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Decision 82 03 057 MAR 16 1982

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of SOUTHERN CALIFORNIA WATER COMPANY for authority to increase rates charged for water service in its Santa Maria District, dba California Cities Water.	Application 60799 (Filed August 5, 1981)

O'Melveny & Myers, by Richard K. Smith, Jr., Attorney at Law, for Southern California Water Company, applicant.
Philip Scott Weismehl, Attorney at Law, for the Commission staff.

O P I N I O N

Applicant Southern California Water Company seeks authority to increase rates in its Santa Maria District. The rate increases proposed by applicant are in steps designed to increase annual revenues in 1981 by $307,200, or 30.93%, over the revenues produced by the rates in effect on April 30, 1981 (i.e., at the time the Notice of Intent was filed); in test year 1982 by $135,800, or 9.98%, over revenues from rates proposed for 1981; in test year 1983 by $107,200, or 6.87%, over revenues from rates proposed for 1982; and in year 1984 by $85,200, or 5.11%, over revenues from rates proposed for 1983.

The foregoing proposed increases exclude the effects of The Economic Recovery Tax Act of 1981 (ERTA). In this connection applicant supplemented the information on this application provided in the notice of hearing mailed to its customers as follows:

> "NOTE The increase in rates requested are further increased by a total of 16.1% in 1982 and 15.4% in 1983 to reflect 'The Economic Recovery Tax Act of 1981' signed into law on August 13, 1981."

An informal public meeting held during the evening on August 25, 1981 in Santa Maria preceded the hearing on this matter. The meeting was sponsored by applicant and the Commission staff to provide an informal setting in which customers could express their views and applicant could explain its asserted need for a general rate increase and respond to questions or complaints. Of the approximately 50 customers who attended the meeting, more than 10 complained about water outages on the largest of the four separate systems in the district. Other complaints concerned low water pressure or dirty water, primarily on two of the other systems.

Because of the presence of service problems, a public witness hearing was held before Administrative Law Judge Main in Santa Maria on December 7, 1981. Approximately 12 customers attended, several of whom either made statements reiterating concerns expressed at the August informal meeting or urged that no rate increase be authorized until service improves. R. L. Anthony, Jr., vice president-Operations for applicant, provided a status report on the measures underway to alleviate the service problems. His report will be covered later in this decision.

Hearing resumed the following day, December 8, 1981, in Los Angeles on a consolidated record with Application (A.) 60798 (Arden-Cordova District). This proceeding was submitted upon the filing of concurrent briefs due on or before December 31, 1981.

Notice of the informal meeting, the public witness testimony, and public hearings was provided by bill inserts mailed to each customer in the Santa Maria District.

General Information

Applicant owns and operates water systems in 19 districts and an electric system in Big Bear Lake, California. Each district is a separate unit for operational, accounting, and ratemaking purposes. The districts are grouped into five divisions. The headquarters and general office is located in Los Angeles. Customers' bills for all districts are prepared at the Los Angeles general office. Overall functions such as accounting, engineering, data processing, and purchasing are also centralized there.

As of December 31, 1980, statewide applicant was serving 231,671 customers and had 380 employees and an investment in utility plant of $147,467,000. Gross operating revenue for the 12-month period ended December 31, 1980 was $36,527,000. Applicant's approximately 2,000,000 shares of common stock are owned by more than 5,000 individual and institutional shareholders. Its preferred stock (200,400 shares in four series) is held by institutional investors.

Santa Maria District

The Santa Maria District has four separate service areas, three of which are in Santa Barbara County and one in San Luis Obispo County. The district is the result of consolidating several small water companies acquired by California Cities Water Company. The latter company, in turn, was acquired by applicant in 1976.

At the end of 1980, there were 7,800 customers in the Santa Maria District, nearly all of whom (99.8%) were in the commercial classification which consists of residential and business customers. The water supply was obtained from applicant's 15 wells. There were 594,981 feet of distribution mains ranging in size up to 16 inches in diameter and eight reservoirs with a combined capacity of 3,382,300 gallons. Utility plant in service was $5,513,045 and depreciation reserve was $1,200,010, yielding $4,313,035 of net utility plant.

Service

The water systems serving the four separate areas in the Santa Maria District are designated as the Orcutt System (the main Santa Maria system), the Vista System, the Sisquoc System, and the Tanglewood System. At the August 25 informal meeting, applicant's customers called attention to service problems encountered in three of the four separate water systems. The most prevalent complaint concerned water outages that occurred June 15, 16, and 17, 1981 in the main Santa Maria system (the Orcutt System). In the Vista System high manganese and hydrogen sulfide concentrations in the water served have caused staining and odor problems. In the Sisquoc System the water supply has an excessive nitrate content.

Applicant's investigation into these service problems and the status of proposed remedial measures as of October 28, 1981 are set forth in Appendix B to Exhibit 12. Excerpts from that appendix follow:

"Water Outages - June 15, 16 and 17, 1981

"Only one of the four water systems in the Santa Maria District experienced a water outage during the period June 15, 16 and 17, which was the main Santa Maria System.

"Commencing on June 15, 1981 extremely high demands for water were experienced causing between 600 to 1,000 customers to be out of water during portions of each of the three days. The extremely high demands for water were experienced in all of the Company's systems throughout the State.

"A review of the conditions at the time of the outages indicate that there were sufficient water production capabilities to meet the demands of the customers during these three days; however, due to the zoning of the system the full water production capacity could not effectively be utilized for the benefit of the entire system.

"The Company has taken the following steps to remedy the situation:

"1. A temporary trailer-mounted transfer booster has been sent to Santa Maria and the necessary connections have been made to the distribution system so that water that could not be utilized on June 15, 16 and 17, 1981, can now be effectively utilized through the system. A permanent booster station (Dartmouth) is actually under construction at this time and should be in service in the next 30 days.

"2. A two-way interconnection has been authorized by the Company with the approval of the City of Santa Maria. This interconnection would allow the Company and the City, in case of an emergency, to utilize each other's water supply. This would have been a substantial benefit to the Company during June 15, 16 and 17 as the City did have water that they could have provided. Construction should get under way and be completed by November 30, 1981.

"3. A new well has been drilled (Kenneth) and will be equipped and placed in service by January 1, 1982. This well has been tested and a pump designed to produce approximately 800 GPM. A second site has been acquired for another well that will be drilled in January 1982.

"At the present time the Company has requested bids for the drilling of the well and has the property. The cost of this facility is included in the Company's 1982 Capital Budget and the well should be in service by June 30, 1982.

"<u>Water Quality Problem</u>

"Water quality problems occurred in two of the four water systems in the Santa Maria District:

"1. <u>Vista System</u>

"The Vista System, of about 700 customers, is located about 25 miles north of the main Santa Maria System, located on a Mesa overlooking the Santa Maria River.

"The Vista System required additional water supply, therefore, the Company drilled the La Serena Well in 1980. The La Serena Well has a production capability of 400 GPM, a good producer; however, the water quality is not as good as the other wells in the Vista System.

"The La Serena water is high in manganese and hydrogen sulfide and the treatment for one item aggravates the ability to control the other. The well is utilized only when necessary which is mainly in the summer months.

"The remedy for improving the quality of water from the La Serena Well is the installation of filters along with a storage tank. The design and construction of filters and storage tank at the La Serena well site is a 1982 Capital Budget item.

"The quality of ground water on the Mesa wherein the Vista System lies, varies greatly and has no discernible pattern to the underground basins, therefore, drilling another well at some other location has no assurance that water quality would be improved.

"2. <u>Sisquoc System</u>

"The Sisquoc System, of about 68 customers, is located about 15 miles due east of the main Santa Maria system and is situated in a large agricultural valley.

"The Sisquoc System is a single well water system, which well has a nitrate level of 54 ppm. The drinking water standard for nitrate is 45 ppm.

"The Company is negotiating for supplemental blending water with the Brochman School. The school has an acceptable water and is the only other water supply that is located adjacent to the Sisquoc System. In addition, the Company is supplying bottled water to customers where there are pregnant women or infants that might be affected by the nitrate level.

"Should negotiations with the Brochman School fail, the alternatives are (1) drill another well which has no assurance that water quality will be improved, and (2) conduct experiments with nitrate removal."

Through his testimony at the December 7 hearing in Santa Maria, applicant's vice president-Operations brought up to date and supplemented the foregoing report as follows:

The improvements for the Orcutt System either have been or will be completed on schedule. The filters necessary for improving the quality of water from the La Serena Well on the Vista System will be installed before next summer (as scheduled) when the water from that well is needed. However, applicant is encountering delays, due to zoning changes, in obtaining from San Luis Obispo County a permit to build the storage tank. The outlook is that tank construction will not be started before mid-summer. But the filters will be in service before then and provide water of satisfactory quality. The Brochman School has decided not to supply water to applicant's Sisquoc System. Rather than conducting experiments with nitrate removal, applicant has elected to, and will very shortly, drill a new well to supply this very small system.

Drilling and equipping the new well for the Sisquoc System will cost about $80,000, bringing the total expenditures budgeted in response to these service problems in the Santa Maria District to $800,000.

A review of the complaints filed in the Santa Maria District in 1980 and 1981, which were investigated and resolved by applicant, is summarized below:

	1980	1981 (Jan.-June)
Water Quality	63	54
Pressure	69	35
Billing	242	155
Main Leak	-	3
Other	23	3
Total	397	250

Applicant's policy is to provide an acceptable level of service. The above-referenced $800,000 in capital expenditures budgeted for 1981 and 1982 indicates its continuing response to and resolution of service problems.

Water Conservation and Pump Efficiency

Applicant has an established program to promote water conservation. Currently, its efforts are directed primarily toward providing conservation reminders through inserts mailed with customers' bills and through newspaper advertisements.

Applicant also has an established program to maintain pump efficiencies. Our staff reports that all "well pumps show above the average-fair efficiency rating. On most booster pumps, no adequate test section is available; however, these pumps are physically checked periodically by utility for excessive wear."

Present and Proposed Rates

Basic rates for the Santa Maria District were set by Decision (D.) 75548 dated April 8, 1969. Since then, the Commission has authorized three rate increases to offset increases in water production-related expenses and authorized a fire protection surcharge. The present general metered service rates are as follows:

Schedule SM-1

	Per Meter Per Month	Fire Protection Surcharge Per Meter Per Month
Quantity Rates:		
First 800 cu.ft. or less	$ 4.00	-
Next 1,200 cu.ft., per 100 cu.ft.	0.34	-
Next 2,000 cu.ft., per 100 cu.ft.	0.27	-
Over 4,000 cu.ft., per 100 cu.ft.	0.18	-
Minimum Charge:		
For 5/8 x 3/4-inch meter	$ 4.00	$0.23
For 3/4-inch meter	7.00	0.24
For 1-inch meter	9.00	0.33
For 1-1/2-inch meter	11.00	0.45
For 2-inch meter	15.00	0.61
For 3-inch meter	23.00	1.13
For 4-inch meter	38.00	1.53
For 6-inch meter	68.00	2.55

The Minimum Charge will entitle the customer to the quantity of water which that minimum charge will purchase at the Quantity Rates.

Offset Cost Adjustment:

The Offset Cost Adjustment is a quantity charge per 100 cu.ft. added to each monthly bill for all water used over 300 cu.ft.

Offset Cost Item	Resolution No.	Advice Letter No.	Rate Per 100 cu.ft.	Date Rate Effective
Power for Pumping	W-2403	67-W	$ 0.041	7/11/78
Property Tax		69-W	(0.014)	10/27/78
Power for Pumping		69-W	0.014	10/27/78
Revenue Act, 1978		544-W	(0.003)	6/16/79
Power for Pumping		591-W	0.060	
Tot. Offset Adj.			$ 0.098	

Applicant's proposed general metered service rates for years 1982, 1983, and 1984 are as follows:

Schedule SM-1

	Per Meter Per Month Effective January 1,		
	1982	1983	1984
Quantity Rates:			
First 300 cu.ft., per 100 cu.ft.	$ 0.415	$ 0.438	$ 0.438
Over 300 cu.ft., per 100 cu.ft.	0.457	0.480	0.480
Service Charge:			
For 5/8 x 3/4-inch meter	$ 4.50	$ 5.00	$ 5.85
For 3/4-inch meter	8.00	9.00	10.50
For 1-inch meter	10.00	11.00	13.00
For 1-1/2-inch meter	13.00	15.00	18.00
For 2-inch meter	18.00	20.00	23.00
For 3-inch meter	28.00	31.00	36.00
For 4-inch meter	46.00	50.00	60.00
For 6-inch meter	80.00	89.00	100.00
For 8-inch meter	110.00	125.00	140.00

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.

In addition, applicant proposes eliminating the monthly charge for public fire hydrant service from Schedule SM-5, as a consequence of Public Utilities (PU) Code Section 2713.

Need For Rate Relief

In its application applicant stated the need for rate relief is "mainly caused by increases in the costs of purchased power, labor, postage, payroll taxes, liability insurance, depreciation, increased rate base and increased cost-of-capital since these costs were last considered by the Commission in setting rates."

Rate of Return

Applicant and staff agree on the types and amounts of financing proposed in test years 1982 and 1983 and in 1984. Applicant accepts staff's use of average year capital costs and also accepts the capital structure of approximately 51% debt, 12% preferred stock, and 37% equity proposed by staff. Applicant and staff disagree on the rate of return on common equity with applicant advocating 16% and staff a 14.50-15.00% range. Applicant and staff also disagree on interest rates on future debt and the dividend rate on a future preferred stock issue.

Four components comprise the debt and preferred stock portion of applicant's capitalization. The four components are long-term debt, bank loans, a term note, and preferred stock. As for long-term debt in 1982, 1983, and 1984, applicant proposes to issue bonds in the principal amount of $6 million, $6 million, and $5 million, respectively. To market these issues, applicant projects that the bonds issued in 1982 will have to bear interest at a rate of 17% and the bonds issued in 1983 and 1984 will have to bear interest at a rate of 15%. Staff has estimated that the applicable interest rates will be 15% in 1982, 14% in 1983, and 13.5% in 1984.

The differences between applicant's and staff's estimated costs of the bank loan and term note components of applicant's capitalization result from the parties' differing estimations of the prime rate during the test years. The bank loan component is a $12 million line of credit with Harris Trust of Chicago and First Interstate Bank. The interest rate on the line of credit floats with the prime rate. The term note component will be a five-year note which applicant is currently negotiating with Harris Trust of Chicago to refinance a portion of the line of credit with that bank and First Interstate Bank. Since the term note is funded debt, the interest coverage requirement imposed by applicant's indentures will limit the term note to a principal amount of $5-6 million. The interest rates on the term note will be the prime rate plus 1/4% in 1982, the prime rate plus 3/8% in 1983, and the prime rate plus 1/2% in 1984, 1985, and 1986. Applicant has estimated that the prime rate will be 17% in 1982 and 15% in 1983 and 1984. Staff has estimated that the prime rate will be 17.5% in 1982, 15% in 1983, and 14% in 1984.

Both applicant and staff agree that applicant should issue $2 million of preferred stock in 1984. However, applicant estimates the dividend rate on that stock will be 15%, whereas staff estimates a dividend rate of 13.5%.

The recent past provides salient examples of the difficulty in forecasting correctly only the direction interest rates will take without attempting to quantify the changes. Nevertheless, specific estimates of the cost of new debt and preferred stock are essential to our rate of return determination.

In D.93887 dated December 30, 1981 in A.60153 and related matters, we assumed at page 51 (mimeo.) that (1) for 1982 all new Pacific Gas and Electric Company (PG&E) long-term debt (with PG&E bonds at an AA rating) would sell at an interest cost of 15% and preferred stock at a dividend rate of 14.75%; and (2) for 1983 all new PG&E long-term debt would sell at an interest cost of 14% and preferred stock at a dividend rate of 13.75%. Although applicant's bonds are privately placed with pension funds or insurance companies and therefore unrated, they very obviously do not qualify as high-grade (AA or better) obligations. Upon careful consideration of the estimates by applicant and staff in light of our above determinations in the PG&E general rate proceeding, we believe the following are reasonable cost rates for applicant's new debt and preferred stock:

	1982 %	1983 %	1984 %
New Bonds	15.50	14.50	14.00
Bank Loans	17.00	15.00	14.50
Term Note	17.25	15.38	15.00
New Preferred	-	-	14.00

Applicant believes a 16% return on equity is necessary to increase its financial coverages. Since 1971, applicant has experienced a steady decline in interest and preferred dividend coverages. At this time, the coverage requirements imposed on applicant by its First Mortgage Bond Indentures will only permit applicant to finance a bond issue in an aggregate principal amount of up to $5 or $6 million. The coverage requirements for additional debt other than first mortgage bonds is imposed by a 5-3/4% debenture indenture. It provides further restrictions on applicant's ability to obtain debt financing, prohibiting applicant at this time from financing a $6 million debenture or term note at an interest rate of 18% or more. Currently, applicant can finance only a small amount of preferred stock, dividend coverage being inadequate to support a practicable issue.

The ability to issue additional debt or preferred stock is crucial, but no more so than the ability to find someone to buy the securities. To find a buyer, applicant must compete in the marketplace for available capital. Generally, as interest or dividend coverages decrease, the risk involved in the security increases and it becomes more difficult to sell the securities. According to applicant, the 16% return on equity it requests would significantly improve its ability, by increasing its financial coverages, to obtain debt financing.

Applicant also contends a 16% return on equity would provide it with a more realistic opportunity to earn a fair return. This contention is in response to applicant's having experienced returns on equity significantly below the authorized level. According to applicant, this may be due to the multi-district nature of the company, underestimation of expenses, inverted rates, or other factors.

In addition, applicant points to an increase in risks faced by a water company as the result of Commission-mandated rate design and makes the following argument: "The volume of water sold by a water company varies significantly with the weather and the company's revenues are affected not only by volume but also by rate design. In the past, rates were set on a cost of service design based mainly on engineering and financial considerations. Four or five years ago, rate designs shifted from a cost of service basis to a lifeline and conservation basis." Applicant asserts that "the authorized fair rate of return on equity was never increased to allow for the change in rate design."

The staff has recommended that return on equity for applicant be set in the range of 14.50% to 15.00%. In reaching this recommendation, staff witness considered the comprehensive array of factors usually considered by staff including, among others, applicant's past earnings performance, its equity ratio, comparative earnings of water utilities, recently authorized rates of return for Class A water utilities under our jurisdiction, interest coverage requirements, capital requirements, and the effects of continued inflation and increases in embedded cost of capital. Staff witness was guided by traditional standards espoused in the Bluefield and Hope decisions. With reference to the comparable risk standard in particular, staff witness considered water utilities to have less risk than other utilities for the following reasons:

> "1. Water utilities are not as capital intensive. Construction programs are much smaller and are financed to a large degree by advances for construction and contributions in aid of construction.
>
> "2. Water companies do not capitalize interest on construction projects. Construction work in progress is included in rate base which results in a better quality of earnings and better cash flow.

> "3. Water utilities are allowed offset increases in costs such as purchased water and power by advice letter filings concurrently with such increases. Energy companies, however, face a lag between the time fuel cost increases are experienced and offsetting rates are authorized.
>
> "4. Water companies are not faced with risks such as fuel costs, source of supply, nuclear generation, technological changes, competition, etc."

Earlier in this discussion of the fair rate of return issue we adopted somewhat higher costs of new debt and preferred stock than those projected by staff. An upward pressure is, of course, exerted on the level of fair return for common equity as the cost of new debt capital increases. Conversely, some downward pressure, even though delayed, will eventuate as ERTA is taken into account in future rate proceedings on applicant's numerous remaining districts. ERTA requires utilities to normalize tax depreciation and investment tax credit on post-1980 plant additions for both book and ratemaking purposes if the utilities are to qualify for such tax benefits.

Upon careful consideration we make the judgment that a 14.50% return on common equity is fair and reasonable for applicant and should be sufficient to improve significantly applicant's ability to obtain essential debt financing. The adopted capital ratios, cost factors, and the resultant rates of return and implicit after-tax interest coverages are tabulated below.

Component	Capital Ratios	Cost Factors	Weighted Cost Totals
Average Year 1982			
Long-Term Debt	44.00%	7.86%	3.46%
Bank Loans	2.00	17.00	.34
Term Note	5.00	17.25	.86
Preferred Stock	12.00	7.85	.94
Common Stock Equity	37.00	14.50	5.37
Total	100.00%		10.97%
			2.35x*
Average Year 1983			
Long-Term Debt	44.00%	8.95%	3.94%
Bank Loans	2.00	15.00	.30
Term Note	5.00	15.38	.77
Preferred Stock	12.00	7.86	.94
Common Stock Equity	37.00	14.50	5.37
Total	100.00%		11.32
			2.26x*
Average Year 1984			
Long-Term Debt	44.00%	9.71%	4.27%
Bank Loans	2.00	14.50	.29
Term Note	5.00	15.00	.75
Preferred Stock	12.00	8.38	1.01
Common Stock Equity	37.00	14.50	5.37
Total	100.00%		11.69%
			2.20x*

* Implicit after-tax interest coverage.

Advice Letter 617-W

We take official notice of Advice Letter 617-W, filed January 20, 1981, by which applicant requests authority under General Order 96-A to increase water rates to offset an under-collection of $136,474 in the water supply cost balancing account. Applicant has given public notice of this request for increase by publishing in the local newspaper on January 8, 1982. No customer protests or correspondence has been received. Applicant proposes to amortize this amount over a 12-month period by applying the increase on a uniform cents per Ccf over all metered sales for estimated year 1982. The Revenue Requirements Division staff has reviewed the workpapers submitted with the advice letter and find applicant's request to offset the amounts in the balancing account to be reasonable. However, due to the large increase in this proceeding, the amortization of the balancing account should be addressed in the utility's next offset rate request.

Results of Operations

To evaluate the need for rate relief, witnesses for applicant and the Commission staff have analyzed and estimated for test years 1982 and 1983 applicant's operating revenues, operating expenses, and rate base for this district. Staff's study of operating results (Exhibit 12) was based, in part, on later information than that available in early 1981 when applicant prepared its study (Exhibit 8). Applicant accepted staff's estimates supplemented to reflect the current rate effective October 25, 1981 for purchased power and then further supplemented them to reflect the effects of ERTA. (The latter causes an increase in federal income tax expense for ratemaking purposes due to elimination of the full flow-through to ratepayers of benefits from accelerated depreciation and investment tax credit on utility plant additions placed in service after December 31, 1980.) At that point staff was still deferring addressing ERTA effects in this proceeding, awaiting our then forthcoming decision in Order Instituting Investigation (OII) 24 (D.93848 dated December 15, 1981).

Staff has now developed for this district information reflecting our adoption in D.93848 of the conventional normalization method for purposes of applying ERTA. Applicant has examined that information and accepts staff's calculations.

In Table 1, which follows, we have developed the adopted operating results for test years 1982 and 1983 from staff estimates modified to reflect the later rate for purchased power, as shown in Exhibit 9, and to reflect conventional normalization, as calculated by staff, for applying ERTA.

Table 1

SOUTHERN CALIFORNIA WATER COMPANY
Santa Maria District

Estimated Results of Operations
Test Year 1982
(Page 1 of 2)

Item	Present Rates: Per Staff Report (Ex. 12)	Present Rates: Operating Expense Adjustments	Present Rates: Effect of 1981 Tax Act	Present Rates: Adopted Results	Authorized Rates: Adopted Results
	(a)	(b)	(c)	(d)	(e)
	(Dollars in Thousands)				
Operating Revenues	$1,071.3	$ -	$	$1,071.3	$1,751.8
Operating Expenses					
O&M Expenses					
Purchased Power	407.4	171.9		579.3	579.3
Purchased Chemicals	2.0			2.0	2.0
Payroll	152.4			152.4	152.4
Uncollectibles	4.8			4.8	7.8
Other	122.1			122.1	122.1
Tot. O&M Exp.	688.7	171.9		860.6	863.6
A&G Expenses					
Payroll	11.5			11.5	11.5
Pensions & Benefits	38.2			38.2	38.2
Other A&G	21.9			21.9	21.9
Tot. A&G Exp.	71.6			71.6	71.6
General Off. Allocation	48.9			48.9	48.9
Subtotal	809.2	171.9		981.1	984.1
Depreciation Expense	127.5			127.5	127.5
Taxes Other Than Inc.	51.3			51.3	51.3
Tot. Exp. (Excl. Inc. Tax)	988.0	171.9		1,159.9	1,162.9
Net Rev. Before Inc. Tax	83.3	(171.9)		(88.6)	588.9
CCFT	(18.7)	(16.5)	-	(35.2)	29.9
FIT Before ITC	(89.4)	(71.5)	29.7	(131.2)	150.5
ITC	(95.4)		95.4	-	
FIT Incl. ITC	(184.8)	(71.5)	125.1	(131.2)	150.5
Tot. Taxes on Inc.	(203.5)	(88.0)	125.1	(131.2)	180.4
Tot. Expenses	784.5	83.9	125.1	993.5	1,343.3
Net Revenues	286.8	(83.9)	(125.1)	77.8	408.5
Rate Base	3,816.5		(92.8)	3,723.7	3,723.7
Rate of Return	7.51%	(2.19)%	(3.23)%	2.09%	10.97%

(Red Figure)

Table 1

SOUTHERN CALIFORNIA WATER COMPANY
Santa Maria District

Estimated Results of Operations
Test Year 1983
(Page 2 of 2)

Item	Present Rates: Per Staff Report (Ex. 12)	Present Rates: Operating Expense Adjustments	Present Rates: Effect of 1981 Tax Act	Present Rates: Adopted Results	Authorized Rates: Adopted Results
	(a)	(b)	(c)	(d)	(e)
	(Dollars in Thousands)				
Operating Revenues	$1,115.9	$	$	$1,115.9	$1,896.8
Operating Expenses					
O&M Expenses					
Purchased Power	422.9	179.2		602.1	602.1
Purchased Chemicals	2.2			2.2	2.2
Payroll	168.4			168.4	168.4
Uncollectibles	5.0			5.0	8.5
Other	138.3			138.3	138.3
Tot. O&M Exp.	736.8	179.2		916.0	919.6
A&G Expenses					
Payroll	12.7			12.7	12.7
Pensions & Benefits	42.1			42.1	42.1
Other A&G	23.4			23.4	23.4
Tot. A&G Exp.	78.2			78.2	78.2
General Off. Allocation	52.8			52.8	52.8
Subtotal	867.8	179.2		1,047.0	1,050.5
Depreciation Expense	143.6			143.6	143.6
Taxes Other Than Inc.	60.6			60.6	60.6
Tot. Exp. (Excl. Inc. Tax)	1,072.0	179.2		1,251.2	1,254.7
Net Rev. Before Inc. Tax	43.6	(179.2)		(135.3)	642.1
CCFT	(26.1)	(17.2)	-	(43.3)	31.3
FIT Before ITC	(122.1)	(74.5)	38.2	(158.4)	164.9
ITC	(92.3)		92.3		
FIT Incl. ITC	(214.4)	(74.5)	130.5	(158.4)	164.9
Tot. Taxes on Inc.	(240.5)	(91.7)	130.5	(201.7)	196.2
Tot. Expenses	831.5	87.5	130.5	1,049.5	1,450.9
Net Revenues	284.4	(87.5)	(130.5)	66.4	445.9
Rate Base	4,197.3		(257.9)	3,939.4	3,939.4
Rate of Return	6.78%	(2.09)%	(3.00)%	1.69%	11.32%

(Red Figure)

Authorized Revenue Increases

By comparing the entries for operating revenues in Table 1, it can be seen that (1) the rates for test year 1982 would yield additional gross revenues of $680,500 which represent a 63.5% increase over revenues at present rates and (2) the rates to be authorized for test year 1983 yield additional gross revenues of $72,100 which represent a 4.0% increase over revenues at rates authorized in 1982. In addition, a third set of rates will be authorized to allow for attrition in rate of return after test year 1983. This is in keeping with our intention that the districts of Class A water utilities will not file a general rate increase application more often than once in three years.

We have recently adopted a general policy guideline for larger water utilities, of authorizing no rate increase greater than 50% during any single year to mitigate the effect of large increases to customers without this guideline, we would authorize rates as set forth above for 1982 and 1983. By holding the first year increase to 50% we will be granting SoCal a revenue increase of $535,700 in 1982. The adjusted difference in revenue between increases of 50% and 63.5%, plus interest at the adopted rate of return for 1982, we will add in equal portions to the new revenues we are granting SoCal for 1983 and 1984. This will ensure that the total amount of new revenue granted over the three-year period 1982-1984 will not be diminished. The calculations showing these adjustments are set forth in Appendix E.

SoCal had sought in its application revenue increases through 1982 of $443,000 and $107,200 for 1983. SoCal did not technically file an amended application to request additional revenues due to the effects of ERTA. While we cannot authorize more in revenues than requested, in this case we believe an exception is warranted. We are required by federal law to set rates recognizing tax expenses imposed by ERTA or have SoCal run the risk of losing its eligibility for accelerated depreciation. This application was filed before passage of ERTA and so did not include its effects. When the effects became known, SoCal furnished notice to its ratepayers and produced witnesses and testimony in support of the increased amount. SoCal should also have amended its application to reflect the increased revenue requirement but it did not. It would be administratively cumbersome to require it to do so now. However, since notice has been provided to customers (and SoCal has supported the additional request) we will authorize it without requiring amendment of the application.

The attrition to be allowed for after 1983 has an operational component and a financial component. Its operational component is 0.56% as indicated by the 1982 rate of return of 10.97% declining to 10.41% for 1983 at the rates authorized for 1982. Its financial component is the adopted estimate of financial attrition in rate of return between years 1983 and 1984 of 0.37% (i.e. the difference between the rates of return of 11.69% and 11.32% for years 1984 and 1983, respectively).

To offset the 0.93% combined financial-operational attrition rate, we may authorize a step increase for 1984 of up to $72,100. Applicant will be required to file an advice letter with supporting workpapers on or after November 15, 1983 to justify such an increase. Fixing rates in this way results in a better matching of the consumers' interests than setting a high initial rate which would yield the adopted rate of return for a three-year average. The required supplemental filings will permit review of achieved rates of return before the final step increase is granted.

Rate Design

In Exhibit 12 staff made the following observations and recommendations on rate design:

> "13.5 The current rate structure is a minimum rate type up to 800 cubic feet per month usage. The utility proposes to change to a service charge rate structure.
>
> "13.6 The utility proposes that service charges provide 30% of the revenues and quantity charges provide 70% of the revenues from the metered service. Because of the high cost of obtaining water for sale, (39%) the staff feels that current ratio of the revenue from the service charges and the quantity charges is reasonable. Therefore, the staff recommends that the proposed rate structure be adopted and the additional increases in revenue requirements in 1983 and 1984 be spread on the same percentage basis between the service charges and the quantity charges.

"13.6 The utility proposed increases in service charge for the meter size should be adopted.

"13.7 The utility proposed quantity rates have two blocks, with the first block of 300 cubic feet for the lifeline allowance and the next block of over 300 cubic feet. The staff feels no special third rate block is necessary because the rate for the second block is not high enough to force the large users to look for alternative sources of water supply. The staff recommends the proposed two-block quantity rate structure be adopted.

"13.8 The accumulated increases in revenue since January 1, 1976, have exceeded 25%. According to Commission policy, any increase in revenue authorized in this proceeding can be applied to lifeline rates. Therefore, the percent increase in lifeline rate be the same as the total revenue increase for this district.

"13.9 The utility also proposes to eliminate the public fire hydrant device charges (Schedule No. SM-5). The staff recommends that the proposal be adopted."

Applicant's proposal to eliminate its Public Fire Hydrant Service Schedule SM-5 is consistent with PU Code Section 2713 and Commission Resolution L-213 dated December 18, 1979. Staff notes that many of the water utilities have entered into a uniform fire hydrant service agreement with their respective fire protection agencies in accordance with Resolution L-213. Since submission, SoCal has made an advice letter filing regarding uniform fire hydrant service agreement; but, to our knowledge, has not yet entered into an agreement for its Santa Maria District. When such an agreement is entered into, cancellation of Schedule SM-5 will be appropriate.

At the hearing it was made clear staff did not intend the foregoing recommendations to apply to the $171,900 revenue requirement attributable to a recent increase in electric rates (Table 1, page 1, column b). It is staff's position that recovery of this increase in the cost of purchased power should be entirely through quantity rates since it is a variable cost linked to water sold. Applicant disagreed and urged that the rate design for the total revenue requirement from general metered service be based on the 30/70 mix (i.e., service charges providing 30% of the revenue and quantity charges providing the other 70%). The basis for applicant's position is that in excess of 60% of the costs comprising its total cost of service is fixed. Both positions have merit.

In our discussion of this issue in D.93687 dated November 3, 1981 in A.60498 of Park Water Company, we said:

> "Currently, the trend in water utility rate design, due to the combined effect of rate design policies in general and offset proceedings, is to recover a declining proportion of the revenue requirement in service charges over time. As the disparity between fixed costs and revenues from fixed charges increases, so does earnings volatility (the tendency to over- or undershoot the authorized rate of return) increase, as well as unfairness (as large users pay fixed costs that they did not necessarily cause the utility to incur).
>
> "In view of the evidence presented in this case, it would be proper to send the trend in rate design in a different direction, but not to the extent recommended by Park. . . ."

In this proceeding neither applicant nor staff considered the effect on rate design of the additional revenue requirement imposed by ERTA. Because the added requirement approximates $236,100 the disparity between fixed costs and revenues from fixed charges will increase even under the 30/70 mix. In light of this situation we favor applicant's position and will use the 30/70 mix for the entire 1982 revenue requirement from general metered service.

In all other respects staff's rate design recommendations will be adopted.

Findings of Fact

1. Upon completion of its improvement program, applicant will have placed in effect the necessary measures to avoid the service and water quality problems experienced last summer. Applicant's conservation and pump efficiency programs are satisfactory.

2. The adopted estimates in Table I of operating revenues, operating expenses, and rate base for the test years 1982 and 1983, together with an annual fixed rate of decline in rate of return of 0.93% for 1984 due to operational attrition, reasonably indicate the results of applicant's future operations.

3. The adopted estimates in Table 1 of the impact of ERTA on net revenues and rate base properly reflect the consequences of ERTA and our decision in OII 24.

4. The compilation of adopted quantities and the adopted tax calculation are contained in Appendix C to this decision.

5.a. Rates of return of 10.97%, 11.32%, and 11.69%, respectively, on applicant's rate base for 1982, 1983, and 1984 are reasonable. The related return on common equity is a constant 14.50%. This requires an increase of $680,500, or 63.5%, in annual revenues for 1982; a further increase of $72,100, or 4.0%, for 1983; and a further increase of $75,400, or 4.0%, for 1984.

b. Limitation of increases in any one year to 50% will mitigate the effect of large increases on customers and will result in increases for 1982 of $535,700, for 1983 of $289,000, and for 1984 of $141,400.

c. Total new revenues granted to SoCal during the period 1982-1984 should not be diminished by deferring that portion in excess of 50%. Interest on the deferred portion at the adopted rate of return will ensure that SoCal receives the full economic value of the rate increase we authorize today.

d. Spreading the deferred amount over two years, 1983 and 1984, for recovery will result in measured gradual increases over the rate life of this decision.

6. Applicant's proposal to eliminate the Public Fire Hydrant Service Schedule SM-5 is consistent with PU Code Section 2713. The revenues authorized under the provisions of Commission Resolution L-213, incorporate the present public fire protection surcharges offsetting loss of fire hydrant revenues. No refund is necessary.

7. The adopted rate design is reasonable.

8. The increases in rates and charges authorized by this decision are justified, and are just and reasonable.

9. The further increases authorized in Appendix B should be appropriately modified in the event 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, 1982 and/or September 30, 1983, exceeds the lower of (a) the rate of return found reasonable by the Commission for applicant during the corresponding period in the most recent rate decision or (b) 10.97% for 1982 and 11.32% for 1983.

Conclusions of Law

1. The application should be granted to the extent provided by the following order; the adopted rates are just, reasonable, and nondiscriminatory.

2. Because of the immediate need for additional revenue, the order which follows should be effective today.

ORDER

IT IS ORDERED that:

1. Applicant Southern California Water Company is authorized to file for its Santa Maria District, effective today, the revised rate schedules in Appendix A. The filing shall comply with General Order 96-A. The effective date of the revised schedules shall be the date of filing. The revised schedules shall apply only to service rendered on and after their effective date.

2. On or after November 15, 1982, applicant is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases for 1983 attached to this order as Appendix B, or to file a lesser increase which includes a uniform cents per 100 cubic feet of water adjustment from Appendix B in the event that the Santa Maria District rate of return on rate base, adjusted to reflect the rates then in effect and

normal ratemaking adjustments for the 12 months ending September 30, 1982, exceeds the lower of (a) the rate of return found reasonable by the Commission for applicant during the corresponding period in the then most recent rate decision, or (b) 10.97%. This filing shall comply with General Order 96-A. The requested step rates shall be reviewed by the staff to determine their conformity with this order and shall go into effect upon the staff's determination of conformity. But the staff shall inform the Commission if it finds that the proposed step rates are not in accord with this decision, and the Commission may then modify the increase. The effective date of the revised schedule shall be no earlier than January 1, 1983, or 30 days after the filing of the step rate whichever is later. The revised schedules shall apply only to service rendered on and after their effective date.

3. On or after November 15, 1983, applicant is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases for 1984 attached to this order as Appendix B, or to file a lesser increase which includes a uniform cents per 100 cubic feet of water adjustment from Appendix B in the event that the Santa Maria District rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ending September 30, 1983, exceeds the lower of (a) the rate of return found reasonable by the Commission for applicant during the corresponding period in the then most recent rate decision, or (b) 11.32%. This filing shall comply with General Order 96-A. The requested step rates shall be reviewed by the staff to determine their conformity with this order and shall go into effect upon the staff's determination of conformity. But the staff shall inform the Commission if it finds that the proposed step rates are not in accord with this decision, and the Commission may then modify

the increase. The effective date of the revised schedules shall be no earlier than January 1, 1984, or 30 days after the filing of the step rates, whichever is later. The revised schedules shall apply only to service rendered on and after their effective date.

This order is effective today.

Dated MAR 16 1982, at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

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

Joseph E. Bodovitz, Executive Director

APPENDIX A
Page 1

Southern California Water Company
Santa Maria District

Schedule No. SM-1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Within the established Santa Maria District, San Luis Obispo County and Santa Barbara County.

RATES

	Per Meter Per Month	
Service Charge:		
For 5/8 x 3/4-inch meter	$ 5.00	(I)
For 3/4-inch meter	9.00	
For 1-inch meter	11.00	
For 1½-inch meter	15.00	
For 2-inch meter	20.00	
For 3-inch meter	31.00	
For 4-inch meter	50.00	
For 6-inch meter	89.00	
For 8-inch meter	125.00	
Quantity Rates:		
For the first 300 cu.ft., per 100 cu.ft.	.306	
For all over 300 cu.ft., per 100 cu.ft.	.480	(I)

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

A.60799 RR/ck

APPENDIX A
Page 2

SOUTHERN CALIFORNIA WATER COMPANY

Schedule No. SM-5

Santa Maria District

PUBLIC FIRE HYDRANT SERVICE

APPLICABILITY

Applicable to all fire hydrant service furnished to municipalities, organized fire districts and other political subdivisions of the State.

TERRITORY

Within the established Santa Maria District.

RATE

	Per Month
For each hydrant	No Charge

(End of Appendix A)

APPENDIX B

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

SM-1 General Metered Service

Service Charges	Effective Dates 1-1-83	1-1-84
For 5/8 x 3/4-inch meter	$ 0.80	$ 0.40
For 3/4-inch meter	1.60	0.40
For 1-inch meter	2.00	1.00
For 1½-inch meter	1.00	1.00
For 2-inch meter	4.00	1.00
For 3-inch meter	8.00	2.00
For 4-inch meter	13.80	3.00
For 6-inch meter	21.00	5.00
For 8-inch meter	30.00	7.00
Quantity Rates:		
For the first 300 cu.ft., per 100 cu.ft.	0.097	0.044
For all over 300 cu.ft., per 100 cu.ft.	0.080	0.040

(END OF APPENDIX B)

APPENDIX C
Page 1

ADOPTED QUANTITIES

Company: Southern California Water Co.
District: Santa Maria District

	1982		1983
1. Water Production:	2,711.2		2,828.4
Wells:	2,711.2		2,828.4
2. Purchased Power: (0.02558 kwh/cf.)			
Electric Cost:	Supplier:	PGE	Date: 10-25-1981
Kwh:	6,984,583		7,284,327
$ per Kwh:	$ 0.076360		$ 0.076360
Quantity Cost:	$ 533,300		$ 556,200
Fixed Cost:	$ 43,700		$ 43,700
Total Electric Cost:	$ 577,000		$ 599,900
So. Cal. Gas Co.			Date: 9-1-1981
Therms:	6,082		6,082
$ per Therm:	$ 0.35060		$ 0.35060
Quantity Cost:	$ 2,132		$ 2,132
Service Charge:	$ 60		$ 60
Total Gas Cost:	$ 2,200		$ 2,200
Total Power Cost:	$ 579,200		$ 602,100
3. Ad Valorem Taxes:	$ 39,400		$ 47,400
Tax Rate:	4.39%		4.39%

Note:

PGE Rate	$/kwh	Date
Basic	$ 0.01951	10-25-1981
ECAC	0.05406	10-25-1981
AER	0.00257	10-25-1981
Solar Fin.	0.00002	10-25-1981
Energy Comm. C.	0.00020	9- 1-1981
	0.07636	

ADOPTED QUANTITIES

4. Number of Services-Meter Size:	1982	1983
5/8 x 3/4	7,087	7,370
3/4	342	352
1	21	22
1½	65	70
2	10	11
3	3	3
4	4	4
6	1	1
8	-	-
	7,533	7,833

5. Metered Water Sales:	1982	1983
Range Ccf	Usage-Ccf	
0 - 3	260,200	271,400
Over 3	2,171,400	2,265,400
Total	2,431,600	2,536,800

6. Number of Services:	No. of Services		Usage-KCcf		Avg.Usage-Ccf/yr.	
	1982	1983	1982	1983	1982	1983
Commercial	7,521	7,820	2,287.0	2,377.9	304.1	304.1
Public Authority	9	10	128.0	142.3	14,225.4	14,225.4
Other	3	3	16.6	16.6		
subtotal	7,533	7,833	2,431.6	2,536.8		
Private Fire Prot.	4	4				
Total	7,537	7,837				
Water Loss: 10.3%			279.6	291.6		
Total Water Produced			2,711.2	2,828.4		

APPENDIX C
Page 3

INCOME TAX CALCULATION

	1982	1983
	(Thousands of Dollars)	
Operating Revenues	$ 1,751.8	$ 1,896.8
O&M Expenses:		
Purchased Power	579.2	602.1
Payroll	163.9	181.1
Other	184.3	206.0
Uncollectible @ 0.4464	7.9	8.6
Payroll Taxes	11.9	13.2
Ad Valorem Taxes	39.4	47.4
Gen. Office Alloc.	48.9	52.8
Interest	173.0	206.3
Total Deductions	1,208.5	1,317.5
State Tax Depreciation	232.3	252.7
Net Taxable Income	311.1	326.7
State Corp. Franch. Tax	29.9	31.3
Federal Tax Depreciation	184.8	188.1
State Income Tax	29.9	31.3
Pref. Stock Div. Credit	0.3	0.3
Net Taxable Income	328.5	359.7
Fed. Income Tax @ 46%	151.1	165.5
Less: Grad. Tax Adj.	0.6	0.6
Total Federal Income Tax	150.5	164.9

Net to Cross Multiplier: 2.05769
Book Depreciation: $ 127,500 (1982); $ 143,600 (1983).

(End of Appendix C)

APPENDIX D

Bill Insert for SoCal Customers
(Santa Maria District)

Of the $535,700 annual rate increase recently granted to SoCal for its Santa Maria District by the Public Utilities Commission, $236,100 was attributable to President Reagan's Economic Recovery Tax Act of 1981, which requires the Public Utilities Commission to charge ratepayers for the expense of taxes which are not now being paid to the Federal Government and which may never be paid. This expense may increase in the future.

(END OF APPENDIX D)

APPENDIX E

1982	Adopted	Adjustments (Dollars in Thousands)	Distribution
Present Rates	$1,071.3		$1,071.3
Adopted Rates	1,751.8	(144.8)	1,607.0
Increase	680.5 (63.5%)		535.7 (50%)
1983			
1982 Authorized Rates	1,824.7		1,673.9
Adopted Rates	1,896.8	66.1[a/]	1,962.9
Increase	72.1		289.0
1984 Attrition Allowance			
Adopted	75.4	66.0	141.4

Deferred amount $680.5 - $535.7 = $144.8

For 9.5 months $\frac{(9.5)}{12}$ = $114.6

Interest

1982 $114.6 x 10.97% x $\frac{16.75 \text{ mo.}}{12 \text{ mo.}}$ = $17.5

Total Amount Deferred

114.6 + 17.5 = 132.1

Distribution

a/ $66.1 in 1983.

b/ $66.0 in 1984.

(END OF APPENDIX E)