

Decision 87 12 043

ORIGINAL

DEC 17 1987

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application )  
of the SOUTHERN CALIFORNIA WATER )  
COMPANY (U 133-W) for an order )  
authorizing it to increase rates )  
for water service in its Arden- )  
Cordova District. )

Application 87-04-066  
(Filed April 29, 1987)

O'Melveny & Myers, by Thomas N. Harding, Attorney  
at Law, for Southern California Water Company,  
applicant.

Carol L. Matchett, Attorney at Law, and Richard  
Tom, for the Public Staff Division.

I N D E X

<u>Subject</u>	<u>Page</u>
OPINION .....	2
Rate of Return .....	6
Rate Base .....	34
General Office .....	35
State Income Taxes .....	37
Adopted Summary of Earnings .....	37
1986 Tax Reform Act .....	39
Rate Design .....	39
Complaints .....	42
Customer Relations Program .....	43
Attrition Allowance .....	44
Balancing Accounts .....	45
Findings of Fact .....	45
Conclusions of Law .....	46
ORDER .....	46
APPENDIXES	

OPINION

This proceeding was heard on a consolidated record with Applications (A.) 87-04-067, A.87-04-068, and A.87-04-069 before Administrative Law Judge (ALJ) John Lemke in Los Angeles August 31 through September 3, 1987. An informal public meeting and the evidentiary hearings were noticed by Southern California Water Company (SCWC) to each customer in the district in accordance with the Commission's Rules of Practice and Procedure. The matter was taken under submission subject to the filing of concurrent briefs October 5, 1987.

By this application, SCWC requests authority to increase rates for water service in its Arden-Cordova District by 13.45% in 1988, 3.48% in 1989, and 2.58% in 1990.

SCWC renders public utility water service in various areas in the counties of Contra Costa, Imperial, Lake, Los Angeles, Orange, Sacramento, San Bernardino, San Luis Obispo, Santa Barbara, and Ventura. It also renders an electric service in its Big Bear District.

The Arden-Cordova District is located in the County of Sacramento, and is comprised of two systems - the Arden system and the Cordova system. The service area is comprised primarily of residential customers, with some small commercial users. Of 10,064 customers served in the district as of December 31, 1986, 97% fell in the commercial classification consisting of residential and business customers. The district is primarily unmetered.

The source of water supply for the Arden system consists of eight company-owned wells, all equipped with turbine pumps. The Cordova system water supply source consists of 18 company-owned wells and includes a full treatment plant. All wells are equipped with turbine pumps driven by electric motors.

The company's Coloma Treatment Plant is rated at 4.3 million gallons per day, and treats surface water coming via the Folsom-South Canal from Folsom Dam. There are distribution mains in the district ranging in diameter up to 24 inches. Storage facilities in the district consist of two 1-million gallon steel reservoirs at the Coloma plant.

On December 31, 1986 the historical cost of utility plant in service in the district was \$11,929,800, the depreciation reserve \$1,943,400, and the net depreciated cost \$9,986,400.

Present rates for the district were established by Decision (D.) 82-03-014, dated March 2, 1982 in A.60798. Step increases were authorized pursuant to advice letter filings in 1983 and 1984.

SCWC alleges that at present rates its rate of return on rate base will be 8.07% based on test year 1988 and 7.37% based on test year 1989. It asserts that this low rate of return is mainly caused by increases in the costs of purchased power, labor, payroll taxes, income taxes, liability insurance, administrative and general expenses, depreciation, increased rate base, and increased cost of capital. At rates proposed herein by SCWC, it estimates it would earn a return on rate base of 11.63% in 1988, 11.74% in 1989, and 11.79% in 1990, based on a 13.50% return on common equity (ROCE). However, SCWC reduced its ROCE request to 13.25% (Exhibit 41) and maintains that this sought ROCE of 13.25% is necessary to attract capital at a reasonable cost and to maintain adequate borrowing capability or credit.

Under its proposal SCWC's quantity rate would increase from the present \$0.173 to \$0.2156 in 1988, \$0.2306 in 1989, and \$0.2418 in 1990. The service charge for a 5/8 x 3/4-inch meter would increase from the present \$3.80 to \$4.20 and \$4.40, respectively, in 1988 and 1989, and would not change in 1990. Flat rate service charges would increase for each single unit of occupancy, including premises not exceeding 12,000 square feet in

area, from the present \$7.90 to \$8.55, \$8.70 and \$8.90 in 1988, 1989, and 1990, respectively. Rates for duplexes would increase by the same percentage amounts.

Table 1 (Table 4-C of Exhibit 1) depicts the percentages used by SCWC to allocate common costs to its various districts, based on 1986 operations.

Table 1

## SOUTHERN CALIFORNIA WATER COMPANY

Allocation of general office  
expenses and revenue (4-factor)

	Four Factor	—Estimated Years—		
		1987	1988	1989
Arden-Cordova	3.46Z	84.9	89.6	94.9
Barstow	4.01Z	98.6	104.0	110.2
Bay	1.50Z	36.9	38.9	41.2
Big Bear	5.50Z	135.2	142.6	151.1
Calipatria-Miland	0.85Z	21.0	22.1	23.4
Clearlake	1.23Z	30.2	31.8	33.7
Desert	1.91Z	46.9	49.5	52.4
Los Osos	1.09Z	26.9	28.4	30.1
Metropolitan	32.87Z	807.8	852.0	902.8
Ojai	1.44Z	35.5	37.4	39.6
Orange County	12.54Z	308.1	324.9	344.3
Pomona Valley	5.32Z	130.7	137.8	146.0
San Bernardino	0.00Z	0.0	0.0	0.0
San Dias	6.48Z	159.3	168.0	178.1
San Gabriel	3.63Z	89.1	94.0	99.6
Santa Maria	4.22Z	103.7	109.4	115.9
Simi Valley	4.29Z	105.5	111.2	117.9
Wrightwood	1.20Z	29.5	31.1	33.0
Total Water	91.55Z	2,249.8	2,372.8	2,514.4
Bear Valley Elec	8.45Z	207.6	219.0	232.0
Total Utility	100.00Z	2,457.4	2,591.8	2,746.4

Rate of Return

SCWC has acceded to all of the financial recommendations made by staff witness Karen Shea except the one concerning return on equity. Staff's recommendations are shown in Table 2 below. SCWC and the staff are agreed on capital structure, cost of long-term debt, and return on preferred stock. SCWC requests a constant 13.25% return on equity.

Table 2

Component	Capital Ratio	Cost Factor 1/	Weighted Costs	Weighted Costs With Taxes 2/
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PSD's Recommended Rates of Return

1988				
Long Term Debt	47.0%	9.75%	4.58%	4.58%
Preferred Stock	2.0	4.47	0.09	0.15
Common Equity	<u>51.0</u>	11.75	<u>5.99</u>	<u>10.19</u>
Total	100.0%		10.67%	14.92%

1989				
Long Term Debt	47.0%	9.78%	4.60%	4.60%
Preferred Stock	2.0	4.46	0.09	0.15
Common Equity	<u>51.0</u>	11.75	<u>5.99</u>	<u>10.19</u>
Total	100.0%		10.68%	14.94%

1990				
Long Term Debt	47.0%	9.82%	4.62%	4.62%
Preferred Stock	2.0	4.45	0.09	0.15
Common Equity	<u>51.0</u>	11.75	<u>5.99</u>	<u>10.19</u>
Total	100.0%		10.70%	14.95%

1/ Midpoint of Recommendation

2/ Assumed a net-to-gross of 1.70



For 1988 through 1990, staff recommends a common equity return in the form of a range - from 11.50% to 12.00%.

The staff recommendation is based on an analysis of three separate equity determining methodologies: The discounted cash flow (DCF), risk premium analysis, and the capital asset pricing model (CAPM). SCWC's recommendation is based on the DCF method, plus the testimony of its president and chief.

Staff has relied upon two guiding principles contained in Federal Power Commission v Hope Natural Gas Company (1944) in arriving at its recommendation:

1. An investor should be able to earn a return comparable to the returns available on alternate investments of similar risks.
2. The return should be sufficient to enable the utility to attract additional equity capital on a reasonable basis and maintain the firm's financial integrity.

Staff also relied upon an analysis of the financial history and performance of the following water utilities in arriving at its recommendation for SCWC:

American Water  
Cal American Water\*  
Cal Water Service\*  
Connecticut Water Service  
Consumers Water Company  
Dominguez Water\*  
E'Town Corporation  
Hydraulic Company  
IWC Resources  
Middlesex Water  
Philadelphia Suburban  
San Gabriel Water\*  
SJW Corporation\*  
Southwest Water\*

The California companies, indicated with an asterisk, are Class A water utilities regulated by the California Public Utilities Commission. The other (comparable) companies were selected because they represent those investor-owned water

companies in California and nationally that have recorded market data. Cal Water Service and SJW Corporation are part of the Comparable group as well as the California group. (See Table 4.)

The following table shows selected year-end statistics for the company during the past ten years. Staff believes that the low return on equity in 1986 is a reflection of lower inflation and interest rates:

Table 3

Selected Year End Statistics  
SoCal Specific  
1977 - 1986

: : Year : :	: Authorized: : Return on : : Equity :	: Earned : : Return : : on Equity:	: Dividend: : Payout : : Ratio :	: Book Value: : Per : : Share :	: Dividends: : Per : : Share :	: Earnings: : Per : : Share :	: Market: : to Book: : Value :
(a)	(b)	(c)	(d)	(e)	(f)	(g)	(h)
1977	12.83%	11.61%	63%	\$16.02	\$1.18	\$1.86	88%
1978	12.83	11.33	67	16.66	1.27	1.89	88
1979	13.00	11.18	68	17.28	1.32	1.94	80
1980	13.40	7.99	90	15.68	1.38	1.53	74
1981	14.35	10.07	89	15.85	1.42	1.60	67
1982	14.50	11.33	80	16.16	1.48	1.84	73
1983	14.50	10.90	87	16.38	1.57	1.80	89
1984	14.50	12.71	76	16.91	1.65	2.18	95
1985	14.75	13.24	76	17.49	1.78	2.34	120
1986	13.50	9.40	77	20.20	1.88	2.43	144

Source: Annual Report to Stockholders, Standard and Poors Stock Guides

Table 4 demonstrates SCWC's return on average total capital, and shows that the utility's average return lags both the California and Comparable companies during the five-year period.

Table 4

Return on Average Total Capital  
Trend and 5-Year Averages  
1982 - 1986

Year	SoCal Water	California Companies	Comparable Companies
(a)	(b)	(c)	(d)
1982	9.74%	9.67%	9.64%
1983	9.40	10.46	10.56
1984	10.62	12.82	10.99
1985	10.55	12.27	11.01
1986	10.27	12.50	11.11
5-Year Average	10.12%	11.54%	10.66%

Source: Annual Reports to Stockholders,  
Annual Reports to California Public Utilities  
Commission

Table 5 shows average common equity ratios for the past five years for SCWC, California companies, and Comparable companies. By the end of 1987 SCWC expects to realize a common equity ratio of 51.8%, placing it in a much better financial position.

Table 5

Average Common Equity Ratio  
Trend and 5-Year Averages  
1982 - 1986

: Year :	SoCal :	California :	Comparable :
: (a) :	Water (b) :	Companies (c) :	Companies (d) :
1982	38.06%	48.87%	37.97%
1983	35.82	50.24	39.25
1984	35.72	52.10	40.53
1985	36.35	53.42	41.72
1986	44.11	54.47	43.43
5-Year Average	38.01%	51.78%	40.58%

Source: Annual Reports to Stockholders,  
Annual Reports to California Public Utilities  
Commission

Table 6 indicates average dividend payout ratios for SCWC and the same groups.



Table 6

Average Dividend Payout Ratio  
Trend and 5-Year Averages  
1982 - 1986

Year	SoCal Water	California Companies	Comparable Companies
(a)	(b)	(c)	(d)
1982	80.28%	58.00%	69.97%
1983	87.19	53.68	63.39
1984	75.45	47.53	64.52
1985	75.85	52.58	66.63
1986	75.02	52.74	68.46
5-Year Average	78.76%	52.91%	66.59%

Source: Annual Reports to Stockholders,  
Annual Reports to California Public Utilities  
Commission

Comparable group data for average after-tax interest coverage is demonstrated in Table 7, below.

Table 7

Average After-Tax Times Interest Earned  
Trend and 5-Year Averages  
1982 - 1986

: Year :	SoCal. :	California :	Comparable :
: (a) :	Water : (b)	Companies : (c)	Companies : (d)
1982	2.27x	2.47x	2.22x
1983	2.10	2.57	2.36
1984	2.23	3.09	2.39
1985	2.38	3.08	2.39
1986	2.52	3.18	2.42
5-Year Average	2.30x	2.88x	2.36x

Source: Annual Reports to Stockholders,  
Annual Reports to California Public Utilities  
Commission

The DCF model utilized by the staff contemplates that stock investors require a return based on expected stock yield plus expected dividend growth rate. The DCF formula is as follows:

$$r = D_1/P_0 + g$$

where  $r$  = investor's total rate of return

$D_1/P_0$  = expected dividend yields at purchase date

$g$  = expected future dividend growth rate

The following tables show group v SCWC's Historical Growth Rates (Table 8), Dividend Yields (Table 9), DCF Analysis (Table 10), Risk Premium Analysis (Table 11), and the Summary of Indicated Investor Required Returns on Equity (Table 12):

Table 8  
Historical Growth Rates  
(1977 - 1986)

Company (a)	Ten Year Growth Rates Per Share			
	Earnings (b)	Dividends (c)	Book Value (d)	Average (e)
American Water	11.25%	12.45%	8.00%	10.57%
Cal Water Service	9.33	8.87	4.86	7.69
Conn Water Service	3.92	3.47	.75	2.71
Cons Water Company	12.95	8.62	5.03	8.87
E'Town Corporation	4.96	8.82	4.31	6.03
Hydraulic Company	6.30	4.90	2.83	4.68
IWC Resources	8.95	4.19	3.22	5.45
Middlesex Water	2.99	8.60	3.01	4.87
Phil Suburban	.20	1.28	1.43	.97
SJW Corporation	10.75	9.25	6.93	8.98
SoCal Water Company	4.69	5.44	2.95	4.36
Composite Average	6.94%	6.90%	3.94%	5.92%

Sources: Annual Reports to Stockholders,  
C. A. Turner's Financial Statistics of  
Telephone and Water Companies

Table 9

Dividend Yields  
January-June 1987-

Company (a)	Monthly Dividend Yields						Averages	
	Jan (b)	Feb (c)	Mar (d)	Apr (e)	May (f)	Jun (g)	6-Mo (h)	3-Mo (i)
American Wtr	2.93%	2.63%	2.64%	2.99%	3.25%	2.95%	2.90%	3.07%
Cal Water	5.41	5.32	5.22	5.15	5.40	5.36	5.31	5.31
Conn Water	6.61	6.27	6.43	6.95	7.20	6.76	6.70	6.97
Consumers Wtr	4.81	4.32	4.14	4.51	4.89	4.46	4.52	4.62
E'Town Water	5.63	5.42	5.50	6.01	6.04	5.93	5.75	5.99
Hydraulic Co	5.10	5.02	4.81	4.83	5.25	4.87	4.98	4.98
IWC Resources	6.22	6.17	6.49	7.26	7.51	6.84	6.75	7.20
Middlesex Wtr	5.98	5.66	5.58	5.12	6.29	5.96	5.93	6.12
Phil Suburban	5.07	5.20	5.51	5.92	5.90	5.61	5.55	5.81
SJW Corp	4.67	4.91	4.60	4.54	4.44	4.72	4.65	4.57
SoCal Wtr	6.85	6.79	6.50	7.00	7.20	6.79	6.85	7.00
Composite	5.40%	5.25%	5.22%	5.57%	5.76%	5.47%	5.45%	5.60%

Source: Standard and Poors Stock Guide

Table 10  
Discounted Cash Flow Analysis

Company	Current Yield (Do/Po)	Growth Rate (g)	Expected Yield (D1/Po)	Indicated Investor Required ROCE (r)
(a)	(b)	(c)	(d)	(e)
American Water	3.07%	10.57%	3.39%	13.96%
Cal Water Service	5.31	7.69	5.72	13.40
Conn Water Service	6.97	2.71	7.16	9.87
Cons Water Company	4.62	8.87	5.03	13.90
E'Town Corporation	5.99	6.03	6.35	12.38
Hydraulic Company	4.98	5.45	5.25	10.70
IWC Resources	7.20	4.68	7.54	12.22
Middlesex Water	6.12	4.87	6.42	11.28
Phil. Suburban	5.81	.97	5.87	6.84
SJW Corporation	4.57	8.98	4.98	13.96
SoCal Water Company	7.00	4.36	7.31	= 11.67
Composite Average	5.60%	5.92%	5.91%	11.83%

where: Current Yield (Do/Po) = 3 Month Average Yield (Table No. 15)  
 Growth Rate (g) = Average ten-year historical growth (Table No. 14)  
 Expected Yield (D1/Po) = (Do/Po) \* (1 + g)  
 Required ROCE (r) = Expected Yield + Growth Rate (D1/Po + g)

Table 11

Risk Premium Analysis  
Composite Average

Year	Return	Yields on		Risk Premiums	
	on Average	Debt Securities			
	Common Equity	A Bond Yields	20 Year T-Bonds	A Bond Yields	20 Year T-Bonds
(a)	(b)	(c)	(d)	(e)	(f)
1977	10.92%	8.61%	7.67%	2.31%	3.25%
1978	10.34	9.28	8.48	1.06	1.86
1979	12.29	10.49	9.33	1.80	2.96
1980	12.07	13.34	11.39	-1.27	0.68
1981	12.01	15.95	13.72	-3.94	-1.71
1982	12.57	15.86	12.92	-3.29	-0.35
1983	14.00	13.66	11.34	0.34	2.66
1984	14.43	14.03	12.48	0.40	1.95
1985	14.37	12.47	10.97	1.90	3.40
1986	13.28	9.58	7.85	3.70	5.43

## Risk Premiums (excluding negatives)

10-Year Average (1977-1986)

1.64%

2.77%

5-Year Average (1982-1986)

1.58

3.36

## Forecasted Rates - 1988

10.00%

8.85%

Indicated Investor Required Return on Equity

using 10-Year Risk Premiums

11.64%

11.62%

using 5-Year Risk Premiums

11.58

12.21

Sources: Annual Report to Stockholders, Federal Reserve Bulletins,  
Moody's Bond Survey, Data Resources Inc,  
Blue Chip Financial Forecasts



Table 12

## Summary of Indicated Investor Required Returns on Equity

:	:	:
:	Analysis	Range of Results
:	(a)	(b)

Discounted Cash Flow Analysis

SoCal Specific	11.67%
Composite Average	11.83

Risk Premium Analysis

Composite Average	11.58 - 12.21
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PSD Recommendation

11.50% - 12.00%

Note: SoCal is included in the Composite Average.

SCWC's request for ROE of 13.25% is summarized as follows:

Discounted Cash Flow Analysis

Dividend Yield	6.69%
Growth Rate	<u>6.62%</u>
Required ROE	13.31%
Rounded	13.25%

The above recommendation presented in Exhibit 41 is based on the information contained in the following two tables also set forth in Exhibit 41:

SOUTHERN CALIFORNIA WATER COMPANY  
 RETURN ON COMMON EQUITY  
 DISCOUNTED CASH FLOW ANALYSIS  
 DIVIDEND YIELD CALCULATION

	<u>Average Stock Price (1)</u>	<u>Annualized Dividend Rate (2)</u>	<u>Dividend Yield</u>
January 1986	\$ 24.10	\$ 1.80	7.47%
February	25.17	1.80	7.15
March	25.81	1.80	6.97
April	25.93	1.90	7.33
May	26.60	1.90	7.14
June	31.26	1.90	6.08
July	32.88	1.90	5.78
August	32.76	1.90	5.80
September	31.81	1.90	5.97
October	31.04	1.90	6.12
November	29.98	1.90	6.34
December	28.31	1.90	6.71
January 1987	27.70	1.90	6.86
February	28.06	1.90	6.77
March	29.35	1.90	6.47
April	27.25	1.90	6.97
May	26.15	1.90	7.27
June	27.28	1.90	6.96
July	27.14	1.90	7.00
Average			6.69%

(1) Average of daily high and low stock prices for each month.

(2) Latest declared quarterly dividend rate annualized.

SOUTHERN CALIFORNIA WATER COMPANY  
RETURN ON COMMON EQUITY  
DISCOUNTED CASH FLOW ANALYSIS  
GROWTH RATE CALCULATION

	<u>Dividend Growth (1)</u>	<u>Earnings Per Share Growth</u>	<u>Book Value Per Share Growth (1)</u>
1982	4.23%	15.00%	1.96%
1983	6.08	<2.17>	1.36
1984	5.10	21.11	3.24
1985	7.58	7.34	3.43
1986	5.63	3.85	15.49
Five Year Average	<u>5.72%</u>	<u>9.03%</u>	<u>5.10%</u>
Three Factor Average			<u>6.62%</u>

(1) Calculated from information included in 1986 Annual Report to Shareholders.

The CAPM is based on the assumption that investors generally hold portfolios of securities, and the riskiness of a security is viewed in terms of its contribution to the overall riskiness of a portfolio.

The formula for CAPM model is shown below:

$$r = R_f + b \times (R_m - R_f)$$

where the expected rate of return (r) is the sum of the risk-free rate of return (Rf) plus the security's beta coefficient (b) times the market return minus the risk-free rate of return (Rm-Rf). The expression (Rm-Rf) is called the market risk premium.

The market risk premium is assumed to be 8.3% based on the classic Ibbotson and Sinquefeld study of historic market risk premiums. The .595 beta used in the staff analysis was developed from data on SCWC's average returns on common equity and average year Standard & Poor's 500 earnings. The proxies for the risk-free rate are U.S. Government securities. Staff used short-term debt forecasts to minimize interest rate risk. Staff selected 3-month and 12-month forecasted rates to capture a range of forecasts over short term; Data Resources, Inc. forecasts for 3-month treasury bills are 6.13% and for 12-month treasury bills are 6.94%.

$$\begin{aligned} r &= R_f + b \times (R_m - R_f) \\ 11.07\% &= 6.13\% + .595 \times 8.3\% \\ 11.88\% &= 6.94\% + .595 \times 8.3\% \end{aligned}$$

The results of the CAPM analysis indicate that the investors' expected return for SCWC for the test period is between 11.07% and 11.88%.

Thus, while the staff-recommended range is based upon three methodologies - DCF, risk premium analysis, and CAPM, SCWC's request is based solely on its DCF analysis. Furthermore, SCWC considered only its own financial information, while the staff considered comparative figures for several comparable water companies, both in and outside of California.

SCWC's DCF analysis included five years of financial history in considering long-run growth in dividends; the staff based its recommendation on 10 years of financial information.

William Caveney, President and Chief Executive Officer of SCWC, contends that data used should be most indicative of the future; that the present company is quite different from the one operated more than five years ago. This is because its current and planned common equity ratio is significantly greater than the one experienced several years ago, and also because company-financed portions of plant additions in the earlier five-year period totaled \$32,673,000; whereas in the most recent five-year period the figure rose to \$57,571,000, an increase of 76%. Caveney expects the level of plant additions funded from company funds in the near future to be similar to the most recent five-year period.

Of further concern to Caveney is the 1986 Tax Reform Act, requiring all advances and contributions to be taxable at the outset as income. The uncertainty over who may have to be liable for these taxes, Caveney believes, argues for a greater capital need than might otherwise be required. (Since this matter was submitted, we have issued D.87-09-026, dated September 10, 1987 in Order Instituting Investigation (I.) (OII) I.86-11-09. The decision, effective October 10, places the major tax burden for contributions in aid of construction on contributors. However, the Commission expressed its sympathy for the competitive problems which may be experienced by water companies, i.e., the argument that any additional cost to developers may force them to deal with municipalities who are not required to pay the tax, or start their own water company to avoid the tax.)

Further commenting with respect to risk, Caveney noted that if the Commission authorizes a higher rate of return in a future proceeding for a different district, the subject district is not allowed to automatically increase its rate of return to get a step rate. However, he maintains, if the Commission authorizes a

lower rate of return in a future proceeding, the subject district cannot have a separate step increase unless its rate of return is below the latest authorized by the Commission for any district.

(Note: This has been, but is no longer Commission policy. See, e.g. D.87-09-071 in A.86-11-021.)

The witness also asserted that there is much more sales volatility within the water utility industry than within the energy utility industry; yet, energy utilities have mechanisms which protect them in the case of declining sales. And he emphasized the product risk of water utilities - that while most water is not actually ingested, all of it has to meet Department of Health standards. More money is required for blending and testing requirements, and more stringent requirements are anticipated from the Environmental Protection Agency at the federal level. Increased storage may be required to aerate some of the hydrocarbons contained in certain wells.

SCWC's need for capital is greater than the needs of other water utilities, Caveney contends. Citing a recent study by the California Water Association of the 12 largest water companies in California, Caveney testified that SCWC's company-financed additions amounted to approximately \$60 million during the period 1981-1986; while the additions by California Water Service Company, the largest company in the state, were about \$50 million, and those of San Jose Water Company were only \$26 million. He stated that those ranges will continue into the future, i.e., SCWC will be investing more dollars in utility plant than any other water company, regardless of size. Furthermore, he declared that SCWC is the only major water utility in California that has had extensive sales of common stock in the public market. In 1980, 550,000 shares of stock were sold, having a value of over \$6 million; and in 1986 the company made two public offerings -one in May of 330,000 shares raising \$8.2 million, and another in December of 560,000 shares raising \$12.2 million. Caveney anticipates that

this program must continue to raise the capital for necessary plant improvements. He stated that SCWC's shareholders are primarily buyers of dividends.

Another significant risk facing the company, Caveney testified, and one shared by other water agencies, is the specter of a major claim by the Internal Revenue Service (IRS) for taxes not paid in the past. The claim, for \$3.2 million, involves the treatment of tax benefits from plant financed by advances for construction. Caveney has testified regarding this situation in rate proceedings over the past several years. The threat, he emphasizes, is much more imminent now because the IRS just recently turned down SCWC's appeal, necessitating court action. He stated that the claim for \$3.2 million involves the years 1976 through 1980; that the years since 1980 are still open with respect to this issue.

The following table illustrates recent Commission action with respect to return on equity for large water utilities:



Return on Equity  
Large Water Utilities  
1987

<u>Utility</u>	<u>Application No.</u>	<u>Decision No. (Date)</u>	<u>Return on Equity Requested</u>	<u>Return on Equity Authorized</u>	<u>Prior Return on Equity</u>
Calif. Water Service Co.	A.86-05-037 through A.86-05-041	D.87-03-078 (3-25-87)	15.00%	13.00%	14.25%
Cal American Water Co.	A.86-05-016 A.86-05-017	D.87-03-030 (3-6-87)	15.00%	13.00%	14.00%
Azusa Valley Water	A.86-04-003	D.87-01-060 (1-28-87)	14.75%	13.00%	
Dominguez Water	A.86-06-048	D.87-01-064 (1-28-87)	16.00%	12.75%	14.50%
Suburban Water	A.86-05-047	D.87-01-059 (1-28-87)	16.00%	12.75%	14.25%
So. Calif. Water	A.86-07-010 A.86-07-011 A.86-07-012 A.86-07-028 A.86-07-029 A.86-07-030	D.87-04-069 (4-22-87)	16.00%	12.75%	13.50%
Park Water	A.86-11-022	D.87-09-071 (9-23-87)	13.00%	12.00%	13.20%

The ALJ informed the parties by letter that he intended to take official notice of the recent increases in the prime lending rate.

After consideration, it is our decision that a fair return on equity for SCWC, for purposes of this proceeding, will be one-half percentage point over the high point of the staff recommendation, or 12.5%. Adoption of this figure will result in cost factors and rates of return as set forth in the following table:

**Recommended Rates of Return  
1988, 1989, 1990**

<u>Component</u>	<u>Capital Ratios</u>	<u>Cost Factors</u>	
<u>1988</u>			
Long-Term Debt	47.0%	9.75%	4.59%
Preferred Stock	2.0	4.47	.09
Common Equity	<u>51.0</u>	12.50	<u>6.38</u>
Total	100.0%		11.06%
<u>1989</u>			
Long-Term Debt	47.0%	9.78%	4.60%
Preferred Stock	2.0	4.46	.09
Common Equity	<u>51.0</u>	12.50	<u>6.38</u>
Total	100.0%		11.07%
<u>1990</u>			
Long-Term Debt	47.0%	9.82%	4.62%
Preferred Stock	2.0	4.45	.09
Common Equity	<u>51.0</u>	12.50	<u>6.38</u>
Total	100.0%		11.09%

Authorization of a 12.5% ROE for this district, as well as those considered on this common record, will afford SCWC opportunity to earn a reasonable rate of return and give adequate consideration to the following factors:

1. SCWC is a regulated public utility engaged in a business which affects the public

interest and must provide service at reasonable rates.

2. Fair and reasonable rates must balance the interests of investors and ratepayers.
3. Capital requirements.
4. SCWC's capital structure, capital costs, and financial history.
5. The recent increase in the prime rate.  
(Although an ROE of 12.5% is reasonable here even without this change.)

We recently issued a decision on a large water utility rate case (D.87-09-071, A.86-11-022) where we authorized a 12.0% ROE, and in which the company's equity ratio was 80%. Caveney referred to the ALJ's proposed decision in that proceeding. SCWC's ratios of 51.0% must be considered riskier than the utility with the 80% ratio. The IRS claim testified to by Caveney has the potential for adversely affecting both the present and future holders of SCWC's common stock. SCWC's long term debt cost is increasing. The most recent five-year period of SCWC's financial history is probably a more accurate indicator of SCWC's near future ability to pay dividends plus its growth rate, than the 10-year history presented by the staff. The company's need to raise new capital is continuing. All these factors combine to suggest that a greater ROE is needed than the range recommended by the staff, although not as great as the 13.25% requested. Finally, recent stock market upheavals may suggest to investors greater risk and the need for greater returns than they previously sought.

#### Rate Base

SCWC estimated a \$290,000 expansion project for the Coloma Treatment Plant in 1989. Staff recommends that such a large amount be included in rates only after it is built; that an advice

letter filing be authorized for the plant expansion when it is completed. We concur with the staff and will authorize the advice letter filing.

General Office

SCWC agreed with the staff recommendations concerning rate base set forth in Exhibit 14 in most instances, but disagreed on three items: General Office Renovation, Replacement of Mainframe Computer, and Customer Information System.

SCWC had requested \$100,000 in its application for renovation of its main office in Los Angeles. Company witness Young testified that SCWC was reducing its request for beginning of year 1988 to \$50,000, stating that about that amount will have been spent by the end of 1987. This amount was to be spent for a comprehensive study comparing costs of renovating the current offices with costs of other options, including moving to a different location. Study costs will include architect fees, an asbestos audit, and property appraisals (Tr. 208). Staff witness Hirsch testified (Tr. 241) that the staff would prefer to have more time to evaluate the proposed study.

As the time of hearing the proposed study, perhaps to be completed sometime in October, was too problematic to be included in rate base. Young stated that another rate case filing will be made early in 1988. If SCWC has made adequate progress on its renovation/relocation plans by then, including a completed study, it can include such information in that filing. Young conceded that SCWC had already received \$100,000 additional in rate base for renovation of its general office in its last rate case which covered the Bay, Calipatria, Clearlake, and Simi Valley Districts (D.87-04-069, Tr. 227). The \$50,000 requested for the study will not be included in our adopted summary of earnings at this time.

There is no dispute over SCWC's need to purchase a new mainframe computer. The controversy concerns the timing and mechanism for inclusion of the computer in rate base. SCWC has

State Income Taxes

The staff state income tax calculation reflects the effect of Senate Bill 572, signed by the Governor on September 29, 1987, and which reduces the applicable tax rate from 9.6% to 9.3%.

Adopted Summary of Earnings

Our adopted summary of earnings shown below will reflect adoption of a 12.5% ROE for 1988, 1989, and 1990, subject to further orders of the Commission to change the ROE during the review of future rate cases involving other districts of SCWC; as well as the exclusion of the three general office rate base items discussed supra and the Coloma Treatment Plan expansion.

TABLE 1

SOUTHERN CALIFORNIA WATER COMPANY  
Arden-Cordova District

Adopted Summary of Earnings  
-----

	-----1988-----	
	Present	Authorized
	-----	
	(Thousands of Dollars)	
Total Revenues	\$ 1,394.1	\$ 1,490.9
Operating Expenses		
Oper. & Maint.	554.1	554.5
Adm. & Gen.	90.2	90.2
Gen. Off. Alloc.	84.3	84.3
Depreciation	222.8	222.8
Other Taxes	79.0	79.5
State Franch. Tax	29.3	38.5
Federal Inc. Tax	63.8	93.3
Total	1,123.5	1,163.1
Net Income	270.6	327.8
Rate Base	2,963.0	2,963.0
Rate of Return	9.13	11.06

	-----1989-----	
	Present	Authorized
	-----	
	(Thousands of Dollars)	
Total Revenues	\$ 1,447.1	\$ 1,582.7
Operating Expenses		
Oper. & Maint.	579.0	579.6
Adm. & Gen.	94.3	94.3
Gen. Off. Alloc.	88.2	88.2
Depreciation	230.0	230.0
Other Taxes	83.9	84.6
State Franch. Tax	28.8	41.7
Federal Inc. Tax	65.9	107.2
Total	1,170.2	1,225.6
Net Oper. Revenue	276.9	357.1
Rate Base	3,225.1	3,225.1
Rate of Return	8.59	11.07

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requested \$400,000 in 1988 for the purchase of the computer. Staff recommends that the computer be excluded from rate base until actually purchased. The computer was included in rate base for purposes of the Bay, Calipatria, Clearlake, Santa Maria, Ojai and Simi Valley Districts. But SCWC's witness Romines testified that the company has just begun its competitive look at different computers. He stated that SCWC is anticipating ordering the computer in December or January, with delivery about 90 days thereafter. In the circumstances, we will disallow inclusion of the computer in rate base for purposes of this proceeding. SCWC is already recovering the cost of the yet-to-be purchased computer in the above six districts. It may request inclusion thereof in rate case filings for other districts in 1988.

SCWC requested \$100,000 in 1989 to expand its Customer Information System (CIS). Young testified that the system grew out of two Commission decisions ordering the company to upgrade its customer relations program in certain districts. Staff witness Hirsch conceded that a CIS would help customer relations; that most other large utilities have on-line data retrieval for customer accounting information, and that there is possibly a need for it. However, he stated, given the indefinite status of the computer replacement, SCWC does not have the capacity for additional terminals. He does not believe the CIS would be operative by 1989.

It is apparent that an effective CIS will depend upon the company's first securing and installing its mainframe computer. Thereafter, terminals would have to be installed in the various districts. The indefiniteness surrounding this general office rate base addition is a recurring theme and we believe that in view of the fact that these general office items - renovation, mainframe computer, and CIS, are not yet on line. There is inadequate justification for including them in rate base for the test year. SCWC will have adequate opportunity to include these general office rate base items in appropriate future rate case filings.



State Income Taxes

The staff state income tax calculation reflects the effect of Senate Bill 572, signed by the Governor on September 29, 1987, and which reduces the applicable tax rate from 9.6% to 9.3%.

Adopted Summary of Earnings

Our adopted summary of earnings shown below will reflect adoption of a 12.5% ROE for 1988, 1989, and 1990, subject to further orders of the Commission to change the ROE during the review of future rate cases involving other districts of SCWC; as well as the exclusion of the three general office rate base items discussed supra and the Coloma Treatment Plan expansion.

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Total	1,170.2	1,225.6
Net Oper. Revenue	276.9	357.1
Rate Base	3,225.1	3,225.1
Rate of Return	8.59	11.07

1986 Tax Reform Act

On September 10, 1987, the Commission issued D.87-09-026 relating to the effects of the 1986 Tax Reform Act on contributions in aid of construction (CIAC) and advances for construction (AIC).

In accordance with that decision, SCWC informed the staff on October 28, 1987, that it was choosing Method 5, as designated in that decision, as its method of handling the taxes affected by CIAC and AIC. This has been reflected in the Summaries of Earnings previously discussed.

Rate Design

In its proposed rates for 1988, 1989, and 1990, SCWC is requesting that the following tariff schedules be changed to reflect the increased revenue requirements:

<u>Schedule</u>	<u>Class of Service</u>
AC-1	General Metered Service
AC-2	General Flat Rate Service
AA-4	Private Fire Service

The service charge rates presently in effect under the General Metered Service tariff schedule were designed to recover approximately 23% of the fixed costs. The utility's proposal for the general metered service maintains that ratio.

The following tables show the effects of the utility-proposed increases and the staff bill analysis for the 5/8" x 3/4" meter for the respective years:

## PROPOSED CHANGE IN RATES

SoCal Water Co.

Arden-Cordova District

## SCHEDULE NO. AC-1, GENERAL METERED SERVICE

Description	1987		1988		1989		1990			
	Rates	Proposed Rates	Dollar Change	Percent Change	Proposed Rates	Dollar Change	Percent Change	Proposed Rates	Dollar Change	Percent Change
SERVICE CHARGE										
5/8" meter	\$3.50	\$4.20	\$ .70	10.53%	\$4.40	\$ .20	4.76%	\$4.40	\$ .00	.00%
3/4" meter	4.25	4.75	.50	11.76%	5.00	.25	5.26%	5.00	.00	.00%
1" meter	4.80	5.50	.70	14.58%	6.00	.50	9.09%	6.00	.00	.00%
1-1/2" meter	6.70	8.00	1.30	19.40%	9.00	1.00	12.50%	9.00	.00	.00%
2" meter	8.50	10.00	1.50	17.65%	11.00	1.00	10.00%	11.00	.00	.00%
3" meter	12.00	15.00	3.00	25.00%	18.00	3.00	20.00%	18.00	.00	.00%
4" meter	26.00	29.00	3.00	11.54%	31.00	2.00	6.90%	31.00	.00	.00%
6" meter	48.00	53.00	5.00	10.42%	54.00	1.00	1.89%	54.00	.00	.00%
8" meter	60.00	66.00	6.00	10.00%	68.00	2.00	3.03%	68.00	.00	.00%
COMMODITY CHARGE										
For all water, per CCF	.1730	.2156	.0426	24.62%	.2306	.0150	6.96%	.2418	.0112	4.86%

## BILL ANALYSIS - 5/8" meter

Monthly Usage CCF	1987		1988		1989		1990			
	Rates	Proposed Rates	Dollar Change	Percent Change	Proposed Rates	Dollar Change	Percent Change	Proposed Rates	Dollar Change	Percent Change
0	\$3.80	\$4.20	\$ .40	10.53%	\$4.40	\$ .20	4.76%	\$4.40	\$ .00	.00%
3	4.32	4.85	.53	12.22%	5.09	.25	5.05%	5.13	.05	.66%
10	5.53	6.36	.83	14.94%	6.71	.35	5.51%	6.82	.11	1.67%
25	8.13	9.59	1.47	18.03%	10.17	.58	6.00%	10.45	.28	2.75%
50	12.45	14.98	2.53	20.32%	15.93	.95	6.34%	16.49	.56	3.52%
100	21.10	25.76	4.66	22.09%	27.46	1.70	6.60%	28.58	1.12	4.08%
138 (avg.)	27.67	33.95	6.28	22.69%	36.22	2.27	6.69%	37.77	1.55	4.27%
200	38.40	47.32	8.92	23.23%	50.52	3.20	6.76%	52.76	2.24	4.43%
300	55.70	68.88	13.18	23.66%	73.58	4.70	6.82%	76.94	3.36	4.57%
400	73.00	90.44	17.44	23.89%	96.64	6.20	6.86%	101.12	4.48	4.64%
500	90.30	112.00	21.70	24.03%	119.70	7.70	6.55%	125.30	5.60	4.68%
1000	176.80	219.80	43.00	24.32%	235.00	15.20	6.92%	246.20	11.20	4.77%

As shown in the table for the General Metered Service, increases were applied to both the service charges and the commodity rates for 1988, 1989, and 1990.

On May 28, 1986, the Commission issued D.86-05-064 in OII 84-11-041, which established a water rate design policy.

That policy, among other things, established fixed costs as they relate to the service charges to be those direct costs that are necessary to provide customer access to water. These fixed costs were defined in the decision as:

1. Maintenance expense
2. Transmission and distribution expense
3. Customer account expense, excluding uncollectibles.
4. Administration and general expense
5. Rent expense
6. Depreciation expense
7. Property tax expense
8. Gross return on investment (rate base)\*

In the interest of balancing the utility's interest with customers' needs, the Commission established as a statewide goal the setting of a utility's service charge to recover up to 50% of its fixed cost.

The above described rate design policy applies only to the metered customers (about 9% of total customers). For the flat rate customers (91%), the rate increase should be equal to the percentage increase authorized by the Commission. Staff recommends that the utility be allowed to increase the rate for private fire protection as requested.

Staff recommends that the balance of the revenue recovery should be obtained from the metered services, and that the utility be allowed to recover approximately 23% of the maximum 50% of fixed

costs pursuant to the water rate design policy. This recommendation is reasonable and will be adopted.

### Complaints

SCWC keeps records of the complaints that it receives from customers. A tabulation of the complaints received over the last four years and the first quarter of 1987 is shown below, from staff Exhibit 16.

<u>Year</u>	<u>Billing</u>	<u>Pressure</u>	<u>Quality</u>	<u>Other</u>	<u>Main Leaks</u>
1983	81	6	90	18	3
1984	195	36	89	20	10
1985	12	27	81	9	9
1986	28	22	64	29	5
1987*	19	2	10	1	4

\*1987 data are for first quarter.

The utility classifies the complaints into several categories. The billing complaints include high bills, possible misreads of the meters, and billing errors. Some of these are caused by excessive use or leaks on the customer's premises, e.g., after the meter. Pressure complaints include high or low pressure at the customer's premises. These complaints are sometimes caused by reduced flow rather than just low pressure. The water quality complaints include complaints about the taste, odor, and appearance (e.g., dirt or color) of the water, and sometimes include suspected problems where there is no physical evidence. Any complaints that cannot be classified into the above categories are listed under the "Other."

The number of complaints is relatively constant except for billing complaints in 1984. Staff states that the records of complaints in the district office showed that the utility personnel and the district manager went to a great deal of effort to resolve complaints and talk to the customers about problems and perceived problems. In addition, the utility personnel would in some cases change the customer's gate valves if the customer provided the

replacement part. This courtesy valve replacement is more than the usual turning off of the water service to the customer so that a plumber could effect repairs to the customer piping.

Customer Relations Program

Commission D.86-10-025 issued October 1, 1986, in conjunction with the rate applications for Barstow, Desert, Metropolitan, San Bernardino, and Pomona Valley Districts included an order requiring SCWC to prepare a plan for the augmentation of its maintenance program and for the improvement of its public relations program for these districts. The next decision, D.87-04-069, ordered SCWC to include in the public relations program the following six districts: Santa Maria, Ojai, Simi Valley, Clearlake, Bay, and Calipatria-Niland.

Realizing that inadequate public relations was not limited to those districts, SCWC has taken the initiative to develop a public relations program for the entire company. SCWC expanded the program with the public relations firm that they had been using. In addition, SCWC hired another firm to survey all of the customers with a "report card" type of grading form to initially determine customer perceptions. The results of this survey were compiled in graphical form and are being used to develop a public relations program. SCWC sends periodic reports of its public relations program to the Commission staff.

SCWC is stepping up public relations activities, and in time the results should be appreciable. SCWC has a preliminary plan for a customer information department which would provide up-to-date customer account information and provide a convenient method for customers to report problems. A customer information department may provide a method for the ratepayers to contact the utility and receive service with a minimum of frustration.

This department was scheduled in the 1989 budget for the general office. Since the plans for the general office are running behind schedule and the method of operation and relaying

### Balancing Accounts

In July 1987 SCWC provided the recorded June 1987 balances in its balancing account set up pursuant to Public Utilities Code Section 792.5. The balance as of June 30, 1987, was \$152,619 undercollections or 11% of the gross annual revenue for Arden-Cordova.

In accordance with established Commission procedures recorded balances exceeding 5% of gross annual revenues should be amortized over a two-year period. Accordingly, the appropriate surcharge has been included in Appendix A.

In accordance with Public Utilities Code Section 311, as amended by Assembly Bill 3383, the ALJ's proposed decision was mailed to appearances on November 16, 1987. Comments were received from the staff concerning our adopted return on equity of 12.5% for the Arden-Cordova, San Gabriel Valley, and Wrightwood Districts. Nothing in the comments persuades us that the proposed decisions should be changed in this regard.

### Findings of Fact

1. The Coloma Treatment Plant expansion, scheduled for completion in 1989, should not be included in rate base at this time. An advice letter filing to cover this expansion should be authorized by this order.
2. The requests by SCWC for general office rate base increase - renovation, mainframe computer, and CIS - are not reasonable at this time because plans for and assurance of their completion are indefinite. Their inclusion in rate base should not be allowed until they are completed, at which time SCWC may submit an advice letter filing to cover such costs.
3. The prime lending rate has increased since submission of this proceeding.
4. Under the circumstances discussed herein under "Rate of Return," a constant ROE of 12.5% will afford SCWC adequate



# **CORRECTION**

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information to the districts is not complete, this may be delayed to 1990 or later until the plans are fully developed. (See discussion under General Office - Rate Base.)

Attrition Allowance

An attrition allowance is needed when increases in revenues and productivity to offset increases in expenses (including the effects of cost of capital) are insufficient, thereby causing a decline in the rate of return for the following year. Attrition consists of two parts: financial and operation. Financial attrition occurs when there is a change in the utility's cost of capital. Operational attrition is the result of changes in operating categories, e.g., revenues, expenses, and rate base.

For the third year, an attrition allowance should be granted for the operational attrition at the newly authorized rates from the adopted summary of earnings for 1988 and 1989. The slippage in rates of return for the respective years is projected into the third year.

The financial attrition allowance is noted in the report on the cost of capital and rate of return.

On or after October 30, 1989, the utility should be authorized to file an advice letter, with appropriate workpapers, in its request for the attrition increase, or file for a lesser or greater increase in the event that the rate of return on rate base adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ending September 30, 1989, differs from the rate of return adopted in this proceeding or a then-current rate of return adopted for another district of this utility, whichever is later. Such a filing should comply with General Order 96-A. The staff shall inform the Commission if it finds that the proposed attrition rate increase is not in accordance with current Commission practices, and the Commission may then modify the increase.

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3. The prime lending rate has increased since submission of this proceeding.

4. Under the circumstances discussed herein under "Rate of Return," a constant ROE of 12.5% will afford SCWC adequate

opportunity to earn a fair rate of return during the period 1988-1990, subject to further orders of the Commission to change the ROE during the review of future rate cases involving other districts of SCWC.

5. The rate design recommended by the staff is reasonable.

6. The revenue requirement increase for attrition year 1990 is estimated to be \$37,000.

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

Conclusions of Law

1. Revenue increases of \$100,900 or 7.3% in 1988, \$56,900 or 3.5% in 1989, and \$37,000 or 2.3% in 1990 are reasonable based upon our adopted results of operations for this district.

2. SCWC should not be allowed to include the Coloma Treatment Plant expansion cost, nor the costs for general office relating to renovation, mainframe computer, and CIS until these items are completed and in use.

3. SCWC should be authorized to file the rate schedules attached as Appendixes A and B, as specified in the following order.

4. This order should be effective today to meet SCWC's need for rate relief.

ORDER

IT IS ORDERED that:

1. Southern California Water Company (SCWC) is authorized to file for its Arden-Cordova District, effective January 1, 1988, the revised rate schedules in Appendix A. The filing shall comply with General Order (GO) 96-A. The revised schedules shall apply only to service rendered on and after their effective date.

2. On or after November 15, 1988, SCWC is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases attached to this order as Appendix B, or to file a proportionate lesser or greater increase which includes a uniform cents per 100 cubic feet of water adjustment from Appendix B in the event that the Arden-Cordova District rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ending September 30, 1988, differs from the later of (a) the rate of return found reasonable by the Commission for SCWC during the corresponding period in the then most recent rate decision, or (b) 11.07%. This filing shall comply with GO 96-A. The requested step rates shall be reviewed by the staff to determine their conformity with this order and shall go into effect upon the staff's determination of conformity. But the staff shall inform the Commission if it finds that the proposed step rates are not in accord with this decision, and the Commission may then modify the increase. The effective date of the revised schedule shall be no earlier than January 1, 1989, or 30 days after the filing of the step rate, whichever is later. The revised schedule shall apply only to service rendered on and after its effective date.

3. On or after November 15, 1989, SCWC is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases attached to this order as Appendix B, or to file a proportionate lesser or greater increase which includes a uniform cents per hundred cubic feet of water adjustment from Appendix B in the event that the Arden-Cordova District rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ending September 30, 1989, differs from the later of (a) the rate of return found reasonable by the Commission for SCWC during the corresponding period in the then most recent rate decision, or (b) 11.09%. Such filing shall comply with GO 96-A. The requested step rates shall be reviewed by

the staff to determine their conformity with this order and shall go into effect upon the staff's determination of conformity. But the staff shall inform the Commission if it finds that the proposed step rates are not in accord with this decision, and the Commission may then modify the increase. The effective date of the revised schedule shall be no earlier than January 1, 1990, or 30 days after the filing of the step rates, whichever is later.

4. SCWC is authorized to make an advice letter filing for the cost of the general office renovation, mainframe computer, and customer information system, and for the Coloma Treatment Plant expansion, subject to approval by the staff, after these projects are completed and in operation.

This order is effective today.

Dated December 17, 1987, at San Francisco, California.

STANLEY W. HULETT  
President  
DONALD VIAL  
FREDERICK R. DUDA  
G. MITCHELL WILK  
JOHN B. OHANIAN  
Commissioners

I CERTIFY THAT THIS DECISION  
WAS APPROVED BY THE ABOVE  
COMMISSIONERS TODAY.

  
Victor Weiss, Executive Director

## APPENDIX A

Page 1

Southern California Water Co.  
Arden-Cordova District

## SCHEDULE NO. AC-1

## GENERAL METERED SERVICE

Applicability

Applicable to all general metered water service.

Territory

Arden Manor area located approximately six miles northeast of Sacramento and Rancho Cordova and vicinity, Sacramento County.

Rates

Service Charge:		Per Meter Per Month*
		-----
For 5/8 x 3/4-inch meter.....	\$	4.00 (I)
For 3/4-inch meter.....		4.40 :
For 1-inch meter.....		5.00 :
For 1 1/2-inch meter.....		7.00 :
For 2-inch meter.....		9.00 :
For 3-inch meter.....		12.50 :
For 4-inch meter.....		27.00 :
For 6-inch meter.....		50.00 :
For 8-inch meter.....		63.00 (I)

## Quantity Rates:

For all water delivered, per 100 cu.ft..... .176 (I)

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

Special Condition

1. Due to the undercollection in the balancing account, an amount of \$0.014 per Ccf is to be added to the quantity rates as shown above until twenty-four months from the effective date of this filed tariff to amortize the undercollection.

\* All rates are subject to the reimbursement fee set forth on schedule No. UF.

APPENDIX A  
Page 2Southern California Water Co.  
Arden-Cordova District

## SCHEDULE NO. AC-2

## FLAT RATE SERVICE

Applicability

Applicable to all flat water service.

Territory

Arden Manor area located approximately six miles northeast of Sacramento and Rancho Cordova and vicinity, Sacramento County.

RatesPer Service  
Connection  
Per Month\*  
-----

- |  |             |
|--|-------------|
| 1. For each single unit of occupancy, including premises not exceeding 12,000 sq. ft. in area.....   | \$ 8.45 (I) |
| 2. For a duplex including premises not exceeding 12,000 sq. ft. in area.....   | 16.90 (I)   |
| 3. For each additional detached unit of occupancy on the same premises and served from the same service connection .....                   | 8.45 (I)    |
| 4. For each swimming pool equipped with recirculating filter system, on the same premises and served from the same service connection..... | 2.00 (I)    |

Special Condition

1. Due to the undercollection in the balancing account, an amount of \$0.45 and \$0.90 is to be added to the monthly rate for single units (including detachments) and duplexes, respectively, as shown above until twenty-four months from the effective date of this filed tariff to amortize the undercollection.

\* All rates are subject to the reimbursement fee set forth on schedule No. UF.



APPENDIX A  
Page 3Southern California Water Co.  
All Districts

## SCHEDULE NO. AA-4

## PRIVATE FIRE SERVICE

Applicability

Applicable to all water service furnished to private fire systems and to private fire hydrants.

Territory

- Rate A - Applicable within the Arden-Cordova, Bay, Calipatria- (T)  
Niland, Clearlake, Los Osos, Metropolitan, Ojai, San (T)  
Gabriel Valley, and Wrightwood Districts. (T)
- Rate B - Applicable within the Barstow, Big Bear, Desert, Orange  
County, Pomona Valley, San Dimas, Santa Maria, and  
Simi Valley Districts.

RatesPer Month

	A	B
For each inch of diameter of service connection	\$ 4.00	\$ 3.00

(End of Appendix A)

APPENDIX B-  
Arden-Cordova District

Each of the following increases in rates may be put into effect on the indicated date by filing a rate schedule which adds the appropriate increase to the rate which would otherwise be in effect on that date.

Effective Dates  
1-1-89      1-1-90

Schedule AC-1 General Metered Service

Service Charge:

Per Meter Per Month

For 5/8 x 3/4-inch meter.....	\$ .10	\$ .10
For 3/4-inch meter.....	.10	.10
For 1-inch meter.....	.10	.10
For 1 1/2-inch meter.....	.15	.15
For 2-inch meter.....	.20	.20
For 3-inch meter.....	.30	.30
For 4-inch meter.....	1.00	1.00
For 6-inch meter.....	1.00	1.00
For 8-inch meter.....	1.00	1.00

Quantity Rates:

For all water delivered, per 100 cu.ft	.005	.003
--	------	------

Schedule AC-2 General Flat Rate Service

1. For each single unit of occupancy, including premises not exceeding 12,000 sq. ft. in area.....	.20	.15
2. For a duplex including premises not exceeding 12,000 sq. ft. in area.....	.40	.30
3. For each additional detached unit of occupancy on the same premises and served from the same service connection .....	.20	.15
4. For each swimming pool equipped with recirculating filter system, on the same premises and served from the same service connection.....	.00	.00

(End of Appendix B)

APPENDIX C  
Page 1

Southern California Water Company  
Arden-Cordova District

Adopted Quantities  
-----

<u>PURCHASED POWER</u>	<u>1988</u>	<u>1989</u>
Supplier: SMUD 3/87 PG&E 1/87		
Wells:		
Total Production (KCcf)	4865.3	5063.9
Kwh per CCF	0.898	0.898
Total Kwh (1000)	4365.8	4544.0
SMUD Kwh (1000)	3974.2	4136.6
Unit Cost \$/kwh	0.05373	0.05363
Total SMUD Energy Cost	\$213,533	\$221,845
Pyrites Well Kwh (1000)	391.6	407.5
Pyrites Cost	\$0	\$0
Energy Cost	\$213,533	\$221,845
Boosters:		
Total Production (KCcf)	5422.4	5621.0
Kwh per CCF	0.094	0.094
Total Kwh (1000)	511.4	530.1
Unit Cost \$/kwh	0.05373	0.05363
Energy Cost	\$27,478	\$27,432
Gas (Total Therms):	10888	11287
PG&E Cost \$/therm	0.56558	0.56561
Total Gas Cost	\$6,158	\$6,384
Total Purchased Power	\$247,169	\$255,661
Total Chemical Cost	\$25,500	\$25,500

## APPENDIX C

Page 2

Southern California Water Company  
Arden-Cordova District

## Adopted Quantities

Number of Services by Meter Size		1988	1989		
-----		----	----		
Schedule AC-1					
5/8 x 3/4		19	24		
3/4		81	86		
1		302	332		
1 1/2		70	75		
2		438	458		
3		58	60		
4		12	12		
6		9	9		
8		9	9		
		-----	-----		
TOTAL		998	1,065		
TOTAL CCF		1,709,500	1,820,300		
No. of Services		Usage (Kccf)		Avg. Usage Ccf/Yr	
1988 1989		1988 1989		1988 1989	
-----		-----		-----	
Commercial Met.	973 1,040	1609.4	1720.3	1654.1	1654.1
Industrial					
Public Auth.	25 25	100.0	100.0	4001.9	4001.9
Other					
		-----			
Total Metered	998 1,065	1709.4	1820.3		
Flat Rate	9,253 9,453	3208.0	3277.4	346.7	346.7
Private Fire Prot.	275 305				
		-----			
Total	10,526 10,823	4917.5	5097.7		
Water Loss: 8.9%		481.5	500.0		
Oper. Usage		23.4	23.4		
		-----			
Total Water Produced		5422.4	5621.0		
Number of Flat Rate Services		1988	1989		
-----		----	----		
Single Unit		8264	8464		
Duplex		292	292		
Single Unit with Swimming Pool		696	696		
Single Unit with Additional Unit		1	1		
		-----	-----		
Total		9253	9453		

## APPENDIX C

Page 3

## Arden-Cordova District

## Utility Plant, Depreciation Reserve, and Rate Base

	1988 -----	1989 -----
	(Thousands of Dollars)	
UTILITY PLANT		
Plant BOY	\$ 12,571.2	\$ 13,393.7
Utility Add.	626.3	345.9
Advances	141.9	257.4
Contributions	59.4	81.9
Total Additions	827.6	685.2
Retirement	5.1	4.2
Plant EOY	13,393.7	14,074.7
Wgt.Plant @ 38.1%	424.1	259.5
Wgt.Avg. Plant	12,995.3	13,653.2
DEPRECIATION RESERVE		
Reserve BOY	2,175.3	2,412.9
Contrib.	17.9	23.4
Depr Exp. (1.92%)	222.8	230.0
Clear.Chg.	2.0	2.0
Total Accrual	242.7	255.4
Retirement	5.1	4.2
Reserve EOY	2,412.9	2,664.1
Wgt.Accr.@ 50%	118.8	125.6
Wgt.Avg.Deprec.Reserve	2,294.1	2,538.5
RATE BASE		
Utility Plant	12,995.3	13,653.2
Material & Sup.	6.9	6.9
Work.Cash Allow.	-145.1	-155.1
Depreciation Reserve	-2,294.1	-2,538.5
Advances For Constr.	-5,953.3	-5,984.9
Contributions-in-Aid	-759.2	-809.2
Gen.Office Alloc.	75.5	86.5
Unamort.Defer.Taxes	-728.1	-854.1
Unamort.ITC	-319.7	-312.9
CIAC FTC	81.5	130.0
Capit.Items	3.2	3.2
Avg RATE BASE	2,963.0	3,225.1

## APPENDIX C

Page 4

## Arden-Cordova District

## Income Tax Calculations

	1988	1989
	-----	-----
	(Thousands of Dollars)	
Total Revenues	\$ 1,490.9	\$ 1,582.7
Purch. Power	247.2	256.7
Purch. Water	.0	.0
Pump Tax	.0	.0
Purch. Chem	25.5	25.5
Payroll	179.3	189.2
OM Other	106.8	112.7
AG Other	25.9	26.5
Pension	25.1	26.5
Inj. Damage	28.7	30.2
Gen. Office Alloc.	84.3	88.2
Payroll Tax	13.2	13.9
Ad Valorem Taxes	59.0	63.0
Uncoll. .00418	6.2	6.6
Loc. Franch. .00489	7.3	7.7
subtotal	808.5	846.7
Interest	142.7	155.5
Total Deductions	951.2	1,002.2
State Tax Deprec.	138.8	145.8
State Tax 9.3	38.5	41.7
Federal Tax Deprec.	226.8	223.4
Fed Tax 34%	93.3	107.2
Total Federal Taxes	93.3	107.2
Net/Gross	1.685800	

(End of Appendix C)

APPENDIX D  
Page 1  
Arden-Cordova District

Comparison of typical bills for commercial metered customers of various usage level and average usage level at present and authorized rates for the year 1988.

General Metered Service (5/8 x 3/4) Inch Meters

: Monthly Usage:	At Present	:At Authorized :	Percent	:
: (Cubic Feet):	Rates	: Rates	: Increase	:
300	\$ 4.32	\$ 4.53	4.8 %	
500	4.67	4.88	4.6	
1,000	5.53	5.76	4.2	
2,000	7.26	7.52	3.6	
3,000	8.99	9.28	3.2	
5,000	12.45	12.80	2.8	
10,000	21.10	21.60	2.4	
13,784 (Avg.)	27.65	28.26	2.2	
20,000	38.40	39.20	2.1	

APPENDIX D  
Page 2  
Arden-Cordova District

Comparison of typical bills for residential flat rate customers of various classes at present and authorized rates for the year 1988.

Flat Rate Service

	<u>At Present Rates</u>	<u>At Authorized Rates</u>	<u>Percent Increase</u>
1. For each single unit of occupancy including premises not exceeding 12,000 sq. ft. in area.....	\$ 7.90	\$ 8.45	7.0%
2. For a duplex including premises not exceeding 12,000 sq. ft. in area.....	15.80	16.90	7.0
3. For each additional detached unit of occupancy on the same premises and served from the same service connection.....	4.00	8.45	111.2
4. For each swimming pool equipped with recirculating filter system, on the same premises and served from the same service connection.....	2.00	2.00	0.0

(End of Appendix D)



State Income Taxes

The staff state income tax calculation reflects the effect of Senate Bill 572, signed by the Governor on September 29, 1987, and which reduces the applicable tax rate from 9.6% to 9.3%.

Adopted Summary of Earnings

Our adopted summary of earnings shown below will reflect adoption of a 12.5% ROE for 1988, 1989, and 1990, as well as the exclusion of the three general office rate base items discussed supra and the Coloma Treatment Plan expansion.

information to the districts is not complete, this may be delayed to 1990 or later until the plans are fully developed. (See discussion under General Office - Rate Base.)

Attrition Allowance

An attrition allowance is needed when increases in revenues and productivity to offset increases in expenses (including the effects of cost of capital) are insufficient, thereby causing a decline in the rate of return for the following year. Attrition consists of two parts: financial and operation. Financial attrition occurs when there is a change in the utility's cost of capital. Operational attrition is the result of changes in operating categories, e.g., revenues, expenses, and rate base.

For the third year, an attrition allowance should be granted for the operational attrition at the newly authorized rates from the adopted summary of earnings for 1988 and 1989. The slippage in rates of return for the respective years is projected into the third year.

The financial attrition allowance is noted in the report on the cost of capital and rate of return.

On or after October 30, 1989, the utility should be authorized to file an advice letter, with appropriate workpapers, in its request for the attrition increase, or file for a lesser increase in the event that the rate of return on rate base adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ending September 30, 1989, exceeds the rate of return adopted in this proceeding or a then-current rate of return adopted for another district of this utility, whichever is later. Such a filing should comply with General Order 96-A. The staff shall inform the Commission if it finds that the proposed attrition rate increase is not in accordance with current Commission practices, and the Commission may then modify the increase.

Balancing Accounts

In July 1987 SCWC provided the recorded June 1987 balances in its balancing account set up pursuant to Public Utilities Code Section 792.5. The balance as of June 30, 1987, was \$152,619 undercollections or 11% of the gross annual revenue for Arden-Cordova.

In accordance with established Commission procedures recorded balances exceeding 5% of gross annual revenues should be amortized over a two-year period. Accordingly, the appropriate surcharge has been included in Appendix A.

Findings of Fact

1. The Coloma Treatment Plant expansion, scheduled for completion in 1989, should not be included in rate base at this time. An advice letter filing to cover this expansion should be authorized by this order.
2. The requests by SCWC for general office rate base increase - renovation, mainframe computer, and CIS - are not reasonable at this time because plans for and assurance of their completion are indefinite. Their inclusion in rate base should not be allowed until they are completed, at which time SCWC may submit an advice letter filing to cover such costs.
3. The prime lending rate has increased since submission of this proceeding.
4. Under the circumstances discussed herein under "Rate of Return," a constant ROCE of 12.5% will afford SCWC adequate opportunity to earn a fair rate of return during the period 1988-1990.
5. The rate design recommended by the staff is reasonable.
6. The revenue requirement increase for attrition year 1990 is estimated to be \$37,000.

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In accordance with established Commission procedures recorded balances exceeding 5% of gross annual revenues should be amortized over a two-year period. Accordingly, the appropriate surcharge has been included in Appendix A.

In accordance with Public Utilities Code Section 311, as amended by Assembly Bill 3383, the ALJ's proposed decision was mailed to appearances on November 16, 1987. Comments were received from the staff concerning our adopted return on equity of 12.5% for the Arden-Cordova, San Gabriel Valley, and Wrightwood Districts. Nothing in the comments persuades us that the proposed decisions should be changed in this regard.

Findings of Fact

1. The Coloma Treatment Plant expansion, scheduled for completion in 1989, should not be included in rate base at this time. An advice letter filing to cover this expansion should be authorized by this order.
2. The requests by SCWC for general office rate base increase - renovation, mainframe computer, and CIS - are not reasonable at this time because plans for and assurance of their completion are indefinite. Their inclusion in rate base should not be allowed until they are completed, at which time SCWC may submit an advice letter filing to cover such costs.
3. The prime lending rate has increased since submission of this proceeding.
4. Under the circumstances discussed herein under "Rate of Return," a constant ROCE of 12.5% will afford SCWC adequate

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

Conclusions of Law

1. Revenue increases of \$100,900 or 7.3% in 1988, \$56,900 or 3.5% in 1989, and \$37,000 or 2.3% in 1990 are reasonable based upon our adopted results of operations for this district.

2. SCWC should not be allowed to include the Coloma Treatment Plant expansion cost, nor the costs for general office relating to renovation, mainframe computer, and CIS until these items are completed and in use.

3. SCWC should be authorized to file the rate schedules attached as Appendixes A and B, as specified in the following order.

4. This order should be effective today to meet SCWC's need for rate relief.

ORDER

IT IS ORDERED that:

1. Southern California Water Company (SCWC) is authorized to file for its Arden-Cordova District, effective January 1, 1988, the revised rate schedules in Appendix A. The filing shall comply with General Order (GO) 96-A. The revised schedules shall apply only to service rendered on and after their effective date.

2. On or after November 15, 1988, SCWC is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases attached to this order as Appendix B, or to file a proportionate lesser increase which includes a uniform cents per 100 cubic feet of water adjustment from Appendix B in the event that the Arden-Cordova District rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking

opportunity to earn a fair rate of return during the period 1988-1990.

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This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.

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This order is effective today.

Dated DEC 17 1987, at San Francisco, California.

STANLEY W. HULETT  
President  
DONALD VIAL  
FREDERICK R. DUDA  
G. MITCHELL WILK  
JOHN B. OHANIAN  
Commissioners