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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of APPLE VALLEY RANCHOS WATER CO. for an order authorizing an increase in rates.	Application 58520 (Filed December 8, 1978; amended March 9, 1979 and December 10, 1980)

Edward F. Taylor, Attorney at Law, for applicant.
Dr. Robert D. Chamberlain, for Apple Valley Ranchos Water Co. customers, protestant.
Philip Scott Weismehl, Attorney at Law, for the Commission staff.

FINAL OPINION

Summary

By amended application, Apple Valley Ranchos Water Company (AV) seeks authorization to increase revenues from $561,600 to $1,248,300, an increase of $686,700 or 122.3% above those produced by interim rates conditionally authorized in Decision (D.) 90435 dated June 19, 1979.

This decision does not order any refunds of the interim rate increase. AV's 1982 revenues will be increased by $339,800 or 54.15% to offset increases in operating expenses. A portion of the authorized increase of $202,900 is deferred until September 1, 1983. This amount is needed to provide a return of 11% on AV's 1982 rate base of $1,109,000. A further increase of $168,900 will amortize the deferred $202,900 plus interest of $22,300 (11% on the deferred $202,900) over 16 months. The September 1, 1983 increase of $371,800 is 40.17% above the 1982 revenue level. The deferred charge of $168,900 will be elimintated on January 1, 1985. The Commission has recently

adopted a policy limiting the magnitude of increases authorized in any year.

This decision (a) adopts 1982 staff revenue estimates at interim rates and those staff expense estimates stipulated to by AV, except for purchased power and purchased gas expenses which have been updated to use later purchased electric and gas rate levels; (b) includes in AV's rate base certain past utility plant expenditures, which were originally expensed or owned by associated companies; (c) provides for equity funding of some 1981 and 1982 plant additions which associated companies or developers had previously agreed to fund with contributions; and (d) requires AV to obtain a reconveyance of funds from its parent to fund replacement plant and to complete construction of water distribution systems in tracts AV has agreed to serve.

The following table shows AV and staff estimates of gross and net revenues and rate of return for 1981 at interim rates and proposed rates. The next table shows test year 1982 staff estimates at interim and proposed rates and the amounts adopted at interim and at authorized rates.

Estimated Year 1981

Item	AV		Staff	
	Interim Rates	Proposed Rates	Interim Rates	Proposed Rates
	(Dollars in Thousands)			
Operating Revenues	$ 561.6	$1,248.3	$ 585.8	$1,322.9
Net Operating Revenues	(250.5)	249.5	(245.9)	322.1
Depreciated Rate Base	2,112.0	2,112.0	202.2	202.2
Rate of Return	(Loss)	11.8%	(Loss)	159.3%

(Red Figure)

Estimated Year 1982

Item	Staff Interim Rates	Staff Proposed Rates	Adopted Interim Rates	Adopted Authorized Rates
	(Dollars in Thousands)			
Operating Revenues	$ 627.5	$1,417.9	$ 627.5	$1,170.2[a/]
Net Operating Revenues	(279.1)	328.6	(338.6)	122.0
Depreciated Rate Base	221.7	221.7	1,109.0	1,109.0
Rate of Return	(Loss)	148.2%	(Loss)	11.0%

(Red Figure)

a/ $202,900 of this increase, plus interest at 11%, is deferred until September 1, 1983.

The rates adopted conform with the current Hydraulic Branch model rate structure which includes service charges, a lifeline quantity block of 300 cubic feet of water per month, and a second rate block which does not exceed the first block by more than 50%.

After distribution of staff exhibits, AV sought to buttress its proposal by submitting Exhibit 13, which develops a revenue requirement based on an 80% operating ratio excluding taxes, and Exhibit 14, a reproduction cost new less depreciation study. AV's limited testimony in support of those approaches and its belated argument that the Commission give them weight in rate fixing as opposed to a rate base developed from the original cost of plant are not convincing.

Background

The original filing in this proceeding is AV's first request for a general rate increase since beginning its operations in 1947. This proceeding is the second one in which AV has been required to determine the original cost of its utility plant in conformity with the Uniform System of Accounts for Water Utilities (USA), to clarify the ownership of utility plant used in its operations, and to bring its records into conformity with the USA.

AV's former owners, either directly or through affiliated companies, failed to cause AV to file for needed rate relief on a timely basis[1/] and failed to build up AV's capitalization or rate base to meet AV's public utility obligations. They did not maintain an AV reserve fund for construction of replacement plant as required by D.58092 and D.66095[2/] in Case (C.) 6160. Furthermore, they caused AV to transfer principal and interest of unexpended advances for construction held for later completion of facilities for other purposes. Their actions subordinated the financial integrity of AV to promote their subdivision and land sales activities and to reduce their income taxes, e.g. they expensed items on their books which should have been capitalized on AV's books for extensions of AV's system and water plant replacement, and they retained title to used and useful utility plant. AV now seeks to incorporate the costs previously expensed by associated

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1/ AV recorded annual losses of $31,045, $41,633, $54,528, and $215,105 between 1974 and 1977. This application was filed on December 8, 1978, the year AV recorded a $347,054 loss.

2/ Ordering Paragraph 2 of Interim D.58092 states:

> "2. That respondent shall not transfer any amounts from its earned surplus account until further order of this Commission."

Ordering Paragraph 1 of D.66095 states:

> "1. Apple Valley Ranchos Water Company shall not declare or pay dividends and all net income, after taxes, shall be placed in a reserve for the replacement of plant, subject to the retention by it of those investments and sources of income producing the funds to be placed in the reserve."

companies in its utility plant, to include those costs in its 1981 rate base, and to increase its rates to meet its operating expenses and to provide an 11.81% return on its estimated $2,112,000 rate base. Even though AV's financial condition is deplorable, AV is providing generally satisfactory water service to its customers at extremely low rates.

In order to clarify the ownership, dedication to public use, and operational status of wells used by AV and to record rate base items under the USA, AV engaged the accounting firm of Arthur Anderson & Co. (Anderson) to determine the original cost and reserve for depreciation of AV's utility plant on December 31, 1978 and December 31, 1979. These studies were incorporated in the amended application and used in the results of operations studies prepared by AV's consulting engineer, Donald R. Howard. The Anderson adjustments include transfers to AV's utility plant of (1) $1,334,227 expensed by associated companies for materials, outside contract labor, internally supplied labor, supervision, equipment and truck expense, and payroll overheads used in installing AV plant; (2) utility plant retirements of $444,125; and (3) transfers of utility plant from associated companies to AV of $446,223.

Staff contends that AV has essentially no equity investment in utility plant. Fred K. Hendricks, a staff accountant, recommends major changes in AV's balance sheet, income statement, and statement of financial position. Arthur B. Jarrett, a staff engineer, adopted and updated Hendricks' rate base adjustments, which include a net increase of $1,968,724 in contributions in aid of construction as of December 31, 1980. Jarrett prepared summaries of earnings studies for 1981 and 1982. His revised estimate of AV's 1982 rate base is $212,464, which is $3,264 below his estimates for working cash and materials and supplies. He estimates that AV will use utility plant which costs approximately $5,621,000 to serve approximately 5,600 customers in 1982.

The staff-recommended 11% rate of return on a $212,464 rate base would generate earnings of $23,400, which is less than 3% of AV's 1982 expenses or less than 10% of its construction budget. That level of earnings would guarantee AV's dependence on its parent for any future debt or equity financing and leave AV with virtually no margin to cope with increased expenses and/or decreased revenues. The background relating to the proposed staff adjustments and the adopted rate base adjustments are discussed in this decision. Hendricks' adjustments are summarized in Tables I and J of Exhibit 19.

AV does not take issue with the 1982 staff estimates for operating revenues or expenses, except for regulatory commission expense, depreciation expense, and income taxes. AV and staff concur that income taxes should be based on adopted revenues and expenses and should be in conformity with the regulatory treatment adopted in Order Instituting Investigation (OII) 24 to conform with the Economic Recovery Tax Act of 1981 (ERTA). Staff accepts AV's restatement of plant for this proceeding.

Ownership

AV's total authorized capitalization is $50,000 for 1,000 shares of $50 par value common stock shares. On December 31, 1980, 75 shares were issued and outstanding. These 75 shares were initially issued to three individuals. Reserve Oil and Gas Company (ROG) acquired ownership of the 75 shares on May 9, 1966. On January 23, 1980, Getty Oil Company (Getty) acquired all of ROG's assets, including the AV stock, in a $628 million merger transaction. D.93675 dated November 1, 1981 granted authorization to Getty to control AV.

C.6160

The Commission instituted C.6160 on July 29, 1958 to investigate the practices, operations, contracts, rules, facilities, and services of AV. Exhibit 12 in C.6160 showed that:

a. AV proposed to construct $2,254,407 of utility plant; it had entered into 12 advance-for-construction contracts for $491,718 and 51 construction contracts, requiring unspecified contributions of utility plant and/or cash.

b. Utility plant of $1,404,832 installed prior to December 31, 1961 had been deducted as operational costs for income tax purposes by affiliated companies of AV.

c. AV's utility plant was generally constructed by affiliated companies or by subdividers dealing exclusively through an affiliated company of AV.

d. AV's practice was to install only the basic feeder lines through a subdivision at the time that an advance for construction was provided. All other plant items were not installed until the development of the subdivision required such installations.

Amended Application

D.90435 authorized an interim rate increase to enable AV to recover its out-of-pocket operating expenses for 1979. In order to secure further rate relief in this proceeding, AV was ordered to comply with Finding 12 of D.90435 which states:

> "12. It would be reasonable to require AV to take the following actions, which may require another amendment to its application and preparation of exhibits prior to setting further hearings on AV's request for further rate relief:
>
> "(a) Prepare an exhibit on AV's agreements to serve areas to be developed in the future by Ranchos and/or ROG which identifies the areas to be served, the facilities required to serve, and the costs of the facilities needed to serve these areas, the obligations and/or commitments of Ranchos and/or ROG to complete the necessary facilities, and the appropriate ratemaking treatment for past and future extensions made on this basis.
>
> "(b) Prepare a proposal to clarify the ownership, dedication to public use, and operational status of the wells used by AV.
>
> "(c) Resolve discrepancies between customer and water use data and projected revenues.
>
> "(d) Record rate base items pursuant to the Uniform System of Accounts for Water Utilities.
>
> "(e) Classify revenues by separate subdivisions in accordance with the Uniform System of Accounts for Water Utilities.
>
> "(f) Present a financing proposal(s) for AV.
>
> "(g) Implement the staff accounting recommendations set forth in paragraph 24 of Exhibit 5."

Hearings

After notice, five days of hearings were held before Administrative Law Judge Levander in Apple Valley and in Los Angeles on the rate increase proposal contained in the second amendment to AV's application. The matter was submitted subject to the receipt of late-filed exhibits and briefs which have been received.

Public Witness Testimony

Twelve persons out of about 200 attending the hearing in Apple Valley made generally critical statements about AV's rate proposal. The primary objections went to the magnitude of the proposed increase, particularly after the interim increase. Customers stated that AV kept its charges artificially low to promote its affiliates' land developments; enough profit was made from land sales to offset water system losses; they could not afford to maintain their gardens at proposed rates; and the impact on elderly persons with fixed incomes was excessive. There were also protests against service charges and service charge increases, the unsatisfactory quality of water, an unsatisfactory response to a leak complaint, and a construction crew overstaffing complaint. Another customer is concerned that the rate increase could enhance the sales value of the system to a local district or to another buyer.3/

AV's Response to Public Testimony

AV assured the Commission that Getty would secure Commission authorization before any sale of AV is completed. AV's manager testified that he expected to resolve a localized water quality problem when a new well being completed is put in service; a leak reported by another customer was overlooked during a winter emergency which required the services of a 10-man repair crew for 13 hours to prevent the flooding out of several houses in freezing weather; and another complaint that AV should have used a smaller crew and/or taken less time to install a new service may be valid.

3/ A contemplated sale of AV's stock or of its system by Getty Oil Company (Getty) to a Canadian company has not materialized.

Interim Rate Refund Issue

D.90435 authorized an interim rate increase designed to produce annualized revenues of $512,760 to enable AV to recover its out-of-pocket operating expenses for 1979. The following tabulation shows AV's 1979 revenues and expenses, excluding depreciation expense, and net out-of-pocket revenues on the bases discussed below:

	Authorized	Recorded	AV Normalized	Staff Adjusted
Operating Revenues	$512,760	$ 442,463	$ 508,400	$512,843
Operating Expenses Excluding Depreciation	512,760	561,041	612,800	469.679
Net Out-of-pocket Revenues	$ 0	$(118,578)	$(104,400)	$ 43,164
		(Loss)		

AV's recorded 1979 operating revenues and operating expenses, excluding depreciation expense, were $442,463 and $561,041, respectively.

AV's weather normalized estimates for 1979 show revenues of $508,400; they increase power for pumping expenses by $60,100 to reflect updated purchased power and purchased gas rates, reduce outside service expenses by $62,500, and reduce regulatory commission expenses by $9,700 (from $33,000 to $20,300).

Staff witness Hendricks proposes adjustments to increase recorded 1979 revenues by $70,380 to $512,843 to reflect the interim rates on a full-year basis; to decrease expenses, excluding depreciation expense, by $109,006, including an adjustment to $65,459 to reflect AV's 1980 transfer of 1979 expenses to capitalized labor and overheads; to transfer regulatory commission expense to deferred rate charges; and to increase other expenses by $17,643.

On a recorded basis, AV did not recover its out-of-pocket costs. AV's normalized estimates show a substantial loss for 1979. On a normalized basis, the staff revenue estimates should be reduced by $4,400 and its expense estimates should be increased by $60,100 to reflect updated purchased power and purchased gas rates. Those adjustments would result in an out-of-pocket loss. Since the interim rates were insufficient to recover out-of-pocket expenses on either a recorded or on an adjusted basis, no refund of the interim rates is warranted.

Results of Operations

As indicated above, the uncontested staff revenue and expense estimates for 1982 should be adopted except for power for pumping. Jarrett's adjustments to AV's estimates are described in Exhibit 16. He used later customer, water use, and expense data than AV for trending purposes. Exhibit 16-1 corrects his estimates for materials and services. Revised Exhibit 16-3 reflects income tax expense and rate base adjustments to comply with ERTA. The criteria used in the adopted staff revenue, operating expense, and estimates of taxes other than income are reasonable. The tabulation of adopted amounts for 1982 reflects the expense and rate base adjustments described below. The summary of earnings at authorized rates reflects the adopted rate of return of 11.00% recommended by staff.

Purchased Power

Staff estimates for purchased electric power of $242,328 and purchased gas of $66,058 should be increased to $264,100 and $86,400, respectively, to reflect the May 4, 1982 rates of Southern California Edison Company and Southwest Gas Corporation.

Regulatory Commission Expense

Howard's results of operations study (Exhibit 8) for AV amortizes $60,900 over the three years 1979 through 1981. The Anderson appraisals for 1978 and 1979 had been prepared and used by Howard at the time the second amendment to the application was filed.

Jarrett's original estimate amortized $83,870 of recorded 1978 to 1980 rate case expenses, including expenditures for outside services, over five years at a rate of $16,774 per year.

AV contends that its actual rate case expenses were substantially understated. AV's late-filed Exhibit 22 summarizes costs of $222,841 incurred from December 1977 through October 1981 ascribed to the rate case and costs of $61,850 for implementing an accounting work order system to account for construction work in progress and to serve as a continuing property record. The costs are principally for outside accounting, legal, and engineering services. AV recommends a three-year amortization of its rate case expenses at $74,280 per year and a five-year amortization for setting up the work order system.

In late-filed Exhibit 23, the staff contends that AV's workpapers do not contain a detailed breakdown between its rate case expenses and other regulatory expenses. However, Jarrett added $38,204 of additional 1981 costs to his regulatory expense estimate and amortized the total of $122,074 over five years at a rate of $24,415 per year.

The staff brief recommends disallowance of expenses incurred in remedying imprudent management decisions to not maintain its books and records in accordance with the USA, after being ordered to do so. In addition, staff believes that any regulatory expenses related to the acquisition of AV by Getty should be disallowed for ratemaking purposes. Staff contends that AV's regulatory expenses are exceptionally large due to its long delay in filing for rate relief; future regulatory expenses should be much lower. AV did not address this issue in its brief.

Given AV's desire to become a self-sustaining entity and the low levels of its capitalization and rate base which limit its earnings potential, it is unlikely that AV will wait five years before again seeking rate relief. The three-year amortization of regulatory expenses proposed by AV is reasonable. However, the request for regulatory expense made by AV in Exhibit 22 is unreasonable. The extraordinary efforts made on its behalf are due to its failure to set its house in order under C.6160. For ratemaking purposes Howard's estimate, contained in Exhibit 8, for amortization of $60,900 at $20,300 per year is reasonable.

In addition, no ratemaking allowance for the following activities would be appropriate:

a. AV incurred expenses of $10,924 in 1978 in a complaint proceeding, C.10924, filed because of its refusal to provide service to Mr. D. E. Parker. D.97871 ordered AV to serve Parker.

b. In addition to the acquisition of AV by Getty, AV and/or its owners discussed selling its utility assets or its stock with a district and with another corporation.

Income Taxes

The adopted 1982 income taxes of $81,060 includes $74,040 which is the result of ERTA. ERTA increases the federal income tax expense for ratemaking purposes by permitting normalization of the benefits from accelerated depreciation and investment tax credit on utility plant additions placed in service after December 31, 1980 rather than permitting flow through of those benefits to AV's customers. Appendix A is a notice to AV's customers to inform them of the impact of ERTA. Adopted income taxes reflect adopted revenues, expenses, and rate base adjustments. The rate base adjustments reduce the staff estimate of contributed plant as a portion of total depreciable plant, which in turn increases depreciation expense.

Getty files a consolidated income tax return, which includes AV's operations. For ratemaking purposes, we will adopt the staff tax treatment based on ERTA which treats AV as a separate entity. The impact of this treatment reduces AV's federal income tax liability by $19,250 for taxable income below $100,000. Consistent with the independent tax status treatment of AV, accrued income tax credits of $145,492 used in the consolidated tax returns of AV's prior owners will not be treated as contributions in aid of construction, as proposed by staff.

Rate Base

The following table compares the rounded 1981 rate base estimates of AV and staff, the 1982 staff estimate, and the adopted rate base for 1982:

Item	1981 AV	1981 Staff	1982 Staff	1982 Adopted
	(Dollars in Thousands)			
Utility Plant	$5,420	$5,351	$5,653	$5,653
Reserve for Depreciation	1,945	1,893	2,020	2,020
Net Plant In Service	3,475	3,458	3,633	3,633
Additions				
Materials and Supplies	51	30	35	35
Working Cash	173	159	174	186
Deductions				
Advances for Construction	612	577	576	656
Contributions in Aid of Construction	975	2,868	3,012	2,075
Reserve for Deferred Income Tax	a/	a/	9	14
Average Rate Base	$2,112	$ 202	$ 212	$1,109

a/ Not calculated.

Utility Plant

Jarrett's 1981 and 1982 estimates are based upon later data than used by AV. In addition, his estimates include capitalized overheads in plant of $58,900 which were expensed by AV. He also noted that there was an error in AV's calculation of average plant for 1981. The staff estimate of average 1982 utility plant rounded to $5,653,000 is adopted.

Reserve for Depreciation and Depreciation Expense

Jarrett's estimates reflect his plant estimates and a 2.32% accrual rate. Howard concurs with the use of the lower service lives proposed by Jarrett. The staff estimate of an average reserve for depreciation rounded to $2,020,000 is adopted.

The adopted 1982 depreciation expense of $74,560 is based on (a) staff estimates of depreciable plant and service lives and (b) depreciable contributed plant of $5,620,850.

Materials and Supplies

For 1981, the respective estimates are $51,400 for AV and $30,600 for staff. The staff 1981 estimate considers the inventory requirements of several large water companies in Southern California. For 1982, Jarrett considered customer growth, and price increases in 1982. The 1982 staff estimate of $35,000 is adopted.

Working Cash

Both AV and staff used a standarized simplified method for determining working cash allowances based on their respective estimates of expenses. This method is used in determining the adopted working cash allowance of $186,000 for 1982, which reflects most recent data on the cost of purchased power.

Ratemaking Treatment of Costs
to Complete or Replace In-
tract Distribution Facilities

During the years 1958 to 1964, AV entered into main extension contracts and accepted deposits of $446,116 to extend its water system to nine tracts listed in Exhibit 20-2. AV initially installed the basic feeder lines for these tracts. Most of the lots in those tracts are vacant. In order to guarantee the availability of the money needed to complete the distribution system in those tracts, AV invested the unused portion of the deposits in 30-day, interest-bearing certificates of deposit (CD). The outstanding balance of these CDs was $436,600 on December 31, 1978. Hendricks testified that the funds from the CDs and accrued interest of over $372,000 were transferred to affiliated companies and used to pay operating expenses. Hendricks contends that since the debt represented by these advances for construction was forgiven, these amounts should be classified as contributions in aid of construction.

Between 1959 and 1980, AV spent $615,820 for utility plant installations in those tracts. Howard estimates the May 1981 cost to complete the distribution systems in these tracts is $296,410.

Pages 2 through 4 of Exhibit 19 contain a summary of five relinquishment agreements, filed in C.6160, in which various developers conveyed water systems and/or money to AV to construct systems in many tracts or for further extensions of service. These assets, including unspent construction funds, were donated to AV. In addition, an affiliate agreed to construct and equip a well or wells to supplement AV's water supply to assure the adequacy of the supply in exchange for AV's agreement to extend service to Tract 3703 and adjacent areas.

Associated companies subdivided various tracts and/or sold lots in AV's service area, and contributed funds for installation of portions of the water distribution systems in those tracts. But those companies did not deposit funds for completion of the systems based on understandings that they would contribute additional funds to AV when needed to construct portions of the systems to serve additional customers and/or complete the water systems in those tracts. Howard estimates the May 1981 cost to complete these facilities is $304,619.

AV proposes to use equity capital to pay for the uncompleted portions of the distribution systems originally funded by either advances or contributions. Staff contends that Getty and/or affiliated companies should pay for installing the remaining facilities and that AV should classify those facilities as contributed plant.

AV's rate base included $465,729 as of December 31, 1979 the depreciated cost of in-tract replacements of distribution plant. Staff classifies those costs as contributions in aid of construction because the replacement plant costs were expensed by associated companies.

The Commission considers the balance of the principal and interest originally deposited as advances for construction as a trust fund for construction of utility plant. Those funds should not have been used to offset operating losses. We take official notice of AV's 1981 Annual Report which shows no outstanding receivables from associated companies. Getty should transfer back[4] to AV unexpended advance-for-construction deposits and accrued interest (including further accruals through the date of the transfer). AV should seek Commission approval, by application, for any use of those funds other than for installing the remaining mains, services, and hydrants in those tracts.

We do not concur with AV's proposal to complete all of those facilities, when needed, with equity capital in tracts originally financed with contributions. Getty's predecessors and/or affiliated companies used AV to enter into unauthorized arrangements requiring contributions for extending service. These associated companies profited as subdividers and/or as land sales agents. AV's rationale for using equity capital to complete in-tract systems initially funded by contributions and relieving associated companies of their obligations to provide those funds is its need to build up an earnings base. In this instance, we are not persuaded. When needed, AV should obtain the remaining costs to complete in-tract mains, services, and fire hydrants from the original tract developer or its successor in interest as contributions in aid of construction. If that is not possible, Getty should provide those funds. However, we are persuaded that AV rather than the associated companies should pay for additional wells and pumping equipment needed to serve additional customers. Therefore, 1981 additions of $61,785 for wells and pumping equipment will be included in the adopted rate base.

4/ Getty could retain the funds as an AV investment at prime interest rates payable to AV on demand.

Installation of replacement plant is the normal obligation of a water utility. AV will not serve additional customers because of the installation of replacement plant. Its associated companies are not receiving additional revenues from lot sales or sales commissions due to installation of plant replacements. AV's customers are receiving the benefits of improved service and expense reductions. Power costs are reduced due to lower water losses and repair costs are reduced due to the installation of those replacements. We adopt AV's proposal to include the replacement plant as equity-financed plant in rate base rather than including it as contributed plant, as proposed by staff. To reach that conclusion, we have considered the relative benefits resulting from installation of the replacement plant discussed above, AV's inability to meet its normal or emergency operating obligations if there is more than a minor increase in its expenses or decrease in its revenues, and AV's inability to borrow funds on its own, absent a significant earnings base.

Advances for Construction

In Table F of Exhibit 19, staff tabulated the original amounts of outstanding advances for construction balances and total refunds paid on those contracts. The net advances for construction totaled \$578,139 on December 31, 1980. AV's recorded advances for construction of \$454,478 were understated by $123,711 on that date. That amount had been classified as contributions in aid of construction. Howard does explain how he derived his December 31, 1980 estimate of $614,200. He assumed that no new advance contracts would be entered into by AV in 1979, 1980, or 1981. The 1982 staff estimate of $576,216 assumes that no new advance contracts were entered into in 1981 or 1982 and partial refunds were paid on prior contracts.

In Exhibit 24, staff broke down its estimate of plant additions for 1981 and 1982 by plant accounts and classified the funding of this plant as equity or contributions in aid of construction. Staff classified as contributed plant $218,552 for installing distribution systems in partially completed tracts. We will allocate $107,800 of that total to advances for construction based on the ratio of $296,400 to complete distribution plant installations in tracts originally funded by advances to the $601,000 cost of completion of all in-tract distribution facilities times the $218,552 cost of new facilities. AV should classify the cost of the fill-in installations in the tracts funded by advances as new, separate advances for portions of the subdivisions originally funded from the restored reserve to construct those facilities. Since a developer is not entitled to any refunds in excess of the amount it advanced, any refunds in excess of the amount of the original contracts should be transferred to AV's capital surplus account. The 1982 staff estimate, based on actual contracts and refunds, should be modified to classify the $107,800 as advances for construction on a weighted basis. This produces an adopted 1982 amount of advances for construction of $656,000.

Contributions in Aid of
Construction

Recorded contributions in aid of construction totaled $995,797 on December 31, 1980. Hendricks proposes four adjustments changing that total to $2,964,521. The disposition of these adjustments is discussed below.

A $1,087,198 credit gives effect to the Anderson utility plant appraisals and allocates the financing of this plant between equity capital and contributions in aid of construction based on the amounts of equity capital and contributed capital shown in AV's general ledger. For 1982 the net average cost of depreciated in-tract replacement plant is $401,000. Based on the staff allocation method (for plant installed through December 31, 1978), $164,000 of that amount was previously classified as equity. We stated above that these replacement costs would be treated as equity capital. Therefore, that staff adjustment is reduced by $237,000 to $850,200.

A $929,231 credit adjusts the 1980 transfer of AV's intercompany debt to capital surplus. Hendricks does not take exception to the transfer of intercompany debt from operating losses to capital surplus, but those losses were exceeded by recorded debt for construction of plant transferred to AV by associated companies to comply with the decisions in C.6160. This plant was primarily funded by contributions in aid of construction. Hendricks testified that it is not proper to transfer contributions in aid of construction to capital surplus (see Los Angeles and Suburban Water Co., et al. (1929) 34 CRC 118, 122) and treated the net of losses and intercompany debt as contributions in aid of construction. This adjustment originally included $353,683 for a possible duplication in the Anderson appraisal of utility plant and a $145,492 adjustment for deferred investment tax credits used by AV's parent(s) in consolidated tax returns. Upon further review, Hendricks agreed that there was no duplication in plant. However, he did not propose to modify his adjustment. He contends that he did not originally consider the transfers of interest on CDs of approximately $372,000 as contributions in aid of construction. These funds held for completion of tracts financed by advances for construction were transferred to AV's parent. For ratemaking purposes, he would rather leave the $353,683 adjustment than substitute an adjustment of approximately $372,000.

Since there is no duplication in construction of plant and we are requiring AV to reacquire the interest transferred to its parent, there is no basis for an adjustment of $353,683. In addition, AV's earned surplus through 1973 was reserved for construction of replacement plant. Since AV improperly used those funds to offset subsequent deficits, we are requiring AV to secure those amounts from Getty. Those losses which will accrue to Getty exceed the deferred investment tax credits realized by ROG. (The benefits of those credits accrued to Getty by reason of ROG's merger into Getty.) We will not adopt the tax adjustment proposed by staff. The remaining portion of the staff adjustment of $430,000, netting the debt on the earlier contributed plant acquisition and operating losses, is adopted.

We will adopt the staff $76,007 credit adjustment to contributions in aid of construction for the following items:

(a) An unrefunded $39,610 item recorded prior to 1978 as a current payable on advances for construction.

(b) Retained earnings adjustment recorded by AV.

We will adopt the staff debit adjustment transferring $123,712 from contributions in aid of construction to advances for construction to reflect the net amount outstanding on advance contracts.

As noted above, we are modifying Jarrett's recommendations for 1981 and 1982 by treating $61,785 for wells and pumping equipment as equity capital and are transferring $107,000 from contributed in-tract facilities to advances for construction. After giving consideration to further depreciation accruals, reducing the contributed balance, and the adjustments described above, we adopt a 1982 average of $2,075,450 for contributions in aid of construction.

Reserve for Deferred Income Tax

Based on noncontributed plant additions and consistent with the treatment of deferred income taxes adopted in OII 24, we have calculated an adopted reserve for deferred income tax of $14,000.

Rate Base

The adopted rate base of $1,109,000 is the summary of the elements described above.

Summary of Earnings

Table 1 contains a summary of earnings at interim and adopted rates for 1982. We have recently adopted a policy for large water utilities which allows no rate increase greater than 50% during any single year in order to mitigate the effect of large increases. The remaining portion of the increase is deferred with interest added at the authorized rate of return on the deferred amount of the increase. The interest assures that the value of the deferred revenue will not be diminished. Since a 50% increase will not cover AV's operating expenses, we will deviate from our policy to allow an increase of $339,800 or 54.15% to cover those expenses. Otherwise, we would have to provide a return on the utility's expenses. If the deferred 1982 increase plus interest at 11.00% is added to the entire 1982 revenue requirement, September 1, 1983 revenues would increase by $428,100 or 44.24% above the partial 1982 increase authorized. The cumulative impact of those two increases on AV's customers is excessive. To mitigate that impact we will amortize the deferred amount plus interest over 16 months in 1983 and 1984. We anticipate that AV will seek further rate relief at the end of that amortization period, i.e., for test year 1985. The September 1, 1983 increase of $371,800 is 40.17% above the 1982 rate level. The deferred charge of $168,900 will be eliminated on January 1, 1985.

Table 1 also contains a summary of earnings at a level designed to offset AV's operating expenses which are the rates authorized for 1982.

TABLE 1

APPLE VALLEY RANCHOS WATER COMPANY

SUMMARY OF EARNINGS

Estimated Results of Operations

Test Year 1982

Item	Interim Rates	Adopted Rates*	Rates Authorized: To Offset Operating Exps.
Operating Revenues	$ 627,500	$ 1,170,200	$ 967,328
Deductions:			
Purchased Power	350,500	350,500	350,500
Payroll	251,596	251,596	251,596
Other O&M Expenses	150,787	150,787	150,787
Admin. & Gen. and Misc.	106,787	106,787	106,787
Subtotal	859,670	859,670	859,670
Depreciation Expense	74,558	74,558	74,558
Taxes Other Than Income	32,900	32,900	32,900
Income Taxes	200	81,060	200
Total Deductions	967,328	1,048,188	967,328
Net Operating Revenue	(339,828)	122,012	0
Depreciated Rate Base	1,109,000	1,109,000	1,109,000
Rate of Return	Loss	11.0%	0

* $202,872 of this increase plus interest at 11% is deferred until September 1, 1983.

Appendix B shows the derivation of the revenue requirement of the deferred portion of the 1982 increase made effective on September 1, 1983 adopted quantities, relevant statistical information, the 1982 income tax calculation, and the derivation of the reserve for deferred income tax credit.

Rate of Return

Howard testified that an 11.81% rate of return would be reasonable for AV. Jarrett testified that the Revenue Requirements Division reviewed AV's finances and concluded that an 11% rate of return is reasonable. We will adopt the staff recommendation. The sum of return on rate base and depreciation expense would be sufficient to pay for equity funded plant and provide a reasonable margin for a decline in net revenues.

Rate Design

The following tabulation shows AV's interim and proposed quarterly rates:

	Per Meter Per Quarter	
	Interim Rates	Proposed Rates
Quantity Rate:		
For all water delivered per 100 cubic feet	$ 0.188	$ 0.4411
Service Charge:		
For 5/8 x 3/4-inch meter	6.00	12.00
For 3/4-inch meter	9.00	18.00
For 1-inch meter	12.00	24.00
For 1½-inch meter	16.00	32.00
For 2-inch meter	24.00	48.00
For 3-inch meter	36.00	72.00
For 4-inch meter	72.00	144.00
For 6-inch meter	144.00	288.00

The Service Charge is applicable to all metered service. It is a readiness-to-serve charge to which is added the charge, computed at the Quantity Rate, for water used during the quarter.

AV submitted Exhibit 15, a comparative rate tabulation showing that its monthly bills at consumptions of 30 Ccf, 37 Ccf, and 44 Ccf at interim rates are far below the rates charged by the Victor Valley County Water District (Victor), Hesperia County Water District, and the Victorville District of Southern California Water Company. At proposed rates its billings are below those of the other purveyors except for Victor's billing at a consumption of 44 Ccf.

The proposed rates would increase quantity rates by 134.6% and increase quarterly service charges by 100%. The relative spread of increases between service and commodity charges is not unreasonable. However, in conformance with our general policy, we will establish a commodity lifeline allowance of 300 cubic feet to encourage conservation and a second inverted block which is not more than 50% above the lifeline block. The adopted rates for 1982 and for September 1, 1983 are shown in Appendix C.

Other Issues

AV did not come forward with an explicit financing proposal. Its implicit proposal for meeting its obligations is its amended request for rate relief based upon its proposed rate base treatment for its restated plant. AV's 1981 Annual Report shows a loss of $208,081 in its earned surplus account. Therefore, this account appears to be unavailable as a source of funds for AV's capital needs. However, a review based on the adjustments adopted in this decision might change that picture. Between 1963 and 1973 AV's net earnings totaled $263,533. Ordering Paragraph 1 of D.66095, which is still in effect, ordered AV to place those earnings in a reserve for replacement of plant and ordered AV to retain those investments and sources producing income to be placed in the reserve. Our ordering the restoration of the $263,533 in 1963 to 1973 earnings and the $436,600 principal and $372,000 interest in the CD reserve funds provides a funding source for new fill-in plant in certain tracts and a source of replacement plant funding. AV therefore should be required to secure from Getty the restoration of these funds, plus whatever further interest has accrued on the CD funds up to the restoration date and minus any expenditures since December 31, 1978, on fill-in plant on tracts originally financed by advances. As indicated above, the disposition of the excess of principal and interest remaining in the advance deposit accounts should be by application. The transfers required in this decision serve to make AV a viable entity. We will require AV to supply documentation that the transfers of funds from Getty have been made.

Hendricks found instances where AV's general ledger and accounting records are not kept in accordance with the USA as prescribed by this Commission. AV should make the accounting adjustments and changes in practices recommended by Hendricks as modified in this decision. AV should properly record all material, labor, and overheads in its plant accounts.

We are putting AV on notice that the Commission will consider penalty action under Public Utilities Code Sections 2100 et seq. if AV embarks on any further unauthorized extension practices.

Findings of Fact

1. AV's former owners, either directly or through affiliated companies, failed to cause AV to file for needed rate relief on a timely basis and failed to build up AV's capitalization or rate base to meet AV's public utility obligations. They did not maintain an AV reserve fund for construction of replacement plant as required by D.58092 and D.66095 in C.6160. Furthermore, they caused AV to transfer principal and interest of unexpended advances for construction held for later completion of facilities for other purposes.

2. These companies expensed items on their books which should have been capitalized on AV's books for extensions of AV's system and water plant replacement and retained title to used and useful utility plant.

3. AV now seeks to incorporate the costs previously expensed by associated companies in its utility plant, to include those costs in its 1981 rate base, and to increase its rates to meet its operating expenses and to provide an 11. return on its estimated $2,112,000 rate base.

4. AV's restatement of utility plant, with minor adjustment, is reasonable.

5. The depreciated cost of replacement plant previously expensed by these companies and transferred to AV should be considered as equity-financed plant.

6. Fill-in, in-tract distribution facilities originally funded by advances for construction should be treated as advances for construction.

7. Fill-in, in-tract distribution facilities in tracts initially funded by contributions in aid of construction should be treated as contributions in aid of construction. AV should obtain the funds for that construction from the developers of those tracts, their successors in interest, or Getty.

8. A rate of return on AV's 1982 rate base of 11% is reasonable.

9. The estimates in Table 1 of the summaries of earnings at authorized and adopted rates for 1982 are reasonable. It is reasonable to defer $202,900 of the increase until September 1, 1983 and to amortize recovery of the deferred increase plus interest of 11% on the deferred increase over 16 months to mitigate the impact of the increase upon customers. It is reasonable to authorize 1982 rates to offset 1982 expenses which would result in an increase of $339,800 or 54.15%. The September 1, 1983 increase of $371,800 is 40.17% above the 1982 revenue level. It would be reasonable to reduce revenues by $168,900 on January 1, 1985 after the deferred amounts have been fully amortized.

10. AV's 1963 to 1973 net earnings, amounting to $263,533, and the principal and interest in AV's CD funds, amounting to $436,600 and over $372,000, respectively, as of December 31, 1978, plus whatever additional interest has accrued on such CD funds to the restoration date, minus any expenditures since December 31, 1978, on fill-in plant on tracts originally financed by advances, should

be made available as a source of funding for new fill-in and replacement plant.

Conclusions of Law

1. The failure of AV's former owners to cause AV to file for timely rate relief subordinated the financial integrity of AV to promote their subdivision and land sales activities and to reduce their income taxes.

2. AV's former owners caused AV to unlawfully use funds ordered to be placed in a reserve for replacement plant and to retain investments and sources producing income to pay operating expenses.

3. The benefits of these actions accrued to Getty by reason of ROG's merger into it.

4. AV should be required to secure from Getty restoration of (a) the $263,533 of 1963 to 1973 net earnings which were expensed rather than set up in a replacement reserve, and (b) the advance for construction reserve funds described in Finding 10.

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

6. The application should be granted to the extent provided by the following order.

7. AV should conform its general ledger and accounting records in accordance with the USA.

8. Because of the immediate need for additional revenue, the order should be effective today.

FINAL ORDER

IT IS ORDERED that:

1. Applicant Apple Valley Ranchos Water Company is authorized to file, effective today, the revised rate schedules in Appendix C. The filing shall comply with General Order 96-A. The revised 1982 schedules shall apply only to service rendered on and after their effective date. The deferred portion of the increase shall apply to service rendered on and after September 1, 1983. Revenues shall be reduced by $168,900 on January 1, 1985.

2. Applicant shall secure from Getty Oil Company the restoration of those amounts described in Finding 10 of the accompanying Final Order.

3. Within 30 days applicant shall file with the Commission documentation showing the detail of the transfer of funds from Getty Oil Company to it.

4. Applicant shall conform its general ledger and accounting records in accordance with the Uniform System of Accounts for water utilities.

5. Within 45 days applicant shall mail to all its customers a bill insert notice as shown in Appendix A.

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

Joseph E. Bodovitz, Executive Director

APPENDIX A

Bill Insert for
Apple Valley Ranchos Water Company

N O T I C E

$72,500 of the recent rate increase granted to Apple Valley Ranchos 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 94102

(END OF APPENDIX A)

APPENDIX B
Page 1

APPLE VALLEY RANCHOS WATER COMPANY

Derivation of Revenue Requirement
Of Deferred Portion of 1982 Increase
(Dollars in Thousands)

1982	Adopted	Adjustments	Authorized
Interim Rates	$ 627.5	$	$ 627.5
Adopted Rates	1,170.2	(202.9)	967.3
Increase	542.7(89.49%)		339.8(54.15%)

1983			
1982 Authorized Rates	$ 967.3	$	$ 967.3
Adopted Rates (Effective Sept. 1, 1983)	1,339.1	371.8	1,339.1
Increase	371.8(38.44%)		371.8(38.44%)

The adjustment in 1982 is the deferred increase.

1,170.2 - 967.3 = (202.9)

The adjustment in 1983 is the deferred portion of the 1982 increase ($202,900) plus a 16-month amortization of the deferred portion of the increase with interest on the deferred amount at 11%.

Interest:

$$\$202.9 \times 0.11 = \$22.3$$

Amortization:

$$(\$202.9 + \$22.3) \times \frac{12}{16} = \$168.9$$

Annualized 1983 Increase:

$$\$202.9 + \$168.9 = \$371.8$$

APPENDIX B

APPLE VALLEY RANCHOS WATER COMPANY

1982
Adopted Quantities

1.	Water Production:	
	Wells	2,815,625 ccf
2.	Electric Power: (Supplier: Edison 5/4/82)	
	Kilowatt-hour (kWh)	3,769,513
	Cost	$264,100
	Cost per kWh	$ .07
3.	Natural Gas: (Supplier: SWGC 5/4/82)	
	Therms	123,455
	Cost	$86,400
	Cost per Therm	$ .70
4.	Ad Valorem Taxes:	$13,100
	Effective Tax Rate	1.2596%
5.	Net-to-Gross Multiplier:	2.0506
6.	Uncollectible Rate:	.1025%

APPENDIX B
Page 3

APPLE VALLEY RANCHOS WATER COMPANY

1982
Adopted Quantities

7. Metered Water Sales Used to Design Rates:

	Range - Ccf	
Block 1	0 - 3	182,143 ccf
Block 2	Over 3	2,331,808 ccf
Total Usage		2,513,951 ccf

8. Number of Services (by classification):

Classification	No. of Customers
Domestic	5026
Commercial	528
Industrial	3
Public Authority	42
Total	5599

9. Number of Services (by meter size):

Meter Size	No. of Customers
5/8 x 3/4-inch	5,119
1-inch	368
1½-inch	63
2-inch	31
3-inch	12
4-inch	3
6-inch	3
Total	5,599

APPLE VALLEY RANCHOS WATER COMPANY

Income Tax Calculation
Test Year 1982

Item	
Operating Revenues	$ 1,170,200
Deductions:	
Oper. and Maint. Expenses	859,670
Taxes Other Than Income	32,900
Interest	0
Subtotal	892,570
State Taxable Income before Depreciation	277,630
State Tax Depreciation	134,950
State Taxable Income	142,680
State Tax @ 9.6%	13,697
Federal Tax Depreciation	74,558
Federal Taxable Income	189,375
First $ 25,000 @ 16%	4,000
Next 25,000 @ 19%	4,750
Next 25,000 @ 30%	7,500
Next 25,000 @ 40%	10,000
Over 100,000 @ 46%	41,113
Total Federal Income Tax	67,363
Total Taxes on Income	81,060

Reserve for Deferred Income Tax (ERTA 1981)

Depreciation	=	$ 5,000
I.T.C.	=	9,000
Total	=	$14,000

(END OF APPENDIX B)

APPENDIX C
Page 1

APPLE VALLEY RANCHOS WATER COMPANY

1982 Rates

Quantity Rate:	Per Meter Per Quarter
First 900 cu.ft., per 100 cu.ft.	$ .22
Over 900 cu.ft., per 100 cu.ft.	.30

Service Charge:	
For 5/8 x 3/4-inch meter	$ 9.30
For 3/4-inch meter	10.20
For 1-inch meter	13.95
For 1½-inch meter	19.50
For 2-inch meter	25.20
For 3-inch meter	46.50
For 4-inch meter	63.30
For 6-inch meter	105.15

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.

APPENDIX C
Page 2

APPLE VALLEY RANCHOS WATER COMPANY

1983 Rates

Quantity Rate:	Per Meter Per Quarter
First 900 cu.ft., per 100 cu.ft.	$ 0.310
Over 900 cu.ft., per 100 cu.ft.	0.415

Service Charge:	
For 5/8 x 3/4-inch meter	$ 12.90
For 3/4-inch meter	14.20
For 1-inch meter	19.35
For 1½-inch meter	27.00
For 2-inch meter	34.80
For 3-inch meter	64.50
For 4-inch meter	87.75
For 6-inch meter	145.80

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.

APPENDIX C
Page 3

APPLE VALLEY RANCHOS WATER COMPANY

1985 Rates

Quantity Rate:	Per Meter Per Quarter
First 900 cu.ft., per 100 cu.ft.	$ .27
Over 900 cu.ft., per 100 cu.ft.	.36

Service Charge:	
For 5/8 x 3/4-inch meter	$ 11.55
For 3/4-inch meter	12.75
For 1-inch meter	17.40
For 1½-inch meter	24.30
For 2-inch meter	31.20
For 3-inch meter	57.75
For 4-inch meter	78.60
For 6-inch meter	130.50

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.

(END OF APPENDIX C)

We will adopt the staff $76,007 credit adjustment to contributions in a d of construction for the following items:

(a) An unrefunded $39,610 item recorded prior to 1978 as a current payable on advances for construction.

(b) Retained earnings adjustment recorded by AV.

We will adopt the staff debit adjustment transferring $123,712 from contributions in aid of construction to advances for construction to reflect the net amount outstanding on advance contracts.

As noted above, we are modifying Jarrett's recommendations for 1981 and 1982 by treating $61,785 for wells and pumping equipment as equity capital and are transferring $107,000 from contributed in-tract facilities to advances for construction. After giving consideration to further depreciation accruals, reducing the contributed balance, and the adjustments described above, we adopt a 1982 average of $2,075,450 for contributions in aid of construction.

Reserve for Deferred Income Tax

Based on noncontributed plant additions and consistent with the treatment of deferred income taxes adopted in OII 24, we have calculated an adopted reserve for deferred income tax of $14,000.

Rate Base

The adopted rate base of $1,109,000 is the summary of the elements described above.

The proposed rates would increase quantity rates by 134.6% and increase quarterly service charges by 100%. The relative spread of increases between service and commodity charges is not unreasonable. However, in conformance with our general policy, we will establish a commodity lifeline allowance of 300 cubic feet to encourage conservation and a second inverted block which is not more than 50% above the lifeline block. The adopted rates for 1982 and for September 1, 1983 are shown in Appendix C.

Other Issues

AV did not come forward with an explicit financing proposal. Its implicit proposal for meeting its obligations is its amended request for rate relief based upon its proposed rate base treatment for its restated plant. AV's 1981 Annual Report shows a loss of $208,081 in its earned surplus account. Therefore, this account appears to be unavailable as a source of funds for AV's capital needs. However, a review based on the adjustments adopted in this decision might change that picture. Between 1963 and 1973 AV's net earnings totaled $263,533. Ordering Paragraph 1 of D.66095, which is still in effect, ordered AV to place those earnings in a reserve for replacement of plant and ordered AV to retain those investments and sources producing income to be placed in the reserve. Our ordering the restoration of the $263,533 in 1963 to 1973 earnings and the $436,600 principal and $372,000 interest in the CD reserve funds provides a funding source for new fill-in plant in certain tracts and a source of replacement plant funding. AV therefore should be required to secure from Getty the restoration of these funds, plus whatever further interest has accrued on the CD funds up to the restoration date and minus any expenditures since December 31, 1978, on fill-in plant on tracts originally financed by advances. As indicated above, the disposition of the excess of principal and interest remaining in the advance deposit accounts should be by application. The transfers required