900 ccf for losses and unaccounted for, while the company's $7,700 estimate reflects water requirements of 182,800 ccf including 41,200 ccf for losses and unaccounted for. The staff amount of $7,300 has been adopted. That is consistent with our adoption of staff revenue estimates and our concurrence with the staff view that losses and unaccounted for on the Etiwanda system, which is both extensive and low in customer density, can reasonably be held, for rate-fixing purposes, to 20 percent of sales.

In estimating Other O & M Expense for 1974 both the utility and the staff started with 1973 expenses. The utility applied a 15 percent increase to the recorded 1973 Other O & M Expense of $6,367. The staff normalized that 1973 recorded expense by adjusting downward reservoir expense by $458 and hydrants maintenance by $373 and arrived at, as set forth in

Table 10 of Exhibit 12, a 1973 normalized Other O&M Expense of $5,500. The staff increased this figure to $6,000 to serve as its 1974 estimate. Our adopted estimate is $6,300 for the test year, which equates to the staff's $5,500 for normalized 1973 plus a 15 percent increase consistent with Exhibit 21.

Administrative & General Expenses

For the total company, Southwest estimated Administrative & General Expenses at $341,400, which is $40,400 above the staff's estimate and $30,000 above the adopted level. The reasons for the differences are for the most part common to both La Mirada and Etiwanda Districts.

Both Southwest and the staff allocated district expenses between Etiwanda and La Mirada on the four-factor basis of 95.8 percent to La Mirada and 4.2 percent to Etiwanda. The staff used Southwest's 1974 four-factor allocation of 21.6 percent for Southwest and 78.4 percent for Suburban in its intercompany allocation of common expenses.

Southwest's payroll estimate of $146,800 exceeds that of the staff by $12,500, which in turn represents nearly one-third of the total difference of $40,400 between their estimates of Administrative & General Expenses. Table 11 of Exhibit 12 shows in some detail the development of the two payroll estimates.

About $8,500 of the $12,500 difference in payroll estimates was due to adjustments made by the staff to reflect personnel levels after the sale of La Sierra District. The other $4,000 resulted from Southwest's estimate including, and the staff's estimate excluding, a 3 percent merit increase applied to Administrative & General Salaries (Account 791). The staff excluded the 3 percent increase because it had not been granted at the time of the staff investigation. Southwest did not undertake to establish for the record whether such an increase or any part of it was actually granted to A&G personnel later in 1974.

The staff's estimate of payroll of $134,300 within Administrative & General Expenses appears the more reasonable and will be adopted.

Southwest's estimate of regulatory commission expense of $18,500 exceeds that of the staff by $3,300. Each of these estimates has two basic components, one of which is the cost of this rate case amortized over three years, and the other is the continuing amortization of expense of the prior rate case, Application No. 52640. Most of the difference in estimates lies in the latter component, for which Southwest and the staff used different periods, three years and five years, respectively, over which to amortize a remaining cost of about $30,000 out of a total cost of $33,965.

Decision No. 80476 dated September 12, 1972 in Application No. 52640 established new rates which were structured in part to reflect an amortization of Southwest's costs of that application over a five-year period. On the basis of those rates, which is more fundamental than a book basis, such costs should be nearly one-half amortized. Accordingly, the level of the staff estimate for the test year is more reasonable and will be adopted.

In Table 13 of Exhibit 12 the estimates of Account 798, Outside Services, were compared. Southwest started with 1973 recorded figures. It used $21,051, which is the sum of the La Mirada and Etiwanda 1973 recorded figures only, for the total company so as to exclude La Sierra District and applied the 1974 four factors to that sum to redistribute it to the two surviving districts. A 15 percent increase in the $21,051 to $24,209 was estimated for 1974.

Although following this same general method, the staff handled several parts of it differently. The staff witness adjusted certain 1973 expenses, because of their variability, by taking their averages over the four-year period 1970-1973. A 1973 normalized amount of $19,247 resulted for this account. To arrive at estimated 1974 he added a 5 percent increment to the 1973 normalized expense base which he had developed.

An estimate of $23,000 for the total company ($22,000 La Mirada, $1,000 Etiwanda) is reasonable and will be adopted. It approximates the result obtainable by applying a 15 percent increase to the staff 1973 normalized expense for outside services. The reasons for a 15 percent increase have previously been discussed and are applicable to Account 798.

In Table 14 of Exhibit 12 the estimates of Account 799, Miscellaneous General Expenses, were compared. Both Southwest and the staff started with 1973 recorded expenses. Southwest developed its estimate for this account in the same way it developed its estimate for Account 798. The staff departed from Southwest's estimate through making deductions from 1973 recorded figures, for a $2,700 portion of director and secretarial fees and for about $1,300 in dues and donations, and through applying a 5 percent increase to the adjusted 1973 expense base in estimating the 1974 expense level. The staff estimate is reasonable except, as will be seen, for the deduction for director and secretarial fees.

Southwest contended, consistent with Decision No. 81249 dated April 10, 1973, in Application No. 53419 of Azusa Valley Water Company, that director's fees for an officer should not be deducted unless his total compensation including director's fees is unreasonable. Southwest made the same contention regarding the secretarial fees. There was no showing that the total compensations were unreasonable.

The staff deduction for dues and donations appears proper and is uncontested. Its application of a 5 percent increase in estimating 1974 expense level is compatible with the content of Account 799 being predominantly director's compensation. A total company estimate of $18,500 ($17,700 La Mirada, $800 Etiwanda) for Account 799 is obtained from the staff estimate upon eliminating the effect of disallowing $2,700 in director and secretarial fees. The staff estimate so modified is reasonable and will be adopted.

For Administrative Expenses Transferred, Account 812, the differences in estimates are small, reaching only $1,400 for the total company. By primarily reflecting allocations of A&G salaries and employees' pensions and benefits to construction costs, this account is linked with payroll. Because of that and since we have adopted the staff's estimate for payroll, we also adopt its estimate for administrative expenses transferred.

In Table 15 of Exhibit 12 the estimates of Other A&G Expense were compared. Those expenses encompassed all of Account 792, Office Supplies and Other Expenses, except its "Other Labor" component; Account 793, Property Insurance; Account 794, Injuries and Damages; Account 795, Employees' Pensions and Benefits; Account 805, Maintenance of General Plant; and Account 811, Rents. To estimate 1974 level of these expenses Southwest increased its 1973 normalized figures by 15 percent, whereas the staff applied a 5 percent increment. Most of the difference in their estimates is due to the different 1974 increments used.

In developing our adopted 1974 Other A&G Expense of $127,600 for the total company we have modified the staff's estimate to reflect a 10 percent increment over 1973. An increment at that intermediate level is compatible with the fact that these expenses are in large part related to payroll, e.g., Account 795, Employees' Pensions and Benefits, and in part related to materials and services.

Depreciation and Rate Base

Southwest and the staff have differently averaged net plant additions; the staff used a weighted average based on monthly figures, whereas Southwest used the mean of beginning- and end-of-year figures. Their estimates of depreciation expense and rate base are developed on a basis consistent with their treatments of net plant additions. We adopt the staff estimates.

Income Taxes

Southwest and the staff have used similar bases to determine income taxes. Both used liberalized depreciation on a flow-through basis and the same estimate in the case of the job development investment credit. The staff adjusted tax depreciation, however, to reflect the full cost of utility plant which was acquired with the proceeds received pursuant to condemnations. That adjustment is proper for ratemaking, as brought out earlier (at mimeo page 7) when contrasted with a related accounting recommendation.

The staff's computations, after modification to reflect the adopted levels of operating revenues and expenses, have been used to determine adopted income taxes.

Attrition

Southwest and the staff have developed the declines in rate of return tabulated below from their respective estimates of operating results for years 1973 and 1974, which are set forth in Exhibits 2 and 5:

	La Mirada	Etiwanda	Total Company
Present Rates			
Southwest	0.51%	0.70%	0.53%
Staff	0.20	0.28	0.21
Proposed Rates			
Southwest	0.57	1.64	0.62
Staff	0.31	1.45	0.37

Of the above attrition figures, those resulting under present water service rates differ for either the total company or the individual districts largely because Southwest's projections of 1974 operating results include a 15 percent increase over 1973 in Other O&M Expenses and Other A&G Expenses, whereas the staff's projections include a 5 percent increase over 1973 for those expenses. Attrition reaches the higher levels shown under Southwest's proposed rates primarily because of the greater impact of growth in rate base projected for 1974 on rate of return at the resulting higher net revenues. None of the figures shown reflect slippage from increases in purchased water price or power rates, i.e., the same unit price or rate levels were used for both 1973 and 1974. In the figures developed by the staff, there is also no slippage reflected for wage increases inasmuch as 1974 wage levels were rolled back into 1973.

Accordingly, a decline of not less than 0.25 percent per year in rate of return for La Mirada District can reasonably be expected. At that level of decline, which is nearly midway between the staff's estimate at present rates and its estimate at Southwest's proposed rates, the effect on attrition of the water service rates authorized herein has been recognized and the more moderate increases projected by the staff in Other O&M Expenses and Other A&G Expenses are reflected. The latter is deemed more representative of the next several years after 1974 than Southwest's 15 percent increment basis, which was founded on the extraordinarily high increases experienced in 1974.

A 0.25 percent annual attrition can be applied also to the total company since Etiwanda District is only a small part of total company operations, e.g., about 6 percent of rate base and but 3 percent of either water sales or customers. That level of annual decline can thus be applied in turn to Etiwanda District and will lessen the impact of attrition on its revenue requirements.

Authorized Increases

With annual attrition at 0.25 percent, a 9.15 percent rate of return must be applied to test year 1974 operating results in order to yield an average rate of return of 8.65 percent over the three-year period, 1975-1977, inclusive, and that is what will be done for the La Mirada District.

For the Etiwanda District, however, both Southwest and the staff have recognized that rates set to yield a full return result in an inordinately large increase. In this regard Southwest said in Exhibit B to its application before amendment:

> "Rates sufficient to provide a reasonable return of the Company's present investment in this District would require an inordinately large increase over present rates. For this reason, the Company has elected to request an increase in revenue of only 26 percent, which will provide revenues sufficient to cover costs and provide a small return on investment."

Although in its application as amended an almost full rate of return is sought for the first year in which new rates would be in effect, Southwest has continued to propose rates for the Etiwanda District which, according to its calculations of attrition, would achieve, as an average over three years, a substantially lower rate of return (8.94 percent vs. 10.94 percent) than would the rates proposed for La Mirada District. For the Etiwanda District the staff recommended in Exhibit 5 at page 24 "...any rate adjustment allowed in this proceeding should be in two steps: a partial increase similar to the original application yielding a reduced rate of return for 1975, and final rates for 1976 yielding a rate of return found reasonable for total company. An attrition of 0.3 percent per year in Etiwanda District should be considered."

The staff recommendation tends to strike a reasonable balance and we will adopt it with some modifications.

For the Etiwanda District to attain and hold an 8.65 percent rate of return during the 1975-1977 period, it appears that attrition considerably above the 0.3 percent per year indicated by the staff in its recommendation would have to be applied in determining additional revenue requirements. However, consistent with Etiwanda District's earning less than the total company rate of return in past years (the outcome of the district's high investment per customer and high operating costs per customer in relation to rates) we will not apply an indicated higher attrition rate but, recognizing Etiwanda as only a small part of Southwest's total operations, apply instead the 0.25 percent per year rate applicable to the total company.

The first step of a two-step increase for Etiwanda District should be sized to yield the same percentage increase in gross revenues as the increase authorized for La Mirada District. The second step, which is to take effect January 1, 1976, should be structured to yield the total company rate of return in that year after allowance for attrition at 0.25 percent per year.

In Table 2 below are set forth the adopted operating results by districts for test year 1974 at the rates authorized herein.

Table 2

Adopted Operating Results
at Rates Authorized Herein
Test Year 1974

Item	La Mirada	Etiwanda Step 1	Etiwanda Step 2
	(Dollars in Thousands)		
Operating Revenues	$1,971.4	$ 83.9	$ 97.15
Operating Expenses			
O&M Expenses excld. Uncollectibles	633.3	25.0	25.0
Uncollectibles	6.8	0.8	1.0
A&G Expenses excld. Franchise Requirements	276.0	12.2	12.2
Franchise Requirements	29.4	1.9	2.2
Depreciation & Taxes Other Than Income	305.3	10.9	10.9
Income Taxes	345.5	15.4	22.1
Total Operating Expenses	$1,596.3	$ 66.2	$ 73.4
Net Revenue	$ 375.1	$ 17.7	$ 23.75
Rate Base	$4,099.5	$259.5	$259.5
Rate of Return	9.15%	6.82%	9.15%

The authorized increases in operating revenues are: $1,971,400 - $1,456,100 = $515,300, or a 35 percent increase for La Mirada; $83,900 - $62,000 = $21,900, or a 35 percent increase, for Etiwanda in Step 1; and $97,150 - $83,900 = $13,250, or a 16 percent increase, for Etiwanda in Step 2.

Other Matters

In Decision No. 83920 dated December 30, 1974 in Application No. 54336 on Suburban Water Systems we rejected a staff recommendation that service charge rates differentiate between the 3/4-inch meters with a 9-inch laying length and those with a 7½-inch laying length. The same recommendation was made by the staff in this proceeding. The evidence clearly establishes that Rockwell's short 3/4-inch meter used by Southwest qualifies as a full 3/4-inch meter by AWWA cold water meter standards for displacement meters.

Before proceeding to our findings and conclusions and the order, we should point out that our objective has been to discuss and rule on those matters which seemed of major importance in deciding the validity of applicant's request. However, broad consideration has been given to all the various points brought before us for consideration though each may not be specifically treated.

Findings

1.a. Southwest is in need of additional revenue, but the proposed rates set forth in the application, as amended, are excessive.

b. The adopted estimates on page 26 of operating revenues, operating expenses, and rate base for test year 1974 are reasonable estimates for Southwest's results of operation.

c. The fair rate of return, exclusive of attrition, for Southwest is 8.65 percent. The corresponding return on common equity, which comprises 61.62 percent of total capital, is 10.44 percent.

d. An annual decline of at least 0.25 percent in rate of return at the rates authorized herein is expected to occur. Accordingly, those rates, except the Step 1 rates for Etiwanda District, have been structured to yield a 9.15 percent rate of return on a test year 1974 basis in order to produce an average rate of return over the three-year period, 1975 through 1977, of 8.65 percent.

2. To avoid an excessively large percentage increase in rates at one time, an increase in rates in two steps for the Etiwanda District, as set forth in Appendix A to this decision, is necessary and proper.

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

4. The authorized increase in rates is expected to produce increased total company gross revenues of $550,450, a 36 percent increase, based on the test year 1974. That increase is nearly $320,000 less than the 57 percent increase which would have resulted at Southwest's proposed rates.

5. The staff's three-part accounting recommendation, appearing at page 13 of Exhibit 4 and reproduced in the section on accounting of this decision, is proper and should be implemented. Accordingly, Southwest's accounting should be suitably modified to accomplish:

a. Amortization of $56,315 in deferred income taxes on gains from condemnations using the composite depreciation rate, determined under the straight-line remaining life method, of its utility plant. Income tax expense is to be reduced in the amount of this amortization. If other involuntary conversions eventually result in similar tax deferrals, such deferrals should also be amortized in this way.

b. Exclusion of expenses which are either related to sold districts or are nonrecurring and arbitrary from operating expenses.

c. Exclusion of nonutility taxes from operating taxes.

The Commission concludes that the application should be granted to the extent set forth in the following order and in all other respects denied.

O R D E R

IT IS ORDERED that:

1. Southwest Water Company is authorized to file with this Commission, on or after the effective date of this order and in conformity with the provisions of General Order No. 96-A, revised tariff schedules with rates, charges, and conditions modified as set forth in Appendix A. The effective date of the revised tariff sheets shall be five days after the date of filing. The revised tariff schedules shall apply only to service rendered on and after the effective date of the revised schedules.

2. Southwest shall bring its accounting for tax deferrals from involuntary conversions and for certain other items into conformity with Finding 5.

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

Dated at San Francisco, California, this 29th day of APRIL, 1975.

Vernon L. Sturgeon
President

William Symons, Jr.

[illegible]

Leonard Ross

Robert Batinovich

Commissioners

Schedule No. LM-1

La Mirada Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

La Mirada, Norwalk, Cerritos, Buena Park, and vicinity, Los Angeles and Orange Counties.

RATES

	Per Meter Per Month	
Service Charge:		
For 5/8 x 3/4-inch meter	$ 4.70	(I)
For 3/4-inch meter	4.95	
For 1-inch meter	6.80	
For 1-1/2-inch méter	9.60	
For 2-inch meter	12.70	
For 3-inch meter	23.50	
For 4-inch meter	32.00	
For 6-inch meter	49.00	
For 8-inch meter	75.00	
Quantity Rate:		
For all water delivered, per 100 cu.ft. ..	$ 0.28	(I)

The service charge is applicable to all metered service. It is a readiness-to-serve charge to which is added the charge, computed at the Quantity Rates, for water used during the month.

Schedule No. EG-1

Etiwanda Tariff Area (T)

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Etiwanda and vicinity, San Bernardino County. (T)

RATES

	Per Meter Per Month		
Service Charge:	Until 1-1-76	After 12-31-75	
For 5/8 x 3/4-inch meter	$ 5.75	$ 6.65	(I)
For 3/4-inch meter	6.20	7.20	
For 1-inch meter	8.60	10.00	
For 1-1/2-inch meter	12.00	13.50	
For 2-inch meter	15.50	18.00	
For 3-inch meter	29.00	34.00	
For 4-inch meter	39.00	45.00	
For 6-inch meter	65.00	75.00	
For 8-inch meter	96.00	110.00	(I)
Quantity Rates:			
For all water delivered, per 100 cu.ft.	.36	.417	(I)

The service charge is applicable to all metered service. It is a readiness-to-serve charge to which is added the charge, computed at the Quantity Rates, for water used during the month.