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Decision 92-04-031 April 8, 1992

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of )	
Santa Paula Water Works, Ltd. )	Application 91-03-026
(U 320 W) for Authority to Increase )	(Filed March 11, 1991)
Rates as authorized by NOI 91-01-047.)	

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protestant.

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Division of Ratepayer Advocates and the  
Commission Advisory and Compliance Division  
and Willem R. Van Lier, for Commission  
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O P I N I O N

I. Introduction

Applicant Santa Paula Water Works, Ltd. (SPWW) provides water service to about 6,700 customers in the City of Santa Paula (City) and vicinity in Ventura County. SPWW is a wholly owned (99.9%) subsidiary of Park Water Company (Park). Park's operating divisions and other subsidiaries provide utility service in two other California locations. Park also operates a water utility in Montana. Park furnishes engineering, financial, data processing, and other management services to SPWW. Park's purchase of SPWW's common and preferred stock was authorized by the Public Utilities Commission (Commission) in 1980 by Decision (D.) 90217.

Historically, water utility operations began in Santa Paula in 1871, when a reservoir and main system were placed in service to distribute water from the nearby creek. Creek water was relied on for domestic water service until 1971, when public concerns about clean water prompted SPWW to drill wells. Wells are now used for all domestic service and some irrigation; creek water is used only for irrigation.

SPWW's existing rates were established by Resolution W-3499 in response to Advice Letter 51-W, an offset filing for increased purchased power costs. SPWW's last general rate case decision was D.88-12-082 in Application (A.) 87-09-035 for Test Years 1988, 1989 and Attrition Year 1990. That decision authorized a rate of return on equity of 13.00% and an overall return on rate base of 10.18%. Park's rate of return was last set by D.91-05-024 in A.90-08-054 (the Central District case) which authorized a rate of return on equity of 12.00% and an overall return on rate base of 11.80% based on equity ratios of 72% for 1991 and 69% for each of 1992 and 1993.

In this application (application), SPWW originally requested three annual rate increases. For Test Year 1992, the increase requested was \$1,223,100 or 56.08%; for Test Year 1993 and attrition year 1994, the increase requested was \$156,400 (4.6%) and \$154,600 (4.3%), respectively. These increases would assertedly produce a return on equity of 13% and an overall return on rate base of 13% for each of these years.

In the application, SPWW also requested the recovery of an undercollection in a Memorandum Account, authorized by Resolution W-3497, effective May 22, 1990. This undercollection, totaling \$93,500, is to be recovered by a commodity rate surcharge effective for one year.

After filing the application, however, SPWW revised its showing on certain issues. SPWW's revised request is for an increase of \$958,100, or 43.2% for Test Year 1992 and additional increases of approximately \$170,000, or approximately 5%, for each of 1993 and 1994. SPWW still requests the recovery of the Memorandum Account undercollection.

Duly noticed public participation hearings were held in Santa Paula at 2:00 p.m. and at 7:00 p.m. on April 24, 1991 before Administrative Law Judge (ALJ) Gilman.

Several irrigation customers expressed opposition to the increase in irrigation rates and complained of losses incurred due to the recent freeze. To a certain extent, some of this opposition resulted from the fact that the application contained a request for an 82% increase in irrigation rates due to an error in SPWW's rate design calculations. SPWW's explanation at the public participation hearings that its intent had been to request an irrigation rate increase consistent with the system average increase mollified these customers to some extent. (However, as noted below there still is significant opposition to the irrigation increase, based in large part on the prediction that irrigation

demand will increase or at least remain stable, instead of decreasing as predicted by SPWW.)

Several customers also expressed dissatisfaction with the overall amount of increase requested by SPWW. No customers stated that there were problems with SPWW's service.

Evidentiary hearings were held in Santa Paula before ALJ Gilman on August 5 through August 9. Statements and testimony were provided by several additional public witnesses concerned with agricultural rates. There were studies which attempted to refute SPWW's contention that agricultural sales would decline. Other customers were concerned that their rates would be expected to cover the investment cost of a large main to serve a new County Jail. The main will be installed in 1992. (SPWW proposed to fund this installation by means of an advance contract.)

Staff contends that SPWW has failed to meet its burden of proof both by failing to supply workpapers well in advance of the hearing, and by failing to provide evidence to satisfy the following holding:

"Of course, the burden of proof is on the utility applicant to establish the reasonableness of energy expenses sought to be recovered through ECAC. We expect an affirmative showing by each utility with percipient witnesses in support of all elements of its application, including fuel costs and plant reliability." (D.92496)

"This statement conforms to the fundamental principal involving public utilities and their regulation by governmental authority that the burden rests heavily upon a utility to prove it is entitled to rate relief and not upon the Commission, its staff or any interested party, or protestant, to prove the contrary."  
(Suburban Water Co., 60 CPUC 768 (1963) rev. denied; SoCal Gas Co., 58 CPUC 57 (1960); So. Counties Gas Co., 58 CPUC 27 (1960); Citizens Utilities Co., 52 CPUC 637 (1953)).

Staff is particularly concerned about the rate of return issues, stating in its brief:

"SPWW waited for the rebuttal phase before it made its real presentation. It ultimately relied on staff's testimony to make it [sic] own case...."

Staff proposes that we condemn "...SPWW's strategy for what it is, an unfair and wasteful practice. It should deem the utility as having failed in its burden of proof for those items that were not presented properly during the utility's direct presentation as well as for those last minute additional requests."

SPWW, on the other hand, challenges staff for trying to relitigate, for example, the imputed equity ratio which was decided adversely to the staff in D.91-05-024 supra, only a few months prior to the hearing in this proceeding. That case, in turn, was an unsuccessful attempt by staff to litigate the issue as decided in A.89-07-011, D.90-02-045 (Park's Apple Valley Ranchos rate case).

SPWW complains that after it agreed to a month's delay in the Regulatory Lag Plan schedule for hearings to accommodate Staff scheduling difficulties, Staff did not deliver either its exhibits or its workpapers to SPWW on time. Staff's report was issued only 17 days prior to the start of hearings rather than the 20 days required by the Rate Case Plan. SPWW alleges that Staff workpapers were not available 15 days before start of hearing. SPWW contends that there was insufficient time for "the informed communications to facilitate understanding of positions which are encouraged by the Rate Case Plan (D.90-08-045) to avoid or resolve discovery disputes."

Each party is clearly dissatisfied with the tactics of its opponent and assigns it the primary responsibility for inefficiencies in the hearing process.

We are also concerned about the cost of the process; the per customer costs of litigating this case are distressingly high.

The company's costs alone will exceed \$5.00 per year per customer; Staff's costs, funded by fees charged to customers of all water customers, will be of a comparable magnitude.

With annual costs at this level, we cannot help asking whether the process has become more expensive than can be justified by possible benefits to the public. We invite both parties in their Comments, to propose strategies and process changes which can lead to more efficiencies and lower costs for the next rate case due three years from now.

Among the problems we wish to avoid are the following:

1. Relitigation of issues recently resolved on the merits without providing new arguments or facts, e.g. merit salary adjustments, capital structure;
2. Reliance on previous findings which do not resolve an issue on the merits; e.g. regulatory expenses.
3. Failure to develop a fall-back position or abandon an issue when cross-examination develops fatal defects, e.g. chemical expenses.
4. Failure of the prehearing process and exchange of information; e.g. rate of return.

#### City's Position

The City's position on the application was expressed in a statement by its Mayor pro tem.

He argued that utility wages and benefits should be the subject of the same kind of bare-bones approach that the City has used for its own employees.

He does not anticipate the need for mandatory reductions in consumption and therefore no need for increases in unit rates to compensate for reduced sales.

He believes that all City residents wish to make sure that they are not called upon to subsidize either operating or



capital costs of the new County jail project. He also recommended especially careful review of the costs of Park services to applicant SPWW. He was further concerned that SPWW might be moving to replace mains earlier than absolutely necessary. Finally, he expressed the community's concerns over the added costs necessary to meet new water quality standards mandated by the Federal government.

## II. Allowances and Disallowances Summarized

### A. Summary-Resolution of Issues

In the discussion which follows, we have explained how we have resolved the issues specified, as summarized:

1. We have adopted the SPWW-recommended figures for predicted consumption, other than agricultural. For agricultural usage, we have found that the record will not permit a reasoned prediction and have adopted the 1990 recorded figure.
2. For water treatment chemicals, we have adopted SPWW's estimate.
3. We have found that SPWW's ad valorem tax estimate for both Park and SPWW property, accurately projects assessments.
4. We have adopted staff's estimate of A&G - Office Expenses.
5. We have allowed applicant the 6.3% actual cost of living allowance (COLA) increase for workers, rejecting staff's position that no more than 5% can be justified;
6. We have adopted staff's estimate for Park director's fees. We have found that an extra executive automobile for Park is justified. (Park's main office expenses are allocated between SPWW's customers and Park's other customers in the ratio of 13.16% for data processing and 12.38% for other expenses.)

7. For Park's expenses for consultants and attorneys, we have adopted SPWW's estimates.
8. We have determined that SPWW needs a new well in 1991 and another in 1993, rejecting staff's recommendation to rely on existing wells and conservation.
9. We have adopted the SPWW methodology and lead/lag analysis for working cash.
10. We have adopted the SPWW projection that Advances from the new County jail project will be booked to plant in 1992 and will be funded by advances, not contributions.
11. We have adopted a ROE which reflects the DRA recommendation; we have found that it is just and reasonable for stockholders to earn 11.75% on their investment.
12. We adopt staff's recommendation that we impute an equity ratio of 60%, rejecting SPWW's recommendation for a 69% ratio.
13. We have adopted the SPWW recommendation that it be allowed to recover 50% of its fixed charges in the service charge; rejected staff's proposal for zone rates and adopted the SPWW recommendation that for the present, irrigation rates be increased by the system average increase, rejecting staff's recommendation for a lower recovery.
14. Since it is non-controversial, we have decided to authorize the recovery of the under-collection from the account established in Resolution W-3497.

The tables which follow compare the parties' estimates with the quantities adopted:

TABLE 1

## SANTA PAULA WATER WORKS

1992

SUMMARY OF EARNINGS  
(\$000)

Items	Utility		Staff		ADOPTED	
	Present	Proposed	Present	Proposed	Present	Authorized
Oper. Revenues	2,182.6	3,405.8	2,275.5	3,546.9	2,256.6	3,127.8
Deferred Revenues	0.0	4.9	0.0	4.9	0.0	4.9
Total Revenues	2,182.6	3,410.7	2,275.5	3,551.8	2,256.6	3,132.7
O & M Expenses	1,102.4	1,102.4	996.7	996.7	1,064.7	1,064.7
Uncollectibles	3.7	5.8	3.9	6.1	3.9	5.4
Subtotal O & M	1,106.1	1,108.2	1,000.6	1,002.8	1,068.6	1,070.1
A & G Expenses	750.4	750.4	660.3	660.3	741.5	741.5
Franchise	0.0	0.0	0.0	0.0	0.0	0.0
Main Off. Alloc.	304.8	304.8	260.7	260.7	283.3	283.3
Subtotal A & G	1,055.2	1,055.2	921.0	921.0	1,024.8	1,024.8
Ad Valorem Taxes	60.8	60.8	29.8	29.8	59.2	59.2
Payroll Taxes	63.7	63.7	59.4	59.4	63.2	63.2
Depreciation Exp.	289.1	289.1	272.2	272.2	287.7	287.7
CA Income Tax	(37.5)	76.5	(14.0)	104.0	(37.3)	44.0
Federal Income Tax	(127.0)	291.3	(52.6)	380.5	(129.8)	168.6
Total Expenses	2,410.4	2,944.8	2,216.4	2,769.7	2,336.4	2,717.6
Net Revenues	(227.8)	465.9	59.1	782.1	(79.8)	415.1
Rate Base	3,578.5	3,578.5	3,361.8	3,361.8	3,593.3	3,593.3
Rate of Return	-6.37%	13.02%	1.76%	23.26%	-2.22%	11.55%

TABLE 2  
SANTA PAULA WATER WORKS  
1993  
SUMMARY OF EARNINGS  
(\$000)

Items	Utility		Staff		ADOPTED	
	Present	Proposed	Present	Proposed	Present	Authorized
Oper. Revenues	3,420.7	3,577.1	3,592.7	3,757.1	3,162.1	3,293.2
Deferred Revenues	4.9	5.6	4.9	5.6	0.0	5.6
Total Revenues	3,425.6	3,582.7	3,597.6	3,762.7	3,162.1	3,298.8
O & M Expenses	1,139.6	1,139.6	1,022.7	1,022.7	1,095.1	1,095.1
Uncollectibles	5.8	6.1	6.1	6.4	5.4	5.7
Subtotal O & M	1,145.4	1,145.7	1,028.8	1,029.1	1,100.5	1,100.8
A & G Expenses	850.6	850.6	743.2	743.2	829.3	829.3
Franchise	0.0	0.0	0.0	0.0	0.0	0.0
Main Off. Alloc.	336.6	336.6	281.7	281.7	305.9	305.9
Subtotal A & G	1,187.2	1,187.2	1,024.9	1,024.9	1,134.2	1,134.2
Ad Valorem Taxes	57.5	57.5	30.1	30.1	56.5	56.5
Payroll Taxes	68.0	68.0	61.1	61.1	66.1	66.1
Depreciation Exp.	330.1	330.1	301.1	301.1	330.8	330.8
CA Income Tax	59.7	74.3	95.4	108.4	29.6	42.4
Federal Income Tax	185.6	239.1	304.0	349.8	86.4	133.0
Total Expenses	3,033.5	3,101.9	2,845.4	2,904.5	2,804.1	2,863.8
Net Revenues	392.1	480.8	752.2	858.2	359.0	435.0
Rate Base	3,680.6	3,680.6	3,494.4	3,494.4	3,767.4	3,767.4
Rate of Return	10.65%	13.06%	21.53%	24.56%	9.50%	11.55%

TABLE 3  
SANTA PAULA WATER WORKS

1992

INCOME TAX  
(\$000)

Items	Utility		Staff		ADOPTED	
	Present	Proposed	Present	Proposed	Present	Authorized
Total Revenues	2,182.6	3,410.7	2,275.5	3,546.9	2,256.6	3,132.7
Expenses						
Oper. & Maintenance	1,106.2	1,108.3	1,000.6	1,002.7	1,068.6	1,070.1
Admin. & General	1,055.2	1,055.2	921.0	921.0	1,024.8	1,024.8
Ad Valorem Taxes	60.8	60.8	29.8	29.8	59.2	59.2
Payroll Taxes	63.7	63.7	59.4	59.4	63.2	63.2
Subtotal	2,285.9	2,288.0	2,110.8	2,012.9	2,215.8	2,217.3
Deductions						
CA Tax Depr.	300.0	300.0	264.5	264.5	280.2	280.2
Interest	0.0	0.0	151.3	151.3	161.7	161.7
CA Taxable Income	(403.2)	822.8	(151.1)	1,118.1	(401.1)	473.5
OCFT	(37.5)	76.5	(14.0)	104.0	(37.3)	44.0
Deductions						
Fed. Tax Depr.	286.3	286.3	261.4	261.4	276.6	276.6
Interest	0.0	0.0	151.3	151.3	161.7	161.7
FTT Taxable Income	(352.1)	873.9	(133.9)	1,135.3	(360.2)	514.4
FTT (Before Adjustment)	(120.1)	298.2	(45.7)	387.4	(122.9)	175.5
Prorated Adjustment	0.0	0.0	0.0	0.0	0.0	0.0
I T C	(6.9)	(6.9)	(6.9)	(6.9)	(6.9)	(6.9)
Net F I T	(127.0)	291.3	(52.6)	380.5	(129.8)	168.6

TABLE 4

## SANTA PAULA WATER WORKS

1993

INCOME TAX  
(\$000)

Items	Utility		Staff		ADOPTED	
	Present	Proposed	Present	Proposed	Present	Authorized
Total Revenues	3,425.6	3,582.7	3,592.7	3,757.1	3,162.1	3,298.8
Expenses						
Oper. & Maintenance	1,146.5	1,146.7	1,028.8	1,029.1	1,100.6	1,100.8
Admin. & General	1,187.2	1,187.2	1,024.9	1,024.9	1,134.2	1,134.2
Ad Valorem Taxes	57.5	57.5	30.1	30.1	56.5	56.5
Payroll Taxes	68.0	68.0	61.1	61.1	66.1	66.1
Subtotal	2,459.1	2,459.4	2,144.9	2,145.2	2,357.4	2,357.6
Deductions						
CA Tax Depr.	324.8	324.8	264.5	288.8	316.4	316.4
Interest	0.0	0.0	157.2	157.2	169.5	169.5
CA Taxable Income	641.7	798.5	1,026.0	1,165.8	318.8	455.3
OCFT	59.7	74.3	95.4	108.4	29.6	42.3
Deductions						
Fed. Tax Depr.	326.3	326.3	261.4	291.2	318.2	318.2
Interest	0.0	0.0	157.2	157.2	169.5	169.5
FIT Taxable Income	563.7	720.5	925.1	1,059.5	273.0	409.5
FIT (Before Adjustment)	192.3	245.8	315.7	361.5	93.1	139.7
Prorated Adjustment	0.0	0.0	0.0	0.0	0.0	0.0
I T C	(6.7)	(6.7)	(11.7)	(11.7)	(6.7)	(6.7)
Net F I T	185.6	239.1	304.0	349.8	86.4	133.0

TABLE 5

## SANTA PAULA WATER WORKS

1992

RATE BASE  
(\$000)

Items	Utility	Staff	ADOPTED
Plant in Service	10,683.5	9,958.5	10,608.5
Work in Progress	41.2	41.2	41.2
Materials & Supplies	56.7	52.8	56.3
Working Cash	229.3	148.3	242.3
Method 5 Adj.	23.8	23.8	23.8
Subtotal	11,034.5	10,224.6	10,972.1
Less:			
Depreciation Reserve	2,482.4	2,470.0	2,480.3
Advances	4,223.2	3,650.1	4,150.1
Contributions	252.3	252.3	252.3
Unamortized ITC	0.0	0.0	0.0
Deferred Income Tax	667.8	658.9	665.9
Subtotal	7,625.7	7,031.3	7,548.6
Net District Rate Base	3,408.8	3,193.3	3,423.5
Main Office Allocation	169.7	168.5	169.7
Total Rate Base	3,578.5	3,361.8	3,593.2

TABLE 6  
SANTA PAULA WATER WORKS  
1993  
RATE BASE  
(\$000)

Items	Utility	Staff	ADOPTED
Plant in Service	11,872.6	10,707.6	11,864.2
Work in Progress	0.0	0.0	0.0
Materials & Supplies	63.0	56.9	63.0
Working Cash	219.6	150.2	230.2
Method 5 Adj.	29.0	29.0	29.0
Subtotal	12,184.2	10,943.7	12,186.4
Less:			
Depreciation Reserve	2,758.0	2,724.7	2,755.5
Advances	4,867.0	3,735.8	4,787.4
Contributions	272.8	405.3	272.8
Unamortized ITC	0.0	0.0	0.0
Deferred Income Tax	772.9	748.5	770.4
Subtotal	8,670.7	7,614.3	8,586.1
Net District Rate Base	3,513.5	3,329.4	3,600.3
Main Office Allocation	167.2	165.0	167.2
Total Rate Base	3,680.7	3,494.4	3,767.5



B. Discussion

1. Water Usage

Staff's and SPWW's estimates of consumption are shown below for each class of water service (numbers shown are in Ccf per year). The estimates are the same for each of Test Years 1992 and 1993.

	<u>Staff</u>	<u>Applicant</u>	<u>Staff Estimate Exceeds Applicant</u>
Public Authority	1,433.5	1,339.7	93.8 (7%)
Resale	12,226.6	11,599.0	627.6 (5.4%)
Irrigation	26,754.7	21,247.9	5,506.8 (25.9%)

SPWW and staff agree on the estimated amount of water consumption for SPWW's commercial customers during the Test Years.

In arriving at its estimated water consumption amounts, SPWW consistently used the "Modified Bean Method" and the "Committee Method" with respect to each class of service. Staff, on the other hand, used the Modified Bean Method to calculate estimated water consumption for commercial customers but decided to adopt a novel approach for estimating consumption for the public authority, resale and irrigation classes of service. Staff's estimates for these classes of service were calculated using the most recent available five-year average (1986-1990) of recorded data.

Staff has explained its departure from established practice by testimony that the noncommercial customers are "less subject to weather and temperature fluctuations" than commercial customers.

SPWW contends that it is unclear from staff's testimony at the hearing whether or not staff objects to SPWW's use of the Modified Bean Method itself or if it objects to the manner in which it was calculated with respect to SPWW's noncommercial customers. SPWW's expert witness asserts that the Modified Bean Method was

intended to apply to all classes of customers and that he properly applied the method.

As SPWW's expert witness testified, the Modified Bean Method is a method of generating weather-normalized consumption predictions. The method is a standard established under the aegis of the Commission with active participation of the water industry.

SPWW's witness testified that public authority and irrigation classes of customers are as affected by weather and temperature fluctuations as commercial customers, and therefore, it is entirely appropriate to use the Modified Bean Method for those classes of customers as well.

Staff asserts, in response, that the results reached by SPWW through this method were "unreasonable" and, therefore, should be disregarded. With respect to the irrigation class of service, Staff points to the fact that SPWW's estimated water consumption for irrigation customers during the Test Years is lower than recently recorded data.

However, in the opinion of SPWW's witness, its projections do not reflect a reduction in consumption, but rather a return to normal pre-drought consumption. In his opinion, this result is a logical result of the normalization process inherent in the Modified Bean Method.

Although some of SPWW's irrigation customers testified at the hearing that they did not expect their future water consumption to decline, SPWW asserts that this testimony is not representative of all of SPWW's customers, is based on recent weather conditions and does not anticipate any weather fluctuations or any statistical variation.

Staff argues that one particular year, 1983, should not have been included in SPWW's analysis because it was a year in which record rainfall was recorded.

SPWW responds that to arbitrarily exclude such a year would violate the Modified Bean Method. As SPWW's expert witness

testified, the Modified Bean Method does not allow certain years to be excluded in the test period merely because they were years of unusually high or unusually low rainfall. In his opinion, the method requires that all relevant years be included unless something other than a naturally occurring event transpires in a particular year which affects consumption (such as mandatory rationing).

Staff has taken the position that SPWW should have used the same time frame (i.e., the five most recent years) in applying the method to each of the various classes of customers. As SPWW's expert witness responded, the Modified Bean Method dictates that the analyst begin with up to 13 years of data (if available) and then select the years during that period that give the best correlation. He followed this procedure and concluded that the best correlation is achieved by analyzing the years 1985-1990 for commercial customers, 1984-1990 for public authority customers and 1979-1990 for irrigation customers.

Staff has also taken issue with SPWW's use of projected acres irrigated rather than the number of customers in predicting irrigation demand. Staff in its testimony showed that the number of acres irrigated has essentially remained constant for the recorded data utilized in this proceeding (1974- 1990). SPWW's witness responded that a customer can significantly change the number of acres he irrigates in a given year. It claims that SPWW's irrigation customers have changed the number of acres irrigated.

Staff criticizes SPWW for predicting a drop in irrigation consumption in California's record fifth year of drought. It points to the testimony of several of local farmers who provided first hand knowledge and experience supporting Staff's position that water usage will not decline in the near future. The farmers also testified that the winter freeze of 1990 has caused them to plant new trees which require more water than mature plants.

We note that one farmer testified that trees are now sprayed to protect them from freezing weather. He also described newer irrigation hardware which permits trees to be watered with less waste.

In our view, irrigation is now influenced by so many new developments that the past, even a weather-normalized past, is not a reliable guide to future consumption. We have, therefore, adopted neither Staff nor SPWW estimates but have adopted the 1990 recorded figures. In so doing, we have given some weight to the efforts of consumer witnesses who attempted to make predictions without using the traditional Bean method. In addition, we have given weight to the testimony of farmers predicting their own individual usage.

For public authority and resale customers, we have adopted SPWW's estimates. We believe that its witness placed less reliance on subjective judgment in his application of the Bean method than most experts and hence have adopted his results.

## 2. Chemicals

SPWW's estimates of AquaMag (a sequestering agent) expense have been calculated at .88 gallon of AquaMag per acre foot (A.F.) of production and \$12.75 per gallon based on its total normalized domestic production estimates. Staff's estimate utilizes the same two factors, .88 per gallon per A.F. and \$12.75 per gallon, and applies them to a five-year average of the production from the three wells where AquaMag is used.

Staff contends that SPWW has failed to provide Staff with sufficient data for purposes of analyzing this expense. Staff argues that utility's analysis is faulty due to its reliance on usage for the entire water supply rather than that portion of its production which specifically relates to AquaMag usage.

Staff notes that the SPWW witness testified that his factor of .88 gallons of AquaMag is incorrect if used in a formula which uses production from only the three wells which need AquaMag

treatment. He also testified that he did not know what the proper factor would be if only the three wells are studied.

Staff contends that SPWW has failed to meet its burden of proof on this issue. Its witness testified that Staff had no recourse but to rely upon the insufficient data provided to it by SPWW. It argues, "The utility has not provided, and apparently is unable to provide any new data other than the .88 factor. Therefore, Staff was unable to investigate the authenticity of SPWW's chemical expense amounts."

SPWW responds that Staff's methodology is inappropriate for three reasons. First, Staff's use of a five-year average for those three wells ignores the fact that there has been a significant change in the production of Well 11. Water was not pumped extensively from this well during most of the five-year period used by Staff due to an iron and manganese problem for which it was being treated. Treatment with AquaMag allowed SPWW to increase production on Well 11 and reduce production on another well which had high TDS (total dissolved solids).

SPWW points to evidence that production from Well 11 went from 316 A.F. in 1986 to 1644 A.F. in 1990, an amount significantly higher than the 619 A.F. average used by Staff.

Second, SPWW also points to an apparent inconsistency between this Staff adjustment and Staff's use of applicant's estimate in accepting the purchased power estimate.

However, SPWW's main criticism is that staff misapplied the .88 factor derived by SPWW to the production figures for only three rather than all the wells. Since the three wells represent only 70% of SPWW's production, SPWW argues that we cannot rely on the Staff estimate.

We share Staff's concern that SPWW's methodology was based on total production rather than production of the three wells which need treatment. This methodology seems on its face capable of producing an accurate prediction, but we are not sure that the

inclusion of the other wells did not introduce an unintended distortion.

On the other hand, the Staff's estimate is plainly wrong. Both parties agree that Staff should have used a much larger factor.

Staff has misconstrued the burden of proof rule. SPWW has met its burden of going forward by presenting a prediction by a qualified credible witness who used an internally consistent methodology. While we have our doubts that an inclusion of untreated wells might have created an error, SPWW's result is clearly more reliable than Staff's which used a factor both parties agree is erroneous. We have, therefore, found that SPWW's prediction is the only acceptable one presented.

### 3. Labor Escalation-1991

Staff's estimates of SPWW's labor escalation during Test Years 1992 and 1993 and attrition year 1994 in are based primarily on the attrition amount (5%) adopted in the Central Basin decision, supra. This decision used the Division of Ratepayer Advocates (DRA)-published general attrition factors. SPWW has agreed to use these estimates for all years for which it is necessary to estimate the labor escalation. For 1991, however, SPWW's labor escalation projection is not an estimate. Rather, it is based on the actual 6.3% cost of living increase to be granted to SPWW's employees effective January 1991.

SPWW claims that this 6.3% increase for 1991 is not "arbitrary" as Staff argues, but is based on the recorded 6.3% increase in the Los Angeles, Anaheim, Riverside regional Consumer Price Index from October 1989 to October 1990 as reported by the U.S. Department of Labor - Bureau of Labor Statistics. SPWW regularly uses this Index figure in determining the cost of living increase granted to its employees.

Staff contends that consumers should not have to pay a full COLA during an admitted recession. It also points to the

depressed conditions in the local agricultural sector caused by the recent freeze.

Staff's reliance on D.91-05-024 is misplaced. The Staff witness relied on Finding of Fact No. 9 of that decision which reads:

"With respect to labor escalation, while the 6.3% increase granted by Park to its employees during 1991 may be proper, there was no opportunity by Branch to verify its propriety because the increase was not brought to Branch's attention until the hearing. Therefore, the 5% labor increase recommended by Branch during both 1991 and 1992 is appropriate."

D.91-05-024 did not determine that the 6.3% increase was improper, merely that SPWW did not raise the issue in a timely fashion.

Staff should be given credit for looking to the prior decision for an opportunity to avoid relitigation. However, a finding such as this indicates that there was no resolution of the issue on the merits, and hence nothing which could be relied on in a subsequent proceeding.

We have considered and rejected Staff's arguments that COLAs are inappropriate because of depressed local or statewide economic conditions. It was not fair to raise an issue with such wide-ranging implications in a proceeding where the directly affected employees do not have organized representation, and where other utility employees who could be indirectly affected have not had notice or opportunity to appear.

We have adopted the company's estimate. It has met its burden of going forward with the evidence by showing what the actual expense will be. Because the COLA percentage was set by unilateral action of the utility, its burden should arguably call on it also to establish that the percentage was selected with reference to an acceptable standard. It has done so. The standard

it used is on its face somewhat more reasonable than Staff's figure. Staff's figure presumably is reasonable for the entire state, but the factor SPWW used is tailored to a smaller area which includes Santa Paula. SPWW's percentage is, for that reason, preferable to that proposed by Staff. Its estimate will be adopted.

4. Local Payroll Expense

Staff and SPWW disagree on four issues in the area of payroll expense. These issues are: (a) the need for an additional employee in a Water Quality/Safety/Conservation position, (b) temporary help, (c) merit increases, and (d) bonuses.

a. Additional Employee

Staff and SPWW agree with respect to the expense associated with an entry level position included in SPWW's 1991 payroll expense. This position became available when an employee was promoted to Inspector. Staff has not included in its estimates, however, the new Water Quality/Safety/Conservation position proposed and, in fact, already hired by SPWW in 1991.

This new position would have responsibility for: Safety - conducting and documenting safety meetings, documenting various reports that have to be kept on file for California Occupational Safety & Health (OSHA) and the state, safety training, analyzing new safety regulations and their application to SPWW's system; Water Quality - keeping track of water quality testing results and schedules and adjusting testing schedules depending upon results; and Conservation - implementing conservation programs at the division levels and documenting effectiveness of these programs. SPWW contends that this position is justified because of the need for SPWW to comply with increasingly stringent water quality laws and regulations now in effect and currently being proposed, including SB 198.

Staff apparently believes that this workload can be absorbed by SPWW's existing employees with the addition of the one entry level position discussed above. The evidence shows that in



1980 SPWW had 22 employees and 5,913 customers. SPWW currently has 23 employees, including the new Water Quality/Safety/Conservation position and will have 24 when the new entry level position is filled this year. The evidence also shows that SPWW currently has 6,773 customers. This is a 13.9% increase in customers and its proposal to add new employees to 24 would mean only a 9.0% increase in employees. It also was shown that that SPWW's number of employees in 1986-1990 has not increased significantly over the 1980 level.

Staff argues that SPWW has an adequate employee per customer ratio. According to SPWW, Staff failed to consider in its analysis the fact that SPWW's employees also operate three mutual water companies, an activity which requires approximately 3.5 employee equivalents. SPWW operates these companies under contract and charges them for this operation.

Staff expects that the burden of compliance with new safety and water quality regulations to be handled by the same SPWW personnel who are now responsible for those functions.

SPWW responds that the need for for this new position complies with the recommendations of Park's outside consultants. Park has established this position at each of its other divisions and subsidiaries, except at Central Basin, Park's largest division, where an entire position is devoted solely to conservation.

On balance, we think that SPWW has adequately demonstrated that a new position for these functions is warranted, and that its overall level of employees to customers (including mutual customers) is not excessively high.

b. Temporary Help

SPWW has included three temporary employees in its payroll estimates for 1992 and 1993. Staff did not include these temporary employees in its estimate, claiming that SPWW had not had any temporary employees for the last five years and there was no justification to include them during the Test Years.

Apparently the dispute arose primarily from a difference in the interpretation of certain utility workpapers supplied to the Staff. In the course of preparing a late-filed exhibit on this topic, SPWW found reason to concede that one of the employees it listed as part-time should instead be listed as a full-time employee.

With this adjustment, we adopt the utility's contention that it has regularly employed what might be described either as part-time or temporary employees. We, therefore, find it reasonable to expect that it will continue to employ the same number of non-full-time employees in the future.

c. Merit Increases

SPWW's payroll estimates include estimates, by individual employee, of merit increases expected to be granted in 1991-1993. Staff has excluded these merit increases from its estimates, arguing: "[b]y escalating SPWW's recorded payroll expense to the Test Years, Staff has properly accounted for merit increases occurring in 1991 and which will occur in 1992 and 1993. ...This methodology is used in connection with all Class A water utilities. The Staff is unaware of any known changes that will produce SPWW employee turnover that will impact merit salary adjustments."

It would appear that Staff has based its position on an assumption that turnover would replace high-salaried with low-salaried individuals offsetting any merit increases. Staff apparently also assumed that the utility might decide not to grant some merit increases. (The Staff witness admitted that he had no information on the number of times the utility had refused a merit increase.)

SPWW claims that the Commission in Central Basin, supra, criticized this assumption that merit increases are offset by turnover, while approving the same detailed methodology now used by SPWW. SPWW quotes Finding of Fact No. 8 which states that:

"Park has utilized, in connection with the development of its payroll expense, a methodology which incorporates specific facts applicable to its circumstances, rather than the general methodology utilized by Branch. The more specific approach is appropriate in these circumstances because it is more accurate."

It also quotes the discussion at mimeo. p. 37:

"...for purposes of estimating appropriate Test Year data, smaller utilities present a much different problem than do those of significantly greater size...Park's Central Basin Division work force is a mere 40 employees. The company is able to ascertain and monitor the precise payroll expense incurred in connection with that force with little apparent difficulty."

Staff has given us no reason why the finding of that prior decision should not be applied directly. In the future when dealing with any district of any utility having 40 or fewer employees, we will expect Staff to cite both this decision and Central Basin if it chooses to sponsor an adjustment based on the methodology it used here.

d. Bonuses

For each of Test Years 1992 and 1993, SPWW has included \$10,000 in its payroll estimate for employee bonuses. Staff did not include bonuses in its estimate arguing that, while SPWW is free to give bonuses, they should not be passed on to the ratepayer.

SPWW argues that it awards bonuses to its employees for activities, efforts or ideas which result in increased efficiency, productivity or service. SPWW's bonus plan is designed to motivate its employees to produce this increased efficiency, productivity and service. SPWW claims that ratepayers are the beneficiaries of any such increase.

It also notes that any savings from employee initiatives will benefit shareholders only until the next rate case, at which time they will be picked up in the recorded experience of SPWW and reflected in rates.

Staff did not brief this issue. We consider the Staff proposal to be short-sighted. It is in the consumers' interest to award employees for innovations. Therefore, these awards are a legitimate charge against consumers. We have adopted SPWW's reasoning and found that the expense should be passed on to the ratepayer.

5. Regulatory Commission Expenses

SPWW bases its estimate of regulatory commission expense upon the actual cost of its most recent prior rate case, escalated from 1987-88 to 1990-91, and rounded down to \$100,000. Staff's estimate is based on the \$60,000 amount adopted in that rate case (D.88-12-082), escalated to 1991. Both applicant and Staff propose that their estimates be amortized over three years.

Staff claims that D.88-12-082 found \$60,000 to be a reasonable and prudent amount. Staff further claims that the backup material provided by applicant on the \$93,814 recorded cost of its last rate case was not sufficiently detailed and that Staff could not verify the actual costs of the proceeding.

Staff claims that it could not verify the recorded expense focuses on the legal expenses which represent about one third of the recorded expense. Staff did not analyze any of the other categories of regulatory commission expense.

D.88-12-082 shows that the \$60,000 adopted for regulatory commission expense in that rate case was the full amount requested by SPWW. The decision also notes that SPWW arbitrarily capped its request at this amount in anticipation of a Staff recommendation for disallowance. D.88-12-082, in adopting this amount, does NOT find, directly or impliedly, that a greater expenditure would have been unreasonable or imprudent. Further, it is clear that the

issue resolved was the proper level of hourly charges by the SPWW attorney, not the reasonable amount of total regulatory costs or even the reasonable number of attorney hours.

Because the actual expense assertedly exceeded \$150,000 in that rate case, SPWW has abandoned the practice of using a "capped" figure for regulatory expense. Attempts to accurately estimate rate case costs in the succeeding two Park rate cases, involving Apple Valley Ranchos Water Company (Apple Valley) and Central Basin, resulted in requests of \$58,200 and \$80,100, both of which were adopted. In both instances the estimates were lower than the actual costs of \$77,800 and \$99,500 respectively.

Assertedly, every one of the last four rate cases of Park and its subsidiaries have cost significantly in excess of the \$64,200 (\$60,000 escalated to 1991) cost estimated by Staff in this proceeding.

Applicant believes that the actual cost of its most recent rate case is a more reasonable basis for an estimate than the outdated and arbitrary amount used by Staff. Staff has not provided any calculations or detail to justify the reasonableness of its estimate.

We have considered Staff's claim that over concise record-keeping made it impossible to verify that the recorded figure did not include some other legal work which should have been accounted for elsewhere. Since we doubt that any incorrect billings would have come anywhere near the \$50,000 which SPWW has decided not to claim, we will not pursue the question further.

If D.88-12-082 had found that \$60,000 was the maximum reasonable amount for regulatory expense, Staff would have had a strong argument for adoption of that amount, escalated to 1991 levels. Its case would have been even stronger if its proposal had also considered an escalated update of the estimates in other recent Park cases. Since, however, it misinterpreted the findings

which it relied on, we cannot give any weight to its recommendation. We will simply adopt the company's figure.

We will observe without finding that \$100,000 does appear to be an excessive amount for the 6,700 customers of this system to pay. Even if there were such a finding it would not necessarily follow that a portion of the actual expense should be disallowed. The number of professional hours actually expended seem to be a rational response to the number of Staff-raised issues and the tenacity of its tactics.

6. Ad Valorem Tax

Staff contends that it has used the same method (Historical Cost Less Depreciation) as used by the State Board of Equalization. Its Brief states:

"Staff's estimates for Test Years 1992 and 1993 are lower than the utility's by \$19,800 and \$14,000 respectively. ... Staff in its calculation used estimated Plant in Service, Construction Work in Progress, Materials & Supplies and Main Office Allocation, less Depreciation Reserve, Advances, and Contributions, and multiplied the resultant by the weighted average tax rate of 1.0453267%."

SPWW's estimates for ad valorem taxes are based on the assessed value placed on SPWW's property for 1990-1991 by the Ventura County Assessor's Office. The ad valorem tax expense for future years has been calculated based on SPWW's estimated plant additions assuming: an effective rate equal to the average 1990-1991 rate; half-year convention, and previously existing plant remains at constant assessed value as depreciation approximately offsets appreciation.

SPWW has calculated the allocated Main Office ad valorem taxes similarly.

SPWW claims that the Staff methodology, if applied to past years, would produce tax expenses significantly less than the amounts actually paid. For example, the calculated 1990 figure

would, according to SPWW, be \$34,988, which is significantly lower than the actual 1990 ad valorem tax expense of \$41,396 as shown in the 1990 Annual Report to the Commission. Assertedly, similar calculations for other prior years show that in Staff's methodology would never generate a sufficient amount to cover SPWW's actual ad valorem tax expense.

According to SPWW, there are several possible explanations for this shortfall. SPWW first points out that, "... it is the Ventura County Assessor's Office, not the Board of Equalization, which determines SPWW's ad valorem taxes."

Staff has also, according to SPWW, excluded property acquired by contribution or through interest-free loans as not subject to property tax. SPWW contends that Staff has provided no justification for this assumption. Finally SPWW asserts that Staff has calculated ad valorem taxes on a modified "rate base" method rather than on the assessed value of SPWW's property.

As a matter of logic and policy, rate cases should accurately reflect the methodology which will actually be used to fix the utility's taxes during the test period. Unfortunately, SPWW has managed to cast sufficient doubt on the Staff evidence, that we cannot adopt its recommendation in this proceeding. We will adopt the SPWW estimates.

We will encourage Staff, in future water rate cases, to verify its methodology with the appropriate taxing authority. To re-emphasize, our findings in this matter are meant to cover this proceeding only and should not be relied on in any future proceeding involving Park or any other utility.

We have found that SPWW's ad valorem tax estimate for both Park and SPWW property is based on a reliable projection of assessments.

7. Outside Consultant Expenses

Staff's estimate for outside services is roughly \$30,000 lower than SPWW's and is based upon the latest five-year recorded average (1986-1990 with an agreed-upon escalation factor).

The Staff brief says only that:

"SPWW based its estimate on the Main Office budget but was unable to provide testimony to sponsor its derivation. SPWW erroneously misinterpreted the Staff position to be only in opposition to the attorney and consultant components of outside service rather than it [sic] entirely."

SPWW's brief, on the other hand, states:

"SPWW's estimates of Outside Service Expense are based on its 1991 budget, escalated to the Test Years (with the exception of the Audit Fees/Income Tax category, where the 1991 budget escalated amounts have been increased by \$10,000 for 1992 and \$5,000 for 1993 to reflect FASB requirements). Staff has based its estimates on five year averages, claiming that SPWW has provided no justification for increases above that amount."

It appears that there was major confusion between the parties concerning this account. Staff changed its main exhibit during the hearing to reflect a different justification for its disallowance. The record indicates that SPWW may have been given conflicting information concerning the amount and justification for the disallowance.

Even by the time for preparation of the joint comparison exhibit, the parties could not agree on a description of the differences between them.

Staff seems to call for SPWW to provide justification for budgeting more for these expenses than would be justified by escalated historical expenditure. We understand that Staff has urged SPWW to supply such justification in its brief, at least



impliedly conceding that the confusion at hearing deprived SPWW of a fair opportunity to rebut or cross-examine.

Since Staff seems to have waived its right to object to providing a substitute for evidence on brief, we will state that the facts in the record as supplemented by SPWW's brief support the following claims:

1. SPWW will incur increased legal expense in the test years for Commission OII's (Drought and Risk).
2. SPWW will incur increased Brown & Caldwell (B&C) consultant costs in connection with new safety laws. SPWW will be doubling the number of safety audit inspections performed annually by B & C, and adding a surprise audit. In addition, there will be increased work being done by B & C in connection with safety and water quality.
3. SPWW will incur additional consultant expense during the Test Years on the following items:
  - FASB (Federal Accounting Standards Board) 96 - Accounting For Income Taxes, which will require restatement of the balance sheet to reflect effects of TRA 86. (The Tax Reform Act of 1986.)
  - FASB 105 - Disclosure of Information about Financial Instruments with Off-Balance Sheet Risk, which requires investigation of all financial instruments and disclosure on financial statements.
  - Retirement Benefits Other than Pension, which requires changes in accounting procedures concerning this account.
  - State Franchise Tax Board rules for taxable status of Contributions.

SPWW's estimates of outside consultant expenses should be adopted.

8. Main Office Expenses

a. Director's Fees

SPWW's estimate of these fees is based upon Park's budget, which assumes Park will hold 12 monthly formal directors' meetings each year. Staff has based its estimate on three directors meetings per year, the average number of meetings over the last five years. This budget reflects a change in policy which now dictates monthly directors' meetings.

Staff relies on the fact that Park did not have formal directors' meetings every month prior to 1991. Staff's estimate is based on a historical average of three meetings per year. It also used the average number of attendees - six - plus a consultant, times the actual fee of \$300.

The utility explains that Park did not have regular monthly meetings in the past because the directors often conducted necessary business informally over the phone. The new monthly meeting policy has been instituted in order to enable Park to have formal minutes of the meetings and, therefore, formal monthly records of the decisions made and business transacted by the Board.

SPWW has overlooked what should have been a significant question--why does Park need to conduct its affairs with such formality when there are apparently no minority interests?

Even if we were to assume that it was necessary to make a formal record of decisions on a monthly basis, there is room to doubt that a formal face-to-face meeting is necessary. This is, after all, the age of the conference call and fax transmission.

For these reasons, the utility showing leaves us unconvinced that monthly meetings are a necessity. We have adopted Staff's adjustment.

b. Outside Services

This expense category includes legal and engineering services provided to Park under contract. Staff used Park's 1990

actual figures with escalation to test year levels. SPWW, on the other hand, escalated a figure representing a five-year average to test year levels.

The difficulty lies in developing an estimate which will fully compensate applicant for unanticipated non-recurring costs which arise during the test years. It is a virtual certainty that there will be such costs and it is clear that we must now give an estimate which adequately compensates SPWW. On the other hand, neither party has come up with a methodology which can be relied on to prevent either over- or under-estimating. We have, therefore, decided to split the difference.

c. Budget vs. Average

This issue affects several Main Office expense categories in both Data Processing and non-Data Processing areas. In both areas, the issue affects office expense, utilities - telephone, meals and travel, and maintenance. In non-Data Processing alone, additional categories are auto expense and utilities-other. For Data Processing alone there is a difference over consulting expense.

The total differences before allocation are:

	<u>SPWW</u>	<u>Staff</u>	<u>Difference</u>
1992	\$420,600	\$326,300	\$ 94,300
1993	437,800	337,100	100,700

SPWW used its 1991 budget figures. Staff used a five-year average. Staff claims that budget figures are inherently unreliable and biased and should be rejected in favor of objectively based estimates. SPWW responds that the Staff methodology will be inherently inaccurate when applied to expenses where there is a clear inflationary trend or where there are other, objectively verifiable changes in circumstances. SPWW contends that Staff has applied its methodology arbitrarily and indiscriminately.

We should observe that there is nothing inherently suspicious about a budget estimate. A realistic management may very well use the same conservative approach to budgeting as it should use for ratemaking. The real question should not be whether a particular ratemaking estimate is the same as a budget estimate, but whether the underlying methodology is sound.

With these expense, a lack of hearing time precluded a detailed, line-by-line analysis of each expense. While there is reason to expect that some expenses would be understated if we split the difference between Staff and utility estimates, the result should nevertheless be more conservatively realistic than the positions of either party.

We have found that it is realistically conservative to adopt an estimate for these expenses which splits the difference between the parties' estimates.

9. A&G Office Expenses-Meals and Travel

SPWW's estimates of A&G - Office Expenses are based on its 1991 budget.

Staff's estimate differs from SPWW's estimate because Staff based its estimate for meals and travel (one of the expense categories in this area) on the recorded 1990 expense rather than on SPWW's 1991 budget.

SPWW claims that Staff offers no explanation for its objection to SPWW's 1991 budget estimate for this one expense category in the area of A&G - Office Expenses.

SPWW's brief complains:

"Staff has apparently ignored the possibility that additional employees and new job responsibilities connected with the conservation and safety efforts of SPWW could result in increases in meals and travel expenses. The burden of proof may be on SPWW, but surely Staff should have a reason for recommending the adoption of a different methodology for one category among all the others in an area of expense."

Staff, on the other hand, complains that budget projections are inherently unreliable, since they represent a unilateral and to some extent, self-serving, estimate. While we will not arbitrarily downgrade a budget estimate, we note that this particular budget item appears to be less well founded on recorded data and other hard evidence than other budget items.

We are concerned that Staff may have overlooked real changes in SPWW's operations, and that it may have underestimated. However, on balance we are not convinced that SPWW's projection is even slightly more reliable than Staff's and hence adopt the more conservative figure.

### III. Rate Base

#### A. Working Cash Allowance

Both SPWW and Staff have arrived at estimates of rate case cost (Regulatory Commission Cost) for this proceeding and agree that the total amounts be recovered through a three-year amortization, with 1/3 of the total being expensed each year. Both SPWW and Staff have included the annual amortization (1/3 of the total) in their lead-lag studies. The issue in this area arises because SPWW and Staff have used different methodologies to account for the lag caused by the amortization process itself, or the impact of the unamortized portion which will be deferred and not yet expensed.

SPWW has included the annual amortization of the Regulatory Commission Costs, the amount being expensed each year, in the Lead-Lag study at zero lag days. A zero lag is, according to SPWW, standard for amortizations and is based on the assumed timing of transferral from the deferred account to expense during the year. SPWW has then included as a working cash item (in the fixed portion of working cash), the average unamortized balance of

the Regulatory Commission Costs for each year to account for the delay between expenditure and recovery caused by the amortization.

Staff does not include the average unamortized balance as a working cash item in the fixed portion, but instead accounts for the delay due to amortization by applying negative lag days (lead days) to the annual amortization expense in the lead-lag study for each year. Staff uses (180) days for 1992 and (540) days for 1993.

SPWW believes that its methodology is more appropriate for the following reasons:

1. This methodology was used for the adopted working cash in D.88-12-082 for SPWW, D.90-02-045 for Apple Valley, and D.91-05-024 for Park.
2. Commission Standard Practice U-16 on the Determination of Working Cash Allowance explains that the Working Cash Allowance is determined as the average balance in certain balance sheet accounts (the fixed portion) and the working cash resulting from the timing difference between paying expenses and receipt of revenues (the Lead-Lag study). One of the balance sheet accounts listed in U-16 is "Other Deferred Debits," which includes those debits that are in process of amortization and abnormal expenses which are being amortized to operating expenses.
3. The lead-lag study is normally used to determine the revenue lag and compare it to an average expense lag. Individual expense components are assigned lag days representing the payment pattern, i.e., monthly vs. quarterly or prepaid vs. paid-in-arrears. This system does not readily lend itself to a situation where (i) most expenses were paid monthly, in various months, over a period of a year, (ii) where this situation will not occur again for three years, and (iii) where the whole process occurred before the Test Years and an average of two years before the revenue will be received.

4. Including the unamortized balance in the fixed portion more closely approximates the reality of the situation by providing SPWW with a return on the average amounts that it actually has in its deferred debit account. Assigning negative lag days results in higher working cash in the record Test Year (due to use of a lag day more negative by 360 days) when SPWW does not have as much investment tied up in the unamortized balance.
5. Appropriate negative lag days are hard to determine because rate case expense is incurred over a long period of time from the preparation of the application to the comments on the proposed decision. Expenses of varying amounts and various types will be incurred each month over a period of more than a year. As such, it is significantly more accurate to use SPWW's methodology than it is to use Staff's.

In addition to the above objections to Staff's methodology, SPWW objects to the lag days which Staff has utilized in its methodology.

Staff has determined the lag between the time when SPWW has incurred the expense and when the revenues will be received based on two assumptions: (1) that revenues will be received evenly over the year thereby approximating the midpoint of the year, and (2) that the expense will be incurred on January 1, 1992. Staff takes the difference between January 1, 1992, and the midpoints of 1992 and 1993 to arrive at (180) and (540) lag days, respectively.

SPWW does not take issue with Staff's assumption regarding revenues, but strongly disagrees with the assumption that all expense will be incurred on January 1, 1992. SPWW has received monthly legal bills in connection with its last rate case, which were paid monthly. Since the Notice of Intent (NOI) in this proceeding was filed in January of 1991, it is obvious that work was being done by consultants, and supplies and reproduction

services were being used in 1990. The bulk of the attorney's time with respect to this rate case has been spent during the hearing and briefing phase just completed. SPWW scoffs at Staff's assumption that all attorneys, consultants, reproduction services, post office (notices), Commission (transcripts), etc., will be willing to wait until January 1, 1992 to be paid. SPWW claims that this assumption is also inconsistent with Staff's estimate of Regulatory Commission Costs which escalates the amount adopted in D.88-12-082 to 1991, obviously assuming that the expense will occur in 1991.

Staff has failed to explain why it has rejected an apparently acceptable methodology used in all other recent Park cases. Nor has it demonstrated that its new methodology is consistent with Standard Practices.

In addition, Staff based its lag calculation on an assumption concerning payment dates. For a lead lag study to be acceptable, there should be a reasoned attempt to show when payments will actually be made.

For these reasons, we will reject the Staff's working cash allowance, for both methodology and the calculation for lag days.

1. Wells

SPWW claims it needs to drill an additional two wells to meet production demands on its water system. It is anticipated that the first well will come on line in 1991 and the second well in 1993.

Staff has taken the position that applicant's present pumping and storage capacities are adequate to meet present and future water requirements during the test period, and beyond.

Staff's position is based on three alternatives available to applicant: recalculate its needs and capacity, take conservation measures, and rely on a future state water supply.



Assertedly, SPWW surprised Staff with a request for a new well for 1993. SPWW allegedly did not provide workpapers or data to support this request for a second well in time for an adequate Staff preparation.

SPWW's Exhibit 10, shows that its capacity, under normal weather conditions, for all present wells is 7,854 gpm. This was the data that was provided to DRA prior to the hearings and upon which Staff relied for its analysis. Assertedly without prior notice or consideration for the need to provide Staff with new data for prior review, SPWW introduced Exhibit 16, intended to show that the total well capacity is 6,613 gpm due to a present decrease in pumping capacity.

According to the Staff witness, even if one relies on SPWW's capacity figure, the system can go for 6.1 days at maximum daily demand before the fire flow requirement of 3,500,000 gallons is tapped.

2. The Witthoft Comment

In the course of preparation of its position on wells, the Staff project manager asked Terry Witthoft, an executive of another water utility, to run some figures through an existing spread sheet routine which displays hourly consumption and replenishment figures. The inputs to be used in this run were from this utility. However, those numbers are somewhat different from the numbers on which Staff now relies to demonstrate adequacy of the system, particularly in the area of pumping capacity. Witthoft in his response to Staff volunteered the following: "This system needs an additional 2,000 gpm of well capacity for safe operation..."

Staff claims that the relevant pumping capacity figures are so different from those given to Witthoft, that his comment is irrelevant and should be disregarded.

We note that Staff's presentation would have been more convincing if it had submitted its additional capacity evidence for

further comment by Mr. Witthoft, rather than giving elaborate explanations of why it did not contact him again.

3. Conservation

Staff has taken the position that applicant should adopt mandatory conservation measures before seeking to add wells. However, since the purpose is to avoid a future expenditure rather than deal with a drought or other emergency situation, it is open to question whether applicant could satisfy Water Code § 350, et seq.

We are also concerned about public response. Compliance with water rationing is relatively high when the public believes that there really is not enough water for normal usage. We have little experience with conservation measures taken merely to reduce rates. Unless the public is willing to conserve to avoid paying for additional plant capacity, we can have little confidence that conservation measures will be an effective long-term substitute for well capacity.

4. Department of Health Services (DHS)  
Capacity Figures

Staff initially relied on capacity figures in a DHS document concerning applicant. This document showed total pumping capacity of 7,435 gpm. However, the Staff witness could not explain what information DHS used to prepare this document. Since no witness was made available to explain the data, we cannot give it any weight.

5. Southern California Edison (SCE) Pump Tests

In California water rate cases, it is customary to rely on electric utility pump tests to measure capacity. The Staff had such figures available to it, but chose to rely on the DHS figures. The exhibit showing SCE capacity tests displayed results under three different modes of operation. The test showing the

lowest capacity favors SPWW's position. Staff chose to rely on capacity figures from the third level of testing which appears to give the theoretical maximum output.

SPWW argued that Test 3's discharge pressure of 45.6 PSI is too low for purposes of analysis and that Test 1's discharge pressure of 60 PSI is more appropriate.

On brief, Staff argued:

"SPWW is incorrect. According to the Commission's General Order 103, II, 3, (a), the minimum pressure requirement is 40 PSI. Thus, all three discharge pressures that result from tests 1, 2 or 3 will suffice for purposes of determining minimum pressure requirements. The significance of this is that SPWW's sole reliance on test 1 results in the 6,613 gpm figure being on the lower end for purposes of trying to determine total well capacity."

We will not adopt a finding based on this Staff reasoning. It involves questions concerning the operation of a water system, and should be supported by the opinion of a qualified system operator and subject to cross examination.

We will find that the Level 3 of the SCE pump tests should not be relied on to determine SPWW's pumping capacity.

#### 6. Average Lives

SPWW points out that two of its existing wells have lives which are approaching the average life expectancy. The company argued that these wells will pose an unacceptable chance of failure.

Staff responds that there are many wells which operate well beyond the average life expectancy and it is not sufficient or prudent to assume that a particular well will fail simply because it has reached its average life expectancy.

In our opinion, the Staff has failed to deal adequately with this issue. We do not accept the view that it is prudent for a utility to rely on over-age wells. If Staff believes that the

utility is being overcautious, it should provide evidence to support use of a test other than average life expectancy.

In our view, the evidence concerning the two oldest wells tends to support SPWW's position that production can be expected to decline significantly, and that it is prudent to avoid the worst case scenario of catastrophic failure during a week-long heat wave.

7. Alternative Supply

SPWW contends that this water supply will most likely not be available for another five years. Furthermore, SPWW argues, the amount of any such supply would be uncertain and outside of the control of applicant at all times.

The evidence on this alternative supply was sparse, to say the least. After submission, the ALJ asked for officially-noticeable information on this project. This possible new supply is discussed in relation to the 1993 well below.

8. Conservation

Staff claims that SPWW could reduce its supply deficiency by adopting mandatory conservation.

SPWW argues that this is an untenable position. It points out that a utility cannot just unilaterally declare mandatory conservation on a given peak day. In order to institute mandatory conservation measures, SPWW contends that it would have to declare a water emergency, hold public meetings in compliance with the California Water Code and obtain Public Utility Commission approval for such measures (TR 615; Cal. Water Code §§ 50, et. seq.), a process which takes a significant amount of time.

9. Water Quality

SPWW's system has very little ability to pump water from a well in one location for use in another part of the service area. Therefore, SPWW's wells must be located to supply peak day demands throughout the system.

According to SPWW, it is probable that it will be unable to pump two existing wells - Wells 8 and 9 - at full capacity because of unacceptable nitrate levels. These wells have a combined capacity of roughly 3 million gallons per day or approximately 2,000 gpm. They are located in the eastern half of the City of Santa Paula, where applicant proposes to locate the new well proposed for 1991. Though portions of the production from these two wells are normally delivered to the irrigation system, Applicant has had the ability to deliver their full production to the domestic system should it be required.

Blending of water from Wells 8 and 9 with water from applicant's other wells is not practical in applicant's water system. Therefore, peak demands can place SPWW in the unfortunate position of either delivering poor quality water to a significant segment of its customers, or compromising its reserve for fireflow.

We recognize that high nitrate content is a threat primarily to senior citizens and infants, and that the majority of Santa Paula's citizens can probably drink such water on a sustained basis. Moreover, it may be reasonably safe for even these high risk groups to drink high nitrate water for a few days.

Arguably, a prudent utility might be willing to deliver high nitrate water for a few days, if it takes reasonable steps to warn parents or older patrons to switch to bottled water.

However, the Staff did not try to balance the extra cost of new wells against the consumers' interest in limiting the amount of nitrate in drinking water.

The Staff witness did concede that if Wells 8 and 9 become nonfunctional, applicant will need additional sources of supply. Since Staff did not adequately consider the risk factor, we will find that this factor supports utility's decision not to rely on Wells 8 and 9.

10. Design Criteria

A SPWW witness testified that there are certain "cardinal rules" which must be followed in designing and operating a water system. One such rule is that a water company's reservoir must always be replenished at night. According to SPWW, a major Staff Exhibit supports applicant's position that the system currently has inadequate capacity if this standard is used. It shows that on a hypothetical single peak day, the reservoir was not replenished by the end of the day.

The second cardinal rule cited by the SPWW witness is that there must always be redundancy in the system to provide for the loss of the largest source of supply on any given peak day.

As applicant's witness testified, if the well with the largest capacity in applicant's system were to fail to function during a week of continual peak days (not an unusual occurrence in Santa Paula), the reservoir would empty twice. This would violate the witness' "cardinal rules"; a decision not to provide additional well capacity would assertedly contradict minimum acceptable design and operational standards for water systems.

Staff responds that applicant's reservoir will never be depleted but will always be completely replenished on a daily basis even with a week of peak days. However, applicant's witness testified on cross-examination, that if applicant were to lose Wells 8 and 9, the system would lose approximately three million gallons of water per day. This would compromise the needed reserve capacity for fire fighting.

11. Analysis

This area does not present a "zero-sum" situation. Customers will lose if we select either an overly optimistic or overly pessimistic solution. If Staff's projections are wrong, consumers could wind up with inadequate water in a worst case situation. On the other hand, if the utility experts are unduly

pessimistic, the worst that can happen is the customers will pay more than the absolute minimum for water service.

Given the interests at stake, we would prefer to ask customers to fund a system which is capable of maintaining adequate fire reserves over an extended hot spell even with a catastrophic failure of two wells. This may be unduly pessimistic today, but will become less so as the existing wells lose capacity. Moreover, our decision should also make it easier to avoid delivering high-nitrate water to a portion of the city. We will, therefore, allow funding for applicant's proposed 1991 well.

We are more concerned about SPWW's proposal to drill a well in 1993. Even though additional capacity will be needed in the long term, the paucity of information about the new imported water makes it impossible to decide whether it would be more prudent to wait until imported state water is available. After submission, the Staff responded to a request for officially-noticeable documents relating to the new water source. The ALJ took notice of the documents; they do not however convince us that consumers can rely on having this water available any time during this decade.

We will, therefore, adopt estimates which reflect a new 1993 well. SPWW is, however, placed on notice that it may not be allowed to recover the full cost of this well in either depreciation or amortization. That issue will turn on the quality of information available to management when it commits itself to the project, and will be decided in the next rate case.

12. 1993 Main Extension Advances

a. 1993 Advances

Applicant's estimate for 1993 advance funded plant additions is based on an average of recent years, as well as the judgment of its General Manager.

Staff criticizes applicant's estimate, in part, because applicant has no specific, definite projects with which to justify its estimate because 1993 is too far in the future. According to SPWW, applicant has not in past rate cases been in a position to provide definite information on advances in the second test year. A Staff witness admitted that this lack of definite information on advances is not unusual for utility companies. Even though applicant has no definite information, it contends there are potential projects or projects in the planning stage which could well cause applicant's advances to equal or exceed its estimate.

Staff's estimate is based on a methodology which uses the approximate 1993 customer growth of 100 customers, generates an amount of expense (less depreciation) for the 100 customers based on the average revenues and expenses per customer, and then adds the depreciation expense that would be generated by advances until the revenues equal expense. The amount of advances that would generate sufficient depreciation expense to equal the revenues was calculated by Staff to equal \$280,000.

SPWW argues that Staff's methodology is flawed. Staff assumes that new customers will generate expenses equivalent to the average customer expense. SPWW argues in response that new customers will be served by new mains, so maintenance expense in connection therewith will be negligible. In addition, SPWW points out that A&G expenses do not increase in direct proportion to number of customers.

SPWW argues that the Staff methodology does not account for the offsetting impact of the tax depreciation on the new plant which is to be advanced. Staff also ignores the fact that the full amount of an advance frequently does not coincide with the full number of potential customers coming on line.

SPWW argues that the biggest flaw in the Staff proposal is the assumption that applicant will be able to "draw the line" after it has received \$280,000 in advances and require all



subsequent developers to make contributions. It argues that Rule 15 makes no provision for such arbitrary line drawing, but requires each project to be judged on its own merits.

This Staff proposal is apparently an innovation. A Staff witness admitted to being unaware of any decisions in which Staff's methodology had been adopted by the Commission.

SPWW implicitly concedes that the underlying Staff philosophy (i.e., that advance estimates, unless based on specific projects, should be consistent with the customer growth experience), could be attractive.

SPWW has offered an alternative calculation in its briefs which relies on information already in the record and develops a figure of \$408,300. This number is consistent with average recorded customer growth.

The SPWW alternative estimate is welcome since it provides a basis for reducing the influence of subjective judgement on the estimating process. We do find the Staff proposal very interesting. If the Water Utilities Branch wishes to pursue the issues raised in this topic (and in the Staff recommendation on the County Jail), it would probably be preferable to consider them in a rule-making proceeding to change the Main Extension Rule, rather than in a rate case involving a single utility.

We have concluded that the Branch proposal would require SPWW to deny some developers the possibility of refunds in contravention of the Main Extension Rule. We have found that an estimate based on long-term growth trends is more reasonable than one based on a single year. While we are reluctant to adopt a methodology not subjected to cross-examination, the alternative proposal produces a compromise figure and eliminates the least satisfactory feature of the original SPWW estimate, its reliance on subjective judgement. The SPWW alternative proposal is adopted.

b. County Jail Main Extension Advance

The utility's estimate of advance funded plant additions estimates that the County jail project will be booked to plant in 1992 and will be funded by an Main Extension advance contract. Staff's evidence indicates that the jail will not be completed within the test years. Staff has not included this project in its projections based on its opinion that it should not be reflected in rates until the jail is completed and occupied. Numerous public witnesses were concerned that new rates might conceal a cross-subsidy of this project by existing customers.

SPWW's evidence shows that, though the jail may not be completed in the test period, construction is scheduled to begin in 1992 and that the schedule calls for the water facilities to be in place in 1992 in order to provide water for construction purposes and fire flow. From this, SPWW concludes that the facilities will be used and useful in 1992, and must therefore be included in rate base.

A Staff witness also claimed that the outlays associated with the jail advance should be proportionate to the revenue generated by it. He recommends that the \$1,000,000 jail advance be treated as a contribution. The principal Staff witness agreed with this recommendation, and stated that:

"Advances should be timed with the revenues that those advances are being built for. You cannot have advances being put on the book[s] of a utility now and charge depreciation expense to the customers and the revenues will be coming four years from now."

SPWW argues that its extensions, even ones as unusual as this, are covered by its tariff Main Extension Rule; the terms of this rule have been dictated by the Commission. The Rule reads:

"If, in the opinion of the utility, it appears that a proposed main extension will not, within a reasonable period, develop

sufficient revenue to make the extension self-supporting, or if for some other reason it appears to the utility that a main extension contract would place an excessive burden on customers, the utility may require nonrefundable contributions of plant facilities from developers in lieu of a main extension contract."

In this case, the utility has exercised the discretion given it by the Rule and determined that the period of construction is a "reasonable period". There is insufficient evidence to justify substituting our judgment for the utility's. Even if there were, County has not been given notice or opportunity to be heard on a proposal which would deprive it of the prospect of Main Extension refunds. While Staff may have found a circumstance which requires a deviation from the Rule, this is not the proper proceeding to adjudicate the merits of its proposal.

If Staff wishes to pursue this matter further, it is free to recommend an OII, naming both SPWW and County. For the purposes of this proceeding, we will adopt SPWW's proposal.

13. Imputed Equity Ratio

Park conducts its California operations through its Central Basin Division and through two wholly-owned California subsidiaries, Apple Valley and SPWW. Park borrows all funds for its subsidiaries and provides them with required capital through intercompany transactions. Park and its subsidiaries have, in effect, a single common capitalization. Park incurs all of the system debt, and its subsidiaries do not incur or maintain any debt.

In A.89-07-011, (Apple Valley), DRA accepted the use of a common capital structure for Park and its subsidiaries, specifically stating that Apple Valley has no debt and that, accordingly, the most appropriate capital structure to use was the capital structure of its parent, Park. Although DRA accepted the use of a common capital structure in that proceeding, it

recommended that Park's actual capital structure be ignored, and recommended an imputed capital structure having equity percentages of 75% for 1990, 70% for 1991, and 65% for 1992 (D.90-02-045, page 21). The Commission rejected DRA's recommendation, however, and adopted an imputed capital structure having equity percentages of 76% for 1990, 72% for 1991, and 69% for 1992.

In A.90-08-054, (Central Basin Division) despite its belief that its actual equity ratio was reasonable, SPWW recommended that the capital structure for 1991 and 1992 be again adopted in order to avoid litigating this issue. DRA, however, elected to litigate this issue and recommended that a capital structure containing 65% equity be imputed to Park for each of Test Years 1991 and 1992 and attrition year 1993.

D.91-05-024, issued by the Commission in that proceeding following hearings in December 1990, adopted equity ratios of 72% for 1991 and 69% for 1992 and 1993, maintaining the ratios adopted in the Apple Valley decision for 1991 and 1992.

DRA has once again decided to litigate the imputed equity ratio, which is not improper, since both D.90-02-045 and D.91-05-024 anticipated that we might revisit the imputed equity ratios adopted by those decisions. The Staff brief states:

"Park's 1990 recorded capitalization of approximately 81% equity and 19% debt, is out of line in comparison to other water utilities. Park's projected capitalization for 1991 is approximately 72% equity and 28% debt. Projections for the test period indicate that Park will have an increasing equity ratio. In such instances, Staff imputes a capital structure that will show a trend toward comparability to other water utilities."

Staff recommended an imputed capital structure of 40% LTD and 60% equity based on an analysis of the last authorized equity ratios for all California Class A water companies. Its brief states:

"...[S]taff draws two major conclusions. Park is really a mid-size Class A water utility, and its last authorized equity ratio of 69% is significantly higher than the average of the medium sized group, which is 55%. Considering only size as a specific measure of risk, one would expect Park to have a capital structure comparable to the other similarly sized Class A companies, all other things being equal. Since there are no other risk factors which distinguish Park from other utilities within this group, Staff recommends that the Commission impute an equity ratio of 60%, which is the highest authorized equity ratio for a comparably sized California Class A water utility."

We agree with Staff that this equity-heavy debt ratio is adverse to consumer interests, and that they would be better served if the ratio were more in line with other Class A companies. We also agree that, from a ratemaking standpoint, it is appropriate to consider whether we should impute a better-balanced capital structure.

SPWN has offered testimony that, among other things, its small size and the fact that its stock is not publicly traded distinguishes it from other Class A companies. It argues that Staff has relied on the arbitrary dividing line between Class A and smaller companies, rather than directly addressing the question of whether lenders would treat it as having the same characteristics as larger companies.

With respect to the latter point, SPWN notes that in 1990, the Commission authorized Park to borrow at a rate not greater than 225 basis points over the interpolated 25-year Treasury bond rate (D.90-11-074). The maximum rate for this borrowing was set, by the above formula, at 10.7%, a rate which was substantially higher than the Standard & Poor's utility bond yield (9.93%) for BBB rated bonds. SPWN implies that this decision supports its contention that SPWN is riskier than other Class A water utilities.

On balance, while SPWW's arguments are not without merit, they do not persuade us to imput an equity ratio of 69% for SPWW. In reaching our decision we have considered the record as a whole. We discuss several important factors below.

We recognize that size is only one of several criteria by which utility risk may be measured. However, the evidence in this case shows that whether one focuses upon the number of service connections (46,230) or upon gross revenues (\$15.7 million), SPWW's parent (Park) is more than three times the size of the smallest of the 14 Class A companies in California. The authorized equity ratios for the 10 Class A companies, excluding Park, which have had recent general rate cases, range from 43% to 60%. The average, or mean, equity ratio for these 10 companies is 54%. In addition, DRA has presented evidence that the average equity ratio for a group of 13 comparable Class A companies drawn from across the United States is 45%.

Assessing how lenders view a given company's risk is made more difficult when the company is privately held. However, SPWW overstates the significance of D.90-11-074 in light of the changed economic circumstances since that time. At the August 1991 hearing in this proceeding, DRA presented then-current DRA/McGraw-Hill interest rate forecasts for the test period. Based upon the economic projections introduced at hearing, were the application underlying D.90-11-074 before us today, we would be unlikely to authorize Park to borrow at such a high rate.

We are not persuaded on the record developed in this proceeding that SPWW is subject to unique or particularly burdensome operational risks or that Park is subject to unusual financial risks. Our conclusion does not address SPWW's contention that water companies, such as SPWW, are as risky as energy companies, since that is an issue to be addressed in the pending phase of our "risk OII," which will examine the risk of Class A water companies. However, we do not need to decide this point to

reject SPWW's recommendation that we maintain the 69% imputed equity ratio authorized in Central Basin. That decision was based upon a different set of operational risks and upon economic conditions which have changed since evidentiary hearings in Central Basin.

We conclude that an imputed equity ratio of 60% is reasonable and should be used for ratemaking purposes in this general rate case proceeding.

14. Rate of Return on Equity

SPWW has requested a 13% return on equity (ROE). DRA has recommended a 11.75% ROE.

The Staff (DRA) witness conducted a discounted cash flow (DCF) analysis and a risk premium analysis based on information for 13 selected companies to estimate the equity cost of a typical water utility. His analysis indicated that the cost of equity capital for a typical water utility falls within a range of 11.52% to 12.33%. Based on those analyses and his own judgement, he concluded that a 11.50% to 12.00% ROE range is appropriate for a typical water utility and recommended that SPWW receive an equity return of 11.75%.

On rebuttal, SPWW contended that its cost of common equity ranges from 12.6 to 13.4% and that after DRA's analyses were "corrected" for "factual errors," they support an equity cost range which includes the 13% ROE requested by SPWW. On brief, Staff has argued that SPWW improperly attempted to make its direct showing on rebuttal, a tactic which afforded Staff and other parties insufficient opportunity to assess SPWW's evidence.

We do not intend to determine the correct ROE in this case based upon a mechanistic application of financial models. We agree with the proposed decision's conclusion that Staff's showing was not flawless. We disagree with the proposed decision's conclusion that SPWW's challenges to the Staff showing have

established that an ROE must be set above the 12% ROE authorized in Central Basin.

We draw our conclusion, in part, from factors cited in the proposed decision but which we interpret differently than did the administrative law judge. For example, in formulating the SPWW position, it is not clear to us how much the SPWW witness relied upon his fixed conviction that water utilities are as risky as energy companies. As we stated previously, this issue will be will be addressed in the pending "risk OII." Nor is it clear how much of SPWW's corrections were based on concepts weighed and found less than fully convincing in Central Basin. Finally, we are uncertain that the process of correcting the difficulties in the DRA presentation is as deterministic and judgement free as the testimony would make it appear.

We give substantial weight to evidence that, absent new and specific risks for SPWW, the state of the economy at the time of hearing, with reduced expectations of earnings in most sectors, warrants an ROE lower than the 12% authorized in Central Basin. We also take official notice of the ROEs we have authorized in the general rate case decisions we have issued for other Class A water utilities during 1991 and in 1992.

Therefore, having considered the record as a whole, we conclude that an ROE of 11.75%, which is the midpoint of the range DRA has recommended, is appropriate for the test period.

15. Rate Design

a. Service Charges

Claiming that its proposal represents Commission policy as set forth in D.86-05-064, SPWW has requested that monthly service charges be increased so that it can recover 50% of its fixed costs through service charge revenues.

Staff has recommended that the service charges be increased to generate 50% of fixed costs or increased by the system average increase, whichever is lower. The Staff witness



also cited this decision. He, however, claims that there is a qualification to that rule which states that the objective should be accomplished, if possible, without increasing service charges by significantly more than the average overall percentage increase.

SPWW claims that this qualification is not found in the ordering paragraphs of D.86-05-064 or its findings. Staff testimony also relies on a Staff memo, the rate design policy memo, dated January 18, 1991, issued by the Water Utilities Branch and circulated as an enclosure to a letter to all water utilities informing them of changes in service charge allocation by meter size.

According to SPWW's analysis, the documents do not contain any basis for Staff's statement or Staff's recommendation.

The Staff brief should have explained the basis for its recommendation, pointing out specifically the findings and/or ordering paragraphs from D.86-05-064 which underlie its statements. It failed to do so. As for Branch memos, they do not bind the industry. When Staff relies on them in a hearing, it must demonstrate that the policy is consistent with Decisions on the same topic and provide a policy witness who can withstand cross-examination on any policy questions not covered by the Decisions. It has failed to do this.

We conclude that the utility's recommendation is in line with expressed Commission policy, and that Staff has provided no support for its recommendation.

**b. Irrigation Cost of Service Study**

During the hearings, irrigation customers expressed concern that the proposed system average percentage irrigation rate increase was too high and suggested that irrigation customers might be subsidizing domestic customers. SPWW's brief challenged this suspicion noting that irrigation customers currently pay a commodity rate less than 1/3 of the domestic rate and pay no service charges.

SPWW has nevertheless agreed to include a cost of service study for irrigation in its next rate case. It also agreed to submit a "ballpark" irrigation cost of service study with the briefs. The study, a 1992 projected Summary of Earnings for irrigation only, at present and proposed rates, is attached to its brief as Schedule 1. This study, with supporting workpapers, has been provided to Staff.

This study is based on SPWW's best estimates of a 1992 stand-alone Summary of Earnings for the irrigation system. If SPWW had filed a separate mini-rate case for the irrigation system only, it would have sought an increase of \$86,650, or 80.8%, from irrigation customers. This is higher than the 56% average increase requested by SPWW and proposed for the irrigation customers. SPWW argues that, therefore, that the concerns of irrigation customers are probably unfounded and that if any subsidization is occurring, it is likely that the irrigation customers are currently being subsidized.

However, SPWW does not assert that this study has sufficient accuracy for adoption in this proceeding and, therefore, recommends that the system average increase be used for the irrigation rate increase. SPWW still intends to present a more complete study in the next rate case.

We have adopted the SPWW recommendation for the purposes of the proceeding only. Irrigation rates will be increased in direct proportion to increase for other classes of service.

#### 16. Zone Rates

Staff proposed zone rates during the hearing and was invited to flesh out its proposal in briefs. It did not do so.

We will treat the proposal as having been abandoned.

SPWW opposes zone rates for the following reasons:

- a. Zone rates require more record keeping, more programming of the billing system, more work during rate cases and offsets and more customer service effort. All of this costs additional money.
- b. Zone rates inevitably result in customer dissatisfaction along zone borders when a customer finds out that his neighbor next door or across the street pays cheaper rates.
- c. Rate case filing would require SPWW to have records of historic use by zone. SPWW does not have such records.

The basic concept in zone rate design is that customers in higher pressure zones (at higher elevation) should pay more because the pumping cost to get them water is higher. This ignores all other element of expense. In SPWW's case, the lower elevation is the old center of town and the upper elevations were added more recently. The lower area is comprised of old pipe that generates rate base, depreciation expense and significant amounts of maintenance expense and replacement plant additions. The higher elevations were largely built later through advance and contributed plant. These factors would offset any increased pumping costs to the higher elevations.

SPWW notes in closing that Staff proposed such a zone rate in the last Apple Valley rate case and the Commission, in D.90-02-045, decided against Staff's contention.

#### Comments

In accordance with our Rules, the assigned ALJ issued a Proposed Decision. Both SPWW and Staff filed Comments. SPWW filed a Reply to Staff's Comments.

The Staff's Comments criticize the proposed decision's findings and conclusions in the areas of cost of capital, the new well for 1993, and aqua mag useage. With the exception of

cost of capital, we do not believe Staff's objections are well-taken.

We do note, however, that the Staff's Comments fail to comply with Rule 77.4 which requires that comments shall include alternative findings and conclusions. In future cases, we expect Staff to explain any deviation from this Rule.

SPWW's Comments, with one exception, are directed to corrections of an editorial nature, each of which will clarify the decision, and are adopted. The exception is SPWW's proposal that the results of operation and the rates be recalculated to reflect current power rates. Staff concurs and that proposal will be adopted.

Findings of Fact

1. SPWW should be authorized a one-year surcharge to recover the Memorandum Account for AquaMag Expense authorized in Resolution W-3497. After expiration of the surcharge, any over- or undercollection of the memorandum account balance should be booked to SPWW's balancing account for recovery or refund.

2. SPWW's estimate of public authority and resale customer sales is less influenced by subjective factors than Staff's, and should be adopted.

3. Neither SPWW's nor Staff's estimates of irrigation usage adequately considered the effects of new uses, or of replanting of freeze-killed trees. The least unreasonable option is to split the difference between their estimates.

4. Other projections of agricultural consumption were based on historical consumption without weather normalization or adequate consideration of the effects of new uses, or of replanting of freeze-killed trees and should not be adopted.

5. SPWW's prediction of AquaMag usage may or may not be erroneous because of the inclusion of untreated wells. Even so, it is less unreliable than Staff's which clearly used an erroneous factor.

6. SPWW will actually pay a COLA of 6.3% in 1991. This amount is based on reliable statistics and is reasonable.

7. SPWW will need an additional employee to take care of compliance with new safety and water quality activities. Its ratio of employees to customers is not unreasonable.

8. Once one of SPWW's employees is properly classed as full time rather than part time, SPWW's estimate of expenses for temporary help is reasonable and should be adopted.

9. SPWW will actually pay merit adjustments to employees during the test years. The amounts have been calculated to satisfy findings and discussion of the Central Basin Decision.

10. SPWW will pay employee bonuses during the test year. These payments are designed to foster efficiency, which will in the long run benefit consumers. The expense is reasonable and should be allowed.

11. Staff's estimates of regulatory commission expense are unrealistic. Even if SPWW's past recorded payments include substantial amounts of disallowable costs, it is unlikely that the amount of adjustment will reduce the actual amounts paid in direct connection with this proceeding to a level less than \$100,000.

12. SPWW's estimate of ad valorem tax is based on past experience and should be adopted.

13. Staff invited SPWW to provide additional justification for its need for outside consultants in briefs. The information provided by SPWW indicates that its projection is reasonable.

14. SPWW has not demonstrated that its parent needs to conduct more than three directors' meetings per year. Staff's estimate of director's fees is reasonable and should be adopted.

15. Neither estimate of Main Office outside sources is satisfactory. The Commission should adopt an estimate which splits the difference.

16. Neither estimate of the Budget/Average is satisfactory. The Commission should adopt an estimate which splits the difference.

17. Staff's projection of meals and travel for SPWW are, at worst, somewhat more reliable than SPWW's and should be adopted.

18. Staff has failed to explain why it used a novel lead-lag methodology for working cash to covered deferred recovery of Regulatory Commission Expense.

19. Staff's lag day calculations assume that all expenses would be incurred on January 1, 1992. On its face, this assumption is contrary to fact.

20. Staff has failed to explain why it has rejected an apparently acceptable working cash methodology used in all other recent Park cases.

21. Staff has not demonstrated that its methodology is consistent with Standard Practices.

22. SPWW's working cash allowance is more reasonable than Staff's.

23. SPWW needs to drill a well to come on line in 1991 and another to come on line in 1993. Capitalization of these wells should be allowed.

24. SPWW's fall-back proposal for 1993 advances is on its face less unreasonable than either estimate considered at hearing.

25. The evidence shows that at least some of the revenue from the jail extension will be received in 1992.

26. SPWW has not demonstrated that SPWW is subject to unique or particularly burdensome risks or that Park is subject to unusual financial risks.

27. Economic conditions at the time of hearing and relative utility risks warrant an imputed equity/debt ratio of 60/40%.

28. The evidence supports an ROE of 11.75% for SPWW of the test period.

29. SPWW should be ordered to provide a cost of service study for agricultural rates in its next rate case. The material submitted after hearing would support a finding that agricultural uses are not subsidizing other customers.

30. The evidence does not support a zone rate proposal.

Conclusions of Law

1. In most situations, consumption for ratemaking should be based on past trends with historical data adjusted to normalize the effects of weather by use of the Modified Bean Method and the Committee Method. It is appropriate not to use the Modified Bean Method and the Committee Method to predict usage when variables other than weather make past consumption an unreliable guide to estimating consumption in the test years.

2. Finding 5 of D.91-05-024 did not determine that the 6.35 actual COLA was excessive. In any proceeding where Staff has an opportunity to verify the propriety of a particular COLA, a 5% figure would have no presumptive validity.

3. Finding 8 of D.91-05-024 rejected the Staff methodology for merit increases. If Staff wishes to rely on the same methodology to estimate merit salary increases in a proceeding involving a subsidiary, it had the burden of going forward with additional evidence to support its methodology.

4. The findings in D.88-12-082 are authority only for the proposition that a "capped" figure of \$60,000 was not unreasonably low. They could not be relied upon to find that amounts paid in excess of \$60,000 were unreasonable.

5. Staff has waived its objection to consideration of, and findings based on, allegations concerning increased consultant and legal expenses.

6. Lead-lag studies to develop working cash allowance should be based on a reasoned prediction of the timing of revenue and of actual payments.

7. As now written, the main extension rule does not permit a water utility to demand donation from a developer on the grounds that previous advances from other developers have exceeded a specified amount.

8. The main extension rule allows a water utility to exercise a wide discretion to determine whether a proposed development will develop enough revenue to make the extension self-supporting within a reasonable period.

9. Where Staff seeks a finding that application of the main extension rule to a specific project produces results so unreasonable that they should be disregarded for ratemaking purposes, the developer is entitled to notice and opportunity to be heard.

10. If a water utility can borrow at rates substantially less than the cost of its equity, consumers will be better off than if the capital structure is mostly equity.

11. It is appropriate to impute a capitalization structure, for ratemaking purposes, which is comparable to other water companies with comparable risks.

12. Rate design should allow SPWW to recover 50% of its fixed costs through service charges. The policy set forth in D.86-05-064 should govern, and cannot be modified by a Staff memo.

#### O R D E R

##### IT IS ORDERED that:

1. Santa Paula Water Works, Ltd. (SPWW) is authorized to file on or after the effective date of this order the revised rate schedules for 1992 shown in Appendix A. This filing shall comply with General Order (GO) 96-A. The effective date of the revised rate schedule shall be the date of filing, but no sooner than January 1, 1992. The revised rate schedules shall apply to service rendered on and after their effective date.



2. On or after November 5, 1992, SPWW is authorized to file an advice letter, with appropriate supporting workpapers, requesting the step rate increases for 1993 shown in Appendix A, attached to this order, or to file proportionately lesser increases than those rates in Appendix A in the event that SPWW's return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ended September 30, 1992, annualized, exceeds the later of (a) the rate of return found reasonable by the Commission in this proceeding or for Apple Valley Ranchos Water Company (Apple Valley) or Park Water Company (Park). This filing shall comply with GO 96-A. The requested step rates shall be reviewed by the staff to determine their conformity with this order and shall go into effect upon the staff's determination of conformity. Staff shall inform the Commission if it finds that the proposed rates are not in accord with this decision, and the Commission may then modify the increase. The effective date of the revised schedules shall be no earlier than January 1, 1993. The revised schedules shall apply only to service rendered on and after their effective date.

3. On or after November 5, 1993, SPWW is authorized to file an advice letter, with appropriate supporting workpapers, requesting the increases for 1994 shown in Appendix A, or to file lesser increases in the event that the rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ended September 30, 1993, annualized, exceeds the later of the rate of return found reasonable by the Commission in this proceeding or for Apple Valley or Park. This filing shall comply with GO 96-A. The requested step rates shall be reviewed by the staff to determine their conformity with this order and shall go into effect upon the Staff's determination of conformity. Staff shall inform the Commission if it finds that the proposed rates are not in accord with this decision, and the Commission may then modify the increase. The effective date of the

revised schedules shall be no earlier than January 1, 1994. The revised schedules shall apply only to service rendered on and after their effective date.

4. The application is granted to the extent set forth in this order.

This order is effective today.

Dated April 8, 1992, at San Francisco, California.

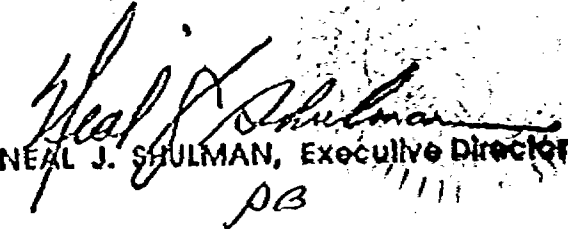
DANIEL Wm. FESSLER  
President

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, Executive Director  
PB

APPENDIX A  
Page 1

Santa Paula Water Works, Ltd.

Schedule No. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all general metered water service.

TERRITORY

Santa Paula and vicinity, Ventura County.

RATES

Quantity Rate:	Per Meter Per Month	
All water delivered per 100 cu.ft. ....	\$ 0.871	(I)
Service Charges:		
For 5/8 x 3/4-inch meter .....	9.51	(I)
For 3/4-inch meter .....	14.27	
For 1-inch meter .....	23.78	
For 1-1/2-inch meter .....	47.55	
For 2-inch meter .....	76.08	
For 3-inch meter .....	142.65	
For 4-inch meter .....	237.75	
For 6-inch meter .....	475.50	(I)
For 8-inch meter .....	760.80	

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

APPENDIX A  
Page 2

Santa Paula Water Works, Ltd.

Schedule No.

GENERAL METERED SERVICE

AUTHORIZED STEP INCREASES

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

		Rates to be Effective	
		<u>1-1-93</u>	<u>1-1-94</u>
Quantity Rate:			
For all water delivered			
per 100 cu.ft. ....		\$0.018	\$0.014
Service Charge:			
For 5/8 x 3/4-inch meter .....		\$0.67	\$0.78
For 3/4-inch meter .....		1.00	1.17
For 1-inch meter .....		1.67	1.95
For 1-1/2-inch meter .....		3.35	3.90
For 2-inch meter .....		5.36	6.23
For 3-inch meter .....		10.05	11.70
For 4-inch meter .....		16.74	19.50
For 6-inch meter .....		33.50	39.00
For 8-inch meter .....		53.60	62.40

APPENDIX A

Page 3

Santa Paula Water Works, Ltd.

Schedule No. 3ML

LIMITED MEASURED IRRIGATION SERVICE

APPLICABILITY

Applicable to all measured irrigation service furnished on a limited basis.

TERRITORY

Santa Paula and vicinity, Ventura County.

RATES

Quantity Rate:

For all water delivered  
per 100 cu.ft. .... \$0.280 (I)

Special Conditions

1. Service under this schedule is limited to the lands being rendered irrigation service as of February 15, 1954.
2. Requests for each irrigation water delivery shall be made to the utility not less than 48 hours in advance of the time said delivery is desired.

APPENDIX A  
Page 4

Santa Paula Water Works, Ltd.

Schedule No. 3ML

LIMITED MEASURED IRRIGATION SERVICEAUTHORIZED STEP INCREASES

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

Quantity Rate:	Rates to be Effective	
	<u>1-1-93</u>	<u>1-1-94</u>
For all water delivered per 100 cu.ft. ....	\$0.015	\$0.012

APPENDIX A  
Page 5

Santa Paula Water Works, Ltd.

Schedule No. 5

FIRE SPRINKLER SERVICE

APPLICABILITY

Applicable to all fire sprinkler service.

TERRITORY

Santa Paula and vicinity, Ventura County.

RATES

Size of Service:	<u>Per Service Per Month</u>	
4-inch .....	\$14.65	(I)
6-inch .....	29.30	
8-inch .....	46.90	(I)

Special Conditions:

1. The customer will pay, without refund, the entire cost of installing the fire sprinkler service.
2. The minimum diameter for fire sprinkler service will be 4 inches and the maximum diameter will not be more than the diameter of the main to which the service is connected.
3. The customer's installation must be such as to effectively separate the fire sprinkler system from that of the customer's regular water service. As a part of the sprinkler service installation there shall be a detector check of other similar device acceptable to the Company which will indicate the use of water. Any unauthorized use will be charged for at the regular established rate for General Metered Service, and/or may be grounds for the Company's discontinuing the fire sprinkler service without liability to the Company.
4. There shall be no cross-connection between the fire sprinkler system supplied by water through the Company's fire sprinkler service to any other source of supply without the specific approval of the Company. The specific approval will require, at the customer's expense, a special double check valve installation or other device acceptable to the Company. Any unauthorized cross-connection may be grounds for immediately discontinuing the sprinkler service without liability to the Company.

(END OF APPENDIX A)

## APPENDIX B

Page 1

## Santa Paula Water Works, Ltd.

ADOPTED QUANTITIES

Net-to-Gross Multiplier	-	1.7704
Uncollectibles Rate	-	0.171%
Franchise Tax Rate	-	0
Federal Tax Rate	-	34.12%
State Tax Rate	-	9.3%

1. <u>WATER CONSUMPTION (A.F.)</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
Water Sales (Dom)	4,533.1	4,593.2	4,653.4
Water Loss	341.2	345.7	350.2
Well Water (Irr.)	747.0	747.0	747.0
Water Production	5,621.3	5,685.9	5,750.6
Surface Water	813.8	813.8	813.8
Replenishment Cost	\$30,746	\$31,128	\$31,516

2. <u>PURCHASED POWER (kWh)</u>			
GS-2			
(Eff. 1-20-1992)	1,823,412	1,842,850	1,862,284
PA-1			
(Eff. 1-20-1992)	676,856	681,872	686,750
TOU-PA-5			
(Eff. 1-1-1992)	1,179,376	1,195,011	1,210,647
Pumping Cost	\$355,967	\$358,620	\$361,275

3. WATER CONSUMPTION/CUST. BY CLASS

Commercial	-	270.2 Ccf
Public Authority	-	1,399.7 Ccf
Temp. Service	-	500.0 Ccf
Resale	-	11,599.0 Ccf
Irrigation	-	24,001.3 Ccf



## APPENDIX B

Page 2

## Santa Paula Water Works, Ltd.

ADOPTED QUANTITIES4. ADOPTED CONSUMPTION BY BLOCK SIZE (Ccf)

	<u>1992</u>	<u>1993</u>	<u>1994</u>
Gravity Flow (Irr.)	354,500	354,500	354,500
Pumped Water (Irr.)	325,400	325,400	325,400
Other Water	<u>1,974,600</u>	<u>2,000,100</u>	<u>2,027,000</u>
	2,654,500	2,680,000	2,706,900

5. ADOPTED AVERAGE SERVICE BY METER SIZE

Commercial Metered			
5/8" x 3/4"	5,561	5,642	5,717
3/4"	0	0	0
1"	895	907	924
1 1/2"	168	168	168
2"	148	148	148
3"	21	21	21
4"	16	16	16
6"	2	2	2
8"	0	0	0
Total	<u>6,821</u>	<u>6,904</u>	<u>6,997</u>
Irrigation	25	25	25
Private Fire			
4"	19	19	19
6"	15	15	15
8"	7	7	7
Total	<u>6,877</u>	<u>6,970</u>	<u>7,063</u>

(End Of Appendix B)

## APPENDIX C

## SANTA PAULA WATER WORKS, LTD.

## COMPARISON OF MONTHLY CUSTOMER BILLS

## AT PRESENT AND ADOPTED GENERAL

## METERED RATES FOR A 5/8 X 3/4-INCH METER

1992

<u>Usage Ccf</u>	<u>Present Rates</u>	<u>Adopted Rates</u>	<u>Amount Increase</u>	<u>Percent Increase</u>
0	\$ 8.20	\$ 9.51	\$ 1.31	\$15.98
3	10.24	12.12	1.89	18.42
10	14.99	18.22	3.23	21.55
20	21.78	26.93	5.15	23.65
25	25.18	31.29	6.11	24.27
25.1 Avg.	25.24	31.37	6.13	24.28
50	42.15	53.06	10.91	25.88
100	76.10	96.61	20.51	26.95

1993

0	\$ 9.51	\$10.18	\$ 0.67	\$ 7.05
3	12.12	12.85	0.72	5.97
10	18.22	19.07	0.85	4.67
20	26.93	27.96	1.03	3.82
25	31.29	32.41	1.12	3.58
25.1 Avg.	31.37	32.49	1.12	3.58
50	53.06	54.63	1.57	2.96
100	96.61	99.08	2.47	2.56

1994

0	\$10.18	\$ 10.96	\$ 0.78	\$ 7.66
3	12.85	13.67	0.82	6.40
10	19.07	19.99	0.92	4.82
20	27.96	29.02	1.06	3.79
25	32.41	33.54	1.13	3.49
25.1 Avg.	32.49	33.63	1.13	3.48
50	54.63	56.11	1.48	2.71
100	99.06	101.26	2.18	2.20

(END OF APPENDIX C)