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Decision 92-03-094 March 31, 1992

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

In the Matter of the Application of Southern California Water Company for authority pursuant to Public Utilities Code Section 851 to sell, and, if necessary, lease back its headquarters property in Los Angeles, California. (U 133 M)	Application 88-12-020 (Filed December 7, 1988)

O'Melveny & Myers, by James Colbert, Attorney at Law, and Susan L. Conway, for Southern California Water Company, applicants.

Laura J. Tudisco, Attorney at Law, for Commission Advisory and Compliance Division

Carol Siegal and Kelly Boyd, for the Division of Ratepayer Advocates.

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OPINION

Summary of Decision

We have concluded that Southern California Water Company's (SoCalWater) decision to sell its Sixth Street headquarters was reasonable as were the terms of that sale and the interim leaseback pending its move to its new headquarters in San Dimas. We also find that the costs of construction of the new headquarters and other facilities in San Dimas to have been reasonable.

The primary contestable issue in this case deals with the allocation of the gain-on-sale of the old headquarters between ratepayers and shareholders. In this decision we rely on the theory of the "enduring enterprise" as the principle by which we will examine gain-on-sales for cases with this fact situation. Given the principle as affirmed in this decision, the gain-on-sale remains in the enterprise to be used as a credit against new and/or existing rate base. Our decision today is consistent in principle with a line of cases, commonly referred to as the *Redding* cases as described in Decision (D.) 89-07-016, 32 Cal. P.U.C.2d 233.

Finally, with respect to the revenue requirement deficiency arising from (1) the undercollection of revenues associated with the lease back of the Old General Office and (2) the undercollection of revenues due to the difference in costs between the Old General Office and the New General Office, we will not allow recovery of these dollars because of retroactive ratemaking considerations.

Background

On December 7, 1988, SoCalWater filed Application (A.) 88-12-020 seeking authority, under Public Utilities Code § 851, to sell and lease back for a limited time its headquarters property (Old General Office) at 3625 Sixth Street in Los

Angeles, California. SoCalWater planned to construct a new headquarters facility in San Dimas, California.

On April 26, 1989, we issued Interim Decision (D.) 89-04-079 authorizing SoCalWater to sell and lease back its Old General Office. Our decision directed SoCalWater to maintain memorandum accounts to track the ownership cost revenues collected and actual lease back costs incurred, with excesses subject to refunding. The consequence was to place SoCalWater at risk for undercollections[1]. That decision also provided for a second phase of the proceeding to consider the reasonableness of the sale, all ratemaking consequences flowing from the sale, leaseback, and associated activities, including the treatment of gain-on-sale. Finally, we ordered SoCalWater to file a Phase II supplemental application to demonstrate the reasonableness of the sale and cost-effectiveness of the leaseback. SoCalWater filed the Phase II application on December 12, 1990.

SoCalWater sold its Old General Office in May 1989 and leased it back until its move in May 1990 to the recently constructed new headquarters building (New General Office) in San Dimas. Along with the construction of its New General Office, SoCalWater also constructed a new production facility and a warehouse on the same parcel of land in San Dimas. The construction costs of the New General Office and other facilities are as follows:

New General Office	$3,165,544
Production Facility & Warehouse	$ 616,305

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[1] This mechanism was put into place so that SoCalWater did not have an incentive to increase the sales price and the amount of gain it was <u>requesting</u> while simultaneously increasing leaseback costs that ratepayers might be required to pay. Without this protection the incentive existed to manipulate the leaseback costs and sales price to benefit shareholders at ratepayer expense without actually changing the total net amount the buyers of the Old Office Building would ultimately have to pay.

Uncontested Issues

We begin with a number of noncontroversial issues raised by the parties in this phase of the proceeding, including: (1) the reasonableness of SoCalWater's decision to move its headquarters, (2) the reasonableness of the terms of the sale and leaseback of the Old General Office, (3) the reasonableness of the costs associated with the construction of the New General Office and other facilities, and (4) the amount of the net gain-on-sale for the Old General Office. On each of the issues there was no disagreement between the Division of Ratepayer Advocates (DRA) and SoCalWater. After reviewing the record we concur with the parties and conclude that: (1) SoCalWater's decision to move its headquarters was reasonable, (2) the terms of the sale and leaseback of the Old General Office were reasonable, (3) the costs associated with the construction of the New General Office and other facilities were reasonable, and (4) that the pretax gain-on-sale of the Old General Office was $1,983,400 and the net after tax gain-on-sale was $1,187,303. Table 1 shows the calculations for gain-on-sale.

Table 1

Gain-on-Sale Calculations for
The Old General Office

Gross Sales =	$3,100,000	
less:		
Commission	160,000	
Studies	8,500	
Cost of Land	262,000	
Undepreciated Cost of Building	653,100	
Closing Costs	33,000	
Total Deductions		$1,116,600
Gain-on-Sale	1,983,400	
Tax on Gain @ 40.138%	796,097	
Net Gain After Tax	$1,187,303	

<u>Contested Issues</u>

<u>Revenue Requirement Deficiency</u>

DRA and SoCalWater agree that SoCalWater is entitled to an adjustment in its revenue requirement to account for the revenue deficiency. However, because of a difference in opinion on how the gain-on-sale should be treated, DRA disagrees with SoCalWater's calculation of the revenue deficiency.

<u>Discussion</u>

The revenue requirement deficiency in question is made up of two components. The first is the amount associated with the memorandum account SoCalWater was ordered to maintain by decision, D.89-04-079, 31 Cal. P.U.C. 2d 533. As noted, we ordered the utility to track the ownership cost revenues collected and the actual costs incurred with regard to the leaseback. In compliance, SoCalWater provided the following table showing undercollections of $94,875 that were booked to this account for the years 1989 and 1990.

Ordering Paragraph 3 in D.89-04-079 clearly states that with respect to the difference in ownership cost revenues collected and the actual costs incurred, "SoCalWater shall maintain memorandum accounts . . . . with excesses subject to refunding, or <u>SoCalWater at risk for undercollections</u>." (Emphasis added.) Given the Commission's clearly stated intention of placing the utility at risk for any undercollections, we will not allow the $94,875 undercollection in this account to be passed through in rates. SoCalWater should make the necessary accounting adjustments to close out this account.

Southern California Water Company
Memorandum Account

Line No.	Lease Period Costs:[2]	1989	1990	Total
1	Lease Payment	178,540	117,698	296,239
2	Ad Valorem	8,149	5,851	14,000
3	Total Cost	186,689	123,549	310,238
4	Revenue Authorized in Rates[3]	125,611	89,752	215,363
5	Under(Over) Collection	61,078	33,797	94,875

The second component of the revenue deficiency is the dollars associated with the ownership cost differential between the New General Office and the Old General Office. Beginning with its occupation of the New General Office and other production and warehouse facilities in May 1990, SoCalWater began incurring ownership costs associated with these facilities. However, until the effective date of this decision, SoCalWater continued to collect, in Commission authorized rates, the revenues associated with ownership of the Old General Office. This delay in inclusion in rate base of the New General Office and other facilities has resulted in an undercollection or revenue deficiency for SoCalWater.

It is a well established tenet of the Commission that ratemaking is done on a prospective basis. The Commission's practice is not to authorize increased utility rates to account for previously incurred expenses, unless, before the utility incurs those expenses, the Commission has authorized the utility to book those expenses into a memorandum or balancing account for possible future recovery in rates. This practice is consistent with the rule against retroactive ratemaking. This impacts not

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[2] Lease period: May 1989 - May 1990; payments are made one month ahead.

[3] Revenues include: Return on (land, General Office net plant), depreciation, and ad valorem.

only rate recovery for operational expenses, but also rate recovery for ownership costs, such as depreciation expense and return on investment.

In response to the interregnum that often exists between a utility's expenditure of funds and the Commission's action to recognize those expenditures in rates, there are several established regulatory procedures available for a utility to recover its ownership costs for new plant additions. These costs can be estimated in a rate case before the new plant goes into service, and rates authorized prospectively based on those estimates. Alternatively, the Commission can grant advance authorization for the utility to book these ownership costs into a memorandum or balancing account for later recovery after any necessary review of the reasonableness of the plant's costs. In this way concerns over retroactive ratemaking are eliminated. If the costs of owning the new plant are not included in authorized test or attrition year rates, and the utility has not obtained a Commission order authorizing the booking of those costs into a memorandum or balancing account, the utility cannot recover those ownership costs incurred from the date the new plant is put in service until the Commission either authorizes an increase in rates or authorizes the creation of such an account.

SoCalWater did not avail itself of these regulatory procedures in this instance. In such circumstances we adhere to our established policy of non-recoverability.[4] To do otherwise would be unacceptable given the concerns over retroactive rate-making. SoCalWater is a large, sophisticated utility with a long history of practice before the Commission. SoCalWater should not be surprised by our decision in this matter. In the future, the

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[4] See D.84-12-060, 16 Cal. P.U.C.2d 495, 505-07 in which the utilities were denied recovery of investment-related costs for San Onofre nuclear power plants from the date the plants began service until MAAC balancing account authorized.

company should avail itself of the regulatory procedures available in this regard so as to avoid a repeat of this matter.

Treatment of Gain-on-Sale

SoCalWater and DRA disagree regarding the treatment of gain-on-sale of the Old General Office. SoCalWater contends that the gain-on-sale should be allocated to its shareholders. DRA recommends that the gain-on-sale be used to benefit SoCalWater's ratepayers. Specifically, DRA recommends that SoCalWater's future revenue requirement be reduced by the net after tax gain-on-sale of $1,187,303 multiplied by the net to gross multiplier.[5]

In support of their respective recommendations, both SoCalWater and DRA refer to our recent decision on the treatment of gain sale in *Re Southern California Gas Company*, (1990) D.90-04-028, 36 Cal. P.U.C.2d 235. In 1987, SoCalGas sold its Flower Street headquarters and, pursuant to the terms of the sale, leased back the building from the buyers until its new headquarters were ready for occupation. SoCalGas filed A.87-07-041 in which it sought to keep for its shareholders all of the proceeds from the gain-on-sale of the Flower Street headquarters and to recover from its ratepayers the cost associated with leasing back its old headquarters building.

In response we allocated the gain-on-sale of SoCalGas' headquarters to ratepayers and shareholders based on the rational of "ratepayer indifference". According to this rationale, the capital gain from the rate based asset should be assigned to ratepayers only to the extent needed to compensate them for the difference between what the old building would have cost and what

[5] DRA included this recommendation for treatment of gain-on-sale in its late-filed Exhibit 22. Counsel for SoCalWater considered this to be a new recommendation made after the proceeding was closed. In her September 18, 1991 letter to the ALJ, she requested that the recommendation not be considered as part of the record in this proceeding. However, this recommendation regarding the treatment of gain-on-sale is identical to the recommendation contained in DRA's Exhibit 16 (page 24, 4th paragraph).

the new building did cost. Upon a petition for rehearing we modified D.90-04-028 rejecting the ratepayer indifference methodology and allocating the gain-on-sale based on a risk-sharing analysis. D.90-11-031, 38 Cal. P.U.C.2d 166.

The Commission concluded that the allocation of gain-on-sale based on ratepayer indifference methodology was about the same as would occur under a risk-sharing analysis. Specifically, D.90-11-031 required SoCalGas to use the principal amount of its after tax gain-on-sale to offset the continuing cost for its new headquarters over an 11-year, 11-month amortization period. According to D.90-11-031, the amortized benefits were to be passed through to ratepayers, by multiplying the principal amount to be amortized each year by SoCalGas' then current net to gross multiplier to determine the amount by which to reduce SoCalGas' revenue requirement.

As to shareholder benefits, D.90-11-031 noted that shareholders will benefit by being able to (1) retain the investment income SoCalGas had been able to earn on the sales proceeds from the date of the sale (October 7, 1987) to the date of the decision; and (2) retain the income SoCalGas will be able to earn on the unamortized balance of the gain-on-sale over amortization period of 11 years and 11 months. We will refer to the final decision in A.87-07-041 as the SoCalGas decision.

SoCalWater and DRA have drawn different conclusions from the Commission's action in the SoCalGas case. A description of each party's position follows.

SoCalWater's Position

SoCalWater concedes that using the SoCalGas approach is one option available to the Commission. However, SoCalWater points out that in the SoCalGas decision the Commission warned against mechanistic repetition of the results of that case and emphasized that the issue of gain-on-sale is best approached on a case-by-case basis. SoCalWater asserts that it has taken the Commission at its word and performed analyses which led to the conclusion that gain-on-sale of the Old General Office should go entirely to the shareholders rather than split between ratepayers and shareholders. The two analyses on which SoCalWater bases its assertion are ratepayer indifference analysis and risk and incentive analysis.

SoCalWater opines that while the Commission modified its opinion regarding the use of ratepayer indifference analysis, it did not disapprove the methodology. SoCalWater insists that ratepayer indifference analysis is a valid methodology to determine the treatment of gain-on-sale.

SoCalWater contends that the ratepayer indifference analysis performed by its witness Dickson clearly shows that the present value cost of staying at the Old General Office exceeds the present value cost of moving to the New General Office by $1.67 million. According to SoCalWater this demonstrates that ratepayers are better off because of SoCalWater's decision to move. Given this result the utility concludes that there is no need to allocate any portion of the gain-on-sale to ratepayers and that the shareholders are entitled to the entire proceeds.

According to SoCalWater, even if risk and incentive analysis was applied to this case, the results would still dictate that shareholders are entitled to the entire proceed from the gain-on-sale of the Old General Office.

In its study, SoCalWater focused on the risk that the rates set for utility service are either too high or too low. According to SoCalWater, this is the only true risk faced by shareholders and ratepayers since there is nothing unfair about the ratepayer paying a proper price, as determined by the Commission, for the water service provided. Ratepayers face a risk if the rates charged are too high and shareholders face a risk if the rates are too low to cover the cost of service and to allow a reasonable return on investment. SoCalWater opines that errors in test year estimates are the only cause of the rates being either too high or too low. SoCalWater believes that such errors tend to balance each other because the number of times the test year estimates are too high is about the same as the number of times the test year estimates are too low. SoCalWater concludes that possibility of errors in test year estimates pose equal risk to shareholders and ratepayers.

While the possibility of error in test year estimates may pose equal risk to shareholders and ratepayers, SoCalWater argues that regulatory lag poses a risk only to shareholders. SoCalWater contends that because of regulatory lag, it has not been able to earn its authorized rate of return. SoCalWater insists that risk analysis plainly suggests that gain-on-sale should be allocated to shareholders.

As to incentive considerations, SoCalWater believes that allowing a utility to keep the gain-on-sale has the socially desirable effect of creating an incentive for the utility to convert unrealized appreciation into usable capital and to negotiate the best price in doing so. In addition, SoCalWater contends that allowing shareholders to receive the gain-on-sale encourages utilities to purchase its headquarter facilities rather than lease them. According to SoCalWater, this approach protects the ratepayers from the costs associated from real estate inflation.

Based on the above, SoCalWater asserts that the gain-on-sale of the Old General Office should be allocated to shareholders.

DRA's Position

DRA asserts that in numerous past decisions relating to the sale of utility assets, the Commission has concluded that the proceeds from the gain-on-sale should be used to reduce the utility's revenue requirements. According to DRA, the conclusion is predicated upon two accepted principles commonly applied to the issue: (1) that the right to gain on utility assets is tied to the risk of capital loss, and (2) that whoever bears the financial burden of a particular utility activity also reaps the benefit therefrom.

DRA cites two precedents which utilized these principles to allocate a utility's gain on sale. In *Felton*

District of Citizens Utilities Company of California, (1982) 9 Cal. P.U.C.2d 197, 209-210, timber rights attached to parcels of watershed land included in Citizens' rate base had been transferred to an affiliate. We held that gain from timber harvest proceeds was to be imputed to Citizens' operating revenue ((1982) 9 CPUC 2d 197, 209-210). *In re Pacific Bell*, (1986) 20 Cal. P.U.C.2d 237, 289 reached the same result. Pacific Bell planned to sell land and buildings which it described as surplus property to its real estate affiliate with any gain-on-sale to be allocated to its shareholders. The Commission required Pacific Bell to allocate the gain-on-sale to ratepayers.

DRA contends that in *Felton* and *Pacific Bell* the Commission has balanced ratepayer and shareholder interests and used the gain-on-sale to reduce the utilities' revenue requirements.

DRA concedes that the SoCalGas decision departs from the Commission's previously adopted treatment of gain-on-sale by adopting a concept of "risk sharing." However, DRA points out that this treatment of gain-on-sale was case specific and that the Commission did not intend to change its long-standing policy regarding the treatment of gain-on-sale is evident from the following:

> "We are not reversing any of our prior precedents, which have frequently applied gains on sale of utility assets to offset the costs of continuing utility service.... This is a unique case -- the relocation of the principal headquarters of the nation's largest gas utility and most importantly from a building that posed health and safety risks and was no longer suitable for long-term use by the utility." (D.90-11-031, Rev. p. 4.)

DRA disagrees with SoCalWater's claim that the "ratepayer indifference" analysis originally used by the Commission remains "an approved approach." DRA takes issue with SoCalWater's argument that because the Commission did not expressly reject the ratepayer indifference theory, it implicitly approved it. According to DRA, while SoCalWater insists on applying the ratepayer indifference analysis, it does not cite any previous cases where the Commission relied on such analysis. DRA maintains that since it does not believe that the ratepayer indifference analysis is the proper methodology to determine the allocation of gain-on-sale, DRA did not perform ratepayer indifference analysis. For the same reason, DRA did not review the ratepayer indifference analysis performed by SoCalWater.

In addition, DRA believes that the facts involved in the SoCalGas case were quite different than the facts in this proceeding. Accordingly, DRA disagrees with the application of ratepayer indifference analysis to this proceeding.

As to the application of risk and incentive analysis, DRA contends that SoCalWater's analysis is flawed. According to DRA, SoCalWater's analysis disregards the principles of original cost ratemaking upon which the Commission's policy is based. In its view original cost ratemaking is designed to provide stability for both shareholders and ratepayers; it insulates both groups from risks of volatile financial markets, economic changes, and shifting demographics. The shareholder knows that he will get a return on his original investment, even if the value of the utility's capitalized assets decline due to obsolescence or casualty. DRA believes that this concept requires ratepayers to not only contribute capital through depreciation, but also to inherit the risk of investment.

DRA also takes issue with SoCalWater's assertion that if the gain-on-sale is not allocated to the shareholders, utilities owned by holding companies might find it more profitable to lease rather than buy their headquarters at great cost to ratepayer. DRA contends that the Commission's oversight of the utility's operation would not allow such an occurrence. According to DRA, the speculative nature of this so-called incentive does not warrant abandoning a ratemaking methodology developed over the years which fairly balances the interest of shareholders and ratepayers. DRA insists that the gain-on-sale be used to reduce SoCalWater's future revenue requirements.

Discussion

We reject the submissions of both DRA and SoCalWater on this issue. In this instance SoCalWater has sold an asset, its Old General Office, realizing a gain, and replaced it with another asset, its New General Office. The scope of SoCalWater's obligation to its ratepayers has neither been reduced nor relieved as a result of this transaction. Working from the principle of the "enduring enterprise", the gain-on-sale from this transaction should remain within the utility's operations rather than being distributed in the short run directly to either ratepayers or shareholders.

The "enduring enterprise" principle, is neither novel nor radical. It was clearly articulated by the Commission in its seminal 1989 policy decision on the issue of gain-on-sale, D.89-07-016, 32 Cal. P.U.C.2d 233 (*Redding*). Simply stated, to the extent that a utility realizes a gain-on-sale from the liquidation of an asset and replaces it with another asset or obligation while at the same time its responsibility to serve its customers is neither relieved nor reduced, then any gain-on-sale should remain within the utility's operation.

The proposals by both DRA and SoCalWater, however, would immediately distribute these gains to either ratepayers or shareholders. We are uncomfortable with either of these proposals in that they liquidate a portion of the utility's assets at the same time that the utility's continuing obligation to serve has not been altered. These proposals ignore a fundamental principle we relied in the *Redding* decision, D.89-07-016, 32 Cal. P.U.C.2d 233. In that decision the Commission extended the principle that a liquidation of utility assets should apply to certain cases involving a partial liquidation. The Commission found that a capital gain or loss realized from a partial liquidation of assets and the associated obligation to serve shall also accrue to shareholders to the extent that (1) the remaining ratepayers on the selling utility's system are not adversely affected, and (2) the ratepayers have not contributed capital to the distribution system.

Here we are dealing with a circumstance where SoCalWater has realized a gain from a sale of an asset. However, there has been no reduction in its obligation to serve and, in addition, SoCalWater has replaced the asset it sold with a new asset. Ratepayers will pay depreciation, operating and maintenance expenses of the new asset while shareholders will receive a return, paid through in rates, on the capital investment in the new asset.

As such, the gain-on-sale should remain in SoCalWater's utility operation to the benefit of ratepayers as long as the utility obligations exist, rather than divesting of the gain in the short term as DRA proposes. At such time as there is a liquidation of assets and cessation of the utility's duty to serve, the gain-on-sale will be available to utility shareholders.

In order to implement this policy, we order SoCalWater to apply the net after-tax gain-on-sale against its rate base. Ratepayers will benefit over the long term through a reduction in rate base by the amount of the gain-on-sale and the consequent reduction in the return on the reduced rate base. By not using the gain-on-sale as a direct offset against the utility's revenue requirement, but rather as a reduction to rate base, the gain-on-sale will remain in the utility's operation. As such, the gain-on-sale will accrue to the benefit of shareholders in the future if and when the utility's operations are liquidated and its obligation to serve is dismissed. The incremental revenue requirement associated with the ownership of the New General Office and other production facilities, based on the above treatment of the gain-on-sale, is discussed in the following section.

Based on the limited record in this case, we have applied the gain-on-sale against the nondepreciable land portion of SoCalWater's rate base. Given the description of the Old Office Building, including its age and general character, as well as the location of the property and the real estate market in Southern California since 1967 when SoCalWater bought the property, it appears that at least some of the gain-on-sale from the Old General Office was the result of an appreciation in value of the land rather than the building. We also note that the alternative of applying the gain-on-sale against depreciable assets or some combination of depreciable and nondepreciable assets would require a much more complex computation each year but result in an insignificant difference. For the above reasons, we find applying the gain-on-sale against nondepreciable land in SoCalWater's rate base is reasonable.

Incremental Revenue Requirement for Plant Additions

The incremental revenue requirement for the New Headquarters and production facility is shown in Table 2 and includes the following:

1. Return on net increase in rate base for the New General Office. Incremental rate base includes the total cost of the New General Office and production facilities less depreciation at an annual rate of 2.44% from January 1, 1991 until March 31, 1992 plus accumulated funds used during construction (AFUDC) through March 31, 1992 less plant balance and cost of land of the Old General Office plus cost of land purchased for New General Office and production facilities less net after tax gain-on-sale. The incremental rate base is multiplied by the weighted average cost of capital of 10.62% authorized in the last general rate case for SoCalWater (D.92-01-025).

2. Incremental ownership cost of the New General Office including incremental depreciation at 2.44% per year on the New General Office plus AFUDC balance beginning March 31, 1992 minus the depreciation that was being taken in rates on the old building plus incremental operating and maintenance and property tax costs on the New General Office and production facilities.

3. The incremental depreciation plus incremental return on rate base plus incremental operating and maintenance expenses and property taxes are

multiplied by the net to gross multiplier to arrive at the incremental revenue requirement impact.

The gross plant additions for the New General Office and other facilities include an allowance for funds used during construction (AFUDC). The New General Office and other production facilities less the net after-tax gain-on-sale will accrue AFUDC through December 31, 1990 when these assets were placed in service. Since SoCalWater had benefit of the use of the funds from the proceeds of the sale, the base upon which to calculate the AFUDC should be reduced by the after-tax amount of these proceeds. The consequences of this, as shown in Table 3, is that we will not authorize SoCalWater to accrue AFUDC before November 1989 when the difference between the cost for the New General Office and production facilities and the net after-tax gain-on-sale was greater than zero.

Traditionally, water utilities, unlike energy utilities, are not allowed to include AFUDC on plant additions. Instead, water utilities are allowed to include construction work in progress (CWIP) in rate base. Inclusion of CWIP in rate base allows a water utility to earn a return on funds used to finance the construction of its plant additions. SoCalWater specifically excluded any CWIP amounts associated with new facilities in its rate base because the reasonableness of all costs for the new facilities was to be determined in this proceeding. We believe that an exception to the traditional ratemaking treatment is justified in this instance.

SoCalWater's move to the New Headquarters results in a change in gross revenue requirement on plant additions of $600,817 for the period April 1, 1992 through December 31, 1992. Accordingly, we will authorize SoCalWater to increase its rates by $600,817 effective April 1, 1992. SoCalWater will be required to adjust its revenue requirements along the lines outlined in this decision for these plant additions in its attrition year filings for 1993 and 1994.

Findings of Fact

1. SoCalWater's Old General Office was located in the Wilshire District of Los Angeles.

2. SoCalWater found the approximately 26,000 square feet space in the Old General Office inadequate to house its employees.

3. To remedy the lack of space, SoCalWater considered the options of improving and expanding the Old General Office and moving to a new location.

4. SoCalWater decided to relocate its New General Office on company owned land in San Dimas.

5. On December 7, 1988, SoCalWater filed A.88-12-020 seeking authority under PU Code section 851, to sell and lease back for a limited time its Old General Office.

6. The Commission issued D.89-04-079 on April 26, 1989 which authorized SoCalWater to sell and lease back its Old General Office.

7. D.89-04-079 directed SoCalWater to maintain memorandum accounts to track the ownership cost revenues collected and the actual costs incurred with regard to the leaseback, with excesses subject to refunding, or SoCalWater at risk for undercollections.

8. There is a $94,875 undercollection in the memorandum account established by D.89-04-079 that tracked the difference in the ownership cost revenues collected and actual cost incurred for leaseback.

9. D.89-04-079 provided for a second phase in this proceeding to consider the reasonableness of the sale, all ratemaking consequences from the sale, leaseback, and associated activities, including treatment of gain-on-sale. D.89-04-079 ordered SoCalWater to file a Phase II supplemental application to consider the above.

10. SoCalWater sold its Old General Office in May 1989 and leased it back until the completion of construction of its New General Office in December 1990.

11. Along with the construction of its New General Office, SoCalWater also constructed a new production facility and a warehouse on the same company-owned parcel of land in San Dimas.

12. SoCalWater filed the Phase II application on December 12, 1990 requesting that the Commission find that: (a) the terms of sale and lease back of its Old General Office were reasonable; and (b) the costs associated with the construction of the New General Office and other facilities are reasonable.

13. Evidentiary hearings were held on August 1 and 2, 1991 in Los Angeles. The issues ordered for consideration in Phase II were addressed during the hearings.

14. DRA and SoCalWater were the only participants in the proceedings.

15. Based on its analysis, DRA stated that:

a. SoCalWater's decision to relocate its New General Office in San Dimas was reasonable.

b. The terms of sale and leaseback of SoCalWater's Old General Office were reasonable.

c. The costs associated with the construction of the New General Office and other facilities were reasonable.

16. SoCalWater and DRA agree that the pretax gain-on-sale of the Old General Office was $1,983,400 and the net after tax gain-on-sale was $1,187,303.

17. The delay in inclusion of the New General Office and other facilities in rate base has created a revenue deficiency for SoCalWater.

18. SoCalWater did not request or obtain a rate increase to cover the cost of ownership of its New General Office in a previous rate case and did not request or obtain balancing account treatment for the increased costs of owning its New General Office.

19. The in-service for the New General Office was December 31, 1990.

20. SoCalWater and DRA disagree regarding the treatment of gain-on-sale of the Old General Office.

21. SoCalWater contends that the gain-on-sale should be allocated to its shareholders based on the ratepayer indifference analysis and risk and incentive analysis.

22. DRA recommends that the gain-on-sale be used to benefit SoCalWater's ratepayers. Specifically, DRA recommends that SoCalWater's future revenue requirement be reduced by the net after tax gain-on-sale multiplied by the net to gross multiplier.

23. SoCalWater sold its Old General Office and replaced it with its New General Office.

24. SoCalWater's utility obligation has not been reduced as a result of its sale of the Old General Office and the replacement by the New General Office.

25. AFUDC accrued on the New General Office and other production facilities, reduced by the net after-tax amount of the gain-on-sale, from November 1989 until December 31, 1990 when these facilities were put into rates.

26. Total accrued AFUDC as of December 31, 1990 was $293,509 and is shown in Table 3.

27. The cost of the New General Office and other production facilities effective April 1, 1992 is $4,560,048.

28. The incremental revenue requirement impact of adding the New Office Building and production facilities in rates for the nine months from April 1, 1992 through December 31, 1992 is $600,817 and is shown in Table 2.

29. Table 2 shows the corrected cost for the New General Office and other production facilities after excluding the cost of the land of $139,887 and the double counting of permit fees of $6,774 that was included in Table 2 of the Proposed Decision.

30. Increase in revenue requirements associated with incremental plant additions result in long-term rate changes.

31. Table 3 shows the corrected calculation for AFUDC.

32. AFUDC did not begin accruing to the New Office Building until its cost reached the level of the net after-tax gain-on-sale. This occurred in November 1989. Then AFUDC was calculated on the difference between the New General Office costs and the net after-tax gain.

33. Using the gain-on-sale as an offset to SoCalWater's nondepreciable rate base retains it in the utility's operation.

Conclusions of Law

1. SoCalWater's decision to relocate its New General Office in San Dimas was reasonable.

2. The terms of sale and leaseback of SoCalWater's Old General Office were reasonable.

3. The costs of construction of the New General Office and other production facilities were reasonable.

4. SoCalWater should be allowed to increase its rates by $600,817 to recover the revenue requirement associated with the ownership of the New General Office and other production facilities.

5. Ordering Paragraph 3 in D.89-04-079 does not permit SoCalWater to pass through in rates the $94,875 undercollection resulting from the difference between ownership cost revenues collected and the actual costs incurred with regard to the leaseback.

6. Since SoCalWater has completed its move to the New General Office and by this decision we will not permit the undercollection in the memorandum account established by D.89-04-079 to be passed through in rates, the memorandum account should be closed.

7. The revenue requirement deficiency due to delay in inclusion of the New General Office and other production facilities in rate base should not be included in rates because of retroactive ratemaking implications.

8. The proposed treatment of gain-on-sale as outlined in this decision, whereby the net after-tax gain-on-sale is applied as an offset to SoCalWater's nondepreciable rate base is adopted.

O R D E R

IT IS ORDERED that:

1. Southern California Water Company (SoCalWater) is authorized to increase its rates by $600,817 for the nine months from April 1, 1992 through December 31, 1992 to recover incremental revenue requirements associated with the ownership of its New General Office and other production facilities.

2. SoCalWater is denied recovery of the $94,875 undercollection in the memorandum account established by D.89-04-079 and this account shall be closed.

3. SoCalWater is denied recovery of revenue requirement deficiency due to delay in inclusion of the New General Office and other production facilities in rate base.

4. The proposed treatment of gain-on-sale as outlined in this decision, whereby the net after-tax gain-on-sale is applied as an offset to SoCalWater's nondepreciable rate base is adopted.

5. The proceeding in Application 88-12-020 is closed.

This order is effective today.

Dated March 31, 1992 at San Francisco, California.

DANIEL Wm. Fessler
President
JOHN B. OHANIAN
PATRICIA M. ECKERT
NORMAN D. SHUMWAY
Commissioners

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

Neal J. Shulman

NEAL J. SHULMAN, Executive Director

Table 2

Incremental Revenue Requirment Calculation

	Total AFUDC	New Bldg Bal	New Bldg + AFUDC	- Old Bldg	Incr. Depn	Incr. Land	Sales Proceeds	Incremental RB (New Bldg + AFUDC - Old Bldg - Old Land + Incr. Land - Proceeds)	ROR	ROR on Incr. RB	Incr. O&M and PropTax	Tot Incr Exp (Depn + RORB + O&M/PT)	NTG Mult.	Incremental Rev Req Impact
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)
	293,509	4,560,048	4,853,557	568,728		139,887	(1,187,303)	2,948,613						
April			4,845,546	566,870	8,011	139,887	(1,187,303)	2,942,460	0.0089	26,068	3,643	37,722	1.78	67,145
May			4,837,535	565,012	8,011	139,887	(1,187,303)	2,936,307	0.0089	26,014	3,643	37,668	1.78	67,048
June			4,829,524	563,154	8,011	139,887	(1,187,303)	2,930,154	0.0089	25,959	3,643	37,613	1.78	66,951
July			4,821,513	561,296	8,011	139,887	(1,187,303)	2,924,001	0.0089	25,905	3,643	37,559	1.78	66,854
Aug			4,813,502	559,438	8,011	139,887	(1,187,303)	2,917,848	0.0089	25,850	3,643	37,504	1.78	66,757
Sept			4,805,491	557,580	8,011	139,887	(1,187,303)	2,911,695	0.0089	25,796	3,643	37,450	1.78	66,661
Oct			4,797,480	555,722	8,011	139,887	(1,187,303)	2,905,542	0.0089	25,741	3,643	37,395	1.78	66,564
Nov			4,789,469	553,864	8,011	139,887	(1,187,303)	2,899,389	0.0089	25,687	3,643	37,341	1.78	66,467
Dec 31, 1992			4,781,458	552,006	8,011	139,887	(1,187,303)	2,893,236	0.0089	25,632	3,643	37,286	1.78	66,370
											1992 Incr. Rev. Requirement Impact			600,817

Table 3

Calculation of AFUDC

Time Period	New Building	Sales Proceeds Net of Tax	Diff btn Bldg & Proceeds	AFUDC (Debt) Rate	AFUDC (Equity) Rate	AFUDC (Debt) Amt	AFUDC (Equity) Amt	AFUDC (D+E) Amt
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
May 31, 1989	270,124	1,187,303	(917,179)	0.0058	0.0020			0
June	272,108	1,187,303	(915,195)	0.0058	0.0020	0	0	0
July	494,968	1,187,303	(692,335)	0.0058	0.0020	0	0	0
Aug	665,756	1,187,303	(521,547)	0.0058	0.0020	0	0	0
Sept	993,585	1,187,303	(193,718)	0.0058	0.0020	0	0	0
Oct	1,002,018	1,187,303	(185,285)	0.0058	0.0020	0	0	0
Nov	1,374,959	1,187,303	187,656	0.0058	0.0020	0	0	0
Dec	2,255,901	1,187,303	1,068,598	0.0058	0.0020	1,093	375	1,468
Jan 31, 1990	2,626,375	1,187,303	1,439,072	0.0058	0.0020	6,225	2,137	8,362
Feb	2,970,022	1,187,303	1,782,719	0.0050	0.0033	7,159	4,725	11,884
March	3,161,898	1,187,303	1,974,595	0.0050	0.0033	8,869	5,853	14,722
April	3,565,115	1,187,303	2,377,812	0.0050	0.0033	9,824	6,483	16,307
May	4,164,632	1,187,303	2,977,329	0.0050	0.0033	11,830	7,807	19,637
June	4,175,549	1,187,303	2,988,246	0.0050	0.0033	14,812	9,776	24,588
July	4,430,814	1,187,303	3,243,511	0.0050	0.0033	14,867	9,811	24,678
Aug	4,692,614	1,187,303	3,505,311	0.0050	0.0033	16,136	10,650	26,786
Sept	4,700,739	1,187,303	3,513,436	0.0050	0.0033	17,439	11,509	28,948
Oct	4,703,506	1,187,303	3,516,203	0.0050	0.0033	17,479	11,536	29,015
Nov	4,703,506	1,187,303	3,516,203	0.0050	0.0033	17,493	11,545	29,038
Dec	4,703,506	1,187,303	3,516,203	0.0050	0.0033	17,493	11,545	29,038
Jan 31, 1991	4,693,942	1,187,303	3,506,639	0.0050	0.0033	17,493	11,545	29,038
Feb	4,684,378	1,187,303	3,506,639	0.0050	0.0033	0	0	0
March	4,674,815	1,187,303	3,497,075	0.0050	0.0033	0	0	0
April	4,665,251	1,187,303	3,487,512	0.0050	0.0033	0	0	0
May	4,655,687	1,187,303	3,477,948	0.0050	0.0033	0	0	0
June	4,646,123	1,187,303	3,468,384	0.0050	0.0033	0	0	0
July	4,636,559	1,187,303	3,458,820	0.0050	0.0033	0	0	0
Aug	4,626,996	1,187,303	3,449,256	0.0050	0.0033	0	0	0
Sept	4,617,432	1,187,303	3,439,693	0.0050	0.0033	0	0	0
Oct	4,607,868	1,187,303	3,430,129	0.0050	0.0033	0	0	0
Nov	4,598,304	1,187,303	3,420,565	0.0050	0.0033	0	0	0
Dec	4,588,740	1,187,303	3,411,001	0.0050	0.0033	0	0	0
Jan 31, 1992	4,579,176	1,187,303	3,401,437	0.0050	0.0033	0	0	0
Feb	4,569,612	1,187,303	3,391,873	0.0050	0.0033	0	0	0
March	4,560,048	1,187,303	3,382,309	0.0050	0.0033	0	0	0