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ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of DEL ESTE WATER COMPANY, a corporation, for an order authorizing it to increase rates charged for water service.	Application 82-01-26 (Filed January 14, 1982)

McCutchen, Doyle, Brown & Enersen, by A. Crawford Greene, Attorney at Law, for Del Este Water Company, applicant.
Alberto Guerrero, Attorney at Law, and Mehdi G. Radpour, for the Commission staff.

I N D E X

O P I N I O N

Summary of Decision

This order will authorize Del Este Water Company (applicant) to increase its rates for providing water by 8.62% ($187,100), 4.44% ($106,000), and 3.83% ($95,600). in 1982, 1983, and 1984, respectively. These new revenues will allow applicant opportunity to earn an overall rate of return on rate base of 12.52%, and its shareholders a return on common equity of 14.00%.

Several issues remained in dispute at the time the proceeding was submitted upon the filing of concurrent briefs in June. Two are noteworthy because this is apparently the first time they have been considered by this Commission.

First, applicant had awarded wage increases of 10% and 12%, respectively, to its employees and officers on January 1, 1982. Applicant also anticipates increased payroll expenses of 8% in 1983. We will recognize an across-the-board increase in 1982 of 10% for ratemaking, but will allow only a further 6.4% in 1983. The Commission staff had recommended that across the board increases of 5% in both 1982 and 1983 be allowed for ratemaking purposes.

Second, applicant chose not to employ the accelerated cost recovery depreciation provisions available under the Economic Recovery Tax Act (ERTA) in calculating its federal income tax liability for the purposes of this proceeding. We are imputing those provisions in our adopted results of operations because they result in a present benefit to ratepayers.

Of applicant's approximate 16,000 total water services, about 13,500 are flat rate connections. Percentage increases granted by this decision will be applied evenly to metered, flat rate, and private fire protection rates.

By this application applicant requests authority to increase revenues by $450,700 (21.2%) in 1982, $147,900 (6.6%) in 1983, and $156,000 (5.8%) in 1984. Applicant's request is designed to produce a return on equity of 17.5% and rates of return of 14.78% in 1982, and 14.86% in 1983.

Applicant's last general rate increase was authorized by Decision (D.) 91120 dated December 18, 1979 in Application (A.) 58184. In that proceeding we authorized a rate of return of 13.0% on equity, resulting in a rate of return of 11.40% on rate base. Present rates became effective April 21, 1981 by Resolution W-2824.

Staff- and applicant-estimated rates of return at present and proposed rates for test years 1982 and 1983 are as follows:

	Rates of Return			
	Staff		Applicant	
	1982	1983	1982	1983
At Present Rates	10.84%	9.32%	7.93%	6.45%
At Proposed Rates	18.88%	19.98%	16.15%	16.79%

Evidentiary hearings in this proceeding were held before Administrative Law Judge (ALJ) John Lemke in San Francisco on May 11 and 12, 1982.

Previously staff and applicant conducted an informal public meeting in the City of Modesto on February 17. The purpose of the meeting was to inform customers of the circumstances underlying applicant's request. Seven customers attended the meeting. Commission procedures and applicant's operations were explained. No service complaints were received. Customer complaints received during the year 1981 fall into the following categories:

Water Quality	95
Pressure	132
Leaks	196
Misc.	3
Total	426

A staff witness testified that these complaints were investigated and resolved by applicant within a reasonable period.

The public meeting and the evidentiary hearings were noticed by applicant to each customer in its district in accordance with the Commission's Rules of Practice and Procedure.

General Information

Applicant was organized and incorporated in 1938. Currently applicant serves over 16,000 customers in the suburban Modesto area and in the communities of Waterford, Empire, Salida, Turlock, Hillcrest, Hickman, and Grayson. Most of the areas in this service territory are isolated areas served by separate systems, except those located in the immediate suburbs of the City of Modesto.

Applicant is a wholly owned subsidiary of the Beard Land and Investment Company. Customer growth for two decades is illustrated in the following Table 1 which shows the number of services for each class of customer during the period 1960 through 1980.

TABLE 1

Year	Flat Rate Commercial	Metered			Private Fire Services	Total Water Services	Public Fire Hydrants
		Commercial	Industrial	Public Authority			
1960	9,191	811	24	36	13	10,075	342
1961	9,498	865	23	38	15	10,439	369
1962	10,069	923	24	36	16	11,068	412
1963	10,239	948	26	34	16	11,263	446
1964	11,565	1,001	23	39	20	12,648	498
1965	11,784	1,049	22	41	24	12,920	523
1966	11,947	1,086	29	43	28	13,133	537
1967	12,107	1,202	27	41	34	13,411	552
1968	12,227	1,255	32	49	39	13,602	584
1969	12,273	1,310	34	50	41	13,708	597
1970	12,433	1,339	38	47	52	13,909	603
1971	12,586	1,382	34	53	54	14,109	629
1972	12,744	1,459	38	52	55	14,348	677
1973	12,844	1,547	46	56	63	14,556	722
1974	12,947	1,643	42	59	66	14,757	741
1975	13,101	1,667	44	62	69	14,943	750
1976	13,309	1,705	43	59	76	15,192	773
1977	13,370	1,815	44	62	82	15,373	788
1978	13,425	1,899	49	62	87	15,522	826
1979	13,763	1,961	51	71	94	15,940	858
1980	13,557	2,349	51	77	101	16,135	860

Applicant has a staff of 29 involved in management, operating, maintenance, and clerical positions. It employs outside services for engineering, auditing, tax accounting, and legal counsel. All general accounting is performed with company personnel, and construction is performed by company crews whenever practical. Applicant's administrative office, operating headquarters, warehouse, maintenance garage, meter repair and testing, and pipe storage facility are all located in Modesto. Applicant provides water for residential, commercial, industrial, and fire suppression purposes. Areas served are comprised of residential, commercial, and industrial developments in the suburbs in the City of Modesto and outlying communities near the city. Most of the systems comprising applicant's present service territory were installed by developers to provide water for industrial and residential use, and some of these systems date back to the early 1900s.

Applicant supplies its customers from 61 wells located throughout the service territory. Each of the separate areas comprising the total system is served by at least two wells, except for three areas which maintain interconnections with adjoining municipal systems. Eleven major pumping units are operated with natural gas engines and therefore are not subject to electrical power outages.

Well water generally meets the standards set by the United States Public Health Service for drinking water.

Company mains are generally steel pipe ranging in size from 2-inch to 16-inch diameter. About 90% of the mains are 4-inch or larger.

Water Conservation

Water conservation kits have been distributed to about 4,500 customers--nearly 1/3 of applicant's total services. Kits are available at company offices and are mailed on request to customers.

In addition, bill stuffers have been distributed to all customers on an ongoing basis since 1977, stressing the need for and encouraging water and energy conservation. Applicant's field personnel are watchful for water waste. Applicant takes advantage of a city-funded youth employment program involving door-to-door contact in areas of high water waste.

Operating pressures range between 45 and 65 pounds per square inch, thus complying with Commission's order to limit maximum operating pressures to 80 pounds per square inch where feasible. Applicant is able to accomplish this due to the level terrain within its service territory, and to the separation of the territory into a number of self-contained local distribution systems. Additionally, applicant has urged the enactment of certain ordinances by the City of Modesto, Stanislaus County, and the City of Waterford prohibiting landscape irrigation during peak hours.

In response to our D.88466, dated February 7, 1978, in Case 10114, applicant has conducted pump efficiency tests for the 61 wells in its system. This has been done in an effort to minimize energy consumption. Funds have been budgeted to provide for repair of pumps identified as inefficient during the testing program.

Results of Operations

The areas of controversy between staff and applicant fall under the following eight categories: large industrial water use; payroll expense; purchased power; regulatory commission expense; working cash; income tax; graduated tax adjustment, and return on common equity.

Large Industrial Water Use

Differences in water sales between staff and applicant are set forth in Exhibit 6 and are due to estimated use by two large customers--Gallo Winery (Gallo) and Tillie Lewis Foods (Tillie Lewis). Applicant estimates that Gallo will use about 50,000 hundred

cubic feet (Ccf) during test years 1982 and 1983; staff estimates 117,128 Ccf in each of those years. Applicant estimates that Tillie Lewis will use 73,513 Ccf and 84,540 Ccf, respectively, during test years 1982 and 1983; staff estimates 93,583 Ccf during each of those years.

The staff witness, Mohsen Kazemzadeh, based his estimate on a letter received from Gallo addressed to applicant dated April 16, 1981 projecting water consumption for 1982 and 1983 of 100,000 Ccf each year. Since receiving the letter, data were furnished by applicant showing consumption by Gallo during 1981 of 117,128 Ccf. During March 1982 Kazemzadeh contacted Gallo's chief engineer, who informed the witness that his projections for 1982 and 1983 would still be correct. The witness therefore concluded that the 1982 and 1983 figures would be about the same as that recorded for 1981.

Kennan Beard is applicant's vice president and manager. He stated that he is in charge of the overall operation of applicant. His projection of 50,000 Ccf for Gallo during each test year is based upon his understanding (since he did not personally make the computation) that the estimate was predicated on actual consumption June through September, 1981, January through May, 1982, and estimated consumption October through December, 1982. Beard stated that nine years ago Gallo began to buy virtually all of its water from applicant. Then about five years ago Gallo bought a cannery facility in Modesto which has a large on-site well. Gallo decided to activate that well and connect it into its own system to provide as much of its own water as possible. Applicant maintains a booster pump in its system having automatic controls. The purpose of this booster pump was to provide Gallo with water when the pressure from Gallo's own wells was not adequate to supply its needs. Gallo determined that applicant's booster was operating erratically, often furnishing Gallo with water it did not need to purchase. Applicant is now in the process of working out a system which will give Gallo manual control of the booster. Beard believes this will significantly reduce the amount of consumption Gallo will be purchasing from applicant in the future.

We believe that applicant's estimate for Gallo of 50,000 Ccf is somewhat low. But neither are we convinced, based on the evidence, that the 1981 actual use figure of 117,128 Ccf is a proper estimate for Gallo for the 1982-1983 test period. While applicant is in the process of "working out" a control system which will give Gallo manual control of the faulty booster, such is not a the case at this point. On the other hand, Gallo's original projection conveyed to the staff witness for both test years was 100,000 Ccf. The witness testified that the chief engineer indicated to him that his projection of 1982 and 1983 would still be correct. The witness then concluded that the 1982 and 1983 figures would be the same as the recorded 1981 figure. We do not necessarily draw that conclusion from the information conveyed to the witness. In light of the conflicting testimony and speculation on both sides, an estimated figure of 100,000 Ccf is appropriate for predicting water sales to Gallo for each test year, and this figure will be used in computing our adopted results of operations.

With respect to the other large industrial user, Tillie Lewis, the staff witness contacted the Manager of Environmental Service and Research of Tri-Valley Packing, the parent company owning Tillie Lewis. The witness was informed that projected 1982 and 1983 consumption will be about 70,000,000 gallons for each test year, which converts to 93,583 Ccf. Applicant's witness testified, on the other hand, merely that he had spoken with a "plant person" at Tillie Lewis, who estimated use of 55,000,000 gallons in 1982 and about 10-15% more than that during 1983. No further information was furnished by applicant concerning the qualifications or position of the person contacted at Tillie Lewis. Little or no weight should be given to the estimate obtained from that anonymous individual. Staff's recommended figure of 93,583 Ccf is clearly the better estimate for use in predicting water sales to Tillie Lewis for test years 1982 and 1983 and will be used in our adopted results of operations.

Payroll Expenses

Applicant's work force is made up of nonunion employees. Effective January 1, 1982 applicant increased employee salaries by 10% and officer salaries by 12%. In support of the request that we recognize the 1982 increase, Beard testified essentially as follows:

> Each year applicant secures a copy of a union labor contract from a large California investor-owned water company. Beard also contacts other water utilities within the State. He examines data from other utilities in Modesto and other prevailing wage rates in Modesto. He measured 1982 wage increases over 1981 levels for five California water companies. This calculation revealed an 11% wage increase paid by California Water Service Company; 10% for San Jose Water Works; 7% in September 1981 and 3% in January 1982 for Southern California Water Company; anticipation of a 9% increase for Dominguez Water Company in 1982; and increases ranging from 8% to 16%, for Southwest Suburban Water Company. Beard obtained this information from officers of each of the companies.
>
> Concerning salary raises granted company employees since 1976, the witness testified that increases were paid as follows: 8% in 1976; 7% in 1977; 6% in 1978; 7% in 1979; 10% in 1980; and 10% in 1981.
>
> Officers' salaries were increased based upon the recommendation of a committee consisting of three nonemployee directors who meet and review whatever data are available and make their recommendation to the board.

A second witness for applicant on this issue testified that 1983 payroll increases over 1982 should total about 8% based upon economic indicators, producer and consumer price indexes, and the expectation of a reduction in the rate of inflation.

Staff recommends that we recognize across-the-board 5% increases for each of test years 1982 and 1983. In arriving at this recommendation the staff witness considered such factors as recent auto workers', steel workers', airline employees', and teamsters' wage concessions, as well as other current economic conditions. He mentioned a proposal which would include freezing of wages for some federal employees. He considered recent California unemployment rates. A major factor in his consideration of this issue is the unemployment rate in the Modesto area, currently exceeding 20%. He also mentioned the March 1982 decline in the consumers price index of 3/10ths of 1%, and the fact that certain commodity future prices have declined in the last two years, e.g., sugar selling at 40 cents per pound in late 1980, currently selling for 8 cents per pound.

In its brief applicant expresses its belief that there is no provision of law authorizing us to make a reduction in an actual existing expense item based on the record before us, and considers such an eventuality an unwarranted intrusion into management prerogatives. It asserts that if we were to use as a basis for reducing wage levels the high unemployment rate in applicant's service area, we might just as reasonably reduce other expenses which were actually incurred, such as purchased power, telephone, gasoline, materials, taxes, etc.

We do not believe this area of administrative expenses may be reasonably compared with operating expenses over which applicant has no control, and we do not hold with the view that we should recognize wage increases simply because they are a fait accompli or

because certain other regulated water companies have awarded similar increases to their employees, which have been, in turn, recognized by us. To continue this trend without justification in the facts underlying a particular application would perpetuate a method of expense allowance over which the Commission would have no control.

With respect to applicant's question concerning our authority to refuse to recognize an existing expense item, we will simply state that merely to rubber stamp any increased expense over which a utility has control would be to abdicate our role as regulator. It is our duty not merely to examine actual incurred expenses, but to ratify or reject expenses on the basis of reasonableness in light of all relevant circumstances. This is especially true in connection with controllable expenses.

In the circumstances, we will recognize as reasonable an across-the-board payroll increase of 10% in 1982, but will recognize for ratemaking purposes only a further increase of 6.4% for 1983. We believe it was reasonable for applicant to grant a 10% salary increase to its employees for 1982 based on expectations as to relevant economic indicators as of the January 1, 1982, effective date of that increase. We are not persuaded, however, that it was reasonable, in view of all relevant economic circumstances, for applicant to have granted a salary increase exceeding 10% to its officers for 1982. On the other hand, neither does staff's reference to evidence of economic downturn in 1982, subsequent to applicant's having granted the instant salary increase, persuade us that a substantial portion of that salary expense should be disallowed. The reasonableness of utility operating expenses must be judged on the basis of information available to the utility at the time such expenses are incurred.

We will not, however, recognize the 8% payroll increase projected by applicant for 1983. This expense increase has yet to occur; it is therefore appropriate that we take into consideration the most recent assessment of relevant economic

factors in determining a reasonable increase for the coming year's payroll expense. The relevant factors must include not only such indicators as producer and consumer price indexes, but also the local and regional trends in wages, salaries, and unemployment. The staff recommendation, based on such considerations, of 5% ceilings on allowable payroll increases for both 1982 and 1983, informs our judgment that a 6.4% increase is reasonable for 1983. We take note of staff's testimony in another water utility rate proceeding, A.82-01-22 of San Gabriel Valley Water Company, also decided today, estimating wage inflation for 1983 at 6.4%. As we have adopted that calculation for purposes of estimating the reasonable 1983 payroll expense increase in A.82-01-22, so we will adopt the same estimate in this proceeding.

Our recognition of an across-the-board increase of 10% in 1982 and 6.4% during 1983 will place this and other utilities on notice that we intend to carefully scrutinize controllable expense items of this type--including labor expenses--and make appropriate adjustments where we believe it necessary. It will be noted that these allowances are within the range of payroll increases paid applicant's employees between 1976 and 1981, which averaged 8%.

Purchased Power

Staff and applicant differ in this area. The total dollar difference between staff's and applicant's recommendation for 1982 is $49,200. Staff's figures are based upon the use of a pump-efficiency factor of 1.083079 average Ccf per kilowatt-hour (kWh) and 5.174370 Ccf/therm. These figures are based upon recorded 1976 data, and are the highest recorded during the period 1976 through 1981. Staff based its decision to use the 1976 figure on information presented in applicant's last general rate increase proceeding (D.91120, A.58184). In that decision we found that applicant's pump-efficiency program was adequate but ordered it (Ordering Paragraph 3) to continue the program. Staff is in effect saying that since we ordered applicant to improve pump efficiency in 1979, it would be unreasonable to use a purchased power figure based on less efficiency than that found reasonable in D.91120.

Applicant takes exception to staff's position that the amount of water produced depends solely upon pump efficiency or inefficiency. Applicant avers that it has continued its pump-efficiency program as mandated in D.91120. Beard testified that it took applicant between two and three years to get all of the power agencies supplying its power to run annual efficiency tests, and 1980 and 1981 were the first years in which complete efficiency tests

were made. During 1978 and 1979 he stated it had partial tests. He testified further that use of the 1976 figure by staff does not take into consideration fluctuations in water levels, which have direct impact on pumping efficiency; that water levels vary considerably from well to well--some fluctuating only two or three feet, others, as much as 20 feet during a season. He pointed out that there has been a continual decrease in pumping levels over the long term, and over the past 20 years water levels have dropped 20 feet in some wells. He testified there was a recent United States Geological Survey (U.S.G.S.) ground water survey in Modesto, primarily sponsored by the City of Modesto. This survey indicated an overall average decline in ground water of nine inches per year in the Modesto area. Beard stated that each drop of one foot in pumping level requires an additional 13 kWh per Ccf. He noted that 15 or 20 years ago applicant could expect about 20 gallons per minute per horsepower (gpm/hp) from an average pump; but that today, about 15 gpm/hp is a reasonable production because of the drop in water levels.

Another factor Beard mentioned is that about 1976 minimum service pressure under General Order (G.O.) 103 was increased to 40 pounds per square inch, and this change requires more energy to maintain head pressure than had previously been required.

It appears to us that applicant's showing provides the better evidence in this issue. Its testimony concerning fluctuating water levels and pump levels is unrefuted. The staff position considers neither the evidence presented by applicant through witness Beard concerning water table and pumping levels, nor that relating to pump tests performed during 1980 and 1981.

Beard's testimony concerning the U.S.G.S. study and our G.O. 103 requirement for maintenance of 40 pounds per square inch is persuasive in that use of the most recent recorded data, set forth in Exhibit 11 and late-filed Exhibit 18, provide the most reasonable basis for estimating purchased power during test years 1982 and 1983. These figures are 0.984673 Ccf/kWh and 4.384002 Ccf/therm for pump efficiency, and 1.146515 Ccf/kWh for booster pumps. They will be used in our adopted results of operations.

Regulatory Commission Expense

Applicant's estimate for this expense is $74,577 plus a reasonable briefing expense, spread over the three-year period 1982 through 1984, whereas staff's estimate is $48,000 plus a reasonable briefing expense spread over the same three-year period. Applicant had not anticipated the briefing expense. The cost for it is set forth in late-filed Exhibit 17. Staff concurs with the total cost of $8,635 shown in that exhibit. Included in the briefing expenses are activities performed by the project manager, such as reviewing the transcript with respect to disputed issues, managing engineer analysis of the data from Data Resources, Inc. (DRI), and work by a consulting engineer on disputed issues.

Bill Ferry, an engineer with Brown and Caldwell, Consulting Engineers, testified for applicant on this subject. He sponsored Exhibit 7 and showed the expenses for applicant's 1974 general rate case ($40,353), its 1977/1978 general rate case ($61,359), and the current general rate case ($74,577). Total hours spent on these three cases were 984, 1,098, and 1,075, respectively. The decrease in hours, Ferry explained, is due to an increased and continuing familiarity with applicant's operations. He pointed out that the above expenses for the two previous rate cases were allowed by the

Commission in those years. He noted that the number of hours spent on this case is less than in the last general rate proceeding, even though the Commission has implemented its regulatory lag plan in connection with these types of general rate increases. This new factor has resulted in greatly increased workloads caused by the preparation of workpapers in the format required by the Commission. Ferry believes the incremental effort required by lag plan work requires about 150 hours. He pointed out the difference between staff and applicant in the area of cost for advice letter filings over the next three years. Ferry notes that staff has allowed about $1,600 for each advice letter, but he believes the cost is closer to $3,000 and feels staff has omitted certain nonconsultant fees, such as notices, mailings, and printing costs.

The amount set forth in Exhibit 7 ($74,577) plus the briefing expense of $8,635 are reasonable. We note from Exhibit 7 that the money spent for the basic study is reasonably in excess of that spent in the 1977-1978 rate case ($74,577 versus $61,359). The trend in increased costs from the 1974 and succeeding two general rate cases appears reasonable. Applicant has itemized each area of cost. Staff has not asserted that applicant's consultants or attorney have expended their efforts inefficiently or imprudently. Applicant's total regulatory expenses, including briefing expenses, are reasonable and will be adopted.

Applicant has also requested unamortized regulatory expense in working cash (rate base) as part of the operational cash balance, while staff has disallowed such treatment. Ferry believes that the total amount of regulatory Commission expense, including the time value of money, is a legitimate expense recoverable in the rates. He stated that if the unamortized balance is not allowed in working cash, then the time value of money associated with this deferred expense would not be recovered. He offered an alternate proposal for resolving this issue of deferred regulatory expense. He suggests

that correct economics would recognize multiplying the second and third year expenses by a factor which takes into account the time value of money--a factor of one plus the cost of money. For example, if the cost of money rate is 17-1/2% (coincidentally the requested return on common equity allowance), then in the second year, regulatory Commission expense should be 1.175 times the first year expense, and in the third year, 1.175 times the second year expense.

Staff states that the ratepayer is already reimbursing applicant for the amount of unamortized regulatory cost as an expense item, and that any money cost should be borne by the stockholders. Staff witness pointed out that in general rate proceedings deferred maintenance expenses are spread over the test year period without the unamortized portion being carried by the ratepayers in rate base. He referred us to D.92497 dated December 5, 1980 in A.59316. In that application Southern California Gas Company attempted to receive rate base treatment on unamortized costs. On page 80 of the decision we stated:

> "Its sole rationale is that the carrying cost of money is a real cost to its investors. We agree that it is a cost, but we do not agree that it is a cost that should be recovered from the ratepayer."

Staff also disagrees with applicant's alternate approach--applying a factor of one plus the rate of return found reasonable for common equity--to calculate the second and third year costs. Staff disagrees with this approach for the same reason expressed in D.92497. Staff believes, in short, that ratepayers are responsible only for adopted reasonable costs of the rate case.

The fact of this entire proceeding working to the benefit of applicant argues for the traditional approach of recognizing only the actual rate case cost in the rate level without inclusion in rate base. To allow the assessment of charges for money based upon the cost of money would be to authorize an even greater return to applicant, and therefore a greater cost to the ratepayer, than to include that cost in rate base.

Staff's recommendation is reasonable and consistent with prior Commission policies and will be adopted.

Income Tax

Under the provisions of Public Law 97-34, the Economic Recovery Tax Act of 1981 (ERTA), utilities must use the normalization method of accounting if they wish to take advantage of provisions in the Internal Revenue Code which permit accelerated depreciation (ACRS) for tax purposes and which provide an investment tax credit.

The normalization method of accounting permits a utility to retain taxes normally paid to the federal government. These deferred taxes are subtracted from the rate base and a benefit thereby accrues to ratepayers.

Applicant, rather than using normalization, has employed the straight-line depreciation method of calculating federal income taxes. It apparently prefers to leave the otherwise deferred amount of taxes in rate base, preserving the opportunity to earn money at our authorized rate of return on rate base (an amount earned after taxes) rather than risking it in some other investment venture. Applicant insists this is a management decision which should not be tampered with.

Staff believes application of the straight-line method of depreciation, rather than ACRS, is inappropriate. Staff observes that federal tax laws have changed regularly throughout the past; that to assume that current tax laws will remain static is to disregard those changes which have occurred over the years. It believes that it is important that tax benefits currently available be taken now in order to prevent the possible loss of those benefits.

Staff points out that the normalization method of accounting permits applicant to retain taxes normally paid to the federal government as interest-free capital which it can invest in plant improvements. It believes these deferred taxes provide a partial solution to applicant's contentions elsewhere that it is unable to obtain necessary funds for plant improvement because of high interest rates and the unavailability of financing. (See our discussion under Rate of Return, infra.)

Staff alleges essentially as follows in further justification of its use of normalization:

In Order Instituting Investigation (OII) 24 (D.93848) the Commission stated that in response to ERTA it would adopt conventional normalization accounting in determining the revenues required by utilities for federal tax expenses. This method of accounting allows utilities to take accelerated depreciation on new plant and equipment investments, but for ratemaking purposes they need to report income tax expenses on the basis of lower straight-line depreciation deductions. For ratemaking purposes, this results in:

1. Allowance of higher income tax expense;
2. The collection of moneys from ratepayers where taxes are not actually paid; and

3. Establishment of a deferred income tax reserve designed to offer the ratepayers some measure of protection by deducting this cumulative deferment from rate base.

Staff further states that use of the straight-line method does not take into consideration changes which may occur as a result of unanticipated growth or large increases in growth additions.

Staff maintains that it has been Commission policy to pass on to the ratepayer those tax benefits available under current tax law. It believes that its proposal accomplishes this end by deducting from rate base the deferred taxes generated under the normalization method. Staff avers that applicant also benefits from this method by increased cash flow through lower actual federal income tax expense due to higher cost recovery deductions.

In summary, applicant used straight-line depreciation in computing federal income taxes. Staff used straight-line for plant additions placed in service prior to January 1, 1981 and conventional normalization for plant additions placed in service after December 31, 1980. Staff then deducted from rate base the deferred amount of taxes resulting from the use of ACRS. Table L-1 of Staff Exhibit 13 shows a reserve for deferred federal income taxes of $8,600. Applicant did not deduct this amount from rate base because it used the straight-line method. This amount (albeit a minor one in this instance) being deducted from rate base has the effect of reducing the cost of service to ratepayers while at the same time improving applicant's cash flow.

In recognition of our duty to utility customers we have traditionally endeavored to authorize rate increases based upon methods of cost development and accounting procedures which produce the lowest immediate costs for ratepayers. This is essentially a "bird in the hand" approach; however, it is also a common sense outlook, particularly in the dynamic area of federal income

taxation. It is important to point out that the proposal offered by the utility is the least advantageous to the ratepayer. While it may appear anomalous for us to require normalization, we do so only because the flow through of benefits under accelerated depreciation is no longer available under ERTA. The evidence is uncontroverted that applicant's ratepayers will benefit now and in the immediate future more through use of normalization than they would if straight line depreciation, with no tax benefits, were utilized. The staff position has greater merit and will be adopted.

Graduated Tax Adjustment

Applicant is a subsidiary of Beard Land and Investment Company, which files a consolidated tax return for three operating companies--applicant, Modesto & Empire Traction Company, and Beard Land and Improvement Company.

In calculating the consolidated federal income tax liability, the first $100,000 of taxable income is taxed at a lower rate than graduated amounts over $100,000. There is a calculated tax savings of $19,750 accruing to the three companies under both applicant's and staff's calculations, which amount must be allocated back to the three companies.

Applicant believes it should be allocated only 5% of the savings; staff believes 21.3% is the correct figure to apply.

Applicant's witness Perry argues that the allocating technique employed by staff, the so-called "three factor" method, does not produce a percentage which recognizes a valid relationship between the relative profitability of the three companies. He testified that applicant's contribution to total profit of the parent company had been only 2-1/2% over the past two or three years. He arbitrarily doubled that figure and applied the resultant 5% to the graduated tax savings of $19,750 to arrive at his recommended figure of a little under $1,000.

Staff witness Mark Pocta testified basically as follows in support of his use of the "three factor" method.

Applicant files its income taxes on a consolidated basis except for this graduated tax adjustment. Pocta's factor of 21.3% was determined from applicant's workpapers showing that its gross plant is 24.2% of all gross plant dollars; its accrued expenses are 17.1% of all expenses; and its number of employees amounts to 22.4%

of all workers employed by the three companies. Averaging these three percentages produces a figure of 21.3%. Pocta applied this figure to the calculated tax saving to arrive at his recommended amount of $4,200.

Pocta stated that most utilities use a four-factor method, basically the same as the three factor, in allocating common expenses, and do not change methods for a specific item such as the graduated tax adjustment.

We see no compelling reason to depart from a method of assigning expenses which has been applied generally by utilities under our jurisdiction. To do so would create unnecessary confusion. The staff-developed figure of $4,200 is reasonable and will be adopted.

Rate of Return

Applicant requests a constant rate of return on common equity of 17.5% for test years 1982 and 1983, resulting in returns on rate base of 14.78% in 1982 and 14.86% in 1983.

Staff recommends that a rate of return in the range of 12.18% to 12.52% for test years 1982, 1983, and 1984 is fair and reasonable to both applicant and its customers. These returns on rate base equate to earnings of between 13.50% and 14.0% on common equity.

Staff evidence on this topic will be discussed first because several tables are reproduced from staff's Exhibit 12.

Staff witness Christopher Blunt testified that in developing his recommendation for this proceeding, he considered recorded information as of December 31, 1981, as well as changes estimated to occur in applicant's capital structure during the test years.

The following table, set forth in staff Exhibit 12, compares applicant's and staff's estimated capital structures and requested rates of return and demonstrates the resulting difference in 1982 gross revenues.

TABLE 2

Test Year 1982

Del Este's Requested Rate of Return

Component	Capitalization Ratios	Cost	Weighted Cost
Long-Term Debt	34.0%	9.52%	3.24%
Common Equity	66.0%	17.50%	11.55%
Total	100.0%		14.79%

Staff-Recommended Rate of Return

Long-Term Debt	32.0%	9.38%	3.00%
Common Equity	68.0%	13.75%*	9.35%
Total	100.0%		12.35%

* Midpoint of staff recommendation.

Effect on Revenue Requirements

Item	Rate of Return Difference		Project Team Rate Base		Net-to-Gross Multiplier		Revenue Requirements
Long-Term Debt	.24%	x	$2,742,100			=	$ 6,581
Common Equity	2.20%	x	$2,742,100	x	2.0674	=	124,781
Total	2.44%						$131,362

Blunt believes that an average test period capital structure consisting of about 32% long-term debt and 68% common equity is appropriate for use in determining a reasonable rate of return. He assumed that applicant would not issue any additional long-term debt during the test period and that the only changes in capital structure through 1984 will result from increases in retained earnings. He further testified that the use of a constant average

capital structure eliminates the need for financial attrition in 1983 and 1984 test years. Blunt's estimate of applicant's embedded cost of debt for the test years used as a starting point the total long-term debt balance outstanding as of December 31, 1981.

With respect to return on common equity, Blunt stated that his recommendation resulted from the consideration of many factors and is by necessity a matter of informed judgment. In arriving at his recommendation he was guided by standards set forth in United States Supreme Court decisions as well as decisions of this Commission. He concedes that his recommended return for common equity is lower than the then current long-term debt rates but believes, nevertheless, that it is appropriate for use during the test period. He states that the return on common stock should exceed the rate of return an investor could obtain upon a risk-free investment. Blunt believes that returns demanded by investors in high-equity ratio companies, as in this case, are generally lower than in low-equity situations.

Blunt believes that water utilities should be considered less risky when compared with other utilities and therefore require a smaller risk premium. He lists the following factors which he believes result in less risk for water utilities:

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 to construction.

2. Water companies do not capitalize interest on construction projects - allowance for funds used during construction (AFUDC). Construction work in progress (CWIP) is included in rate base which results in a better quality of earnings and improved cash flow.

3. Nearly all external financing undertaken by water utilities is accomplished through private placement with insurance companies, resulting in relatively lower interest rates.

4. Water utilities' service areas are well defined and are not subject to the same degree of risks as other utilities, such as fuel costs, source of supply, nuclear generation, and competition.

5. Water utilities can offset increases in the cost of purchased water and power by advice letter filings concurrently with such increases, whereas energy utilities experience a lag between the time their costs increase and offsetting rates are authorized.

Blunt believes that applicant's current debt-to-equity ratio of 36:64 is extremely low. He states that such a structure penalizes ratepayers by raising revenue requirements to accommodate the effects of income taxation while providing few, if any, benefits to the ratepayer. He demonstrates this revenue requirement effect in staff's Exhibit 12 with the following illustration.

Utility A has a debt-equity ratio of 50:50 and Utility B, a ratio of 35:65. The hypothetical situation assumes returns on equity of 17%, embedded costs of debt of 10%, and tax rates of 50%. Pre-tax costs of equity and debt are expressed as follows:

TABLE 3

[Debt x Cost of Debt]+[Equity x ROE / tax rate],
or
For Utility A,
[.50 x .10]+[.50 x .17 / .5] = .220, or 22.0%;
and
For Utility B,
[.35 x .10]+[.65 x .17 / .5] = .256, or 25.6%.

The example shown above demonstrates that Utility B has a 16.4% greater revenue requirement than Utility A, and Blunt believes the difference should be reflected by adjusting Utility B's return on common equity to reflect the lower financial risk inherent with a higher equity ratio.

Information in the next table depicts reported earnings rates on average total capital and on average common equity, times interest earned and capital structures for eight Class A water utilities, including applicant, during the period 1976 to 1980.

TABLE 4

Reported Earnings Rates on Average Total Capital
And on Average Common Equity
Class A California Water Utilities
5-Year Averages, 1976-1980

Company	Earnings Rate on Average Total Capital (a)	Earnings Rate on Average Common Equity (b)	Times Interest Earned (c)	Average Long-Term Debt Ratio (d)	Average Preferred Stock Ratio (e)	Average Common Stock Equity Ratio (f)
Azusa Valley Water Company	9.06%	12.06%	4.34	29.88%	16.77%	53.35%
California-American Water Co.	4.84	1.20	1.18	47.12	-	52.88
Dominguez Water Corporation	7.99	8.83	2.01	52.48	6.92	40.60
San Gabriel Valley Water Co.	13.83	22.66	4.84	49.33	4.17	46.50
San Jose Water Works	8.49	10.84	2.63	48.68	8.43	42.89
Southwest Suburban Water Company	8.42	7.68	1.70	53.55	4.77	41.68
Park Water Company	2.88	.41	1.00	33.06	-	66.94
Range - Average	7.93	9.10	2.53	44.87	8.21	49.26
High	13.83	22.66	4.84	53.55	16.77	66.94
Low	2.88	.41	1.00	29.88	4.17	40.60
Median	8.42	8.83	2.01	48.68	6.92	46.50
Del Este Water Company	8.67	8.95	2.33	44.67	-	55.33

Sources: Annual Reports to Stockholders.
Annual Reports to California Public Utilities Commission.
5-Year Studies, Rate of Return Unit.

Table 5 shows rates of return we have authorized for Class A water utilities during the past three years.

TABLE 5

Del Este Water Company

Rates of Return Authorized
By the California Public Utilities Commission
For Class A Water Utilities

Month	Company	Decision No.	Rate of Return Authorized	Common Equity Ratio	Rate Per Common Equity
1979					
July	Tustin Water Works	90590	9.80	34.13	12.68
August	CP National Corp. - Susanville District	90650	9.50	38.89	12.21
August	Cal-Cities Water Co. - Los Osos District	90659	9.28	34.01	13.00
August	So. Calif. Water Co. - Calipatria - Niland	90660	9.29	34.01	13.00
September	Azusa Valley Water Company	90780	10.25	53.76	12.54
October	Cal-American Water Co. - Coronado District	90925	10.06	52.50	11.25
November	San Gabriel Valley Water Co.- Los Angeles County District	90979	9.57	42.40	13.25
November	So. Calif. Water Co. - Ojai District	91024	9.23	33.36	13.00
December	Del Este Water Company	91120	11.40	54.17	13.00
1980					
March	Santa Clarita Water Company	91372	10.10	-	11.05
April	California Water Service Co. - Various Districts	91537 et al	10.28	42.02	13.20
September	Cal-American Water Co. - Various Districts	92237 et al	10.19	52.90	11.50
September	So. Calif. Water Co. - Metropolitan Districts	92244	9.85	37.00	13.40
December	PG&E - Tuolumne Water System	92490	9.00	39.08	11.49
1981					
January	California Water Service Co. - Various Districts	92604 et al	10.89	41.60	13.70
January	So. Calif. Water Co. - Bonita Valley District	92605	9.83	37.00	13.40
February	Southwest Suburban Water - San Jose-Whittier District	92666	11.48	48.50	13.50
February	Dominguez Water Corporation	92708	10.97	43.00	14.00
February	San Jose Water Works	92719	10.02	45.00	13.30
July	Cal-American Water Co. - Coronado District	93263	10.96	52.00	13.00
August	So. Calif. Water Co. - Orange County District	93427	10.44	36.00	14.35
September	Southwest Suburban Water - La Mirada	93539	11.73	45.50	14.00
October	Laguna Hills Water Company	93588	12.02	60.80	12.85
November	Park Water	93687	12.09	63.00	13.50
December	California Water Service - Various Districts	93845 et al.	11.58	43.00	14.50
1982					
February	Citizens Util. of Calif. - Sacramento County Water District	82-02-059	12.04	68.00	13.20
March	So. Calif. Water Co. - Various Districts	82-03-011 et al	10.97	37.00	14.50
March	So. Calif. Water Co. - Big Bear	82-03-071	11.15	37.00	15.00

Blunt states that the information in Table 5 shows that applicant's earnings rate on average total capital is above the average of water utilities over the last five years, that its interest coverage is slightly below the average shown for other utilities, and that its long-term debt ratio is below average,reflecting lower financial risk. He stated that applicant is currently not rated by either Moody's or Standard and Poor's, but that the midpoint of his recommended rate of return provides an after-tax interest coverage of 4.12 and is an improvement over applicant's already higher-than-average interest coverage. Additional factors considered by Blunt in arriving at his recommendation are as follows:

1. Applicant is a regulated public utility engaged in a business which affects thepublic interest and must provide its service at reasonable rates.
2. Applicant's capital structure, capital costs, and financial history.
3. Economic conditions--the effects of continued inflation.
4. Applicant's capital requirements.
5. Lack of competition.
6. Water utilities are less risky than other utilities.

Blunt states he is recommending a return on equity lower than the Commission has authorized for some other Class A water utilities because of a lower level of financial risk to applicant's equity holders than for those in typical Class A utilities. He notes that as of December 31, 1980, Class A water utilities had average debt to equity ratio of 50:50 which reflects more financial risk to equity holders than applicant's low debt ratio of 38:62 for the same period.

Concerning risk, Blunt's testimony included information from Valu Line, a trade publication employing a risk measurement technique known as Beta measure. He states Beta determines the sensitivity of a particular investment considered against the New York Stock Exchange Index and Standard and Poor's 500 Index. If Beta is greater than one, the particular stock is considered riskier than average; if less than one, it is less risky. Blunt testified that as of June 30, 1981, according to Valu Line, water company Betas were .57.

Blunt also relied upon information published in Data Resource, Inc. (DRI) for his estimate that the prime rate, AA utility bonds and long-term government bonds would decrease during the test years 1982-1984. This DRI information is set forth in Exhibit 14, and projects that the then current average prime interest rate will decrease to 14.04%; AA utility bonds will decrease from 15.00% to 12.57%; and long-term government bonds will reduce from 13.45% to 11.57%.

Applicant's evidence concerning the cost of capital was offered through two witnesses, Richard Bratz, its assistant treasurer, and Marv Winer, a consultant with Brown and Caldwell.

Bratz testified that applicant's long-term debt needs have been met by Pacific Mutual Life Insurance Company (Pacific) since 1951; that bank borrowings are its source of short-term debt, although it has no short-term debt outstanding at the present time. Pacific had indicated to Bratz quite recently that it had no long-term funds to commit to a utility such as applicant. He sponsored Exhibit 1, a letter dated May 4, 1982 from Pacific indicating that there were now limited funds available at rates of about 17% or higher. These are considered "bullet loans", which mature in five years and not considered long-term financing. He believes that there is no long-term debt financing available to applicant at the present time due to unfavorable money market conditions.

Bratz referred to a chart in Exhibit 10 showing applicant's long-term debt issues outstandng with Pacific and maturing at various dates between 1986 and 1997. Interest rates range between 5-1/2% for those issues which are due in 1986 and 1988 to a high of 10% for those due in 1997. He testified that Pacific, without expressly stating it, has nevertheless hinted that at such time as money becomes available it may be necessary to refinance all of applicant's existing long-term debt at current rates of interest.

Bratz referred to a number of provisions in the original Pacific indenture and subsequent amendments which he believes effectively prevent applicant from obtaining long-term financing from any party other than Pacific. He testified that the original indenture and subsequent amendments have been approved by this Commission and are a matter of record in past proceedings.

Bratz stated applicant would prefer not to seek additional equity financing at this time and thereby induce a further increase in its already high-equity ratio. He believes that since applicant has forgone dividend payouts to a large extent over recent years in order to maintain plant integrity, an investor might very well look elsewhere for a better return on his investment. Bratz views the general unavailability of debt as well as its reliance on internal financing as major reasons for applicant's relatively low-debt ratio position.

Bratz states that an ability to attract long-term debt financing is essential if applicant is to maintain its ability to service its existing debt and provide essential capital improvements in plant maintenance programs. He asserts that applicant must be in a position to reflect adequate financial stability and believes that reasonable rate relief is essential if applicant is to be able to demonstrate credibility in the financial community.

On cross-examination Bratz conceded that the information in applicant's Exhibit 10 indicates that no new financing is necessary until 1986, at which time certain balloon payments will fall due on existing debt. However, he states that these tables do not take into consideration low dividend payouts and operational expenses involved in applicant's plant maintenance programs.

Marv Winer testified concerning applicant's request that it be allowed a 17-1/2% return on common equity. He stated essentially as follows:

1. He bases his recommendation upon U.S. Supreme Court decisions which require that a rate of return be fair and equitable and commensurate with risks of similar businesses.

2. In determining applicant's risk, he employed a measure called semi-variance, rather than standard variance, or standard deviation. Applicant's risk premium was examined over the last two decades. During the period 1960 to 1968 its return on equity was fairly constant. Its return on equity during this period averaged about 2.4 percentage points higher than the Standard and Poor's public utility bond index. Then, during the period 1969 through 1980, applicant's return on equity began to fall off and average less than Standard and Poor's public utility bond index by 1.5 percentage points.

3. Applicant's risk was compared with the Dow Jones Industrial Average. It was found through use of the semi-variance method of comparisons that the Dow Jones Average was less risky than applicant's. Its return on common equity was compared to earnings of nine other nonwater utilities throughout the nation. The average cost of capital for these nine companies was 17%, considerably higher than applicant's.

4. Recent debt offerings of seven nonwater non-California utilities were examined. Yields were found in excess of 17% on average. Three AAA, one AA, one A, and two BAA bond ratings were applicable in connection with the seven utilities. Applicant's current return on equity (11.10% in 1981) is considerably less than the individual as well as the average debt costs of these nonwater utilities.

Winer determined that allowance of a rate of return on common equity of 17-1/2%, combined with embedded cost of debt, would produce revenue enabling applicant to pay dividends of about 25% from its projected net operating income. Winer sponsored Exhibit 2 which shows return on equity for three California and four non-California water utilities. The average return during 1981 shown in this exhibit is 18.9%; for 1980 it is 17.9%. Winer testified that he has determined that the average dividend yields of those seven companies was 12%. Thus, he observes that not only would an investor on average receive a return on his investment of 18.9% in these companies, but would receive a dividend return of 12%; while applicant's request, if granted, would produce only 17.5% return on equity. He concludes therefore that an authorized rate of return in excess of 17% would be fair and equitable for the purposes of this proceeding.

Winer sponsored Exhibit 3, a tabular showing of sources and applications of funds based upon the midpoint of staff's recommended range for return on equity. Winer concludes that the staff midpoint recommendation does not allow for reasonable dividend payouts or capital additions in 1983.

He further observed that the staff proposal could not fund applicant's recommended capital program even with an asserted low payout dividend of about 25% to 30%, amounting to $100,000 in each of the test years shown. He stated that under the above scenario, applicant would either cover the deficit by paying no dividend or cut back its capital improvement program. He notes that applicant's dividend ratio over the last decade has been an already comparatively low 25%.

Winer stated that for a number of years, since applicant has been unable to borrow money to finance capital improvements, it has had to either fund capital improvements from retained earnings or allow service to deteriorate to a substandard level. He believes that if and when debt money does become available at a reasonable cost, applicant should borrow money in order to fund projected capital improvement programs, thereby decreasing its equity position; but it has been unable to do so, requiring it to invest earnings back into the business and at the same time experiencing a rate of return below the commonly accepted no-risk rate of return. This perpetuates and exacerbates a Catch-22 situation whereby, because of its high equity ratio, applicant is viewed by the staff as less risky than the average company.

Winer also sponsored Exhibit 4, a rebuttal to the testimony of staff witness Blunt, concerning requirements when debt-equity ratios are changed. He agrees that applicant is essentially a two-thirds equity capitalized corporation, and that in order to get a debt ratio of 50% they would need to borrow $1 million to give them $2 million in debt and $2 million in equity. He states that if they were to do this, and could in fact get a million dollars in debt at 18%, and then the Commission decided that under a 50:50 ratio they were riskier and allowed a return on equity of about 18%, the ensuing numbers would certainly change but would result in only 2.7% revenue requirement than the amount set forth in Blunt's example.

Winer's portrayal of this hypothetical situation is set forth in the following table:

TABLE 6

Before Change in Capital Structure

[0.35 x .10] [0.65 x .17 .5] = 25.6%

After Change in Capital Structure

[0.50 x .1386*] [0.50 x .18 .5] = 24.9%

* 51.7% @ 10%.
48.3% @ 18%.

Winer presented this exhibit to demonstrate that if higher risk could be imputed simply by changing the debt-equity ratio, nonetheless virtually the same revenue requirements would ensue. It will be noted that he has arbitrarily imputed debt costs of 18% on 48% of applicant's embedded cost of debt in order to depict his "real world" model.

In summary, Winer characterized applicant's financial problems as (1) its inability to obtain any long-term financing and (2) failure to receive a high enough return on its rate base and common equity to allow the payment of dividends and at the same time perform its capital improvement program.

The record is replete with expert testimony expressing arguments in support of both staff and applicant's recommendations. On balance, it seems to us that the high end of staff's recommended range of 13.50%-14.00% on common equity is reasonable; applicant's request of 17.50% is unrealistically high for the purposes of this proceeding.

Several factors lead us to this conclusion.

First, we concur with staff that applicant's high equity ratio position presents a lower level of financial risk to applicant's equity holders than a company with a low equity ratio position. We have previously reflected a utility's reduced financial risk by authorizing a return on equity which is slightly lower than that of a more risky utility.

Second, while we are concerned with applicant's ability to secure long-term loans at reasonable cost, we observe that applicant will not have to reenter the debt market during test years 1982-1984. We also note that a 14% return on equity provides an after-tax times interest coverage of 4.17 which is a healthy indicator of applicant's general ability to finance and its financial stability.

Third, we observe that staff and DRI projections of various interest rates more closely reflect current economic trends than the projections of applicant.

Lastly, we conclude that the authorized return to applicant is commensurate with the returns authorized for other water utilities having similar risks.

Applicant's comparison of dividend payout ratios among utilities deserves comment. Applicant claims that since its dividend payout ratio averages less than other water utilities, applicant requires a substantial increase in its return on equity to bring its payout ratio up to the level of other utilities.

Obviously, any utility must have sufficient earnings if it is to pay a suitable dividend to its stockholders. However, what constitutes the optimum dividend payout ratio is a management decision to be made by each individual company. A high payout ratio could very well indicate that a company experienced poor earnings while maintaining a constant dividend per share. Conversely, a low payout ratio could indicate good earnings coupled with a conservative dividend policy.

The proper analytical reviews should be to the earnings level which supports the dividend payout ratio. The return we are authorizing for Del Este will provide sufficient earnings for its management to exercise its discretion as to what constitutes a reasonable dividend payout ratio for the applicant.

For debt cost and capitalization structure, we will adopt the staff recommendation set forth in Exhibit 12 since it is based upon year-end 1981 data and is the more recent information.

The tabulation below shows our adopted debt, equity, and capitalization factors, as well as interest coverages and rates of return during the period 1982-1984.

	Capital Ratios	Cost Factors	Weighted Costs	After Tax Interest Coverages
Long-Term Debt	32.00%	9.38%	3.00	
Common Equity	68.00%	14.00%	9.52	
Total	100.00%		12.52%	4.17

The relatively high interest coverage shown will be necessary to allow applicant to borrow long-term debt at reasonable prices when the needs and opportunities are present.

Summary of Earnings

The information shown in Tables 7 and 8 reflect applicant's and staff's adjusted estimates, effect of our adopted results of disputed issues, and adopted revenues and expenses for test years 1982 and 1983.

TABLE 7

Del Este Water Company
Comparison of Applicant and Staff Estimates

	Test Year 1982		Test Year 1983	
	Applicant	Staff	Applicant	Staff
At Present Rates				
Operating Revenues	$2153.5	$2174.1	$2187.4	$2205.4
Operating Expenses				
O&M Payroll	470.0	423.2	507.5	444.3
Purchased Power	423.0	377.3	427.6	380.6
Other O&M	255.0	255.0	271.8	271.8
A&G Salaries	130.4	109.9	141.7	115.7
Reg. Comm. Exp.	24.9	16.4	29.2	16.4
Other A&G	286.3	286.3	309.2	309.2
Depreciation Exp.	165.2	165.2	175.5	175.5
Ad Valorem Tax	37.0	37.0	39.2	39.2
Payroll Tax	42.8	45.4	46.1	47.5
Subtotal	1834.6	1715.7	1947.8	1800.2
Uncollectible	7.1	7.2	7.2	7.3
Local Franchise Tax	12.7	12.7	12.9	12.9
State Corp. Tax	15.4	26.9	5.8	21.7
Federal Income Tax	65.7	114.5	25.3	93.9
Total Oper. Exp.	1935.5	1 77.0	1999.0	1936.0
Net Operating Revenues	218.0	297.1	188.4	269.4
Rate Base	2750.3	2741.7	2921.5	2889.1
Rate of Return	7.93%	10.84%	6.45%	9.32%
At Prooosed Rates				
Operating Revenues	2604.8	2630.1	2818.8	2841.7
Operating Expenses				
Subtotal	1834.6	1715.7	1947.8	1800.2
Uncollectible	8.6	8.7	9.3	9.4
Local Franchise Tax	15.3	15.4	16.6	16.7
State Corp. Tax	56.4	70.3	65.9	82.3
Federal Income Tax	245.8	302.4	288.5	356.0
Total Oper. Exp.	2160.7	2112.5	2328.1	2264.6
Net Operating Revenues	444.1	517.6	490.7	577.1
Rate Base	2750.3	2741.7	2921.8	2889.1
Rate of Return	16.15%	18.88%	16.79%	19.98%

TABLE 8

Del Este Water Company
Adopted Summary of Earnings

	Test Year 1982	Test Year 1983
	(Dollars in Thousands)	
At Present Rates		
Operating Revenues	$2170.1	$2201.4
Operating Expenses		
O&M Payroll	443.9	471.6
Purchased Power	427.0	430.9
Other O&M	255.0	271.8
A&G Salaries	115.1	122.7
Regulatory Commission Exp.	27.7	27.7
Other A&G	286.3	309.2
Depreciation	165.2	175.5
Ad Valorem Tax	37.0	39.2
Payroll Tax	45.0	48.2
Subtotal.	1802.2	1896.8
Uncollectibles	7.2	7.3
Local Franchise Tax	12.8	12.9
State Corp. Tax	18.2	12.1
Federal Income Tax	76.9	52.1
Total Operating Expenses	1917.3	1981.2
Net Operating Revenues	252.8	220.2
Rate Base	2741.7	2889.1
Rate of Return	9.22%	7.62%
At Adopted Rates		
Operating Revenues	2357.2	2494.1
Operating Expenses		
Subtotal	1802.2	1896.8
Uncollectibles	7.8	8.2
Local Franchise Tax	13.8	14.6
State Corp. Tax	36.0	39.9
Federal Income Tax	154.0	172.8
Total Operating Expenses	2013.8	2132.3
Net Operating Revenues	343.4	361.8
Rate Base	2741.7	2889.1
Rate of Return	12.52%	12.52%

The constant 12.52% return on rate base we are authorizing will result in revenue increases of 8.62% or $187,100 in 1982, 4.44% or $106,000 in 1983, and 3.83% or $95,600 in 1984. Since we are authorizing a constant rate of return for all three years, there will be no financial attrition during 1984.

Net-to-Gross Multiplier

Staff's net-to-gross multiplier of 2.0675 is based on the following percentages:

California Corporation Franchise Tax Rate	9.6%
Federal Income Tax Rate	46.0
Uncollectible Rate	0.330
Local Franchise Rate	0.588

The net-to-gross multiplier represents the change in gross revenue required to produce a unit change in net revenues; e.g., a change in net revenues of $1 requires a change in gross revenues of $2.0675.

Operational Attrition In Rate of Return

Applicant has requested step rate increases for 1983 and 1984. Staff has computed rates of return for 1982 and 1983 based on present rates. This calculation indicates there will be operational attrition of 1.60% in the rate of return.

To compensate for 1.60% attrition, an approximate increase in gross revenue between 1983 and 1984 of $95,600 based upon adopted 1983 rate base, is required.

Rate Design

Cumulative increases in revenue since January 1, 1976 have exceeded 25%. Increases resulting from this proceeding should therefore be applied to lifeline rates.

Applicant's present metered, flat rate, private fire protection, and public hydrant service rates are shown in Table 14. Applicant proposes to cancel its public fire protection tariff, having entered into an agreement with local fire districts. Staff concurs with the proposed cancellation of this service.

TABLE 9

Schedule No. 1

METERED SERVICE

	Per Meter Per Month
RATES	
Quantity Rates:	
First 500 cu.ft. or less	$ 3.90
Next 9,500 cu.ft. per 100 cu.ft.	.349
Over 10,000 cu.ft. per 100 cu.ft.	.236
Minimum Charge:	
For 5/8 x 3/4-inch meter	3.90
For 3/4-inch meter	5.40
For 1-inch meter	6.80
For 1-1/2-inch meter	14.00
For 2-inch meter	22.00
For 3-inch meter	41.00
For 4-inch meter	70.00
For 6-inch meter	128.00
For 8-inch meter	199.00
For 10-inch meter	299.00
For 12-inch meter	401.00

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

Schedule No. 2

FLAT RATE SERVICE

	Per Service Connection Per Month
RATES	
For a premise served by an unmetered water connection having the following areas:	
6,000 sq.ft. or less	$ 6.50
6,001 to 10,000 sq.ft.	7.30
10,001 to 16,000 sq.ft.	8.55
16,001 to 25,000 sq.ft.	10.60
Over 25,000 sq.ft.	13.10

TABLE 9 - Cont.

Schedule No. 4

PRIVATE FIRE PROTECTION SERVICE

	Per Month
RATE	
For each inch of diameter of service connection	$2.40

Schedule No. 5

PUBLIC FIRE HYDRANT SERVICE

	Per Hydrant Per Month
RATES	
Hydrants owned by the fire protection agency:	
Wharf Type	$1.67
Standard Type	3.33
Hydrants owned by the utility:	
Wharf Type	2.36
Standard Type	4.02

In accordance with our order in D.91120, applicant proposes to replace its present minimum charge-type rate schedule with a service charge-type schedule. Staff concurs with this proposed conversion.

In the circumstances, percentage increases authorized by this decision will be applied evenly to metered, flat rate, and private fire protection rates.

Pump Efficiency

Staff recommends that applicant be ordered to continue its program for improving its pumping efficiency in accordance with our previous order in D.91120.

Findings of Fact

1. Applicant's service is of good quality. Its conservation program is adequate.

2. Applicant has demonstrated a need for increased revenues during the years 1982-1984.

3. A factor of 100,000 Ccf per year is appropriate for predicting water sales to Gallo during 1982 and 1983. A factor of 93,583 Ccf is the best estimate of water sales in 1982 and 1983 to Tillie Lewis Foods.

4. Recognition of annual across-the-board payroll increases in 1982 and 1983 of 10% and 6.4%, respectively, is reasonable for the purposes of this proceeding.

5. Use of purchased power factors of 0.984673 Ccf per kWh and 4.384002 Ccf/therm, and a booster pump factor of 1.146515 Ccf per kWh will provide applicant with adequate revenues for these expenses during 1982 and 1983.

6. Allowance of a total regulatory commission expense of $83,212 to be amortized over the three-year period 1982-1984 is reasonable. However, it would be unreasonable to allow any carrying charges or to recognize a cost for the time value of money in our adopted results of operations for this expense. The total regulatory commission expense includes $74,577 in initial costs and $8,635 for briefing costs.

7. Use of the normalization method of accounting for calculating applicant's federal income tax liability for the purposes of this proceeding will provide a present benefit for applicant's ratepayers and is therefore more reasonable and will be adopted.

8. The staff's application of the "three factor" method in calculating applicant's portion of the graduated income tax adjustment is more reasonable than the relative profitability approach recommended by applicant.

9. Authorization of a constant rate of return of 14.00% on common equity for 1982-1984 will result in a constant rate of return of 12.52% and is reasonable. Staff's projected debt cost of 9.38% during this period is reasonable.

10. Applicant will suffer operational attrition of 1.60% between 1983 and 1984.

11. Revenue percentage increases granted by this decisionshould be spread evenly throughout applicant's rate schedules, including lifeline rates, since cumulative increases have exceeded 25% since 1976.

12. Applicant should be ordered to continue the pump efficiency program mandated in D.91120.

Conclusions of Law

1. Revenue increases of $187,100 or 8.62% in 1982 and $106,000 or 4.44% in 1983 are reasonable based upon adopted results of operations. A further increase in 1984 of $95,600 or 3.83% is reasonable based upon operational attrition of 1.60%.

2. Applicant should be authorized to file the rate schedules attached as Appendixes A and B, subject to the condition set forth in Conclusion of Law 4.

3. The adopted rates are just, reasonable, and nondiscriminatory.

4. The further increases authorized in Appendix B should be appropriately modified in the event the rates 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 and/or September 30, 1983, exceed 12.52%.

5. Because of the present need for additional revenue, the following order should be effective the date of signature.

O R D E R

IT IS ORDERED that:

1. Del Este Water Company (applicant) is authorized to file, effective today, the revised rate schedules in Appendix A. The filing shall comply with General Order (G.O.) 96-A. The revised rates shall aply 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 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 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 12.52%. This filing shall comply with G.O. 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.

3. On or after November 15, 1983, applicant is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases attached to this order as Appendix B, or to file a lesser increase which includes a uniform cents per 100 cubic feet of water adjustment from Appendix B in the event that the rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ending September 30, 1983, exceeds 12.52%. Such filing shall comply with G.O. 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, 1984, or 30 days after the filing of the step rate, whichever is later.

4. Applicant shall continue its pump efficiency improvement program.

5. By November 1, 1982, applicant shall mail to all its customers in this district a bill insert notice as shown in Appendix D.

This order is effective today.

Dated SEP 22 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

Schedule No. 1

DEL ESTE WATER COMPANY

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Portions of Modesto and Turlock and Empire, Salida, Waterford, Hickman, Grayson, and Hillcrest and vicinity, Stanislaus County.

RATES

	Per Meter Per Month
Service Charge:	
For 5/8 x 3/4-inch meter	$ 3.00
For 3/4-inch meter	4.50
For 1-inch meter	5.50
For 1½-inch meter	7.60
For 2-inch meter	9.60
For 3-inch meter	13.50
For 4-inch meter	18.00
For 6-inch meter	28.00
For 8-inch meter	40.00
For 10-inch meter	55.00
For 12-inch meter	75.00
Quantity Rates:	
For the first 300 cu. ft., per 100 cu. ft.	0.200
For the next 9,700 cu. ft., per 100 cu. ft.	0.300
For all over 10,000 cu. ft., per 100 cu.ft.	0.268

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.

Schedule No. 2

FLAT RATE SERVICE

APPLICABILITY

Applicable to all water furnished on a flat rate basis.

TERRITORY

Portions of Modesto and Turlock, and Empire, Salida, Waterford, Hickman, Grayson, and Hillcrest and vicinity, Stanislaus County.

RATES

	Per Service Connection Per Month
For a premise served by an unmetered water connection having the following areas:	
6,000 sq. ft. or less	$ 7.00
6,001 to 10,000 sq. ft.	8.05
10,001 to 16,000 sq. ft.	9.50
16,001 to 25,000 sq. ft.	11.50
Over 25,000 sq. ft.	14.20

SPECIAL CONDITIONS

1. Meters may be installed at the option of the utility or the customer, in which event service will be furnished only under Schedule No. 1, Metered Service. A customer's request for metered service must be made in writing.

2. Customers requesting service of the following types will not be served under this schedule, but will be served under Schedule No. 1, Metered Service.

a. Residential service connections larger than 3/4" diameter or any 3/4" residential service that, in the utility's judgment, may consume excessive water because of lot size, special equipment, or unusual use.

b. Service connections to commercial or business establishments.

c. Service connections for agricultural purposes.

d. Service connections to premises containing multiple dwellings or dwellings and occupied trailer houses.

Schedule No. 4

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service furnished to privately owned fire protection systems.

TERRITORY

Portions of Modesto and Turlock, and Empire, Salida, Waterford, Hickman, Grayson, and Hillcrest and vicinity, Stanislaus County.

RATE

	Per Month
For each inch of diameter of service connection	$2.60

SPECIAL CONDITIONS

1. The fire protection service connection shall be installed by the utility and the cost paid by the applicant. Such payment shall not be subject to refund.

2. The minimum diameter for fire protection services shall be four inches, and the maximum diameter shall be not more than the diameter of the main to which the service is connected.

3. If a distribution main of adequate size to serve a private fire protection system in addition to all other normal service does not exist in the street or alley adjacent to the premises to be served, then a service main from the nearest existing main of adequate capacity shall be installed by the utility and the cost paid by the applicant. Such payment shall not be subject to refund.

(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.

METERED RATES

	Effective Dates	
	1-1-83	1-1-84
Service Charge		
	Per Meter Per Month	
For 5/8 x 3/4-inch meter	$0.20	$0.10
For 3/4-inch meter	0.20	0.20
For 1-inch meter	0.25	0.25
For 1-1/2-inch meter	0.30	0.30
For 2-inch meter	0.40	0.50
For 3-inch meter	0.60	0.60
For 4-inch meter	1.00	1.00
For 6-inch meter	2.00	1.00
For 8-inch meter	2.00	2.00
For 10-inch meter	3.00	2.00
For 12-inch meter	3.00	3.00
Quantity Rates:		
For the first 300 cu. ft., per 100 cu. ft...	0.010	0.008
For the next 9,700 cu. ft., per 100 cu. ft...	0.013	0.012
For all over 10,000 cu. ft., per 100 cu. ft..	0.012	0.010

FLAT RATES

6,000 sq. ft., or less	$0.30	$0.20
6,001 to 10,000 sq. ft.	0.35	0.35
10,001 to 16,000 sq. ft.	0.45	0.35
16,001 to 25,000 sq. ft.	0.50	0.50
Over 25,000 sq. ft.	0.60	0.60

PRIVATE FIRE PROTECTION

For each of diameter of service connection	$0.10	$0.10

(End of Appendix B)

ADOPTED QUANTITIES

Name of Company: Del Este Water Company

Net-to-Gross Multiplier: 2.06745

Federal Tax Rate: 46%

State Tax Rate: 9.6%

Local Franchise Tax Rate: 0.588%

Uncollectibles Rate: 0.330%

Offset Items	Test Years 1982	1983
1. Purchased Power:		
Total Production - Ccf	8,088,706	8,161,428
Acre-Feet	18,569.1 A.F.	18,736.1 A.F.
Electric:		
(a) Modesto Irrigation District		
Total Cost	$ 178,700	$ 180,300
KWh	5,689,294	5,739 998
Eff Sch Date	1/1/82	1/1/82
$/kWh Used	$ .03141	$ .03141
(b) Pacific Gas & Electric Company		
Total Cost	$ 3,900	$ 4,000
KWh	46,094	46,512
Eff. Sch. Date	5/4/82	5/4/82
$/kWh Used	$ .08521	$ .08521
(c) Turlock Irrigation District		
Total Cost	$ 43,600	$ 44,000
KWh	930,347	938,823
Eff. Sch. Date	4/15/82	4/15/82
$/kWh Used	$ .04688	$ .04688
Gas		
(d) Pacific Gas & Electric Company		
Total Cost	$ 200,800	$ 202,600
Therms	395.473	395,065
Eff. Sch. Date	5/4/82	5/4/82
$/Term Used	$ .50771	$ .50771
2. Purchased Water:		
	80,600 Ccf	80,600 Ccf
	185.1 A.F.	185.1 A.F.

ADOPTED QUANTITIES

Name of Company: Del Este Water Company

Pump Tax - Replenishment Tax: None

Payroll and Employee Benefits

	Test Years 1982	1983
Operation and Maintenance	$443,900	$471,600
Administrative & General	115,100	122,700
Total	559,000	594,300
Payroll Taxes	45,000	48,200

Ad Valorem Taxes:

Ad Valorem Taxes -	37,000	39,200
Tax Rate -	0.862%	0.862%

Metered Water Sales Used to Design Rates:

	Range - Ccf	Usage-Ccf 1982	1983
Block 1	0-3	86,420	91,961
Block 2	4-100	797,841	845,463
Block 3	100	1,977,460	1,977,218
Total Metered Usage		2,861,721	2,914,642

ADOPTED QUANTITIES

Name of Company: Del Este Water Company

Customers & Usage

	No.		Usage-KCcf		Avg. Usage-Ccf/svc/yr.	
	1982	1983	1982	1983	1982	1983
Commercial						
Metered	2,544	2,714	1,089.3	1,162.1	428.2	428.2
Flat Rate	13,400	13,438	4,418.1	4,430.6	329.7	329.7
Industrial	46	48	332.4	346.9	7,226.0	7,226.0
Industrial-large Users	8	8	1,085.5	1,163.4	135,687.5	145,425.0
Public Authority	72	74	187.1	198.4	2,599.0	2.681.0
Public Authority Large Users	3	1	167.4	43.9	55,800.0	43,900.0
Subtotal	16,073	16,283	7,279.8	7,345.3		
Private Fire Protection	112	119				
Total	16,185	16,402				
Water Loss at 10.00%			808.9	816.1		
Total Water Produced			8,088.7	8,161.4		

DEL ESTE WATER COMPANY

ADOPTED SERVICE BY METER SIZE
(all classes)

Meter Size	1982	1983
5/8" x 3/4"	590 services	629 services
3/4"	1267	1352
1"	425	452
1-1/2"	148	158
2"	160	169
3"	42	43
4"	19	19
6"	12	12
8"	9	10
10"	1	1
Total	2673	2845

FLAT-RATE SERVICES

	1982	1983
6,000 sq. ft., or less	1,566	1,571
6,001 to 10,000 sq. ft.	9,183	9,209
10,001 to 16,000 sq. ft.	1,501	1,505
16,001 to 25,000 sq. ft.	519	520
Over 25,000 sq. ft.	631	633
Total	13,400	13,438

DEL ESTE WATER COMPANY

ADOPTED TAX CALCULATIONS

	Item	1982 CCFT	1982 FIT	1983 CCFT	1983 FIT
		(Dollars in Thousands)			
1.	Operating Revenues	$2357.2	$2357.2	$2494.1	$2494.1
2.	O & M - A & G Expenses	1576.6	1576.6	1656.7	1656.7
3.	Taxes Other Than Income	82.0	82.0	87.4	87.4
4.	CCFT	0.0	36.0	0.0	39.9
5.	Subtotal	1658.6	1694.6	1744.1	1784.0
6.	Deductions from Taxable Income				
7.	Tax Depreciation	199.4	194.4	212.4	203.7
8.	Capitalized Overhead	25.8	25.8	27.0	27.0
9.	Interest	98.4	98.4	94.7	94.7
10.	Subtotal Deductions	323.6	318.6	334.1	325.4
11.	Not Taxable Income to CCft	375.0		415.9	
12.	CCFT	36.0		39.9	
13.	Total CCFT	36.0		39.9	
14.	Not Taxable Income for FIT		344.0		384.7
15.	Federal Income Tax		158.2		177.0
16.	Graduated Tax Adjustment		-4.2		-4.2
17.	Fed. Income Tax Before Adj.		154.0		172.8
18.	Investment Tax Credit		0.0		0.0
19.	Total FIT		154.0		172.8

(End of Appendix C)

APPENDIX D

N O T I C E

$2,500 of the recent rate increase granted to Del Este Water Company was made necessary by changes in tax laws proposed by the President and passed by Congress last year. This was the Economic Recovery Tax Act of 1981. Among its provisions was a requirement that utility ratepayers be charged for certain corporate taxes even though the utility does not have to pay them. This results from the way utilities may treat tax savings from depreciation on their plant and equipment. The savings can no longer be credited to the ratepayer, but must be left with the company and its shareholders.

For a more detailed explanation of this tax change, send a stamped self-addressed envelope to:

Consumer Affairs Branch
Public Utilities Commission
350 McAllister Street
San Francisco, CA 941021

(End Of Appendix D)

O P I N I O N

Summary of Decision

This order will authorize Del Este Water Company (applicant) to increase its rates for providing water by 9.15% ($198,500), 3.90% ($93,400), and 4.17% ($104,500) in 1982, 1983, and 1984, respectively. These new revenues will allow applicant opportunity to earn an overall rate of return on rate base of 12.52%, and its shareholders a return on common equity of 14.00%.

Several issues remained in dispute at the time the proceeding was submitted upon the filing of concurrent briefs in June. Two are noteworthy because this is apparently the first time they have been considered by this Commission.

First, applicant had awarded wage increases of 10% and 12%, respectively, to its employees and officers on January 1, 1982. Applicant also anticipates increased payroll expenses of 8% in 1983. We will recognize an across-the-board increase in 1982 of 10% for ratemaking, but will allow only a further 6.4% in 1983. The Commission staff had recommended that across the board increases of 5% in both 1982 and 1983 be allowed for ratemaking purposes.

Second, applicant chose not to employ the accelerated cost recovery depreciation provisions available under the Economic Recovery Tax Act (ERTA) in calculating its federal income tax liability for the purposes of this proceeding. We are imputing those provisions in our adopted results of operations because they result in a present benefit to ratepayers.

Of applicant's approximate 16,000 total water services, about 13,500 are flat rate connections. Percentage increases granted by this decision will be applied evenly to metered, flat rate, and private fire protection rates.

because certain other regulated water companies have awarded similar increases to their employees, which have been, in turn, recognized by us. To continue this trend without justification in the facts underlying a particular application would perpetuate a method of expense allowance over which the Commission would have no control.

With respect to applicant's question concerning our authoriy to refuse to recognize an existing expense item, we will simply state that merely to rubber stamp any increased expense over which a utility has control would be to abdicate our role as regulator. It is our duty not merely to examine actual incurred expenses, but to ratify or reject expenses on the basis of reasonableness in light of all relevant circumstances. This is especially true in connection with controllable expenses.

In the circumstances, we will recognize as reasonable an across-the-board payroll increase of 10% in 1982, but will recognize for ratemaking purposes only a further increase of 6.4% for 1983. We believe it was reasonable for applicant to grant a 10% salary increase to its employees for 1982 based on expectations as to relevant economic indicators as of the January 1, 1982, effective date of that increase. We are not persuaded, however, that it was reasonable, in view of all relevant economic circumstances, for applicant to have granted a salary increase exceeding 10% to its officers for 1982. On the other hand, neither does staff's reference to evidence of economic downturn in 1982, subsequent to applicant's having granted the instant salary increase, persuade us that a substantial portion of that salary expense should be disallowed. The reasonableness of utility operating expenses must be judged on the basis of information available to the utility at the time such expenses are incurred.

We will not, however, recognize the 8% payroll increase projected by applicant for 1983. This expense increase has yet to occur; it is therefore appropriate that we take into consideration the most recent assessment of relevant economic

Purchased Power

Staff and applicant differ in this area. The total dollar difference between staff's and applicant's recommendation for 1982 is $49,200. Staff's figures are based upon the use of a pump-efficiency factor of 1.083079 average Ccf per kilowatt-hour (kWh) and 5.174370 Ccf/therm. These figure are based upon recorded 1976 data, and are the highest recorded during the period 1976 through 1981. Staff based its decision to use the 1976 figure on information presented in applicant's last general rate increase proceeding (D.91120, A.58184). In that decision we found that applicant's pump-efficiency program was adequate but ordered it (Ordering Paragraph 3) to continue the program. Staff is in effect saying that since we ordered applicant to improve pump efficiency in 1979, it would be unreasonable to use a purchased power figure based on less efficiency than that found reasonable in D.91120.

Applicant takes exception to staff's position that the amount of water produced depends solely upon pump efficiency or inefficiency. Applicant avers that it has continued its pump-efficiency program as mandated in D.91120. Beard testified that it took applicant between two and three years to get all of the power agencies supplying its power to run annual efficiency tests, and 1980 and 1981 were the first years in which complete efficiency tests

For debt cost and capitalization structure, we will adopt the staff recommendation set forth in Exhibit 12 since it is based upon year-end 1981 data and is the more recent information.

The tabulation below shows our adopted debt, equity, and capitalization factors, as well as interest coverages and rates of return during the period 1982-1984.

	Capital Ratios	Cost Factors	Weighted Costs	After Tax Interest Coverages
Long-Term Debt	32.00%	9.38%	3.00	
Common Equity	68.00%	14.00%	9.52	
Total	100.00%		12.52%	4.17

The relatively high interest coverage shown will be necessary to allow applicant to borrow long-term debt at reasonable prices when the needs and opportunities are present.

Summary of Earnings

The information shown in Tables 12 and 13 reflect applicant's and staff's adjusted estimates, effect of our adopted results of disputed issues, and adopted revenues and expenses for test years 1982 and 1983.

TABLE 8

Del Este Water Company
Adopted Summary of Earnings

	Test Year 1982	Test Year 1983
	(Dollars in Thousands)	
At Present Rates		
Operating Revenues	$2170.1	$2201.4
Operating Expenses		
O&M Payroll	435.3	470.1
Purchased Power	427.0	430.9
Other O&M	255.0	271.8
A&G Salaries	113.0	122.1
Regulatory Commission Exp.	27.7	27.7
Other A&G	286.3	309.2
Depreciation	165.2	175.5
Ad Valorem Tax	37.0	39.2
Payroll Tax	45.0	48.2
Subtotal	1791.5	1894.7
Uncollectibles	7.2	7.3
Local Franchise Tax	12.8	12.9
State Corp. Tax	19.2	12.3
Federal Income Tax	81.4	53.0
Total Operating Expenses	1912.1	1980.2
Net Operating Revenues	258.0	221.2
Rate Base	2741.7	2889.1
Rate of Return	9.41%	7.66%
At Adopted Rates		
Operating Revenues	2346.4	2492.1
Operating Expenses		
Subtotal	1791.5	1894.7
Uncollectibles	7.7	8.3
Local Franchise Tax	13.8	14.6
State Corp. Tax	36.0	39.9
Federal Income Tax	154.0	172.8
Total Operating Expenses	2003.1	2130.3
Net Operating Revenues	343.3	361.8
Rate Base	2741.7	2889.1
Rate of Return	12.52%	12.52%

The constant 12.52% return on rate base we are authorizing will result in revenue increases of 9.15% or $198,500 in 1982, 3.90% or $93,400 in 1983, and 4.17% or $104,500 in 1984. Since we are authorizing a constant rate of return for all three years, there will be no financial attrition during 1984.

Net-to-Gross Multiplier

Staff's net-to-gross multiplier of 2.0675 is based on the following percentages:

California Corporation Franchise Tax Rate	9.6%
Federal Income Tax Rate	46.0
Uncollectible Rate	0.330
Local Franchise Rate	0.588

The net-to-gross multiplier represents the change in gross revenue required to produce a unit change in net revenues; e.g., a change in net revenues of $1 requires a change in gross revenues of $2.0675.

Operational Attrition In Rate of Return

Applicant has requested step rate increases for 1983 and 1984. Staff has computed rates of return for 1982 and 1983 based on present rates. This calculation indicates there will be operational attrition of 1.75% in the rate of return.

To compensate for 1.75% attrition, an approximate increase in gross revenue between 1983 and 1984 of $104,500 based upon adopted 1983 rate base, is required.

Rate Design

Cumulative increases in revenue since January 1, 1976 have exceeded 25%. Increases resulting from this proceeding should therefore be applied to lifeline rates.

Applicant's present metered, flat rate, private fire protection, and public hydrant service rates are shown in Table 9. Applicant proposes to cancel its public fire protection tariff, having entered into an agreement with local fire districts. Staff concurs with the proposed cancellation of this service.

9. Authorization of a constant rate of return of 14.00% on common equity for 1982-1984 will result in a constant rate of return of 12.52% and is reasonable. Staff's projected debt cost of 9.38% during this period is reasonable.

10. Applicant will suffer operational attrition of 1.75% between 1983 and 1984.

11. Revenue percentage increases granted by this decisionshould be spread evenly throughout applicant's rate schedules, including lifeline rates, since cumulative increases have exceeded 25% since 1976.

12. Applicant should be ordered to continue the pump efficiency program mandated in D.91120.

Conclusions of Law

1. Revenue increases of $198,500 or 9.15% in 1982 and $93,400 or 3.90% in 1983 are reasonable based upon adopted results of operations. A further increase in 1984 of $104,500 or 4.17% is reasonable based upon operational attrition of 1.75%.

2. Applicant should be authorized to file the rate schedules attached as Appendixes A and B, subject to the condition set forth in Conclusion of Law 4.

3. The adopted rates are just, reasonable, and nondiscriminatory.

4. The further increases authorized in Appendix B should be appropriately modified in the event the rates 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 and/or September 30, 1983, exceed 12.52%.

5. Because of the present need for additional revenue, the following order should be effective the date of signature.

Schedule No. 1

DEL ESTE WATER COMPANY

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Portions of Modesto and Turlock and Empire, Salida, Waterford, Hickman, Grayson, and Hillcrest and vicinity, Stanislaus County.

RATES

	Per Meter Per Month
Service Charge:	
For 5/8 x 3/4-inch meter	$ 3.00
For 3/4-inch meter	4.50
For 1-inch meter	5.50
For 1½-inch meter	7.50
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For 4-inch meter	18.00
For 6-inch meter	28.00
For 8-inch meter	40.00
For 10-inch meter	55.00
For 12-inch meter	75.00
Quantity Rates:	
For the first 300 cu. ft., per 100 cu. ft.	0.200
For the next 9,700 cu. ft., per 100 cu. ft.	0.300
For all over 10,000 cu. ft., per 100 cu.ft.	0.268

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.

Schedule No. 2

FLAT RATE SERVICE

APPLICABILITY

Applicable to all water furnished on a flat rate basis.

TERRITORY

Portions of Modesto and Turlock, and Empire, Salida, Waterford, Hickman, Grayson, and Hillcrest and vicinity, Stanislaus County.

RATES

	Per Service Connection Per Month
For a premise served by an unmetered water connection having the following areas:	
6,000 sq. ft. or less	$ 7.00
6,001 to 10,000 sq. ft.	8.00
10,001 to 16,000 sq. ft.	9.25
16,001 to 25,000 sq. ft.	11.50
Over 25,000 sq. ft.	14.20

SPECIAL CONDITIONS

1. Meters may be installed at the option of the utility or the customer, in which event service will be furnished only under Schedule No. 1, Metered Service. A customer's request for metered service must be made in writing.

2. Customers requesting service of the following types will not be served under this schedule, but will be served under Schedule No. 1, Metered Service.

a. Residential service connections larger than 3/4" diameter or any 3/4" residential service that, in the utility's judgment, may consume excessive water because of lot size, special equipment, or unusual use.

b. Service connections to commercial or business establishments.

c. Service connections for agricultural purposes.

d. Service connections to premises containing multiple dwellings or dwellings and occupied trailer houses.

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.

METERED RATES

	Effective Dates 1-1-83	1-1-84
Service Charge		
	Per Meter Per Month	
For 5/8 x 3/4-inch meter	$0.20	$0.10
For 3/4-inch meter	0.20	0.20
For 1-inch meter	0.25	0.25
For 1-1/2-inch meter	0.40	0.30
For 2-inch meter	0.40	0.50
For 3-inch meter	0.60	0.60
For 4-inch meter	1.00	1.00
For 6-inch meter	2.00	1.00
For 8-inch meter	2.00	2.00
For 10-inch meter	3.00	2.00
For 12-inch meter	3.00	3.00
Quantity Rates:		
For the first 300 cu. ft., per 100 cu. ft.	0.010	0.010
For the next 9,700 cu. ft., per 100 cu. ft.	0.016	0.014
For all over 10,000 cu. ft., per 100 cu. ft.	0.012	0.010

FLAT RATES

6,000 sq. ft., or less	$0.30	$0.20
6,001 to 10,000 sq. ft.	0.40	0.40
10,001 to 16,000 sq. ft.	0.45	0.40
16,001 to 25,000 sq. ft.	0.50	0.50
Over 25,000 sq. ft.	0.60	0.60

PRIVATE FIRE PROTECTION

For each of diameter of service connection	$0.10	$0.10

(End of Appendix B)

ADOPTED QUANTITIES

Name of Company: Del Este Water Company

Pump Tax - Replenishment Tax: None

Payroll and Employee Benefits

	Test Years 1982	1983
Operation and Maintenance	$435,300	$470,100
Administrative & General	113,000	122,100
Total	548,300	592,200
Payroll Taxes	44,700	48,100
Ad Valorem Taxes:		
Ad Valorem Taxes -	37,000	39,200
Tax Rate -	0.862%	0.862%

Metered Water Sales Used to Design Rates:

	Range - Ccf	Usage-Ccf 1982	1983
Block 1	0-3	86,420	91,961
Block 2	4-100	797,841	845,463
Block 3	100	1,977,460	1,977,218
Total Metered Usage		2,861,721	2,914,642

ADOPTED QUANTITIES

Name of Company: Del Este Water Company

Customers & Usage

	No.		Usage-KCcf		Avg. Usage-Ccf/yr.	
	1982	1983	1982	1983	1982	1983
Commercial						
Metered	2,544	2,714	1,089.3	1,162,1	428.2	428.2
Flat Rate	13,400	13,438	4,418.1	4,430.6	329.7	329.7
Industrial	46	48	332.4	346.9	7,226.0	7,226.0
Industrial-large Users	8	8	1,085.5	1,163.4	135,687.5	145,425.0
Public Authority	72	74	187.1	198.4	2,599.0	2.681.0
Public Authority Large Users	3	1	167.4	43.9	55,800.0	43,900.0
Subtotal	16,073	16,283	7,279.8	7,345.3		
Private Fire Protection	112	119				
Total	16,185	16,402				
Water Loss 10.00%			808.9	816.1		
Total Water Produced			8,088.7	8,161.4		

DEL ESTE WATER COMPANY

ADOPTED TAX CALCULATIONS

	Item	1982 CCFT	1982 FIT	1983 CCFT	1983 FIT
		(Dollars in Thousands)			
1.	Operating Revenues	$2346.4	$2346.4	$2492.1	$2492.1
2.	O & M - A & G Expenses	1565.8	1565.8	1654.7	1654.7
3.	Taxes Other Than Income	82.0	82.0	87.4	87.4
4.	CCFT	0.0	36.0	0.0	39.9
5.	Subtotal	1647.8	1683.8	1742.1	1782.0
6.	Deductions from Taxable Income				
7.	Tax Depreciation	199.4	194.4	212.4	203.7
8.	Capitalized Overhead	25.8	25.8	27.0	27.0
9.	Interest	98.4	98.4	94.7	94.7
10.	Subtotal Deductions	323.6	318.6	334.1	325.4
11.	Net Taxable Income to CCft	375.0		415.9	
12.	CCFT	37.8		39.9	
13.	Total CCFT	36.0		39.9	
14.	Net Taxable Income for FIT		344.0		384.7
15.	Federal Income Tax		158.2		177.0
16.	Graduated Tax Adjustment		-4.2		-4.2
17.	Fed. Income Tax Before Adj.		154.0		172.8
18.	Investment Tax Credit		0.0		0.0
19.	Total FIT		154.0		172.8

(End of Appendix C)