

Decision 90 07 057

JUL 18 1990

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Alisal Water Corporation
for authority (1) to include the area
formerly served by Moss Landing Harbor
District in its service area and (2) to
establish rates for service.

(U-206-W)

Application 88-06-011
(Filed June 10, 1988)

ORIGINAL

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O P I N I O N

Application

Alisal Water Corporation (Alisal) filed this application for authority to include the Moss Landing Harbor District's (Harbor District) water system in Alisal's public utility service area and for authority to establish rates for service.

Alisal, doing business as Alco Water Service (Alco), is an established public utility serving water to approximately 4,300 customers in Monterey County. Its primary service area encompasses the eastern portion of the City of Salinas. It also owns and operates satellite water systems serving approximately 1,200 customers in the rural areas of Monterey County.

The Harbor District, a public corporation, whose primary function is to maintain and operate the harbor and the berthing of boats at Moss Landing in Monterey County has entered into an agreement to sell and to transfer its water system to Alco.

Customers of the water system were notified of this application by a bill insert. No protest letters were received by the Harbor District, Alco, or the Commission. However, the Commission Advisory and Compliance Division's Water Utilities Branch (Water Branch) opposed the application. Therefore, an evidentiary hearing was held in San Francisco before Administrative Law Judge (ALJ) Galvin on August 7, 1989. Robert Adcock and John Gibbons testified for Alco. Donald McCrea testified for the Water Branch. Alco sponsored six exhibits into the record and Water Branch sponsored one exhibit, all of which are received into evidence. The proceeding was submitted on September 11, 1989.

Water System

The water system is situated approximately 12 miles west of Alco's major service area, and four miles due west of three of its satellite systems in the Prunedale area of Monterey County. The system has over 100 active service connections. Approximately

69 metered customers are in the Moss Landing Harbor area and 59 metered customers in the adjacent Moss Landing Heights area.

The original Moss Landing water system constructed in 1962 provides water to the harbor area. In 1965, the water system was extended to provide water to the Moss Landing Heights Mutual Water System (Heights) in the adjacent Moss Landing Heights area. The Heights is a residential development which owns its own distribution mains and meters.

The water supply is obtained from a 12-inch well, located on Dolan Road. The well is 850 feet deep and is sealed down to the 400-foot level. It is equipped with a 75 hp submersible turbine pump which produces 500 gallons per minute (gpm), at 75% of capacity.

The average system demand is 45 gpm with a maximum demand of 81 gpm. Additional water is available from a well owned by National Refractories Corporation. This back-up well is 1,000 feet deep with a 400-foot seal and a production of 800 gpm and is available pursuant to a mutual benefit lease agreement between Alco and National Refractories Corporation, attached to the application.

Water storage is provided by a 100,000-gallon elevated tank located on a hill south of the harbor area, and in close proximity to the main service area.

There are 18 fire hydrants on the system, ten of which are wharf hydrants. The system's combined well and storage is capable of producing 1,300 gpm for a two-hour period. The majority of mains are eight-inch asbestos-cement pipe. Except in the Heights area where the fire flow capacity is limited by the small mains serving the area, the system is capable of delivering over 2,500 gpm and meeting General Order 103 fire flow requirements.

Applicant represents that the system is in good condition. However, it acknowledges that the following deficiencies exist:

1. Fire protection on the "island" needs to be improved.

2. Exposed portions of mains need painting.
3. The interior and exterior of the storage tank needs to be painted.
4. The Heights distribution system needs to be replaced.

Reason for Sale

Adcock testified that the Harbor District first approached Alco to determine whether Alco was interested in acquiring the system. Although the system was efficiently managed, it was too small to be economically viable by itself. The Harbor District found it to be a drain on its resources because it required a continuing subsidy from other Harbor District activities. Also, the Harbor District was aware that the storage tank needed painting and that funds for this were not available.

There are no public utility water companies in the vicinity of Moss Landing with which the system is likely to compete. The nearest water system is Castroville Water District which has indicated that it has no desire to serve the Moss Landing area.

Alco acquired the system because it believes that its full-time maintenance crews, office personnel, and billing system can operate the system at a lower cost than the Harbor District has operated it.

Sales Agreement

Alco entered into an agreement with the Harbor District to acquire the Harbor District's water system on February 9, 1988, four months prior to the filing of this application.

The terms of the agreement provided for Alco to pay the Harbor District \$100 for the system in its present condition and with the knowledge that the system is in need of major repair and renovation. It also provided for Alco to make available 374,000 gallons of water per month to the Harbor District for use on Harbor District's docks, boat ramps, and office facilities, at no cost to

the Harbor District. The water is to be provided from the well being sold to Alco and is scheduled to continue so long as the well has the production capacity to provide the system's needs in an economical and efficient manner. Additional provisions give the Harbor District an option to share the cost of implementing a new water source should one be needed.

In return, Alco received the Harbor District's water business consisting of one well and well lot approximately 100' by 100', one deep well submersible pump, one 100,000-gallon water storage tank and tank lot approximately 70' by 70', the complete water distribution system of the Harbor District, 106 metered water services, all fire hydrants, approximately four miles of eight-inch steel transmission water main, and the Harbor District's inventory of supplies and equipment pertaining to its water system.

Heights Water Service

Prior to 1965, the Heights obtained water from its own well. However, because of salt water intrusion into the well, the Heights petitioned the Harbor District for water service. A service agreement was reached between the Heights and the Harbor District which provided for the Heights to receive water from the Harbor District through a master meter connected to the Heights existing mains. This agreement was renewable on a unspecified periodic basis.

Subsequent to the service agreement, the Heights installed meters for each of its members and made arrangements with the Harbor District so that the Harbor District would read the individual meters and bill Heights members individually. The Heights still owns its own mains and meters and is still responsible for maintaining its own transmission system.

The Heights mains are in poor condition. They are undersized and do not meet American Water Works Association (AWWA) standards. Alco does not propose to obtain title to the Height's system or to assume any responsibility for repairs or maintenance

to the Heights system. However, as a "good neighbor" Alco intends to handle routine maintenance and repairs without cost to the Heights homeowners.¹ Alco intends to add the following "Special Condition" to its Moss Landing tariff:

"Water as well as billing and collection services will be provided to customers in Moss Landing Heights under contract and through the water distribution system of the Moss Landing Heights Mutual Water Company at the same rates and under the same conditions as the Moss Landing water system except that the mutual water company will continue to be responsible for the maintenance, repair, and replacement of mains, services, meters, hydrants, and other water distribution facilities. Alco accepts no responsibility for maintenance, repair, or replacement of water plant owned by the Moss Landing Heights Mutual Water Company."

McCrea explained in his direct testimony that the Heights mutual association was an active organization until the early 1980s. Members were charged annual dues for the purpose of covering repair work on the association's mains and meters. However, since 1984 the Heights association has been inactive. Its former president, and Harbor District Board Commissioner, Mr. Green, has assumed responsibility for maintaining the association.

Water Branch recommends that Alco and the Heights Association be required to submit a written agreement to the Water Branch clarifying the ownership rights of the Heights mains and meters.

Alco's and Water Branch's testimony on the ownership of the Heights mains and meters substantiate that there is no dispute that the Heights' mains and meters are owned by the Heights.

¹ Alco will treat routine maintenance and repair costs as an operating expense, and will bill the Heights members the same rate that Alco bills its public utility customers.

Therefore, Water Branch's recommendation that Alco and Heights clarify the ownership rights of the Heights mains and meters to the Water Branch need not be required. Alco's special tariff language pertaining to the Heights is reasonable and should be adopted. Alco should be required to notify each of its customers of this special tariff condition within 30 days from the effective date of this decision.

Although we are authorizing the special tariff provision for Heights customers, we are concerned that Alco does not intend to serve the Heights as a public utility, particularly in the face of needed repairs and improvements to Heights antiquated system. Alco has good intentions to meet with Heights members to attempt to have the Heights members work out a piecemeal replacement of the most critical sections of the Heights distribution system. However, as Adcock testified, the Heights is not an active organization. We are also disturbed that Heights members may not even realize that they are a mutual water company, particularly since each member has been billed for water usage based on an individual meter for a number of years, and since the sales agreement between Alco and the Harbor District provides for the sale and transfer of 106 metered services, a portion of which represent Heights services.²

For the above-mentioned reasons, Alco should explore with Heights members the feasibility of acquiring the Heights as part of Alco's public utility system and obtain the necessary funds, through the Safe Drinking Water Bond Act or other means, to bring the Heights system up to AWWA standards. Irrespective of whether the Heights becomes a part of Alco's public utility system, Alco

2 By ALJ examination, Adcock confirmed that the 106 metered services identified in the sales agreement included Heights metered customers.

should encourage the Heights to upgrade their system to AWWA standard prior to any extension of Alco's service area within and/or adjacent to the Moss Landing Harbor area. Alco should file a report on its efforts to acquire the Heights system and to encourage upgrade of the Heights system with the Water Branch within 120 days from the effective date of this decision.

Rate Base

The application provided no information on the system's original cost or how Alco intended to record this acquisition. However, Alco did provide testimony on this matter at the evidentiary hearing.

Alco's Rate Base

Alco proposes to record this acquisition based on the Harbor District's original cost of the plant, pursuant to the acquisition method prescribed by the Commission's Uniform System of Accounts for Class A Water Utilities. Although recorded rate base is the established method to set and to measure the reasonableness of rates and reasonableness of return on investment for water utilities, Adcock recommends that we use innovative ideas to establish Alco's water utilities rates, as explained in the rates section of this decision.

Gibbons recommends that the following journal entry be recorded in Alco's books of account to represent the true and correct cost figures of the water system as of December 31, 1988³:

³ Alco actually acquired the Harbor District's water system on February 9, 1988, the date of escrow closing.

<u>Description</u>	<u>Debit</u>	<u>Credit</u>
Water Plant in Service	\$367,200	\$
Accumulated Depreciation		121,130
Contribution-in-aid-of-construction		56,070
Acquisition Adjustment		185,000
Liability for Future Water Deliveries to Harbor District		5,000

Alco extrapolated the \$367,200 water plant in service amount from the Harbor District's accounting records. This amount is comprised of construction activity during three specific time periods. Detailed construction activity is shown in column 1 of Appendix B to this order, and summarized below.

<u>Date</u>	<u>Activity</u>	<u>Amount</u>
1962	Initial Construction	\$ 218,863
1979	Heights Extension	86,662
1983	Main Relocation Due To Highway Construction	<u>61,680</u>
	Total Plant In Service	\$ 367,205 ⁴

Alco's \$121,130 accumulated depreciation is based on the remaining life expectancy of individual plant components pursuant to Standard Practice U-4 (U-4), "Determination of Straight-Line Remaining Life Depreciation Accruals." Consistent with Alco's need to reconstruct the amount of water plant in service because the Harbor District's accounting records were maintained by a governmental fund accounting basis, Alco used the U-4 to calculate

⁴ There is a \$5 difference between the plant amount testified by Adcock and the amount shown in the detail plant schedule due to rounding of numbers.

accumulated depreciation. The \$56,070 contribution-in-aid-of-construction (contribution) amount represents the amount of funds net of amortization that the Harbor District received from California Department of Transportation (Caltrans) for relocating water mains due to 1983 highway construction.

The liability for future water deliveries to the Harbor District is derived from the application of a formula which measures the value of metered water delivered to the Harbor District in relationship to total metered water delivered throughout the system, and reflects power costs, incidental costs, and the remaining life of the well.

The acquisition adjustment represents the difference between the original plant in service amount and the amounts distributed to accumulated depreciation, contribution, and liability for future water deliveries to the Harbor District.

Water Branch's Recommended Rate Base

Water Branch concurs with Alco's requested utility plant in service and accumulated depreciation amounts.⁵ However, Water Branch disagrees with Alco's liability for water delivery to the Harbor District and the acquisition adjustment because Water Branch believes that the water system has already been paid for from public funds collected by the Harbor District.

Water Branch places a \$40,131 present worth value on future water deliveries to the District. For future rate proceedings, Water Branch recommends that the value of free water delivered to the District be inputed as a component of operating revenue.

⁵ Although Water Branch concurs with Alco's accumulated depreciation amount, Water Branch's \$131,130 amount used in its prepared testimony is \$10,000 higher than the \$121,130 amount that Alco uses in its testimony.

Water Branch proposes to allow Alco \$2,100 in net rate base with the balance of the difference to be recorded as contributions. Water Branch's rate base consists of the \$100 purchase price and a \$2,000 working cash allowance, as developed from the revised simplified working cash allowance method approved on January 27, 1989.

Water Branch asserts that if Alco's rate base is allowed, the ratepayers will be required to pay for the system twice. They will pay first, through rates, contributions, and hook-up charges already paid to the Harbor District, and second, through depreciation and a return on the same plant.

Rate Base Discussion

There is simply no easy way to reconcile the positions taken by the parties regarding the proper amount of rate base to be recorded by Alco as the result of its acquisition of the Harbor District system. Unfortunately, there is Commission precedent to support each side's arguments. Applicant accurately notes that the Commission has, on occasion, held that when a public utility purchases a water system, the "original cost" of construction, and not the purchase price, will be charged to plant accounts. The Commission has, however, on other occasions declared that:

"The Commission has definitively established a policy that a mutual water company when purchased by a private individual or entity, who thereby becomes a public utility, should be valued at no more than the new owner's actual investment. [citation omitted.] This policy is no more than an application of generally applicable ratemaking principle which has been long followed by this Commission. That rule requires that after a transfer, a utility's rate base must be valued at the lower of either depreciated original

cost or purchase price." (Mira Monte Water Co.;
D.91324, 3 CPUC 2d 263, 267.)⁶

The Uniform System of Accounts for Water Companies establishes certain guidelines for accounting for acquisition adjustments necessitated by purchase prices that are either higher or lower than the net book value of the utility system being acquired, but leaves the actual ratemaking treatment to the Commission's discretion.

The Commission has uniformly held it impermissible to place in rate base any acquisition premium - that is, any sum paid for a water company in excess of its net rate base. To do otherwise would be to sanction a ratemaking game whereby utility systems were continually sold and re-rate based at levels reflecting the artificially inflated purchase prices paid for the utility. Negative acquisition adjustments are another matter. The Commission has at times stated that because we don't allow acquisition premiums to be added to rate base we don't require negative rate base adjustments when the situation is reversed. In other cases, the Commission has noted that the fact that a purchaser is able to obtain a system at less than its depreciated original cost may well say something about the actual value of the system.

In the case before us today, the system seems to be in good shape, with the Harbor District wanting to unload the system not because of any physical problem with the system, but rather

⁶ Water Branch relies on Decision 89-07-012, Conclusion of Law 6, in asserting that Alco should only be allowed to earn on its actual investment. The decision cited pertains to a public utility owned by a partnership requesting authority to dissolve the partnership and become a corporation. It has nothing to do with the acquisition of a water system by a public utility or the determination of what value should be placed on the acquired rate base. The fact that this citation is not decisive does not detract from the point Water Branch makes or preclude us from finding in its favor. The Commission is not limited by the arguments made by the parties before it.

simply because the system is a money loser for the District which operates it only as an incidental sideline to its basic business of operating the harbor and the berthing of boats at Moss Landing. Both parties believe that Alco will be able to operate the water system more efficiently and economically.

One question apparently not addressed at length in prior Commission decisions is why should the purchaser of a utility be allowed to earn a return on rate base paid for by someone else? Here, the District, not the purchaser, invested in and maintained the water system up to the date of the transfer. Whether this money came from customer contributions, Caltrans, or from subsidies from other revenue obtained by the District, it is absolutely clear that the plant was not paid for by the purchaser.

The purchaser may well ask what incentive it has to take over this small water company if it cannot rate base the original cost less depreciation. First, we are not convinced of the need for a generic policy of encouraging the take over of small water systems such as the Harbor District, especially those not presently subject to the Commission's jurisdiction. In this case, for example, the transfer is not of a troubled water system whose ratepayers are suffering from system decay or bad management, but rather of a system in good shape whose owner views it as a money losing operation incidental to its primary responsibility as a harbor district. The transfer is of benefit to both the former owner and the purchaser, but is born more of convenience than necessity. Other cases involving different facts may cry out for different solutions. We prefer to continue to make such determinations on a case by case basis.

Second, our decision to exclude from rate base plant not paid for by the purchaser does not preclude the purchaser from recovering from ratepayers the cost of operating the system in the future. The purchaser is free to file for rate increase, or for any other type of financial relief it feels is necessary to allow it to

operate the system in a satisfactory manner. By allowing the purchaser the opportunity to earn a return only on its own investment, we are simply following the basic regulatory principle that utilities are entitled to a fair return on their investment (not on someone else's investment.)

We note that the rates presently proposed do not include a return on rate base component, but that there is nothing to preclude the utility from seeking such a return in the future. Therefore, the absence of such a return now is not a convincing reason to duck the fundamental issue of how to treat the original cost rate base. We note further that both Alco and the Harbor District assume that the utility will be able to operate the system more efficiently than the Harbor District. Alco will retain the benefits of its more efficient operations at least until such time as rates are reconsidered in the future. At that point, the company may well seek a return on its plant investment.

We understand that applicant believes it has the weight of Commission precedent solidly of its side, but as we have noted there are two sides to every story, and Water Branch could have pointed to cases leading to an opposite result. In any event, we have made this decision according to our belief that utility purchasers should not receive a return on someone else's investment absent extreme circumstances not present here. Therefore, Alco should record the difference between the net plant purchased and Alco's actual purchase price as a contribution from the Harbor District.

Having concluded that Alco should be allowed to place in rate base the amount it actually paid to acquire the water system, and not the original cost of the water system, we need to determine the net rate base of the water system. The \$367,200 gross amount to construct the water system is not in dispute and should be adopted. Although Alco and Water Branch also agree on the amount of accumulated depreciation, we need to resolve the \$10,000 accumulated

depreciation discrepancy between Alco's \$121,130 amount and Water Branch's \$131,130, as identified above.

Alco's detailed analysis supporting its accumulated depreciation amount is based on U-4, the details of which are shown in Appendix A. Water Branch did not present a detailed analysis of how it derived its \$131,130 accumulated depreciation amount. Therefore, we will rely on Alco's analysis of gross plant additions and depreciation rates shown in Column 5 of Appendix A to derive an adopted accumulated depreciation amount of \$121,130 as of December 31, 1988.

Another component of rate base is contributions. Alco and Water Branch concur that a 1983 payment of \$61,680 payment to the Harbor District from Caltrans should be recorded as a contribution. This payment represented compensation for relocating the Water District's water main across the Elkhorn Slough Bridge due to highway work.

Although there is no dispute that the Caltrans contribution should be recorded as a contribution, ratemaking treatment for such contributions provide for the amortization of contributions over the expected life of the applicable plant. Therefore, the Caltrans contribution should be reduced by \$6,174⁷ to \$55,512 to properly reflect the amortized portion of the Caltrans contribution as of December 31, 1988.

Alco does not intend to recognize any contributions other than the Caltrans contribution. However, Gibbons acknowledged that the Harbor District received a maximum of \$59,600 contributions from customers to pay for the initial construction of the water system in 1962. By Exhibit 4, Gibbons clarified that a review of Harbor

⁷ \$61,680 times the 1.82% depreciation rate for 1983 mains times 5-1/2 years, pursuant to Attachment 1 of Exhibit 1.

District data enabled him to identify only \$21,554⁸ of customer contributions. The remainder of the initial system was financed by a Wells Fargo Bank loan. The loan was repaid from water district revenue and from other Harbor District funds. Gibbons also identified \$55,710 of customer contributions pertaining to the 1979 Heights area extension.

Contributions from customers are no different than contributions from Caltrans. Therefore, \$21,554 and \$55,710, or \$77,264 of customer contributions should be treated as contributions and reflected in Alco's rate base for ratemaking purposes. Alco's customer contributions at December 31, 1988 should be \$77,264 less \$25,968⁹ of amortization for a net customer contribution of \$51,296.

Alco should record its purchase of the Harbor District water system to reflect a December 31, 1988 net plant for bookkeeping purposes of \$100 as follows:

<u>Item</u>	<u>Amount</u>
Water Plant in Service	\$367,200
Less:	
Accumulated Depreciation	121,130
Caltrans Contribution	55,512
Customer Contributions	51,296
Harbor District Contributions	<u>\$139,162</u>
Net Plant @12/31/88	\$ 100

8 This amount consists of \$6,407 offsite meter fee collections and \$15,147 direct benefit fee collections.

9 The amortized customer contribution applicable to the 1962 customer contributions was based on the 2.86% depreciation rate for services and meters installed in 1962, or \$16,336. The amortized customer contribution applicable to the 1979 customer contributions was based on 1.82% depreciation rate for water mains installed in 1979, or \$9,632.

Future Water Delivery Discussion

Although Alco proposes to record a \$5,000 liability for future water deliveries to the Harbor District, it does not intend to reflect such a liability for ratemaking purposes. Instead, for ratemaking purposes, Alco proposes to reduce its operating expense by the current year's cost to provide the water to the Harbor District. Costs to be deducted from operating expense include power costs and related operating expenses to deliver the water to the Harbor District.

Water Branch interpreted the sales agreement between Alco and Harbor District as requiring Alco to provide free to the Water District up to 500 hundred cubic feet (Ccf) of water each month so long as the well remains economically practical to operate. Based on its interpretation, Water Branch imputed the present value of free water as a component of operating revenue.

However, by a Harbor District July 26, 1989 letter attached to Exhibit 1, Alco and the Harbor District clarified that the Harbor District retained ownership to up to 500 Ccf of water per month so long as the well is economically operational. With this clarification, it is not reasonable to require Alco to impute Harbor District water revenue for ratemaking purposes. Alco's ratepayers should not be required to pay the cost of pumping and delivering water to the Harbor District. Therefore, for ratemaking purposes, Alco should reduce its operating expenses by its actual cost to pump and transport Harbor District's water. For accounting purposes, Alco should be authorized to record on its accounting records the \$5,000 projected liability for future water deliveries to Harbor District.

Tank Painting

The 100,000-gallon elevated steel tank acquired as part of the water system needs repair. Adcock explained that the tank, located near the ocean, needs to be sandblasted and painted. This is an ongoing maintenance project expected to occur every 15 years.

Although Alco has a \$90,000 written bid for sandblasting and painting the tank, Alco believes that its own personnel can do the work at a cost of \$50,000 to \$55,000.

Alco proposes to advance the funds to paint the tank and to recover the cost through a monthly \$4.00 to \$5.00 per customer readiness to serve fee. This readiness to serve fee is a new proposal, not a part of its transfer application.

Alco explained that it did not request rates to cover the tank painting in its application because Alco did not know how much it would cost, or how much it would cost to run the water system. Alco relied on its experience of over 50 years in the water business and believed that the water system would "fold" in with the rest of its operations easily. Therefore, it didn't make any projections on what it would cost to operate the system.

However, on ALJ examination, Adcock acknowledged that the Harbor District told Alco that it would cost approximately \$100,000 to paint the tank. Customers have been notified of Alco's application to transfer the water system from the Harbor District to Alco, but customers have not been notified of Alco's proposed readiness to serve fee. Also, Alco is uncertain as to the amount of funds it will need to paint the tank.

There is no dispute that the tank needs to be painted. Alco should seek authority to recover the tank painting cost after it has been incurred through an advice letter filing, not in this application. Alco's customers should be notified of the advice letter filing through a bill insert, when Alco actually files its proposed advice letter.

Proposed Rates

By its application, Alco seeks to adopt the water rates currently being charged to the Harbor District water customers. It is not requesting a return on rate base. Its proposed rate structure provides for a \$7.00 per month charge for the use of 0 to

500 cubic feet of water, with a \$0.90 quantity charge for each additional 100 cubic feet of water used.

By testimony, Adcock recommended that incentive ratemaking should be authorized for Alco's new water operations. Adcock proposes:

1. To freeze rates for a three-year period, except for a monthly \$5.00 per customer readiness to serve charge to cover tank painting.
2. At the end of the three-year rate moratorium to be allowed to earn a return on plant additions placed in service after June 30, 1989 and to recover related depreciation.
3. To recover any income tax liability incurred from Alco's purchase of the water system through rates.
4. At the end of the three-year rate moratorium to tie future rate changes to the consumer price index.
5. To record on its accounting records plant and accumulated depreciation without any contributions.

Alco's results of operations for the fiscal year ended June 30, 1989 shows that it actually received \$29,746 of gross revenue from its customers and actually incurred \$29,356 of operating cost, excluding depreciation and income taxes. Water Branch's projected results of operations based on 1986 recorded data should not be considered because of the availability of more recent data. We will use Alco's results of operations as follows:

<u>Iten</u>	<u>Amount</u>
Revenue	\$ 29,746
Operating Expenses	27,548
Less Cost to Pump Harbor District Water	589
Add Taxes Other Than Income	<u>2,397</u>
Total Operating Expenses	29,356
Net Income Before Depreciation and Income Taxes	\$ 390

These results of operations show that Alco is providing water service at a break-even level. That is, the cash received from its customers at present rates is sufficient to pay for all of the utility's bills associated with the water system's operations. It does not provide for recovery of depreciation or any profit.

Gibbons acknowledged that Alco is well aware that the inclusion of any rate base could result in an unacceptable rate increase for customers. It is for this reason that Alco did not seek any rate increase in this application.

Adcock believes that the alternative rate proposal is necessary because water customers have benefited from Harbor District subsidized water service for years. It was not until 1986 that the Harbor District imposed its first major rate increase in an attempt to break-even. Absent this alternative rate proposal, Adcock is concerned that it would be too much to ask customers to pay for the tank painting, plant improvements, increased maintenance, depreciation expense, and a return on investment.

Alco has not provided any study demonstrating that the consumer price index is a reasonable trigger to determine a rate increase. It has already found a need to modify its index proposal for painting its tank and can reasonably be expected to find additional modifications, given the age of the water system. Items

a, c, and e of the alternative rate proposal are not appropriate for the reasons discussed in separate sections of this decision. Further, water customers have not been notified of any proposed rate increase. It is for these reasons that we are not prepared to adopt Alco's alternative rate proposal. Alco's proposal to use the rates it presently charges its customers will enable Alco to break-even and should be adopted.

Income Tax Liability

McCrea testified that Alco may incur a tax liability as a result of Alco's purchase of the system. This is because contributions are normally considered taxable income by the Internal Revenue Service (IRS). If Alco is authorized to record its proposed journal entry to reflect its acquisition of the system, McCrea believes that the IRS may consider the entire acquisition amount as a contribution and levy a large tax on Alco. However, if the acquisition adjustment were recorded as a contribution from Moss Landing customers, the tax liability may be avoided. Therefore, McCrea recommends that any tax liability that may result from Alco's acquisition of the system be paid by Alco's shareholders, and not by Alco's ratepayers.

Gibbons agrees that Alco may incur a tax liability as a result of this acquisition. However, he does not believe that the tax can be avoided by recording the acquisition amount as a contribution. On the contrary, he believes that such a treatment of the acquisition amount will increase the possibility of it being viewed as a taxable transaction by the IRS.

Gibbons recommends that any contingent tax liability be charged to the acquisition adjustment account.

Although Alco's and Water Branch's witnesses differ on the tax liability of this acquisition, both concur that Alco may incur a tax liability irrespective of the method by Alco to record its acquisition. We do not look favorably at requiring ratepayers to shoulder the payment of an entity's tax liability incurred

solely because one entity acquired a water system from another entity. In the eyes of the ratepayers, the only difference is a change in ownership of the system. There is no change in plant facilities, water supply, or service.

We do not speculate on whether a tax liability will be incurred and do not intend to order a utility to make a specific accounting entry to avoid a legitimate tax liability. Also, because the sales agreement was consummated in February 1988 any recovery of tax liability incurred as a result of the purchase may be construed as retroactive ratemaking. We will not decide this issue at this time. If the tax liability becomes a reality and Alco believes that it is entitled to recover prospectively any of the liability from its ratepayers then Alco should apply at that time for rate relief.

Separate Set of Accounting Records

McCrea recommends that Alco establish and maintain a separate set of accounting books for Alco's Moss Landing system.

Since Alco concurs with this recommendation no further discussion is necessary. Alco should maintain a separate set of accounting books for its Moss Landing system to record its Moss Landing plant, depreciation, revenues, and direct expenses. Indirect expenses such as labor, billing and collection, office and administrative, insurance, truck operations, and income taxes, as testified to by Gibbons are nothing more than allocations of Alco's costs. These indirect expenses need not be recorded in the Moss Landing accounting books. However, we will require Alco to allocate indirect costs to the Moss Landing system and to present financial statements on a fully allocated cost basis in Commission proceedings that impact the Moss Landing system as a stand-alone operation.

Monterey Dunes

Adcock included in his direct testimony a request to expand Alco's proposed service territory to include Monterey Dunes,

an exclusive community of 126 townhouses located on the Pacific Ocean, with a water main terminating approximately one mile from the southerly end of the Moss Landing system. Adcock represents that Transamerica, the Monterey Dunes developer, "seems willing" to pay the cost of a main to interconnect the two systems, and believes that the Monterey Dunes homeowners would be happy to receive service from Alco if they can be assured of quality water at reasonable rates. Monterey Dunes is experiencing salt water intrusion in its well.

If Alco receives a favorable decision on its Moss Landing application, Alco will negotiate contracts with Transamerica and the Monterey Dunes Homeowners Association, and will construct approximately one mile of transmission mains to connect the two systems together. Alco proposes to charge the same rates to Monterey Dunes customers as are approved for the Moss Landing system.

Water Branch's McCrea acknowledges that Alco foresees the need to extend the Moss Landing system at some future time to serve Monterey Dunes. It also acknowledges that Alco intends to expand the system to Moss Landing State Beach, Zmudowski State Beach, and Dolan Road located east of the present well site. However, McCrea opposes any expansion beyond the requested Moss Landing service territory. The Water Branch recommends that Alco submit a separate application for each service area expansion at the time service is requested.

By Adcock's own testimony, Alco's request to include Monterey Dunes in the Moss Landing service territory was an afterthought. There is no mention of this proposal in its application. Not only is there no firm commitment on who will bear the cost to construct the approximately one mile of transmission mains to connect the two systems, there is no information on whether such an annexation will impact Moss Landing customers or will result in an increase in rates to the Monterey Dunes

customers. Alco's request to extend its proposed system to include Monterey Dunes is premature at this time and should not be authorized.

Section 311 Comments

The Administrative Law Judge's (ALJ) proposed decision on this matter was filed with the Docket Office and mailed to all parties of record on May 17, 1990, pursuant to Rule 77 of the Commission's Rules of Practice and Procedure.

Timely filed comments were received from Water Branch and Alisal, on June 6, 1990. We have carefully reviewed the comments, but have not summarized them in this order. To the extent that they required discussion, or changes to the proposed decision, the discussion and changes have been incorporated into the body of this order.

Findings of Fact

1. Alco is an established public utility.
2. The Harbor District is a public corporation which primary function is to maintain and operate the harbor and berthing of boats at Moss Landing Harbor.
3. Water Branch opposed the application.
4. The Harbor District found the water system is a drain on its resources because the water system requires a continuing subsidy from other Harbor District activities.
5. There are no public utility water companies in the vicinity of Moss Landing with which the system is likely to compete.
6. Alco entered into an agreement to acquire the Harbor District's water system on February 9, 1988.
7. Alco paid the Harbor District \$100 for the water system.
8. The Harbor District retained ownership of 374,000 gallons of water per month as long as it was economically practical to operate the well.

9. The Heights owns its own transmission system and is responsible for maintaining its own water system.

10. The Heights system is in poor condition.

11. The mutual responsible for maintaining the Heights water system has not been an active organization since the early 1980s.

12. Alco proposes to record this acquisition based on the Harbor District's original cost to construct the water system.

13. Alco extrapolated its \$367,200 water plant in service amount from Harbor District's accounting records.

14. Alco's \$121,130 accumulated depreciation is based on the remaining life expectancy on individual plant components pursuant to Standard Practice U-4.

15. Water Branch concurs with Alco's plant in service amount as of December 31, 1988.

16. The traditional ratemaking process provides a utility the opportunity to earn a return on its investment and to recover reasonable operating expenses.

17. Decision 89-07-012's Conclusion of Law 6 is not applicable in this application.

18. A Caltrans \$61,680 payment in 1983 is a contribution for plant additions.

19. Ratemaking treatment for contributions provides for the amortization of contributions over the expected life of the applicable plant in service.

20. The Harbor District received contributions from Harbor District customers totaling \$21,554 in 1962 and \$55,710 in 1979.

21. A Harbor District July 26, 1989 letter clarified that the Harbor District retained ownership of up to 500 Ccf of water per month from the well it transferred to Alco.

22. Tank painting is an ongoing maintenance project expected to occur every 15 years.

23. Alco proposes to advance the funds to paint the tank and to recover the cost through a monthly customer readiness to serve fee.

24. Alco did not request rates to cover the tank painting in its application.

25. Alco's application requests that rates currently in effect be adopted.

26. Alco's testimony requests that an alternative ratemaking proposal be adopted in establishing rates.

27. The water system is breaking even at present rates.

28. Alco provided no study on the impacts of its alternative rate proposal.

29. Harbor District customers have not been notified of any proposed rate increase.

30. Alco may incur a tax liability as a result of acquiring the Harbor District's water system.

31. Alco will maintain a separate set of accounting records for the Moss Landing system.

32. By direct testimony, Alco requests authority to extend service to the Monterey Dunes area.

Conclusions of Law

1. The sale and transfer of Harbor District's water system to Alco should be authorized.

2. Alco should work with the Heights Association to upgrade the Heights system to AWWA standard.

3. Alco should seek authority to recover tank painting cost through an advice letter filing.

4. Alco should not be authorized to recover any tax liability that it may incur from the purchase of the Harbor District's water system at this time.

5. Alco's proposed expansion into Monterey Dunes area should not be authorized at this time.

6. Alco should be authorized to charge the same rates that are presently being charged to Harbor District customers.

7. Plant investments paid for by the Harbor District but not reflected in Alco's purchase price should be recorded as a contribution from the Harbor District.

O R D E R

IT IS ORDERED that:

1. Alisal Water Corporation (Alisal) is authorized to acquire and to operate the Moss Landing Harbor District's (Harbor District) water system, the service area shown in Appendix A.

2. Alisal shall keep its books and records in accordance with the Uniform System of Accounts for Water Utilities prescribed by this Commission.

3. Alisal shall file a report on its efforts to acquire and to upgrade the Moss Landing Heights Mutual Water System with the Commission Advisory and Compliance Division within 120 days from the effective date of this order.

4. Alisal shall record the purchase of the Harbor District's water system at a December 31, 1988 net book value of \$100, as discussed in this decision.

5. Alisal shall reduce its operating cost by the cost of pumping and delivering the Harbor District's water from its well to the Harbor District for ratemaking purposes.

6. Alisal may apply for recovery of its cost to paint the tank through an advice letter filing and shall notify each of its customers of the proposed advice letter filing.

7. Alisal shall be authorized to file, after the effective date of this order, and in compliance with General Order 96-A, tariffs applicable to the service authorized containing rates, charges, and rules applicable to its water system. The rates and charges shall be as proposed for service in Attachment C to the application and shall include the special condition applicable to Heights service identified in this decision.

8. Alisal shall provide Moss Landing system financial statements on a fully allocated cost basis in all Commission proceedings that impact the Moss Landing system as a stand-alone operation.

9. Alisal shall use its existing Corporate Identification No. U-206-W in connection with the certificate or authority issued in this proceeding. The number shall appear in the caption of all original pleadings and in the title of pleadings filed in existing cases before this Commission.

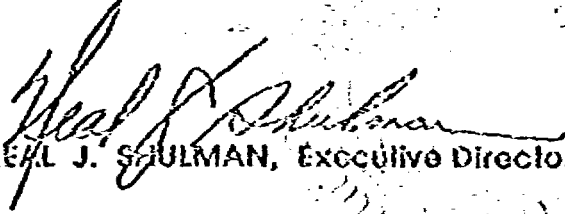
This application is granted as set forth above.

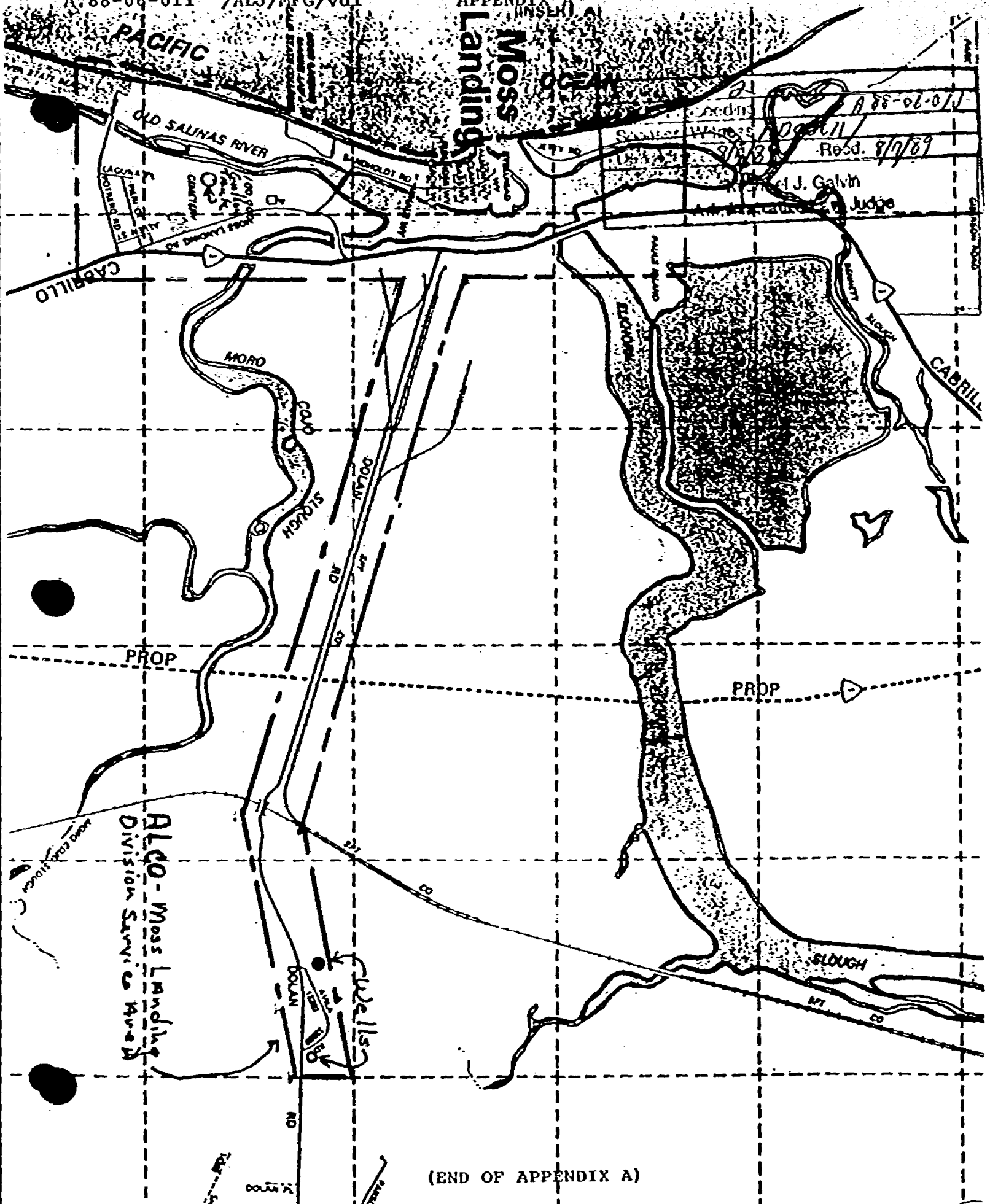
This order is effective today.

Dated JUL 18 1990, at San Francisco, California.

G. MITCHELL WILK
President
FREDERICK R. DUDA
STANLEY W. HULETT
JOHN B. OHANIAN
PATRICIA M. ECKERT
Commissioners

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


NEAL J. SHULMAN, Executive Director



(END OF APPENDIX A)

Assurance Water Sewer
Statement of Plant & Accumulation N of 1/31/88

Asset #	DESCRIPTION	COST	ACQUISITION YEAR	Salvage Value	Net Depreciable Plant	Life Yes	Rate %	Accum. Deprec.	Years to 1987	Accum. Deprec. as of 1/31/87	Service Period 1987	Accum. Deprec. as of 1/31/88
303	Non-Depreciable Plant Land Plant Ponds	8,700.-	1982									
	DEPRECIABLE PLANT											
307	Wells	281,700.-	1982		23,175.-	55	2.41	6,043	285	11,100.-	1987	17,143.-
311	Spring Eastern	21,700.-	1981	31	21,062.-	30	2.31	5,120	285	17,400.-	1987	18,800.-
330	Feederline Tunnels	213,125.-	1982	41	51,582.-	50	2.50	12,875	285	30,400.-	1987	31,175.-
331	Water Meters	10,100.-	1982		4,150.-	60	1.67	1,005	285	10,050.-	1987	11,155.-
333	Sanitary & Water Installations	15,300.-	1982		1,331.-	30	2.2	1,237	285	8,150.-	1987	12,332.-
334	Houses	3,050.-	1982	41	3,009.-	25	2.4	2,016	285	2,105.-	1987	2,251.-
335	Appurtenances	6,112.-	1982	31	1,881.-	25	2.4	1,109	285	1,240.-	1987	1,531.-
		218,917.-			48,244.-			11,110		11,201.-	1987	12,188.-
	ADDITIONS											
331	Water Meters	17,700.-	1987		17,712.-	55	1.81	1,000	85	1,173.-	1987	1,000.-
333	Sanitary & Water Installations	1,700.-	1987		1,700.-	30	2.2	1,057	85	1,13.-	1987	1,000.-
334	Houses	600.-	1987	41	559.-	25	2.2	1,107	85	1,107.-	1987	1,000.-
335	Appurtenances	16,500.-	1987	31	1,510.-	35	2.1	1,246	85	1,018.-	1987	1,246.-
		21,600.-			11,122.-			2,110		2,457.-	1987	2,182.-
	ADDITIONS											
331	Water Meters	4,680.-	1982		4,630.-	55	1.82	1,215		5,040.-	1987	6,167.-
		30,605.-						6,303		11,210.-	1987	12,133.-
	TOTAL PLANT	287,000.-										