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Decision _____ November 17, 1982

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
CALIFORNIA WATER SERVICE COMPANY, a)
corporation, for an order)
authorizing it to increase rates)
charged for water service in the)
East Los Angeles District.)

Application 82-03-94
(Filed March 26, 1982)

McCutchen, Doyle, Brown & Enersen, by
A. Crawford Greene, Attorney at
Law, and Donald Houck, for
California Water Service Company,
applicant.
Lynn T. Carew, Attorney at Law, and
Sung E. Han, for the Commission
staff.

O P I N I O N

By this application California Water Service Company (CWS) seeks authority to increase the rates for water service in its East Los Angeles District to produce annual revenue increases of 24.3% or \$1,489,200 in 1983, and by additional amounts of 5.4% and 3.2% or \$413,800 and \$258,200, respectively, in 1984 and 1985.

Public hearings on a consolidated record with Application (A.) 82-03-95, A.82-03-96, A.82-03-97, and A.82-03-98 were held before Administrative Law Judge (ALJ) Orville I. Wright in San Francisco on August 2, 3, 4, 5, 6, and 12, 1982. Donald Houck, Barney Tumey, Parker Robinson, and Harold Ulrich presented evidence on behalf of CWS. Oscar David, Donald Yep, Arthur Gallegos, Donald McCrea, Chew Low, Ernst Knolle, Christopher Blunt, and Sung Han presented evidence on behalf of staff. There were no intervenors or interested parties.

The matter was submitted with the filing of concurrent briefs on August 31, 1982. Areas of difference between staff and CWS are:

1. Industrial and public authority sales.
2. Payroll increases.
3. Postage expense.
4. Tank painting maintenance.
5. Construction budgets.
6. Rate of return.
7. Rate design.
8. Offset proposals.
9. Ordering paragraph revision.

Decision Summary

Applicant's request for rate increases and our adopted increases are as follows:

| | <u>Additional Revenues Requested</u> | <u>Percent Rate Increase</u> | <u>Additional Revenues Adopted</u> | <u>Percent Rate Increase</u> |
|------|--|--------------------------------------|--|--------------------------------------|
| 1983 | \$1,489,200 | 24.3 | \$1,240,300 | 19.9 |
| 1984 | 413,800 | 5.4 | 284,900 | 3.8 |
| 1985 | 258,200 | 3.2 | 164,500 | 2.1 |

Table I shows the adopted summary of earnings at present rates and at the rate level adopted for test years 1983 and 1984.

TABLE I

CALIFORNIA WATER SERVICE COMPANY
East Los Angeles District

ADOPTED SUMMARY OF EARNINGS

| | <u>Test</u> <u>Year 1983</u> | <u>Test</u> <u>Year 1984</u> |
|-------------------------------|---------------------------------|---------------------------------|
| | (Dollars in Thousands) | |
| <u>Present Rates</u> | | |
| Operating Revenues | \$ 6,224.3 | \$ 6,280.9 |
| <u>Operating Expenses</u> | | |
| Purchased power | 395.4 | 396.4 |
| Purchased water | 1,826.9 | 1,861.8 |
| Replenishment assessment | 76.4 | 76.4 |
| Purchased chemicals | 1.8 | 1.8 |
| Payroll - District | 960.1 | 1,024.4 |
| Other O & M | 431.2 | 469.2 |
| Other A&G and misc. | 59.4 | 63.1 |
| Ad valorem taxes - District | 158.8 | 163.0 |
| Payroll taxes - District | 67.5 | 72.0 |
| Depreciation | 387.3 | 399.3 |
| Ad valorem taxes - G.O. | 2.7 | 2.7 |
| Payroll taxes - G.O. | 12.3 | 13.0 |
| Other prorates - G.O. | 554.7 | 593.8 |
| Balancing account adjustment | (229.2) | (232.0) |
| Subtotal | 4,705.3 | 4,904.9 |
| Uncollectibles | 2.5 | 2.5 |
| Local franch. tax & bus. lic. | 104.5 | 105.5 |
| Income taxes before ITC | 272.1 | 165.8 |
| Investment tax credit | - | - |
| Total operating expenses | 5,084.4 | 5,178.7 |
| Net operating revenues | 1,139.9 | 1,102.2 |
| Rate base | 14,257.2 | 14,622.3 |
| Rate of return | 8.00% | 7.54% |
| <u>Authorized Rates</u> | | |
| Operating revenues | \$ 7,464.6 | \$ 7,817.4 |
| <u>Operating expenses</u> | | |
| Subtotal | 4,705.3 | 4,904.9 |
| Uncollectibles | 3.0 | 3.1 |
| Local franch. tax & bus. lic. | 125.1 | 131.0 |
| Income taxes before ITC | 896.1 | 938.9 |
| Investment tax credit | - | - |
| Total operating expenses | 5,729.5 | 5,977.9 |
| Net operating revenues | 1,735.1 | 1,839.5 |
| Rate base | 14,257.2 | 14,622.3 |
| Rate of return | 12.17% | 12.58% |

(Red Figure)

A rate of return on rate base of 12.17% for 1983 and 12.58% for 1984 is found reasonable. Authorized return on equity is 14.50%.

For test year 1983, \$336,700 of the revenue requirement increase is due to the Economic Recovery Tax Act (ERTA). The effect could increase in the future. We will direct applicant to notify its customers of the ERTA effect on rates. (Appendix D.)

Operating Revenues

Staff's estimate of operating revenues is \$74,700 greater than that of applicant for test year 1983 and \$136,100 greater in test year 1984 at present rates. The difference rests in the parties' respective estimates of consumption by industrial and public authority customers.

Applicant states that its original sales projections for industrial and public authority customers are based on recent trends adjusted for any known or expected changes that will have a significant impact on sales levels in the future.

Industrial metered sales were first estimated by applicant as 1,457.8 KCcf for 1982, 1,458.1 KCcf for 1983, and 1,458.1 KCcf for 1984. These estimates were the result of separate treatment of small industrial users and of 18 large industrial users. Data were trended for the period 1975-1981.

Staff estimated industrial metered sales as 1,564.1 KCcf for 1983 and 1,610.3 KCcf for 1984. Higher estimates of staff are the result of contact with industrial customers which indicated an expected increase in consumption and later data, i.e. 12 months ending March 1982. An average sales per service was developed by staff using 1979-1981 recorded figures.

After circulation of the staff showing, but before the hearing, applicant revised its flat 1983-1984 projection of industrial sales to 1,469.5 KCcf for 1983 and 1,425.5 KCcf for 1984, an increase of 11.4 KCcf and a decrease of 32.6 KCcf in the two test years, respectively. These revisions were necessary, according to

applicant, in order to reflect sales data from October 1, 1981 to March 31, 1982 which were not available at the time first estimates were prepared. CWS states that these data confirm that a seven-year downward sales trend is continuing.

Staff objected to the later revised estimates of sales on the ground that they constituted a bulk updating of exhibits contrary to our Regulatory Lag Plan provisions, but the material was admitted into evidence by the ALJ in a ruling with which we concur. However, as staff further asserts, the revisions complained of constitute a departure from the methodology used by both parties of segregating customers by size and, thus, must be viewed with caution in our determinations.

Applicant followed a similar course with regard to public authority customers, initially estimating these sales at 876.3 KCcf for 1982, at 917.5 KCcf for 1983, and at 958.5 KCcf for 1984, an increase of 41.2 KCcf for 1983 and an increase of 41.0 KCcf for 1984. Revisions reflecting later data brought these estimates to 872.0 KCcf for 1983 and 889.8 KCcf for 1984, a decrease of 45.5 KCcf for 1983 and a further decrease in 1984 of 68.7 KCcf from the original showing. Again, the principle of customer segregation was abandoned in the later estimates although such segregation is admitted by applicant to produce a more reliable result.

Staff concurred with applicant's original estimates for public authority sales after conducting a survey of individual customers, as it had done for industrial sales, and having at hand the data through December 31, 1981 and beyond which prompted applicant's proffered exhibit revisions.

We find staff's use of a three-year average and established methodology, supported as it is by customer sampling revealing higher consumption projections by the users to be more persuasive than

applicant's original or revised estimates. We adopt staff's estimates on metered industrial and public authority sales.

Payroll - District

Staff's estimate of payroll expense for test year 1983 is \$4,500 less than that of applicant and is \$30,700 less for test year 1984.

Although staff's witness testified that his wage recommendations were largely the product of his independent judgment, they conform to forecasts issued by the Revenue Requirements Division in April 1982, which project a labor escalation factor of 6.4% for 1983 and 6.7% for 1984, based on historical trended increases from the US All Urban Consumer Price Index for the six months ending January 1, 1982. ✓

Staff's payroll estimates adopted existing negotiated increases for union employees through 1983; however, wage increase estimates for nonunion employees were reduced to 6.4% in 1983 from the parity 11% figures applicable in 1982. Both union and nonunion wages were estimated at 6.7% for 1984. Staff's witness testified that but for the fact that the current union contract is effective through 1983, he would have recommended the same treatment of costs associated with union and nonunion employee wages in 1983; i.e. a uniform 6.4% increase, rather than 9.5% for union employees and 6.4% for nonunion employees.

Applicant based its 1983 nonunion payroll estimate on its longstanding policy of granting both groups approximately the same percentage increase each year. Its 1984 estimate of 9.5% was based on the past practice in rate proceedings involving applicant of continuing the use of the latest contract's final year increase. Applicant objects to staff's estimate of different percentage wage increases to different employee groups because this is not the manner in which applicant has generally raised wages. It alleges that wide acceptance of staff's procedure would shortly put applicant in the

untenable position of paying its supervisory personnel less than the people working under them. Further, applicant points out that the Commission has already found reasonable for ratemaking purposes in six of applicant's other districts payroll increases for 1983 for all employees consistent with applicant's union agreement. Applicant states that there is no justification for discriminating between these districts and those in the last series of rate decisions due to payroll estimates, citing Decision (D.) 93845 dated December 15, 1981, A.60567.

This argument overlooks the fact that the record before us constitutes new proceedings on all issues. We neither adopt past decisions with respect to applicant nor do we retroactively impose the views we take here upon applicant's districts which have not filed for rate increases.

In support of its position staff maintains that full flow through of a 9.5% wage increase for nonunion employees in 1983 and a 9.5% wage increase for all employees in 1984 is an unreasonable cost to ratepayers in view of the current recessionary economy and concomitant unemployment hardship experienced by some ratepayers. Additionally, staff argues that the company itself provides no independent basis for its 1983 estimates apart from the existing union contracts. Nor can it justify the 1984 increase of 9.5% other than to point to 1983. Thus, staff deems applicant's evidence to be insufficient. ✓

Anticipating approval by us of staff wage escalation proposals, applicant suggests an offset procedure to be concurrently adopted. Applicant proposes that the offset would be reviewed by staff as are all other offset filings before Commission approval is received. If, for example, Commission were to adopt a 6.7% payroll increase for 1984, but applicant granted a 10% increase to all employees, whether applicant was entitled to offset rate relief would

depend on conditions near the end of 1983. If the Commission were granting rate increases at that time including wage increases of 9.5% to 11% or higher, applicant's wage increase should be deemed reasonable. However, if utilities were only granting 7% wage increases during this period, no offset filing from applicant would be accepted. Again, this argument overlooks that our rate decisions for this district is to be made upon the record before us rather than upon the decisions we make in other cases at other times on other facts. Further, staff argues that the availability of later offset rate increases for future labor costs will militate against the utility's incentive to take a hard negotiating stance.

We find that the level of wage increase contained in the union contract is reasonable for both union and nonunion employees. We will adopt CWS's payroll for 1983. For 1984, we find that staff's estimate reflects a more reasonable wage level to all employees, based on forecasts of the Consumer Price Index. We will adopt staff's payroll for 1984.

Other Operating and Maintenance Expense

Tank Painting

A difference exists between applicant and staff on the amount required for necessary painting of the exterior of water storage tanks in the test years. Staff recommends that applicant's estimate of this expense be reduced by \$6,700 in 1983 and by \$6,700 in 1984.

Applicant prepares maintenance budgets for tank paintings for the three-year period in which rates are to be in effect. One-third of the total cost is then included in each test year in determining revenue requirements.

Applicant's assistant chief engineer testified on the various considerations that went into the final determination of whether or not a tank needed painting. These included preserving the physical integrity of the tank itself, since rusting results in the loss of metal, and maintaining the physical appearance of the tank at

a level consistent with the neighborhood in which it is located. He explained that the time between painting tank exteriors varies between locations due to weather conditions, those close to the coast deteriorating far faster than those in the San Joaquin Valley. Further, vandalism may necessitate tank painting at unpredictable intervals. Applicant states that all of its tanks are inspected each year for exterior painting and that steel tanks are drained, cleaned, and inspected internally every five years. It was testified that tank paintings are scheduled strictly on the basis of need except that if one tank at a given location requires exterior painting, all tanks at that location are painted to present a uniform appearance.

Staff accepted applicant's interior painting estimates without exception as visual inspection of the tank interiors was not feasible. But field inspections of tank exteriors were conducted in all districts, including East Los Angeles, by staff engineers. On the basis of these personal observations, staff recommends disallowance of exterior painting estimates of \$101,600 on eight tanks within the three-year period. These are mainly paintings projected for 1985 by applicant where staff's visual check shows little or no signs of present paint distress.

Applicant argues that the judgment of its experienced engineers should prevail; its chief inspector has 20 years of experience. As it is applicant which must bear the responsibility if tanks begin to leak or neighbors complain about their appearance, applicant asserts that it should have the authority to plan and carry out its own maintenance schedule.

We note that staff witnesses, too, have considerable experience in the matter of proper utility maintenance practices. In East Los Angeles they recommended disallowance of 1985 painting of two reservoirs only because they appeared presently sound.

Applicant testified that these tanks (1) show distress and are chipped due to being hit by rocks, (2) are located in a residential area where appearance of the tanks is important esthetically, and (3) will be 13 years away from their last painting by 1985.

We find the specific visual criteria relied upon by staff to outweigh the more general considerations advanced by applicant and will adopt staff's tank painting disallowances.

Postage

A difference exists between applicant and staff on the amount required for postage in the test years. Staff recommends that applicant's postage estimate be reduced by \$6,800 in 1983 and by \$6,700 in 1984.

The principal reason for the differences shown is staff use of the "carrier route" postage rate in making its estimates. This rate is 16 cents a mailing, compared to the 17-cent bulk rate applicant actually pays for 90% of its mailings. Some of the difference is the result of staff's added allowance of a judgmental 1.5 cent per mailing to cover additional mailings for closing bills, overdue notices, and general mailings. However, applicant points out that using staff's method of calculating postage expense produces expense estimates below actual costs when tested against recorded expenses.

Applicant's vice president and treasurer testified that a study of sorting mail by carrier route had been made in 1981, and it was found that applicant's customer master file could not efficiently be matched with the post office tapes of carrier routes. Since applicant is in the process of revising its entire billing system, it is expected that in the next two or three years applicant might be able to use the postal address format.

We think that applicant's estimate of postage expense is the more reasonable at this time, and we adopt it. However, we will require applicant to continue its study of the practicality of using "carrier route" postage rates. If the lower rate is not implemented by 1983, we will expect strong justification in the next group of rate cases to continue using the higher postage expense.

Construction Budget

Applicant's utility-funded additions to plant in 1983 and 1984 are \$897,900 and \$907,600. Staff recommends disapproval of \$39,700 of such additions in 1983 and of \$11,000 of such additions in 1984.

There are 21 items in the East Los Angeles construction budget sought to be disallowed by staff based upon physical inspection and staff witness' weighing of the interests of applicant and of its customers of the necessity of the proposed expenditure in the light of current severe economic conditions. Disallowed budget items range from a \$200 drafting table to a \$33,000 lift truck.

Applicant submits that it is management's decision of what plant facilities are required to furnish water service under the rules and regulations of both the Public Utilities Commission and the Department of Health Services as it is management which must answer any charges of inadequate service. While applicant agrees that it must be able to justify the prudence of any installation found suspect by staff before it is allowed in rate base by the Commission, applicant asserts that staff itself surely must make its case for excluding items from plant. In these proceedings applicant believes it has shown the need for the disputed plant additions while staff has based its adjustments entirely on economics without giving any weight to their effect on service. Although staff adjustments in this area may result in minute reductions in water rates in the short

run, staff and Commission are acutely aware that nothing raises the ire of water utility customers more than poor or inadequate service. The strict dollar and cents approach used by staff in deleting budgeted plant additions ignores completely any consideration of service, according to applicant.

With the exception of a lift truck in the 1983 budget, all the exclusions in this district were miscellaneous field and office equipment. Staff witness testified he deleted this equipment because he believes it is unreasonable, given the current economy, to charge customers for the cost of upgrading or replacing equipment which is still functioning adequately.

Applicant's witness testified that these items were placed in the budget only after close scrutiny at a number of supervisory and management levels. He further explained that tool replacement had to be anticipated before it failed or the company would end up with a crew out of business while the equipment was being repaired or replaced. As an example of why this equipment needs to be replaced, applicant pointed out that in connection with radio equipment, tubes were difficult to get for this old equipment and, worse, insulation had dried out and was falling off the wires. The lift truck, the witness testified, was 16 years old and its reliability was questionable. He also stated that a lift truck was mandatory for unloading heavy bundles of pipe and the old lift truck was no longer dependable or safe. Without going into a full explanation of the need for each stricken item in each year's budget, applicant submits that it is preposterous to suggest that applicant should be told to operate a \$21-million plant providing water service to over 25,000 customers without purchasing any office or field equipment for at least three years.

We believe that construction budgets should be reviewed to determine whether proposed expenditures are reasonable and reasonably

scheduled as the needs of the service require. We also suggest that benchmarks of magnitude should be observed so that rate proceedings will not bog down in minute issues; in this case, for example, rebuttal evidence and cross-examination of these relatively small rate base disallowances were discouraged by the ALJ.

In this case, then, we will apply the test of reasonableness only to those construction budget items sought to be disallowed by staff which exceed \$25,000.

Applicant has scheduled a lift truck for replacement in 1983 at a cost of \$33,000. It is 16 years old and of questionable reliability, according to the utility. Staff's physical inspection and observation of the vehicle in operation disclosed no apparent infirmities. Staff recommends disallowance of this budget item, and we concur. We will allow all other proposed additions to plant.

Balancing Account

Staff testified that, as of the date of hearings, the East Los Angeles balancing account was overcollected by approximately \$295,000. In view of the magnitude of the present balance, staff makes the following recommendation: to the extent the overcollected balance as of July 31, 1982 exceeds 1% of adjusted gross annual revenue for this district, that the balance be amortized over a one-year period through an appropriate adjustment to quantity rates based on adopted sales. As this recommendation is consistent with the current "Procedures for Maintenance of Balancing Account for Water Utilities" adopted by us on September 6, 1978, it will be adopted.

Rate of Return

Table II shows the rate of return comparison of applicant's request and our adopted rate of return.

TABLE II
CALIFORNIA WATER SERVICE COMPANY
RATE OF RETURN COMPARISON
1983 - 1985

| | <u>Applicant's Request</u> | | | <u>Adopted</u> | | |
|-----------------------------|----------------------------|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| | <u>Capital Ratios</u> | <u>Effective Rate</u> | <u>Rate of Return</u> | <u>Capital Ratios</u> | <u>Effective Rate</u> | <u>Rate of Return</u> |
| 1983 | | | | | | |
| Long-term debt | 51.5 | 10.69 | 5.50 | 50.0 | 10.47 | 5.24 |
| Preferred stock | 4.0 | 6.41 | .26 | 4.0 | 6.41 | .26 |
| Common equity | <u>44.5</u> | 18.00 | <u>8.01</u> | <u>46.0</u> | 14.50 | <u>6.67</u> |
| Total | 100.0 | | 13.77 | 100.0 | | 12.17 |
| After-tax interest coverage | | | 2.50X | | | 2.32X |
| 1984 | | | | | | |
| Long-term debt | 50.2 | 11.79 | 5.92 | 50.0 | 11.32 | 5.66 |
| Preferred stock | 3.8 | 6.37 | .24 | 4.0 | 6.36 | .25 |
| Common equity | <u>46.0</u> | 18.00 | <u>8.28</u> | <u>46.0</u> | 14.50 | <u>6.67</u> |
| Total | 100.0 | | 14.44 | 100.0 | | 12.58 |
| After-tax interest coverage | | | 2.44X | | | 2.22X |
| 1985 | | | | | | |
| Long-term debt | 48.8 | 11.87 | 5.79 | 50.0 | 11.36 | 5.68 |
| Preferred stock | 3.6 | 6.32 | .23 | 4.0 | 6.30 | .25 |
| Common equity | <u>47.6</u> | 18.00 | <u>8.57</u> | <u>46.0</u> | 14.50 | <u>6.67</u> |
| Total | 100.0 | | 14.59 | 100.0 | | 12.60 |
| After-tax interest coverage | | | 2.52X | | | 2.22X |

Staff witness Christopher J. Blunt presented Revenue Requirements Division's analysis, recommending a range of rates of return of 12.40% to 12.63%, 12.81% to 13.04%, and 12.83% to 13.06% for 1983, 1984, and 1985, respectively. These rates equate to an earnings allowance of 15% to 15.50% on common stock equity. The recommendation takes into account applicant's projected new financing in 1982 by reflecting the anticipated higher interest cost in 1984 and 1985, as seen in Table II.

The tabulation shows that CWS's embedded cost of long-term debt increases from 10.47% in 1983 to 11.32% in 1984 and to 11.36% in 1985. Conversely, the effective dividend rate on preferred stock decreases from 6.41% in 1983 to 6.36% in 1984 and to 6.30% in 1985. The resulting amounts of financial attrition are 41 basis points in 1984 and two basis points in 1985.

Both parties agree that the primary guidelines to be adhered to in determining an appropriate rate of return are as follows:

The return to the equity holders should be commensurate with returns on investments in other enterprises having similar risks.

The return should be sufficient to enable the utility to attract capital at reasonable rates and to assure confidence in the utility's financial integrity.

The return should balance the interests of both the investors and ratepayers.

Staff's study included data presenting a comparison of the earnings performance of CWS, of seven water utilities in California, and of seven water utilities located throughout the United States. These data show that CWS's 9.32% earnings rate on average total capital for the five-year period 1977 through 1981 was greater than both the 8.80% average for the California group and the 8.82% average for the United States group. CWS's 11.24% earning rate of average common equity was above the 10.58% average for the California group

and below the 11.65% average for the regional group. CWS's times interest earned was below the average of both groups.

Operational data for CWS and its East Los Angeles, Livermore, Los Altos-Suburban, Palos Verdes, and San Carlos Districts were compared with the two groups of seven utilities for 1981, showing CWS's average net plant investment per customer of \$447 in 1981 to be the highest in California, but less than the average of the regional utilities. CWS's return on average net plant investment was higher than the recorded averages for both groups of utilities. Blunt assembled a list of rates of return authorized by us for Class A water utilities for the period from August 1979 through May 1982. The last authorized rate of return for applicant was 11.58% granted in December 1981 in D.93845 et al. This return provided a 14.50% earnings allowance for common equity based on a 43% common equity ratio. Applicant received a 10.89% return on rate base in January 1981 in D.92604 et al., providing 13.70% on equity on a 41.60% common equity ratio. D.91537 et al., April 1980, granted applicant a 10.28% rate of return to provide 13.20% on equity on a 42.02% common equity ratio.

These data show an increase of 130 basis points for CWS in both return on common equity and rate of return from April 1980 to December 1981 decision dates.

Decisions in 1982 considered by the witness show Citizens Utilities Company of California receiving a 12.04% rate of return to provide 13.20% on equity where the equity ratio was 68% (D.82-02-059) and Southern California Water Company receiving a 10.97% rate of return to provide 14.50% on equity where the equity ratio was 37% (D.82-03-011 et al.).

Since the preparation of the staff showing in these cases, we have issued the following decisions which require our notice:

1. Santa Clarita Water Company was granted 13.50% return on equity in August (D.82-08-019).
2. CP National Corporation was granted 15.00% on equity in September for its Susanville District (D.82-09-022).
3. San Gabriel Valley Water Company was granted 14.75% on equity in September for its Fontana division (D.82-09-069).
4. Del Este Water Company was granted 14.00% on equity in September (D.82-09-061).
5. Azusa Valley Water Company was granted 14.25% on equity in November (D.82-11-018).

Staff's development of the test year capital structure considered recorded information as of December 31, 1981, and changes estimated to occur in the capital structure during 1982, 1983, 1984, and 1985. Having reviewed applicant's financing scheduled for 1982 through 1985, and with consideration given to the estimated additions to retained earnings for the above years, Blunt arrived at a capital structure consisting of: 50% long-term debt; 4% preferred stock; and 46% common equity (Table II). Staff's showing includes an assumption that CWS will refinance approximately \$26 million in long-term debt in 1983. Blunt concludes that a coupon rate of 14.50% will be required in the refinancing whereas CWS urges the adoption of 16% for long-term debt throughout the test years.

Staff estimates of interest costs associated with long-term financings were based in part on a review of historical data for CWS from 1979 forward along with interest rate forecasts published by Data Resources, Inc. CWS believes that the 16% bond rate existing at the time of the hearings should be assumed to continue into the foreseeable future.

Staff admits that Data Resources, Inc. projections have proven inaccurate in the past, but sees them as a useful guide to be considered with other data in determining fair and reasonable rates of return.

Blunt suggests that a range of 15% to 15.50% return on equity will adequately compensate investors for the risks inherent in CWS common stock ownership. According to the witness, one method which tests what investors demand as compensation for investing in CWS is to analyze prior Commission decisions to derive the implied premium between the authorized return on equity and the embedded debt cost for the test period. Blunt presents the premiums implicit in CWS's last five general rate case decisions noting the average premium to be 4.78%. Adding the average premium of 4.78% to embedded cost of 10.47% in 1983, 11.32% in 1984, and 11.36% in 1985 produces returns on equity of 15.25%, 16.10%, and 16.14%, respectively. Thus, staff's recommended return on common stock provides a premium to CWS investors which is consistent with historic premiums. Staff also performed a discounted cash flow analysis (DCF) for applicant and compared the results with the recommended return for common equity. The DCF model recognizes that the current market price of a share of common stock equals the present value of the expected future stream of dividends and the future sale price of the share of stock, discounted at the investor's discount rate. Using assembled statistics of nine water utilities throughout the United States, the stocks of which are publicly traded, staff finds that a reasonable dividend yield for CWS is between 11% and 11.50% and that a reasonable growth rate for applicant is in the range of 3.75% to 4.25%. Combining growth rate with dividend yield results in a range of 14.75% to 15.75% as the investors' expected return on equity for applicant.

Blunt believes that water utilities can generally be considered less risky than energy utilities, and we have expressed this view in D.93845, A.60567, December 15, 1981. Some of the reasons for this conclusion are as follows:

1. Water utilities are not as capital intensive. Construction programs are much smaller and are financed to a large degree by advances for construction and contributions in aid of construction.
2. Water utilities do not capitalize interest on construction projects. Construction work in progress is included in rate base which results in a better quality of earnings and better cash flow.
3. Water utilities are allowed offset increases in costs such as purchased water and power by advice letter filings concurrently with such increases. Energy companies, however, face a lag between the time fuel cost increases are experienced and offsetting rates are authorized.
4. Water utilities are not faced with risks such as fuel costs, source of supply, nuclear generation, technological changes, competition, etc.
5. Water utilities do not have to raise large amounts of equity capital in order to maintain balanced capital structures because of better cash flows and lesser capital requirements for construction. For example, during the six-year period 1976-1981, there were only five authorizations to issue common stock by water utilities for a total of \$8.8 million, whereas, during the four-year period 1978-1981, for the energy companies alone, there were 33 authorizations to issue common stock for a total of \$2.2 billion.

Staff believes that the return on common equity that is recommended is fair and reasonable and balances the interests of applicant's investors and ratepayers. It gives adequate consideration for financial attrition in that it considered the estimated retirements and issuances of debt and preferred stock through 1985, the period that rates will be in effect. An equity allowance between the range of 15% to 15.50% should allow CWS to service its fixed charges and provide the opportunity to pay suitable dividends as well as provide moderate additions to retained earnings.

Applicant contends that an 18% return on equity is reasonable as opposed to staff's 15.25% and that 16% for long-term debt should be used in lieu of staff's 14.50% anticipated coupon rate.

Applicant testified that the test of the implied risk premium which investors demand as compensation for investing in CWS common stock instead of bonds can be best determined by comparing the return on market value of the common with the yield on A-rated bonds. Applicant calculates an average risk premium of 3.85% for the five years 1977 to 1981, as compared with a risk premium of 4.78% calculated by staff's financial witness. CWS argues that comparing the embedded cost of debt with the allowed return on common equity does not result in the intended objective of determining an investor's expectation of risk premium in the current market place since the embedded cost of debt includes accumulated costs of up to 30 to 40 years rather than current costs. Further, Commission allowances of return on common equity have often not borne any relation to actual returns earned, according to applicant's testimony. CWS asserts that use of applicant's calculation of a 3.85% risk premium and current A-rated bond yields of approximately 16% produce a more realistic expected return by investors in CWS common stock of 19.85% in the market place. This is opposed to staff recommendation of a 15.25% return on common which results in a negative risk premium when compared with current bond yields of 16%.

Applicant believes that we have been favoring bond holders over equity holders and energy utilities over water utilities in the last half decade. According to CWS, in the last five years we have fully recognized the known increases in long-term interest rates from 8.73% to 16.56%, an increase of 783 basis points. However, during this same period we have only increased the allowance for common equity 172 basis points (247 basis points if staff's 15.25% recommendation is allowed), raising the allowance for common equity from 12.78% in 1977 to 15.25%. The 12.78% return allowed in 1977 was

more than 400 basis points over the cost of new bonds sold at that time whereas the current recommendation is 131 basis points below the cost of applicant's bonds sold in May 1982 at a cost of 16.56%. Thus, applicant contends that our decisions have implicitly reduced the risk premium which we recognized for equity above debt of 4 percentage points to a present level below debt.

This perceived overall policy aside, CWS takes issue with staff's and our reasoning that energy utilities are more risky than water utilities. Applicant cites ongoing staff recommendations for the energy utilities which are higher than staff recommendations for water companies. It cites our decisions adopting higher rates of return for the energy utilities. It seeks the same return on equity from us as we allow the energy utilities. To this end, CWS presented extensive argument to show that CWS is at least as risky as the major energy utilities.

Little would be gained in going through the regulatory history which led to the reasons staff and we summarize as showing energy utilities to be generally more risky than water companies. The argument undoubtedly will persist whether this opinion be long or short. We concur with staff that known facts, rather than argument, are the best foundation for ratemaking decisions.

Our review of the record of these proceedings supplemented by our notice of the most recent decisions we have issued persuades us that a return on equity of 14.5% is most reasonable for this CWS district. This return is the same as last granted to applicant in March 1982 (D.82-03-011), and comports with our most recent decisions.

For purposes of setting 1983 rates, we will adopt staff's forecast of a 14.5% interest rate on long-term debt issued by CWS in 1983.

Review of Financing Costs

In order to account for financial attrition likely to occur in 1983, staff recommends that the Revenue Requirements Division be required to review applicant's 1983 financing costs before incremental rates are put into effect for 1984. At that time, the allowance would be adjusted for any differential between the adopted interest rates and recorded results. This would ensure protection of the ratepayers if capital markets improve and interest rates decline, and will also protect CWS in the converse situation, since it will be able to recover actual interest costs prior to the end of the three-year regulatory cycle.

Applicant concurs in this proposal, and it will be adopted.

Rate Design

In these consolidated proceedings, applicant has proposed a significant departure from our present rate design policy. Our current policy provides that all rates will be increased by the same percentage after a 25% lifeline differential has been achieved. Applicant has requested that almost all of its requested increase be granted by increases in the service charge rate. Applicant's reason for its proposal is its contention that its current rate structure, where most revenues are recovered through the quantity rate, causes wide fluctuations in earnings and in the long run prevents it from having any reasonable opportunity to earn its authorized rate of return.

Applicant's evidence is similar to a California Water Association (CWA) report presented at a special Commission meeting held in August 1981. As did the CWA, applicant contends that our rate design policy for water utilities has grown out of its policy for energy utilities and that although we have investigated energy utility rate designs in numerous formal proceedings through the past six or seven years, we have never held an in-depth investigation into water rate design.

Water sales vary from year to year, applicant testified, and earnings stability can best be achieved for water companies by

substantially increasing the fixed charge on the customers' bills and reducing the quantity charges in a commensurate manner. While this policy, as proposed specifically in these proceedings, would result in service charge increases of well over 100%, CWS states that the impact on customers will be small because the average water bill is small. Of course, a difficulty with that argument is that the water customers do not consider their bills to be small, and we can officially notice the many complaints we are receiving from users currently who may or may not understand the demand charge, but strenuously object to increases of it.

In D.93845, December 15, 1981, we stated (page 25):

"Before we adopt a rate design significantly different from (the) one currently in effect, we require substantial information from parties concerning the impact of the new design on all users. We will also require concrete data concerning the price elasticity of water and historical and projected results relating to the effects of radical rate design changes upon conservation."

While CWS has supplied a quantity of material on the questions of elasticity and conservation, our review of it compels us to agree with staff that the showing is wholly insufficient to cause us to change rate design for applicant in the extreme fashion it desires.

Staff presents a proposal which attempts to address some of the problems raised by applicant while retaining the quantity rate oriented rate design based on maintenance of the 25% lifeline differential. As explained by staff, the 25% lifeline differential has been eroded through repeated offset rate increases in nonlifeline quantity rates. The Utilities Division's proposal follows:

"First, continue the present policy of granting purchased water and purchased power offsets to the quantity charges only. The present policy of

granting equal percentage increases rather than equal cents should be revised. Since most offset increases are small very little distortion between the block rates would result if we use equal cents. The advantages would be the simplification of the balancing accounts.

"Second, in a general rate proceeding, the authorized rate increases for 300 cubic feet (lifeline) should be 25% less than accumulative system average increase since January 1, 1976.

"Third, continue the present policy of limiting increase to any usage level to not more than twice the average system increase to limit the impact to individual customers."

Staff asserts that its proposal would result in substantial increases in the service charge in many cases, but would still retain a lifeline differential of 25%. It criticizes applicant's proposal, maintaining that it results in essentially eliminating any lifeline provisions and in most cases results in requests for larger increases to lifeline customers than the overall increase being requested.

Staff submits that its proposal will achieve much to resolve concerns about the impact of sales fluctuations on CWS's ability to earn its authorized rate of return. Additionally, staff opposes implementation of CWS's proposal in the absence of a generic inquiry into the impact of such a rate design change on water utilities as a whole. Applicant does not oppose such a generic inquiry, but is concerned about the delay associated with such a proceeding.

In the event that applicant's rate design is not adopted, CWS asks that it be authorized to put a sale of water adjustment mechanism (SWAM) into effect, contending that it has shown that the current rate design has greatly inhibited its ability to earn its authorized rate of return. It requests institution of a procedure similar to that available to the large energy utilities which will allow applicant to recover revenues less water production savings which are lost due to actual sales falling below the adopted levels.

Staff opposes this request, pointing out that such an offset mechanism should best be considered in a generic proceeding involving all water utilities. We do not address the proposal in this proceeding.

While applicant complains that staff's proposal falls far short of its perceived needs, we find staff's recommendations on rate design to be reasonable and will adopt them.

Ordering Paragraph Revision

Applicant presented a proposed change to the wording in the ordering paragraphs which authorize the filing of step rates in the second and third years covered by the decision. Presently, applicant may file its next step increase if its rate of return for the 12 months ending September 30, of the current year does not exceed the rate of return authorized that district in the current year. Further, if a decision is issued for other districts of applicant subsequent to the decision on the district filing step rates, and that decision authorizes a lower rate of return for applicant for the corresponding period, applicant's rate increase in the filing district will be reduced or canceled entirely if the district's September 30 return exceeds the later authorized return. No consideration is given if the later authorized return is higher than that authorized in the filing district.

CWS proposes to make the limitation a two-way street by allowing the step rate filing as long as the September 30 return does not exceed the latest authorized rate of return, whether it is lower or higher. It should be noted that applicant's proposal only affects rates when its September 30 return falls between the filing district's authorized return and a later higher authorized return. Also, applicant would not be allowed to file an increase in rates in excess of that authorized by our decision. The only effect of applicant's proposal is to keep its authorized increase from being reduced when applicant's September 30 return exceeds the return authorized for the filing district but not the last authorized return applicable to other districts of applicant.

Staff opposes this policy change, and we will not adopt it as we view it as a necessary protective measure for customers resulting from our implementation of a three-year cycle for applicant's rate cases.

Findings of Fact

1. The adopted estimates of operating revenues, operating expenses, rate base, and rate of return for test years 1983 and 1984 are reasonable.
2. A rate of return of 12.17% on the adopted rate base of \$14,257,200 for test year 1983 is reasonable.
3. A rate of return of 12.58% on the adopted rate base of \$14,622,300 for test year 1984 is reasonable.
4. CWS's earnings under present rates for test year 1983 would produce net operating revenues of \$1,139,900 on a rate base of \$14,257,200 based on the adopted results of operations, resulting in a rate of return of 8.00%.
5. CWS has not demonstrated a need to replace its lift truck.
6. Staff's visual inspection of eight tanks failed to disclose any distress or deterioration requiring painting before 1985.
7. CWS's earnings under present rates for test year 1984 would produce net operating revenues of \$1,102,200 on a rate base of \$14,622,300 based on the adopted results of operations, resulting in a rate of return of 7.54%.
8. The authorized increases in rates are expected to provide annual increases in revenues of \$1,240,300 in 1983 and \$284,900 in 1984.
9. Operational attrition on the basis of adopted rates is 0.52% and financial attrition is 0.02% for 1985.
10. CWS's level of water service is adequate.
11. The increases in rates and charges authorized for the year 1983 in Appendix A are just and reasonable; and the present rates and charges insofar as they differ from those prescribed are for the future, unjust and unreasonable.

12. Increases in rates authorized for 1984 and 1985 in Appendixes B and C are required to offset attrition in earnings and are reasonable.

13. The adopted rate design will limit the impact on individual customers and is nondiscriminatory.

14. The proposed change in ordering paragraphs for step rates reduces ratepayer protection during economic fluctuations and is not adopted.

Conclusion of Law

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

O R D E R

IT IS ORDERED that:

1. California Water Service Company (CWS) is authorized to file the revised schedules attached to this order as Appendix A and to concurrently cancel its present schedules for such service. This filing shall comply with General Order (GO) Series 96. The effective date of the revised schedules shall be 4 days after the date of filing, but not earlier than January 1, 1983. The revised schedules shall apply only to service rendered on and after their effective date. ✓

2. After CWS has completed its 1983 refinancing of its Series T Bonds, CWS shall file an advice letter, with appropriate workpapers, requesting changes in the authorized step rates for 1984 and 1985 to reflect the changes in the adopted rates of return for 1984 and 1985 resulting from actual 1983 refinancing costs of Series T Bonds differing from those costs adopted in this decision. Staff shall review the refinancing costs of the Series T Bonds and determine whether the refinancing costs are prudent. If staff finds that the refinancing costs are prudent, the revised rates of return for 1984 and 1985 shall be determined by substituting the actual 1983 refinancing costs of the Series T Bonds for the estimated costs adopted in order to derive the revised embedded debt costs for each

of the two years. All other ratios, cost factors, and weighting factors adopted in this decision shall be used in calculating the revised rates of return. Changes in revenues for each year shall be calculated by multiplying the 1984 adopted rate base by the change in rate of return less the offsetting income tax effect due to the change in the embedded cost of debt for 1984. The resulting change in net revenues shall then be multiplied by the adopted net-to-gross multiplier to arrive at the change in gross revenues. The revised step rates resulting from the above determinations shall become effective on the date the authorized step rates would normally become effective, or on the date the changes in rates authorized in this ordering paragraph are approved by the Commission, whichever is later.

3. On or after November 15, 1983, CWS is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases attached to this order as Appendix B or to file a lesser increase which includes a uniform cents per hundred cubic feet of water adjustment from Appendix B in the event that the East Los Angeles District 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, 1983, exceeds the lower of (a) the rate of return found reasonable by the Commission for CWS during the corresponding period in the then most recent rate decision, or (b) 12.17%. Such filing shall comply with GO 96-A. The requested step rates shall be reviewed by staff and shall go into effect upon staff's determination that they conform with this order. But staff shall inform the Commission if it finds that the proposed step rates are not in accord with this decision, and the Commission may then modify the increase. The effective date of the revised schedule shall be no earlier than January 1, 1984, or 30 days after the filing of the step rates, whichever is later.

4. On or after November 15, 1984, CWS is authorized to file an advice letter, with appropriate workpapers, requesting the step rate increases attached to this order as Appendix B or to file a lesser

increase which includes a uniform cents per hundred cubic feet of water adjustment from Appendix B in the event that the East Los Angeles District 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, 1984, exceeds the lower of (a) the rate of return found reasonable by the Commission for CWS during the corresponding period in the then most recent rate decision, or (b) 12.58%. Such filing shall comply with GO 96-A. The requested step rates shall be reviewed by staff and shall go into effect upon staff's determination that they conform with this order. But staff shall inform the Commission if it finds that the proposed step rates are not in accord with this decision, and the Commission may then modify the increase. The effective date of the revised schedule shall be no earlier than January 1, 1985, or 30 days after the filing of the step rates, whichever is later. Before January 31, 1983, CWS shall send the bill insert in Appendix D to its East Los Angeles District customers.

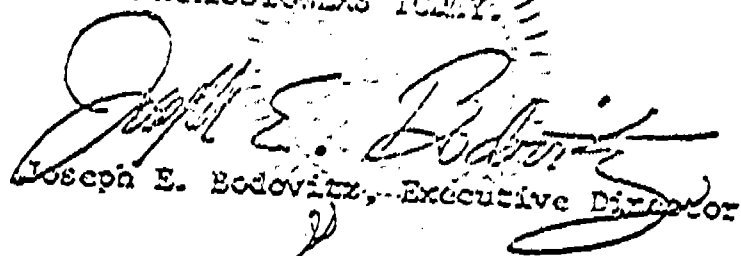
This order becomes effective 30 days from today.

Dated NOV 17 1982, at San Francisco, California.

I will file a concurring opinion.
/s/ LEONARD M. GRIMES, JR.
Commissioner

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

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


Joseph E. Bodovitz, Executive Director

APPENDIX A

Page 1

Schedule No. EL-1

East Los Angeles Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

East Los Angeles, Commerce and vicinity, Los Angeles County.

RATES

| Service Charge: | <u>Per Meter</u> <u>Per Month</u> | |
|--------------------------------|--------------------------------------|-----|
| For 5/8 x 3/4-inch meter | \$ 5.65 | (I) |
| For 3/4-inch meter | 8.30 | |
| For 1-inch meter | 11.40 | |
| For 1 1/2-inch meter | 15.90 | |
| For 2-inch meter | 20.00 | |
| For 3-inch meter | 37.00 | |
| For 4-inch meter | 51.00 | |
| For 6-inch meter | 86.00 | |
| For 8-inch meter | 127.00 | |
| For 10-inch meter | 158.00 | |

Quantity Rates:

| | | |
|---|------|-----|
| For the first 300 cu.ft., per 100 cu.ft. | .423 | |
| For the next 29,700 cu.ft., per 100 cu.ft. | .647 | |
| For all over 30,000 cu.ft., per 100 cu.ft. | .613 | (I) |

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

SPECIAL CONDITION

Due to the overcollection in the balance account, a credit of \$0.035 per Ccf of water usage is applied to the quantity rates to amortize the overcollection.

APPENDIX A
Page 2

Schedule No. EL-4

East Los Angeles Tariff Area

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

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

TERRITORY

The unincorporated community of East Los Angeles and vicinity, located adjacent to the cities of Los Angeles, Montebello, and Monterey Park, Los Angeles County.

RATES

| | <u>Per Month</u> | |
|-----------------------------------|------------------|-----|
| For each 1½-inch connection | \$ 4.05 | (I) |
| For each 2-inch connection | 5.40 | |
| For each 3-inch connection | 8.10 | |
| For each 4-inch connection | 10.80 | |
| For each 6-inch connection | 16.10 | |
| For each 8-inch connection | 21.50 | |
| For each 10-inch connection | 26.90 | (I) |

(END OF APPENDIX A)

APPENDIX B

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

| Effective Dates | |
|-----------------|--------|
| 1-1-84 | 1-1-85 |

SCHEDULE EL-1

Service Charges:

| | | |
|--------------------------------|--------|--------|
| For 5/8 x 3/4-inch meter | \$0.20 | \$0.15 |
| For 3/4-inch meter | 0.30 | 0.20 |
| For 1-inch meter | 0.40 | 0.30 |
| For 1 1/2-inch meter | 0.60 | 0.40 |
| For 2-inch meter | 1.00 | 0.50 |
| For 3-inch meter | 1.00 | 1.00 |
| For 4-inch meter | 2.00 | 1.00 |
| For 6-inch meter | 3.00 | 2.00 |
| For 8-inch meter | 5.00 | 3.00 |
| For 10-inch meter | 6.00 | 4.00 |

Quantity Rates:

| | | |
|---|-------|-------|
| For the first 300 cu. ft., per 100 cu. ft. | 0.015 | 0.009 |
| For the next 29,700 cu. ft., per 100 cu. ft. | 0.026 | 0.013 |
| For all over 30,000 cu. ft., per 100 cu. ft. | 0.024 | 0.013 |

SCHEDULE EL-4

Rates :

| | | |
|--------------------------------------|------|------|
| For each 1 1/2-inch connection | 0.25 | 0.00 |
| For each 2-inch connection | 0.40 | 0.00 |
| For each 3-inch connection | 0.60 | 0.00 |
| For each 4-inch connection | 0.80 | 0.00 |
| For each 6-inch connection | 1.20 | 0.00 |
| For each 8-inch connection | 1.60 | 0.00 |
| For each 10-inch connection | 2.00 | 0.00 |

(END OF APPENDIX B)

APPENDIX C
Page 1

ADOPTED QUANTITIES

Company: California Water Service Co.
District: East Los Angeles District

| | <u>1983</u> | <u>1984</u> |
|--------------------------------|-------------------|-------------------|
| 1. Water Production: Ccf(1000) | 9,165.4 | 9,273.0 |
| Wells: | 2,080.1 | 2,080.1 |
| Purchased Water: | 7,085.3 | 7,192.9 |
| 2. <u>Purchased Power</u> | Supplier: SCE | Date: 5-82 |
| <u>Well Stations</u> | | |
| Production - MG | 1,556.0 | 1,556.0 |
| kWh per MG | 2,652 | 2,652 |
| Req'd kWh, Wells | 4,126,512 | 4,126,512 |
| kWh Unit Cost | \$ 0.06336 | \$ 0.06336 |
| Energy Cost | 261,456 | 261,456 |
| Fixed Cost | 30,857 | 30,857 |
| Total Cost, Wells | <u>\$ 292,313</u> | <u>\$ 292,313</u> |
| <u>Booster Stations</u> | | |
| Total Production - MG | 6,856.1 | 6,936.5 |
| At 39% Boosted, MG | 2,673.9 | 2,705.2 |
| kWh per MG | 510 | 510 |
| Req'd kWh, Boosters | 1,363,689 | 1,379,670 |
| kWh Unit Cost | \$ 0.06232 | \$ 0.06232 |
| Energy Cost | 84,985 | 85,981 |
| Fixed Cost | 18,151 | 18,151 |
| Total Booster Cost | <u>\$ 103,136</u> | <u>\$ 104,132</u> |
| Total Cost | \$ 395,400 | \$ 396,400 |

APPENDIX C

Page 2

ADOPTED QUANTITIES

| | <u>1983</u> | <u>1984</u> |
|--|-------------|-------------|
| 3. <u>Purchased Water Expenses</u> | | Date: 7-82 |
| <u>Central Basin MWD,</u> <u>Noninterruptible Water</u> | | |
| Total Production Acre-Feet (AF) | 16,265.5 | 16,512.2 |
| Less In Lieu Interruptible Purchased Water - AF | 6,000 | 6,000 |
| Total Noninterruptible AF | 10,265.5 | 10,512.2 |
| Unit Cost - AF | \$ 141.40 | \$ 141.40 |
| Cost of Noninterruptible | \$1,451,500 | \$1,486,400 |
| | | |
| <u>In Lieu Interruptible Water from</u> <u>Central Basin</u> | | |
| Agreed Quantities - AF | 6,000 | 6,000 |
| Cost per AF | 106.05 | 106.05 |
| Cost | 636,300 | 636,300 |
| Credit from Replenishment District | (210,000) | (210,000) |
| Net Cost, In Lieu Interruptible | \$ 426,300 | \$ 426,300 |
| | | |
| <u>Reduced Extraction Credit from</u> <u>Central and West Basin</u> | (48,900) | (48,900) |
| | | |
| <u>Exchange Pool Credit</u> | (2,000) | (2,000) |
| | | |
| <u>Total Cost Purched Water</u> | \$1,826,900 | \$1,861,800 |
| | | |
| 4. <u>Pump Tax</u> | | Date: 7-81 |
| <u>Central & West Basin Water</u> <u>Replenishment District</u> | | |
| Acre-Feet | 4,774 | 4,774 |
| \$ per AF | \$ 16.00 | \$ 16.00 |
| Cost | \$ 76,400 | \$ 76,400 |
| | | |
| 5. <u>Ad Valorem Taxes</u> | 158,800 | 158,800 |
| Tax Rate | 1.031% | 1.031% |

APPENDIX C

ADOPTED QUANTITIES

6. Number of Services - Meter Size

| | <u>1983</u> | <u>1984</u> |
|-----------|---------------|---------------|
| 5/8 x 3/4 | 21,724 | 21,766 |
| 3/4 | 0 | 0 |
| 1 | 2,722 | 2,727 |
| 1 1/2 | 324 | 324 |
| 2 | 556 | 558 |
| 3 | 113 | 113 |
| 4 | 40 | 40 |
| 6 | 26 | 26 |
| 8 | 5 | 5 |
| 10 | 2 | 2 |
| | <u>25,512</u> | <u>25,561</u> |

7. Metered Water Sales

Range Ccf

| | | |
|----------|------------------|------------------|
| 0 - 3 | 886,600 | 888,400 |
| 4 - 297 | 5,519,000 | 5,541,400 |
| Over 300 | 2,024,900 | 2,099,600 |
| | <u>8,430,500</u> | <u>8,529,400</u> |

8. Number of Services

| | <u>No. of Services</u> | | <u>Usage-KCcf</u> | | <u>Avg. Usage-Ccf/Yr.</u> | |
|----------------------|------------------------|---------------|-------------------|----------------|---------------------------|-------------|
| | <u>1983</u> | <u>1984</u> | <u>1983</u> | <u>1984</u> | <u>1983</u> | <u>1984</u> |
| Commercial | 24,876 | 24,925 | 5,940.4 | 5,952.1 | 238.8 | 238.8 |
| Industrial | 300 | 300 | 1,564.1 | 1,610.3 | 5,213.7 | 5,367.7 |
| Public Authority | 330 | 330 | 917.5 | 958.5 | 2,780.3 | 2,904.5 |
| Other | 6 | 6 | 8.5 | 8.5 | 1,416.7 | 1,416.7 |
| Subtotal | <u>25,512</u> | <u>25,561</u> | <u>8,430.5</u> | <u>8,529.4</u> | | |
| Private Fire Prot. | 496 | 497 | | | | |
| Total | <u>26,008</u> | <u>26,058</u> | | | | |
| Water Loss: 8.7% | | | <u>734.9</u> | <u>743.6</u> | | |
| Total Water Produced | | | <u>9,165.4</u> | <u>9,273.0</u> | | |

APPENDIX C
Page 4

INCOME TAX CALCULATION

| | <u>1983</u> | <u>1984</u> |
|--------------------------------|------------------------|----------------|
| | (Thousands of Dollars) | |
| Operating Revenue | \$6,224.3 | \$6,280.9 |
| <u>O&M Expense</u> | | |
| Purchased Power | 395.4 | 396.4 |
| Purchased Water | 1,826.9 | 1,861.8 |
| Replenishment Assessment | 76.4 | 76.4 |
| Purchased Chemicals | 1.8 | 1.8 |
| Payroll-District | 960.1 | 1,024.4 |
| Other O&M | 431.2 | 469.2 |
| Other A&G | 59.4 | 63.1 |
| G O Allocation | 569.7 | 609.5 |
| Balancing Account | <u>(229.2)</u> | <u>(232.0)</u> |
| Subtotal | 4,091.7 | 4,270.6 |
| Uncollectibles | 2.5 | 2.5 |
| Franchise | 104.5 | 105.5 |
| Taxes Other | <u>226.3</u> | <u>235.0</u> |
| Transportation Depr. Adj. | <u>(26.7)</u> | <u>(31.7)</u> |
| Soc. Sec. Taxes Capitalized | 6.7 | 7.1 |
| Interest | <u>743.7</u> | <u>820.9</u> |
| Total Deductions | 5,148.7 | 5,409.9 |
| State Tax Depreciation | 626.7 | 649.7 |
| Net Taxable Income | 448.9 | 221.3 |
| State Corp. Franch. Tax @ 9.6% | 43.1 | 21.2 |
| Federal Tax Depreciation | 523.7 | 524.9 |
| State Income Tax | 43.1 | 21.2 |
| Prof. Stock Div. Credit | 4.1 | 4.1 |
| Net Taxable Income | 504.7 | 320.8 |
| Fed. Income Tax @ 46% | 232.2 | 147.6 |
| Less Grad. Tax Adj. | 1.8 | 1.8 |
| Less Invol. Conv. Adj. | 1.3 | 1.2 |
| Total Federal Income Tax | 229.1 | 144.6 |

Net to Gross Multiplier: 2.0839

Book Depreciation: \$387,300 (1983); \$399,300 (1984).

(Red Figure)

(END OF APPENDIX C)

APPENDIX D

Bill Insert for East Los Angeles District Customers
of California Water Service Company

N O T I C E

\$336,700 of the recent rate increase granted to California Water Service Company for its East Los Angeles District 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 D)

LEONARD M. GRIMES, JR., Commissioner, Concurring:

I concur; but in so doing, I wish to support the contention of Administrative Law Judge Wright that staff should spend its time developing benchmarks of magnitude to be used in assessing the reasonableness of operational expenditures rather than the line item approach that seems to be so prevalent. The line item nit-picking audit technique gets too close to taking over company management decision making and bogs down our staff with minutiae that can be reviewed in a less costly manner. Well understood regulatory guidelines and benchmarks should virtually eliminate this problem, or at least put the debate at the policy level where it belongs. Here, too much time was spent on these issues and ultimately we had to agree with the company's argument (page 12 and 13) and allow them to buy the items needed to run their business. In addition, I would have allowed the \$33,000 to replace the 16 year old lift truck that appears to be a major operational tool of the company and is deemed by them to be unreliable and unsafe. There is no convincing evidence to the contrary. Cost of operations are best controlled by maintaining a high level of productivity of the labor force. This cannot be satisfactorily accomplished when tools and systems are not maintained at a high level of performance and, above all, at a level safe for the worker. I repeat my admonition that we not be "pennywise and pound foolish." A workman's compensation claim against this company for unsafe working conditions will cost a lot more than the cost of the truck.



LEONARD M. GRIMES, JR., Commissioner

San Francisco, California
November 17, 1982

Decision 82 11 058 NOV 17 1982

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
CALIFORNIA WATER SERVICE COMPANY, a)
corporation, for an order)
authorizing it to increase rates)
charged for water service in the)
East Los Angeles District.)

Application 82-03-94
(Filed March 26, 1982)

McCutchen, Doyle, Brown & Emersen, by
A. Crawford Greene, Attorney at
Law, and Donald Houck, for
California Water Service Company,
applicant.
Lynn T. Carew, Attorney at Law, and
Sung B. Han, for the Commission
staff.

O P I N I O N

By this application California Water Service Company (CWS) seeks authority to increase the rates for water service in its East Los Angeles District to produce annual revenue increases of 24.3% or \$1,489,200 in 1983, and by additional amounts of 5.4% and 3.2% or \$413,800 and \$258,200, respectively, in 1984 and 1985.

Public hearings on a consolidated record with Application (A.) 82-03-95, A.82-03-96, A.82-03-97, and A.82-03-98 were held before Administrative Law Judge (ALJ) Orville I. Wright in San Francisco on August 2, 3, 4, 5, 6, and 12, 1982. Donald Houck, Barney Tumey, Parker Robinson, and Harold Ulrich presented evidence on behalf of CWS. Oscar David, Donald Yep, Arthur Gallegos, Donald McCrea, Chew Low, Ernst Knolle, Christopher Blunt, and Sung Han presented evidence on behalf of staff. There were no intervenors or interested parties. ~~One public witness appeared at the San Francisco hearings opposing the magnitude of the proposed increase in the Livermore District.~~

SS

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A rate of return on rate base of ~~12.52%~~ ^{12.17%} for 1983 and ~~12.93%~~ ^{12.58%} for 1984 is found reasonable. Return on equity is ~~15.25%~~ ^{14.50%}.

For test year 1983, \$336,700 of the revenue requirement increase is due to the Economic Recovery Tax Act (ERTA). The effect could increase in the future. We will direct applicant to notify its customers of the ERTA effect on rates. (Appendix D.)

Operating Revenues

Staff's estimate of operating revenues is \$74,700 greater than that of applicant for test year 1983 and \$136,100 greater in test year 1984 at present rates. The difference rests in the parties' respective estimates of consumption by industrial and public authority customers.

Applicant states that its original sales projections for industrial and public authority customers are based on recent trends adjusted for any known or expected changes that will have a significant impact on sales levels in the future.

Industrial metered sales were first estimated by applicant as 1,457.8 KCcf for 1982, 1,458.1 KCcf for 1983, and 1,458.1 KCcf for 1984. These estimates were the result of separate treatment of small industrial users and of 18 large industrial users. Data were trended for the period 1975-1981.

Staff estimated industrial metered sales as 1,564.1 KCcf for 1983 and 1,610.3 KCcf for 1984. Higher estimates of staff are the result of contact with industrial customers which indicated an expected increase in consumption and later data, i.e. 12 months ending March 1982. An average sales per service was developed by staff using 1979-1981 recorded figures.

After circulation of the staff showing, but before the hearing, applicant revised its flat 1983-1984 projection of industrial sales to 1,469.5 KCcf for 1983 and 1,425.5 KCcf for 1984, an increase of 11.4 KCcf and a decrease of 32.6 KCcf in the two test years, respectively. These revisions were necessary, according to

applicant, in order to reflect sales data from October 1, 1981 to March 31, 1982 which were not available at the time first estimates were prepared. CWS states that these data confirm that a seven-year downward sales trend is continuing.

Staff objected to the later revised estimates of sales on the ground that they constituted a bulk updating of exhibits contrary to our Regulatory Lag Plan provisions, but the material was admitted into evidence by the ALJ in a ruling with which we concur. However, as staff further asserts, the revisions complained of constitute a departure from the methodology used by both parties of segregating customers by size and, thus, must be viewed with caution in our determinations.

Applicant followed a similar course with regard to public authority customers, initially estimating these sales at 876.3 KCcf for 1982, at 917.5 KCcf for 1983, and at 958.5 KCcf for 1984, an increase of 41.2 KCcf for 1983 and an increase of 41.0 KCcf for 1984. Revisions reflecting later data brought these estimates to 872.0 KCcf for 1983 and 889.8 KCcf for 1984, a decrease of 4.3 KCcf for 1983 and a further decrease in 1984 of 31.3 KCcf from the original showing. Again, the principle of customer segregation was abandoned in the later estimates although such segregation is admitted by applicant to produce a more reliable result.

Staff concurred with applicant's original estimates for public authority sales after conducting a survey of individual customers, as it had done for industrial sales, and having at hand the data through December 31, 1981 and beyond which prompted applicant's proffered exhibit revisions.

We find staff's use of a three-year average and established methodology, supported as it is by customer sampling revealing higher consumption projections by the users to be more persuasive than

applicant's original or revised estimates. We adopt staff's estimates on metered industrial and public authority sales.

Payroll - District

Staff's estimate of payroll expense for test year 1983 is \$4,500 less than that of applicant and is \$30,700 less for test year 1984.

Although staff's witness testified that his wage recommendations were largely the product of his independent judgment, they conform to forecasts issued by the Revenue Requirements Division in April 1982, ^{which} project a labor escalation factor of 6.4% for 1983 and 6.7% for 1984, based on historical trended increases from the US All Urban Consumer Price Index for the six months ending January 1, 1982.

Staff's payroll estimates adopted existing negotiated increases for union employees through 1983; however, wage increase estimates for nonunion employees were reduced to 6.4% in 1983 from the parity 11% figures applicable in 1982. Both union and nonunion wages were estimated at 6.7% for 1984. Staff's witness testified that but for the fact that the current union contract is effective through 1983, he would have recommended the same treatment of costs associated with union and nonunion employee wages in 1983; i.e. a uniform 6.4% increase, rather than 9.5% for union employees and 6.4% for nonunion employees.

Applicant based its 1983 nonunion payroll estimate on its longstanding policy of granting both groups approximately the same percentage increase each year. Its 1984 estimate of 9.5% was based on the past practice in rate proceedings involving applicant of continuing the use of the latest contract's final year increase. Applicant objects to staff's estimate of different percentage wage increases to different employee groups because this is not the manner in which applicant has generally raised wages. It alleges that wide acceptance of staff's procedure would shortly put applicant in the

untenable position of paying its supervisory personnel less than the people working under them. Further, applicant points out that the Commission has already found reasonable for ratemaking purposes in six of applicant's other districts payroll increases for 1983 for all employees consistent with applicant's union agreement. Applicant states that there is no justification for discriminating between these districts and those in the last series of rate decisions due to payroll estimates, citing Decision (D.) 93845 dated December 15, 1981, A.60567.

This argument overlooks the fact that the record before us constitutes new proceedings on all issues. We neither adopt past decisions with respect to applicant nor do we retroactively impose the views we take here upon applicant's districts which have not filed for rate increases.

In support of its position staff maintains that full flow through of a 9.5% wage increase for nonunion employees in 1983 and a 9.5% wage increase for all employees in 1984 is an unreasonable cost to ratepayers in view of the current recessionary economy and concomitant unemployment hardship experienced by some ratepayers. Additionally, staff argues that the company itself provides no independent basis for its 1983 estimates apart from the existing union contracts. Nor can it justify the 1984 increase of 9.5% other than to point to 1983. Thus, staff deems applicant's evidence to be insufficient.

Anticipating approval by us of staff wage escalation proposals, applicant suggests an offset procedure to be concurrently adopted. Applicant proposes that the offset would be reviewed by staff as are all other offset filings before Commission approval is received. If, for example, Commission were to adopt a 6.7% payroll increase for 1984, but applicant granted a 10% increase to all employees, whether applicant was entitled to offset rate relief would

depend on conditions near the end of 1983. If the Commission were granting rate increases at that time including wage increases of 9.5% to 11% or higher, applicant's wage increase should be deemed reasonable. However, if utilities were only granting 7% wage increases during this period, no offset filing from applicant would be accepted. Again, this argument overlooks that our rate decisions for this group of districts is to be made upon the record before us rather than upon the decisions we make in other cases at other times on other facts. Further, staff argues that the availability of later offset rate increases for future labor costs will militate against the utility's incentive to take a hard negotiating stance.

insert ~~We will adopt CWS's payroll for 1983 and staff's payroll for 1984.~~

Other Operating and Maintenance Expense

Tank Painting

A difference exists between applicant and staff on the amount required for necessary painting of the exterior of water storage tanks in the test years. Staff recommends that applicant's estimate of this expense be reduced by \$6,700 in 1983 and by \$6,700 in 1984.

Applicant prepares maintenance budgets for tank paintings for the three-year period in which rates are to be in effect. One-third of the total cost is then included in each test year in determining revenue requirements.

Applicant's assistant chief engineer testified on the various considerations that went into the final determination of whether or not a tank needed painting. These included preserving the physical integrity of the tank itself, since rusting results in the loss of metal, and maintaining the physical appearance of the tank at

run, staff and Commission are acutely aware that nothing raises the ire of water utility customers more than poor or inadequate service. The strict dollar and cents approach used by staff in deleting budgeted plant additions ignores completely any consideration of service, according to applicant.

With the exception of a lift truck in the 1983 budget, all the exclusions in this district were miscellaneous field and office equipment. Staff witness testified he deleted this equipment because he believes it is unreasonable, given the current economy, to charge customers for the cost of upgrading or replacing equipment which is still functioning adequately.

Applicant's witness testified that these items were placed in the budget only after close scrutiny at a number of supervisory and management levels. He further explained that tool replacement had to be anticipated before it failed or the company would end up with a crew out of business while the equipment was being repaired or replaced. As an example of why this equipment needs to be replaced, applicant pointed out that in connection with radio equipment, tubes were difficult to get for this old equipment and, worse, insulation had dried out and was falling off the wires. The lift truck, the witness testified, was 16 years old and its reliability was questionable. He also stated that a lift truck was mandatory for unloading heavy bundles of pipe and the old lift truck was no longer dependable or safe. Without going into a full explanation of the need for each stricken item in each year's budget, applicant submits that it is preposterous to suggest that applicant should be told to operate a \$21-million plant providing water service to over 25,000 customers without purchasing any office or field equipment for at least three years.

~~While we do not agree that staff should act as a surrogate utility ratepayer in reviewing proposed construction budgets, we do~~

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I believe that such budgets should be reviewed to determine whether proposed expenditures are reasonable and reasonably scheduled as the needs of the service require. We also suggest that benchmarks of magnitude should be observed so that rate proceedings will not bog down in minute issues; in this case, for example, rebuttal evidence and cross-examination of these relatively small rate base disallowances were discouraged by the ALJ.

In this group of districts, then, we will apply the test of reasonableness only to those construction budget items sought to be disallowed by staff which exceed \$25,000.

Applicant has scheduled a lift truck for replacement in 1983 at a cost of \$33,000. It is 16 years old and of questionable reliability, according to the utility. Staff's physical inspection and observation of the vehicle in operation disclosed no apparent infirmities. Staff recommends disallowance of this budget item, and we concur. We will allow all other proposed additions to plant.

Balancing Account

Staff testified that, as of the date of hearings, the East Los Angeles balancing account was overcollected by approximately \$295,000. In view of the magnitude of the present balance, staff makes the following recommendation: to the extent the overcollected balance as of July 31, 1982 exceeds 1% of adjusted gross annual revenue for this district, that the balance be amortized over a one-year period through an appropriate adjustment to quantity rates based on adopted sales. As this recommendation is consistent with the current "Procedures for Maintenance of Balancing Account for Water Utilities" adopted by us on September 6, 1978, it will be adopted.

Rate of Return

Table II shows the rate of return comparison of applicant's request and our adopted midpoint of staff's recommendation.

more than 400 basis points over the cost of new bonds sold at that time whereas the current recommendation is 131 basis points below the cost of applicant's bonds sold in May 1982 at a cost of 16.56%. Thus, applicant contends that our decisions have implicitly reduced the risk premium which we recognized for equity above debt of 4 percentage points to a present level below debt.

This perceived overall policy aside, CWS takes issue with staff's and our reasoning that energy utilities are more risky than water utilities. Applicant cites ongoing staff recommendations for the energy utilities which are higher than staff recommendations for water companies. It cites our decisions adopting higher rates of return for the energy utilities. It seeks the same return on equity from us as we allow the energy utilities. To this end, CWS presented extensive argument to show that CWS is at least as risky as the major energy utilities.

Little would be gained in going through the regulatory history which led to the reasons staff and we summarize as showing energy utilities to be generally more risky than water companies. The argument undoubtedly will persist whether this opinion be long or short. We concur with staff that known facts, rather than argument, are the best foundation for ratemaking decisions.

Our review of the record of these proceedings supplemented by our notice of the most recent decisions we have issued persuades us that a return on equity of 14.5% is most reasonable for this group of California Water Company districts. This return is the same as last granted to applicant in March 1982 (D.82-03-011), and comports with our most recent decisions.

Review of Financing Costs

In order to account for financial attrition likely to occur in 1983, staff recommends that the Revenue Requirements Division be required to review applicant's 1983 financing costs before .

incremental rates are put into effect for 1984. At that time, the allowance would be adjusted for any differential between the adopted interest rates and recorded results. This would ensure protection of the ratepayers if capital markets improve and interest rates decline, and will also protect CWS in the converse situation, since it will be able to recover actual interest costs prior to the end of the three-year regulatory cycle.

Applicant concurs in this proposal, and it will be adopted.

Rate Design

In these consolidated proceedings, applicant has proposed a significant departure from our present rate design policy. Our current policy provides that all rates will be increased by the same percentage after a 25% lifeline differential has been achieved. Applicant has requested that almost all of its requested increase be granted by increases in the service charge rate. Applicant's reason for its proposal is its contention that its current rate structure, where most revenues are recovered through the quantity rate, causes wide fluctuations in earnings and in the long run prevents it from having any reasonable opportunity to earn its authorized rate of return.

Applicant's evidence is similar to a California Water Association (CWA) report presented at a special Commission meeting held in August 1981. As did the CWA, applicant contends that our rate design policy for water utilities has grown out of its policy for energy utilities and that although we have investigated energy utility rate designs in numerous formal proceedings through the past six or seven years, we have never held an in-depth investigation into water rate design.

Water sales vary from year to year, applicant testified, and earnings stability can best be achieved for water companies by

12. Increases in rates authorized for 1984 and 1985 in Appendixes B and C are required to offset attrition in earnings and are reasonable.

13. The adopted rate design will limit the impact on individual customers and is nondiscriminatory.

14. The proposed change in ordering paragraphs for step rates reduces ratepayer protection during economic fluctuations and is not adopted.

Conclusion of Law

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

O R D E R

IT IS ORDERED that:

1. California Water Service Company (CWS) is authorized to file the revised schedules attached to this order as Appendix A and to concurrently cancel its present schedules for such service. This filing shall comply with General Order (GO) Series 96. The effective date of the revised schedules shall be 4 days after the date of filing. The revised schedules shall apply only to service rendered on and after their effective date.

2. After CWS has completed its 1983 refinancing of its Series T Bonds, CWS shall file an advice letter, with appropriate workpapers, requesting changes in the authorized step rates for 1984 and 1985 to reflect the changes in the adopted rates of return for 1984 and 1985 resulting from actual 1983 refinancing costs of Series T Bonds differing from those costs adopted in this decision. Staff shall review the refinancing costs of the Series T Bonds and determine whether the refinancing costs are prudent. If staff finds that the refinancing costs are prudent, the revised rates of return for 1984 and 1985 shall be determined by substituting the actual 1983 refinancing costs of the Series T Bonds for the estimated costs adopted in order to derive the revised embedded debt costs for each