ALJ/emk/md

ORIGINAL

Decision 82 11 018 NOV 3 1982

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of AZUSA VALLEY WATER COMPANY, a California corporation, for authorization to increase rates and charges for water service.	Application 82-03-65 (Filed March 18, 1982)

Gibson, Dunn & Crutcher, by Raymond L. Curran, Attorney at Law, for applicant.
F. Javier Plasencia, Attorney at Law, for the Commission staff.

O P I N I O N

Applicant Azusa Valley Water Company seeks authority to increase its rates for water service. The rate increases proposed by applicant are in steps designed to increase annual revenues in test year 1982 by $307,680, or 17.5%, over the revenues produced by rates in effect at the time this application was filed; in test year 1983 by $122,950, or 5.9%, over revenues from rates proposed for 1982; and in test year 1984 by $121,380, or 5.5%, over revenues from rates proposed for 1983.

Applicant provides public utility water service to approximately 14,200 general metered customers in a service area consisting of a portion of the Cities of Azusa, Covina, Glendora, Irwindale, West Covina, and adjoining unincorporated territory in Los Angeles County. Its water supply is obtained from groundwater wells in the San Gabriel Basins and from surface runoff diverted from the San Gabriel River.

An informal public meeting held during the evening on May 4, 1982 in Azusa preceded the hearing on this matter. The meeting was sponsored by applicant and the Commission staff to provide an informal setting in which customers could express their views and applicant could explain its asserted need for a general rate increase and respond to questions or complaints. Only six customers attended the meeting. Several of them viewed the size of the requested increases as excessive and/or complained about low water pressure they had experienced.

After due notice, public hearing on this application was held before Administrative Law Judge (ALJ) Main in Los Angeles on August 2, 1982. One of applicant's customers attended the hearing. Applicant presented testimony and exhibits through its general manager and the utility engineering and financial experts of its consultant. The staff studies were presented by a project manager, a financial analyst, and two utilities engineers. The matter was submitted on August 26, 1982 upon receipt of concurrent briefs.

Present and Proposed Rates

Applicant provides water service under Schedule No. 1, General Metered Service, and Schedule No. 4, Private Fire Protection Service. Applicant proposes to increase its rates by applying approximately the same percentage increase to each schedule. A tabular comparison of present, proposed, and adopted rates for general metered service is included in Appendix B to this decision.

Need for Rate Relief

In its application, applicant listed "the increased costs of payroll, purchased power and water assessment costs" as the major causes of earnings deteriorations.

Rate of Return

Applicant requested a 17% return on equity for the years 1982, 1983, and 1984 resulting in an overall rate of return on rate base of 14.12%, 14.02%, and 13.87%, respectively. During the hearing, applicant accepted staff's capitalization ratios, cost of long-term debt, and cost of preferred stock. The only issue remaining is the return on equity and consequently the overall rate of return. Applicant's revised requested rate of return and staff's recommended rate of return are summarized as follows:

Test Period - 1982, 1983, and 1984

Component	Capitalization Ratios	Cost	Weighted Cost Applicant	Weighted Cost Staff
Long-term Debt	35.25%	14.15%	4.99%	4.99%
Preferred Stock	12.75	3.29	0.42	0.42
Common Equity	52.00	17.00/14.25*	8.84	7.41
Total	100.00%		14.25%	12.82%

* Midpoint of 14.00% to 14.50% recommendation.

While applicant's request for a return on equity of at least 17% was based on economic conditions as they appeared almost a year ago, there have been changes in the economy which applicant, according to its brief, would agree appear to support a somewhat lower return. The staff recommendation, which is based on more

current information, relies in part on the expectation that current high interest rates will drop and that they will remain at a substantially lower level than they have been in the recent past. Staff also considered applicant's capital structure and returns recently granted by this Commission for comparable water utilities.

Applicant disagrees with the staff forecast of continued lower interest rates for the full period that these new rates for water service will be in effect in view of the $100 billion budget deficit which the federal government will be required to finance over the same period of time. Applicant believes it is not prudent or reasonable to expect that interest rates will continue to fall or remain at levels well below current interest rates for the three- year period.

We recently discussed the considerations relevant to determination of a fair rate of return on equity for water utilities in Del Este Water Co., D.82-09-061, issued September 22, 1982, in which case we set rates based on a 14.0 percent equity return. The staff's showing in this proceeding, particularly viewed in light of the recent downward trend in interest rates, persuades us that a comparable rate of return on equity is appropriate for applicant. We note that applicant's common equity ratio of 52% is significantly lower than the 68% ratio we adopted for Del Este in D.82-09-061.

In our judgement, a 14.25% return on equity is reasonable for applicant and strikes a balance between the consumers' short-term concern to obtain the lowest possible rates and the need to maintain good water service over the long run. The resultant overall rate of return is 12.82%.

Results of Operations

To evaluate the need for rate relief, witnesses for applicant and the Commission staff have analyzed and estimated for test years 1982 and 1983 applicant's operating revenues, operating expenses, and rate base. Staff's report of operating results (Exhibit 7) was based, in part, on later information than that available in late 1981 when applicant prepared its report (Exhibit 1). In Exhibit 9 applicant and staff recast their respective estimates of operating results to reflect the revised positions they took after the first day of hearing. Staff accepted applicant's estimate of operating revenues.

Applicant accepted most of staff's estimates of operating expenses, and most elements of rate base. In Table 1, which follows, the results for test years 1982 and 1983, as shown in Exhibit 9, and the operating results we adopt, are set forth.

TABLE 1
Page 1

AZUSA VALLEY WATER COMPANY

Estimated Results of Operations
Test Year 1982

Item	Present Rates: Applicant's Estimate (1)	Present Rates: Staff Estimate (2)	Difference (3)=(1)-(2)	Adopted Estimate (4)
	(Dollars in Thousands)			
Operating Revenues	$1,762.7	$1,762.7	0	$1,762.7
Operating Expenses:				
Water Assessment	118.0	118.0	0	118.0
Purchased Power	210.0	210.0	0	210.0
Payroll	337.6	337.6	0	337.6
Reg. Comm. Exp. & Outside Service	32.8	32.8	0	32.8
Other Expenses	275.5	268.0	7.5	271.9
Depreciation Exp.	159.7	158.1	1.6	159.7
Taxes Other Than Income	77.9	77.9	0	77.9
Subtotal	1,211.5	1,202.4	9.1	1,207.9
Uncoll. & Franchise Tax	29.3	29.3	0	29.3
Income Taxes	117.4	122.1	(4.7)	118.9
Total Operating Exp.	1,358.2	1,353.8	4.4	1,356.1
Net Operating Revenues	404.5	408.9	4.4	406.6
Rate Base:				
Utility Plant in Service	7,920.2	7,854.0	66.2	7,920.2
Working Capital	168.1	150.5	17.6	168.1
Subtotal	8,088.3	8,004.5	83.8	8,088.3
Customer Adv. & Contrib.	1,159.7	1,159.7	0	1,159.7
Def. Fed. Tax Res.	0	3.1	(3.1)	4.5
Unamortized ITC Res.	168.3	159.2	9.1	168.3
Depreciation Res.	3,016.7	3,019.8	(3.1)	3,016.7
Subtotal Deductions	4,344.7	4,341.8	2.9	4,349.2
Avg. Depre. Rate Base	3,743.6	3,662.7	80.9	3,739.1
Rate of Return	10.81%	11.16%		10.87%
Authorized Rates				
Operating Revenues				1,932.5
Operating Expenses:				
Oper. Exp. Excl. Income Taxes				1,241.0
Income Taxes				204.3
Total Operating Exp.				1,445.3
Net Operating Revenues				487.2
Rate Base				3,739.1
Rate of Return				13.03%

(Red Figure)

TABLE 1
Page 2

AZUSA VALLEY WATER COMPANY

Estimated Results of Operations
Test Year 1983

	Present Rates			
	Applicant's Estimate (1)	Staff Estimate (2)	Difference (3)=(1)-(2)	Adopted Estimate (4)
	(Dollars in Thousands)			
Operating Revenues	$1,770.7	$1,770.7	0	$1,770.7
Operating Expenses:				
Water Assessment	118.5	118.5	0	118.5
Purchased Power	210.1	210.1	0	210.1
Payroll	369.6	369.6	0	369.6
Reg. Comm. Exp. & Outside Service	33.2	33.2	0	33.2
Other Expenses	300.9	292.9	8.0	297.2
Depreciation Exp.	166.5	162.9	3.6	166.5
Taxes Other Than Income	82.1	80.7	1.4	82.1
Subtotal	1,280.9	1,267.9	13.0	1,277.2
Uncoll. & Franchise Tax	29.4	29.4	0	29.4
Income Taxes	90.6	98.2	(7.6)	92.6
Total Operating Expenses	1,400.9	1,395.5	5.4	1,399.2
Net Operating Revenues	369.8	375.2	(5.4)	371.5
Rate Base:				
Utility Plant in Service	8,217.1	8,084.7	132.4	8,217.1
Working Capital	189.2	158.8	30.4	189.2
Subtotal	8,406.3	8,243.5	162.8	8,406.3
Customer Adv. & Contrib.	1,152.7	1,152.7	0	1,152.7
Def. Fed. Tax Res.	0	15.2	(15.2)	20.2
Unamort. ITC Res.	195.3	177.0	18.3	195.3
Depreciation Res.	3,177.5	3,181.8	(4.3)	3,177.5
Subtotal Deductions	4,525.5	4,526.7	(1.2)	4,545.7
Avg. Depre. Rate Base	3,880.8	3,716.8	164.0	3,860.6
Rate of Return	9.52%	10.09%		9.62%
Authorized Rates				
Operating Revenues				2,044.7
Operating Expenses:				
Oper. Exp. Excl. Income Taxes				1,311.2
Income Taxes				230.5
Total Operating Exp.				1,541.7
Net Operating Revenues				503.0
Rate Base				3,860.6
Rate of Return				13.03%

(Red Figure)

In Table 1 the differences remaining between the estimates of applicant and staff were entered in column (3). They are attributable to the nonlabor inflation factors used in projecting expenses, the amount allowed for the development of an additional well, the inclusion or exclusion of unamortized regulatory expense in the computation of a working cash allowance, and the Accelerated Cost Recovery System (ACRS) under the Economic Recovery Tax Act of 1981 (ERTA). We will now address these differences.

A. Nonlabor Inflation Factors

Applicant's original estimates of operating results prepared in late 1981 included inflation factors for labor of 10% each for 1982 and 1983 and inflation factors for nonlabor also of 10% each for 1982 and 1983. Staff used labor inflation factors of 8.5% and 6.4% for 1982 and 1983 and nonlabor inflation factors of 4.1% and 8.6% for 1982 and 1983. Applicant, in its revised position (Exhibit 9), accepted all of staff's inflation factors except the one for 1982 nonlabor which it urges be increased from 4.1% to 7.0%. The staff estimate for this factor, we agree, appears to be on the low side.

A nonlabor inflation factor of 6% for 1982 is reasonable based on recent estimates for the year and has been reflected in our adopted operating results.

B. Development of An Additional Well

Applicant needs an additional well capable of producing large volumes of water of acceptable quality. In the Main San Gabriel Valley Basin applicant's wells have high yields but often produce water of poor quality. Recently, however, two of applicant's neighboring water utilities succeeded in obtaining

a better quality water from this basin by drilling through to a lower aquifer. Applicant's plan for its proposed well calls also for drilling through to a new aquifer from an existing well site in that basin.

The estimated cost to drill and test this proposed new well is $65,000. To complete the well, if the water is of sufficiently good quality, will cost an estimated $142,000 more. Should the water quality be unacceptable, applicant has as a backup plan the drilling and equipping of a well in an area adjoining its filtration plant near the San Gabriel River. At this alternative site the aquifers are, according to applicant, known to yield water of acceptable quality but in lesser volumes than those obtainable from wells in the Main San Gabriel Valley Basin. The estimated cost of drilling and equipping this alternative well exceeds the $142,000 which would be required to complete the main basin well after its testing.

Because staff was not made aware of this backup plan until about one week before the hearing, there was insufficient time for staff to review and investigate the second well proposal adequately. Staff has therefore confined its evaluation to the proposed Main San Gabriel Valley Basin well and recommends only the estimated $65,000 cost of drilling and testing the well be included in test year 1982 utility plant, with the estimated cost of completing the well to be included under an advice letter procedure at a later date after the well has proven to be of sufficiently good quality to warrant the expenditure of the additional funds to complete the construction and equipping of the well.

The record indicates clearly that:

1. Applicant must have an additional well;
2. Its plans for both the main basin well and the alternative well in the filtration plant area are supported by studies prepared by Montgomery Engineering Company, retained by applicant as its consulting hydrologists;
3. It has available the necessary funds to carry out its plans for providing an additional well;
4. An additional well will be drilled and equipped in 1982 as planned; and
5. The estimated cost of $207,000 for an additional well in 1982 is reasonable.

Staff does not dispute in any way the need for an additional well or that approximately $207,000, or more in the event the main basin well is unsuccessful, will be expended to provide it. Staff's main concern is that it did not have sufficient time to investigate adequately the plan for a second well as a fallback contingency.

To be fair to applicant while still meeting our staff's concern, we will include $207,000 in test year 1982 utility plant for an additional well subject to two conditions:

1. Applicant is to submit monthly written reports to the Commission staff on its progress in completing a new well supplying water of acceptable quality;[1/] and
2. If such a well is not timely completed, the step rates for 1983 will be lowered through an adjustment in test year 1983 estimated operating results reflecting a disallowance of $142,000 in utility plant.

1/ As used here, acceptable quality water is either water not requiring blending to meet health standards or water which can be cost-effectively blended to meet health standards.

Although stringent, the later condition is consistent with applicant's representations and staff's having insufficient time for an adequate investigation of the second well as a fallback contingency.

C. Unamortized Regulatory Expense

The level of regulatory expense is not disputed. At issue is whether applicant's deferred debits, representing unamortized rate case expenses, should properly be included in the computation of the working cash allowance. Applicant argues that these costs represent above-the-line expenses valid for ratemaking purposes, the prepayment of which represents a legitimate use of working cash which should be recognized in rate base. Staff argues against such treatment.

The staff's treatment is based on the principle that the ratepayer is already reimbursing applicant for the amount of unamortized regulatory costs as an expense item. The staff calculates the reasonable costs associated with regulation and amortizes them over appropriate time periods. Staff does not usually include these costs in its computation of rate base.

It is the staff's view that it is not reasonable for ratepayers to pay for the carrying costs of unamortized amounts. The Commission affirmed this view in Decision 92497 (Application 59316) signed December 5, 1980. In that application, Southern California Gas Company requested rate base treatment of unamortized costs associated with the abandonment of a gas project. On Page 80 of that decision, the Commission 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."

Similarly, amortization of deferred maintenance expenses and other extraordinary expenses typically has not provided for rate base treatment of unamortized amounts. See, e.g., D.93887 (Pacific Gas & Electric Co.), at 77; D.93892 (San Diego Gas & Electric Co.), at 105.

Recently, the Commission addressed the issue of whether regulatory expenses should be included in the rate base. In Decision 82-09-061 (Application 82-01-26), signed September 22, 1982, the Commission denied such treatment of regulatory expenses to Del Este Water Company.

Staff's recommendation is reasonable and consistent with prior Commission policy. We will not include regulatory expenses in the working case allowance.

D. Accelerated Cost Recovery System Under ERTA

At the hearing and in the comparison exhibit (Exhibit 9) applicant took the position that it was not in the best interests of either applicant or its customers "to in effect require the Applicant to elect to take accelerated depreciation by deducting the cumulative tax benefits imputed through the use of ACRS from rate base whether or not Applicant actually uses ACRS in the computation of its federal income tax obligation".

Applicant's basic concern stems from the cash-flow simulation studies in Exhibit 11, which purportedly evaluate the long-term impact of ACRS versus straight-line depreciation to calculate federal tax liability. According to Exhibit 11:

> ". . . ACRS could be a bad choice:
>
> "1. Initial years' annual cash savings must be invested to earn greater than return on rate base granted by commission, in order to provide funds to compensate for negative cash flow in later years.
>
> "2. In the long term, use of ACRS could almost eliminate the company's equity investment.
>
> "Conclusion
>
> "It is entirely prudent for company to elect straight line ACRS option, to eliminate normalization deduction from rate base. The company did this for 1981. The California Public Utility [sic] Commission staff's imputation of cumulative tax benefit deduction from rate base neglects a prudent management decision, and is therefore improper."

Late in the hearing it was brought out by the ALJ that a different conclusion should be reached if the deferred federal tax reserve and its deduction from rate base are recognized as equivalent to an interest-free loan carrying a zero cost of money factor in a computation of a fair rate of return. The fair rate of return is on total capitalization which, in this case, would include the "interest-free loan". By the nature of the computation, the rate of return so determined times the rate base, from which the tax deferral reserve has not been deducted, must yield virtually the same return as the corresponding higher rate of return on the smaller rate base where the tax deferral reserve

is deducted. The extent of any variation depends on how closely total capitalization and rate base are matched. Except for such variation, it is thus seen that for noninterest-bearing debt it is immaterial whether plant in the amount of that debt is deducted from rate base or the cost factor of zero is used for noninterest-bearing debt in the fair rate of return computation and the plant is retained in rate base.

Viewed in this way the shift in capital structure taking place under conventional normalization is not toward less but more equity (i.e., away from interest-bearing debt to cumulative tax deferrals). Likewise, an eventual reduction in cash flow simply stems from a reduction in revenue requirements caused by the shift from interest-bearing debt to "noninterest-bearing debt".

Before filing its brief applicant reconsidered its position and now concurs in the staff's proposed treatment shown in Exhibit 9. The adopted operating results reflect that treatment (i.e., conventional normalization for applying ERTA adopted in our Decision (D.) 93848).

Under ERTA the full flow-through to ratepayers of benefits from accelerated depreciation and investment tax credit on utility plant additions placed in service after December 31, 1980 is no longer available. This causes an increase in federal income tax expense for ratemaking purposes. For test year 1982 the added revenue requirement imposed by ERTA is $19,800. The corresponding amount for test year 1983 is $46,100. We will require applicant to provide its customers with a notice, Appendix C, explaining the impact of ERTA on the rates authorized by this decision.

Authorized Revenue Increases

By comparing the entries for operating revenues in Table 1 above, it can be seen that (1) the rates to be authorized for test year 1982 yield additional gross revenues of $169,800 which represent a 9.63% increase over revenues at present rates and (2) the rates to be authorized for test year 1983 yield additional gross revenues of $274,000 which represent a 15.47% increase over revenues at present rates. In addition, a third set of rates will be authorized to allow for attrition in rate of return after test year 1983. This is in keeping with our intention that single district Class A water utilities will not file a general rate increase application more often than once in three years.

Employing the rate of return of 13.03% authorized by this decision and the method of calculating operational attrition used by both applicant and staff in Exhibit 12, we show in the following tabulation a summation of the components of operational attrition totaling $83,600 for 1984:

Attrition for 1984
(Dollars in Thousands)

Component	
Operating Expense: O & M and A &G	$55.3
Ad Valorem and Payroll Tax	3.7
Depreciation Expense	8.7
Rate Base Effect	2.7
Income Tax Impact	13.2
Total Operational Attrition	$83.6

Because the fair rate of return of 13.03% determined in this decision is based on a stable capital structure (i.e., constant capital ratios and cost factors) over the three-year period, no allowance for financial attrition is indicated. Thus, the total attrition allowance is the $83,600 for operational attrition.

To offset this attrition, we may authorize a step increase for 1984 of up to $83,600. Applicant will be required to file an advice letter with supporting work papers on or after November 15, 1983 to justify such an increase. Fixing rates in this way results in a better matching of the consumers' interests than setting a high initial rate which would yield the adopted rate of return for a three-year average. The required supplemental filings will permit review of achieved rates of return before the final step increase is granted.

Rate Design

Applicant's present rate structure complies with the Commission's policy of a service charge, a lifeline allowance of 300 cubic feet, and a second block inverted rate which is no more than 50% higher than the first block rate. The second block rate is 33% greater than the rate for the first 300 cubic feet.

Applicant concurs in, and we adopt, staff's recommended structuring of rate increases as set forth in paragraphs 13.5 and 13.6 of Exhibit 7:

> "13.5 The utility's present lifeline rate, as of July 7, 1981, by Advice Letter No. 26, is 23 cents per 100 cu. ft. The same 23 cents per 100 cu. ft. also existed in January 1, 1976. The service charge for a 5/8 x 3/4-inch meter, however, was increased from $1.50 to $2.60 by Decision No. 90780, dated October 1, 1979. The Decision stated that:

'Increases in the magnitude of plant additions, in the recent past and as contemplated for 1979 and 1980, which are not primarily related to customer growth, are increasing Azusa's fixed costs. This increase in fixed costs justifies increases in Azusa's relatively low service charges.'

"Since January 1, 1976, the total cost for a customer using the 300 cu. ft. lifeline allowance, including the service charge, has increased 50.2 percent. The total system rate has increased 37.7 percent. During the same period of time, the service charge for larger meters has increased by amounts varying from 101 percent for a 2-inch meter to 170 percent for an 8-inch meter, and the quantity charge for usage over 10,000 cubic feet has increased by 91 percent.

"13.6 Since the increase to the lifeline user was 50.2 percent compared to the system-wide of 37.7 percent, the staff, in order to provide a lifeline differential, would normally recommend that there be no increase in the service charge for a 5/8 x 3/4-inch meter and no increase for the quantity rate for the first 300 cubic feet until the differential of 25 percent is accomplished. This would, however, place an inordinate burden of the rate increase upon the larger users who have already borne increases for greater than the system-wide increase as described in Paragraph 13.5. Therefore, the staff recommends that the Commission adopt a phased transition of future rate increases to gradually achieve the lifeline differential while recognizing and reducing the impact on the larger users. To accomplish this, the staff recommends that the increase to the lifeline user be one-half of the percentage increase that is

> adopted for each of the test years, and that this policy be continued in future rate proceedings until the 25 percent lifeline differential is attained."

Conservation and Pump Efficiencies

Applicant's conservation program is a permanent aspect of its ongoing operations and is summarized on pages 3-10 through 3-12 of Exhibit 1.

In response to D.88466 in Case 10114, pump efficiency tests have been performed for all wells and boosters in applicant's water system. In Exhibit 7 staff addressed pump efficiency as follows:

> "The utility submitted well and booster pumps efficiency data for all electrically powered equipment. Pump efficiency tests were conducted in 1981 by Edison and a private testing company. Although the overall pump efficiencies of pumps, used by the company on a daily basis, still have reasonable efficiency levels, staff observed that some, compared to 1978 and 1979 tests, have dropped sizably. Booster pumps with low efficiency levels are used only on an emergency basis; the utility indicated that it would replace these pumps as soon as their economics would warrant them. Also, the utility plans to inspect some of the pumps during the winter when water demand is lowest."

Service

A review of the Commission's customer complaint records from October 1, 1981 through May 11, 1982 indicates that five informal complaints were filed against applicant and that all of the complaints were satisfactorily resolved.

Tabulated below from applicant's records are customer complaints for 1980 and 1981. Applicant's investigative reports reveal the complaints were all satisfactorily resolved.

	1980	1981	
Taste, Odor, and Color	9	4	
Pressure (High or Low)	74	99	
Leaks at Meter	207	283	
Mainline Leaks	6	15	
High Bills	22	85	(Hot Summer)

In March 1982 staff inspected applicant's service area. Staff considers applicant's service to be satisfactory.

Findings of Fact

1. Applicant's service, conservation program, pump efficiency program, and water quality are satisfactory.

2. The adopted estimates, previously discussed, of operating revenues, operating expenses, and rate base for the test years 1982 and 1983, together with an additional revenue requirement of $83,600 for 1984 due to operational attrition, reasonably indicate the results of applicant's future operations.

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

4. A rate of return of 13.03% on applicant's rate base for 1982, 1983, and 1984 is reasonable. The related return on common equity is a constant 14.65%. This will require an increase of $169,800, or 9.63%, in annual revenues for 1982; a further increase of $112,200, or 5.81%, for 1983; and a further increase of $83,600, or 4.09%, for 1984.

5. The adopted rate design is reasonable.

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

7. The further increases authorized in Appendix A should be appropriately modified (1) in the event the rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ended September 30, 1982 and/or September 30, 1983, exceeds 13.02%; or (2) in the event the additional well, as discussed on pages 8, 9, and 10 of this decision, is not completed before January 1, 1983.

Conclusions of Law

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

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

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

O R D E R

IT IS ORDERED that:

1. Applicant Azusa Valley Water Company is authorized to file, effective today, the revised rate schedules in Appendix A. The filing shall comply with General Order Series 96. The effective date of the revised schedules shall be the date of filing. The revised schedules shall apply only to service rendered on and after their effective date.

2. On or after November 15, 1982, applicant is authorized to file an advice letter, with appropriate work papers, requesting the step rate increases for 1983 shown in Appendix A attached to this order, or to file a lesser increase which includes a uniform

cents per 100 cubic feet of water adjustment from Appendix A (1) in the event that applicant's rate of return on rate base, adjusted to reflect the rates then in effect and normal rate-making adjustments for the 12 months ending September 30, 1982, exceeds 13.03% and/or (2) in the event the additional well cited in Finding 7 of this decision will not be completed before January 1, 1983. This filing shall comply with General Order 96-A. The requested step rates shall be reviewed by the staff to determine their conformity with this order and shall go into effect upon the staff's determination of conformity. The staff shall inform the Commission if it finds that the proposed step rates are not in accord with this decision, and the Commission may then modify the increase. The effective date of the revised schedules shall be no earlier than January 1, 1983, or 30 days after the filing of the step rates, whichever is later. The revised schedules shall apply only to service rendered on and after their effective date.

3. On or after November 15, 1983, applicant is authorized to file an advice letter, with appropriate work papers, requesting the step rate increases for 1984 shown in Appendix A attached to this order, or to file a lesser increase which includes a uniform cents per 100 cubic feet of water adjustment from Appendix A in the event that applicant's 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 13.03%. This filing shall comply with General Order 96-A. The requested step rates shall be reviewed by the staff to determine their conformity with this order and shall go into effect upon the staff's determination of conformity. The staff shall inform the

Commission if it finds that the proposed step rates are not in accord with this decision, and the Commission may then modify the increase. The effective date of the revised schedules shall be no earlier than January 1, 1984, or 30 days after the filing of the step rates, whichever is later. The revised schedules shall apply only to service rendered on and after their effective date.

4. Within 60 days after the effective date of this order applicant shall mail to all its customers the bill insert notice set out in Appendix C.

5. Applicant shall submit written monthly progress reports to the Hydraulics Branch of the Commission's Utilities Division, commencing 60 days after the effective date of this order, concerning completion of a new well to supply water of acceptable quality. If the well is not completed by the date of applicant's advice letter filing seeking implementation of its authorized 1983 step rates, the test year 1983 estimated operating results shall be adjusted to disallow $142,000 in utility plant.

This order is effective today.

Dated NOV 3 1982, at San Francisco, California.

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

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

Joseph E. Bodovitz, Executive Director

APPENDIX A
Page 1

AZUSA VALLEY WATER COMPANY

Schedule No. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Portions of Azusa, Covina, Glendora, Irwindale, West Covina and vicinity, Los Angeles County.

RATES

	Per Meter Per Month	
Service Charge:		
For 5/8 x 3/4-inch meter	$ 2.70	(I)
For 3/4-inch meter	3.75	|
For 1-inch meter	6.65	|
For 1 1/2-inch meter	11.60	|
For 2-inch meter	19.10	|
For 3-inch meter	34.60	|
For 4-inch meter	55.50	|
For 6-inch meter	94.20	|
For 8-inch meter	141.00	(I)
Quantity Rates:		
First 300 cu.ft., per 100 cu.ft.	0.250	(I)
Over 300 cu.ft., per 100 cu.ft.	0.342	(I)

The Service Charge is a readiness-to-serve charge to which is added the charge, computed at Quantity Rates, for water used during the month.

APPENDIX A
Page 2

AZUSA VALLEY WATER COMPANY

AUTHORIZED INCREASE IN RATES

TO SCHEDULE NO. 1

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 rates in effect on that date.

	Rates to be Effective 1-1-83	1-1-84
Service Charge:		
For 5/8 x 3/4-inch meter	$0.05	$0.05
For 3/4-inch meter	0.05	0.20
For 1-inch meter	0.10	0.25
For 1½-inch meter	0.40	0.60
For 2-inch meter	0.0	1.00
For 3-inch meter	1.90	1.80
For 4-inch meter	3.30	2.90
For 6-inch meter	5.60	5.00
For 8-inch meter	7.00	7.00
Quantity Rate:		
First 300 cu.ft., per 100 cu.ft.	0.017	0.004
Over 300 cu.ft., per 100 cu.ft.	0.023	0.015

AZUSA VALLEY WATER COMPANY

Schedule No. 4

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

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

TERRITORY

Portions of Azusa, Covina, Glendora, Irwindale, West Covina and vicinity, Los Angeles County.

RATE

	Per Month	
For each inch of diameter of service connection.....	$2.94	(I)

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 service 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.

(Continued)

APPENDIX A
Page 4

AZUSA VALLEY WATER COMPANY

AUTHORIZED INCREASE IN RATES

TO SCHEDULE NO. 4

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 rates in effect on that date.

	Per Month Rates to be Effective	
	1-1-83	1-1-84
RATE		
For each inch of diameter of service connection.....	$0.17	$0.17

(END OF APPENDIX A)

APPENDIX B
Page 1

AZUSA VALLEY WATER COMPANY

COMPARISON OF MONTHLY RATES

GENERAL METERED SERVICE - SCHEDULE NO. 1

Item	Current Rates*	Proposed Rates 1982	Proposed Rates 1983	Proposed Rates 1984	Adopted Rates 1982	Adopted Rates 1983	Adopted Rates 1984
Service Charge:							
For 5/8 x 3/4 inch meter	$ 2.60	$ 3.05	$ 3.24	$ 3.42	$ 2.70	$ 2.75	$ 2.80
For 3/4-inch meter	3.60	4.25	4.50	4.75	3.75	3.80	4.00
For 1-inch meter	6.60	7.75	8.20	8.65	6.65	6.75	7.00
For 1-1/2-inch meter	11.10	13.00	13.80	14.55	11.60	12.00	12.60
For 2-inch meter	20.10	23.70	25.10	26.40	19.10	19.10	20.10
For 3-inch meter	33.10	39.00	41.00	43.00	34.60	36.50	38.30
For 4-inch meter	53.10	62.00	66.00	70.00	55.50	58.80	61.70
For 6-inch meter	90.10	106.00	112.00	118.00	94.20	99.80	104.80
For 8-inch meter	135.10	160.00	170.00	179.00	141.00	148.00	155.00
Quantity Rates:							
First 300 cu.ft. per 100 cu.ft.	0.230	0.270	0.286	0.302	0.250	0.267	0.271
Over 300 cu.ft. per 100 cu.ft.	0.306	0.360	0.381	0.402	0.342	0.365	0.380

The Service Charge applies to all metered service connections, to it is added the charge for water used during the month at Quantity Rates.

Schedule No. 4

Private Fire Protection Service

Rate Per month

For each inch of diameter of service connection.

Current Rates*	Proposed Rates 1982	Proposed Rates 1983	Proposed Rates 1984	Adopted Rates 1982	Adopted Rates 1983	Adopted Rates 1984
$2.50	2.94	3.11	3.28	2.94	3.11	3.28

APPENDIX B
Page 2

AZUSA VALLEY WATER COMPANY

ADOPTED QUANTITIES

Net-to-Gross 2.0833

Federal Tax Rate 46%

State Tax Rate 9.6% (for both test years)

Uncollectibles Rate 0.45%

Offset Items	Test Years 1982	1983	1984
1. Purchased Power			
Used for: Pumped Water (CCF)	1,729,200	1,729,200	1,729,200
Surface Water (CCF)	2,517,700	2,535,700	2,556,700
Total Production (CCF)	4,246,900	4,264,900	4,285,900
Electric: (A.F.)	9,748.87	9,789.74	9,837.94
Southern California Edison Company			
Total Cost $	130,000	130,100	130,400
kWh	1,886,599	1,877,985	1,879,011
Eff. Sch. Date	5-4-82	5-4-82	5-4-82
$/ kWh	0.06628	0.06628	0.06628

	$/kWh
In effect on	5-4-82
Basic Rate (composite)	0.02082
ECAC	0.04286
AER	0.00236
CLMAC	0.00004
State Energy Tax	0.00020
	0.06628

City of Azusa			
Total Cost $	80,000	80,000	80,000
kWh	1,047,199	1,057,021	1,057,403
Eff. Sch. Date	7/1/82	7/1/82	7/1/86
$/DWH Used			
First 100 kWh	0.10197	0.10197	0.10197
Next 400 kWh	0.09313	0.09313	0.09313
Next 1,000 kWh	0.08429	0.08429	0.08429
Next 1500 kWh	0.07341	0.07341	0.07341
Next 2000 kWh	0.06933	0.06933	0.06933
See "General Service - Rate G" for applicable "Customer Charge" and "Demand Charge"			

APPENDIX B
Page 3

AZUSA VALLEY WATER COMPANY

METERED WATER SALES USED TO DESIGN RATES

ADOPTED QUANTITIES

Meter Size	Metered Service 1982	1983	1984
5/8 x 3/4	13,051	13,111	13,165
3/4	442	445	447
1	202	203	204
1½	138	138	139
2	230	233	234
3	33	33	33
4	31	31	31
6	2	2	2
8	2	2	2
Total	14,131	14,198	14,257

Quantity Blocks (CCF)	Consumption 1982 (CCF)	1983 (CCF)	1984 (CCF)
0-3	266,833	268,088	269,249
Over 3	3,709,737	3,725,372	3,743,881
Total	3,976,570	3,993,460	4,013,130

APPENDIX B

ADOPTED TAX CALCULATION

AZUSA VALLEY WATER COMPANY

	Test Year 1982		Test Year 1983	
	CCFT	FIT	CCFT	FIT
	(Dollars in Thousands)			
Operating Revenue	$1,932.4	$1,922.4	$2,044.8	$2,044.8
Expenses				
Operation & Maintenance	707.0	707.0	742.2	742.2
Administrative & General	296.4	296.4	320.3	320.3
Taxes Other Than Income	77.9	77.9	82.1	82.1
CCFT	0	42.0	0	47.0
Subtotal	1,081.3	1,123.3	1,144.6	1,191.6
Deductions from Taxable Income				
Tax Depreciation	162.3	162.3	168.5	168.5
Interest Expense	251.1	251.1	241.6	241.7
Subtotal Deduction	413.4	413.4	410.1	410.2
Net Taxable Income (CCFT)	437.7		490.0	
CCFT @ 9.6%	42.0		47.0	
Net Taxable Income (FIT)		395.6		443.0
FIT @ 46%		182.0		203.4
Graduated Tax Adjustment		-19.8		-20.3
ITC		0		0
Total FIT		162.1		183.5

(END OF APPENDIX B)

APPENDIX C

Bill Insert for Azusa Valley Water Company

$19,800 and $46,100 of the recent rate increase granted to Azusa Valley Water Company for 1982 and 1983, respectively, were made necessary by changes in tax laws proposed by the President and passed by Congress. 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 C)

current information, relies in part on the expectation that current high interest rates will drop and that they will continue at a substantially lower level than they have been in the recent past for the three-year period that these proposed new rates will be in effect.

Applicant disagrees with the staff forecast of continued lower interest rates for the full period that these new rates for water service will be in effect. In view of the $100 billion budget deficit which the federal government will be required to finance over the same period of time, applicant believes it is not prudent or reasonable to expect that interest rates will continue to fall or remain at levels well below current interest rates for the three-year period.

Obviously, it would be extremely difficult to forecast correctly the level of interest rates over the 1982-1984 period. However, we do know that the yields on "BAA" utility company bond offerings thus far through 1982 have exceeded 15%, that this recorded period represents about one-fourth of the three-year span, and that applicant's embedded long-term debt has an effective interest cost of 14.15%. Unless long-term debt rates were to fall well below their current levels and remain there for the remainder of the three-year period, it would not appear to warrant fixing a return on common equity below 14.65%, which allows only a 0.5% increment above applicant's 14.15% cost of embedded long-term debt.

In our considered judgment, a 14.65% return on equity is reasonable for applicant and strikes a balance between the consumers' short-term concern of obtaining the lowest possible rates while maintaining good water service over the long run. The resultant overall rate of return of 13.03% is developed as follows:

Test Period - 1982, 1983, and 1984

Component	Capitalization Ratios	Cost	Weighted Cost
Long-term Debt	35.25%	14.15%	4.99%
Preferred Stock	12.75	3.29	0.42
Common Equity	52.00	14.65	7.62
Total	100.00%		13.03%

Results of Operations

To evaluate the need for rate relief, witnesses for applicant and the Commission staff have analyzed and estimated for test years 1982 and 1983 applicant's operating revenues, operating expenses, and rate base. Staff's report of operating results (Exhibit 7) was based, in part, on later information than that available in late 1981 when applicant prepared its report (Exhibit 1). In Exhibit 9 applicant and staff recast their respective estimates of operating results to reflect the revised positions they took after the first day of hearing. Staff accepted applicant's estimate of operating revenues. Applicant accepted most of staff's estimates of operating expenses, and most elements of rate base. In Table 1, which follows, the results for test years 1982 and 1983, as shown in Exhibit 9, and the operating results we adopt, are set forth.

Although stringent, the later condition is consistent with applicant's representations and staff's having insufficient time for an adequate investigation of the second well as a fallback contingency.

C. Unamortized Regulatory Expense

The level of regulatory expense is not disputed. At issue is whether applicant's deferred debits, representing unamortized rate case expenses, should properly be included in the computation of the working case allowance. Applicant argues that these costs represent above-the-line expenses valid for ratemaking purposes, the prepayment of which represents a legitimate use of working cash which should be recognized in rate base. Staff argues against such treatment.

The staff's treatment is based on the principle that the ratepayer is already reimbursing applicant for the amount of unamortized regulatory costs as an expense item. The staff calculates the reasonable costs associated with regulation and amortizes them over appropriate time periods. Staff does not usually include these costs in its computation of rate base.

It is the staff's view that it is not reasonable for ratepayers to pay for the carrying costs of unamortized amounts. The Commission affirmed this view in Decision 92497 (Application 59316) signed December 5, 1980. In that application, Southern California Gas Company requested rate base treatment of unamortized costs associated with the abandonment of a gas project. On Page 80 of that decision, the Commission 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."

** Similarly, amortization of deferred maintenance expenses and other extraordinary expenses typically has not provided for rate base treatment of unamortized amounts. See, e.g., D.93887 (Pacific Gas & Electric Co.), at 77; D.93892 (San Diego Gas & Electric Co.), at 105.

Recently, the Commission addressed the issue of whether regulatory expenses should be included in the rate base. In Decision 82-09-061 (Application 82-01-06), signed September 22, 1982, the Commission denied such treatment of regulatory expenses to Del Este Water Company.

Staff's recommendation is reasonable and consistent with prior Commission policy. We will not include regulatory expenses in the working case allowance.

D. Accelerated Cost Recovery System Under ERTA

At the hearing and in the comparison exhibit (Exhibit 9) applicant took the position that it was not in the best interests of either applicant or its customers "to in effect require the Applicant to elect to take accelerated depreciation by deducting the cumulative tax benefits imputed through the use of ACRS from rate base whether or not Applicant actually uses ACRS in the computation of its federal income tax obligation".