ALJ/rr/vdl

H-4

Decision 82 12 122 DEC 30 1982

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of CALIFORNIA-AMERICAN WATER COMPANY for an order authorizing it to increase its rates for water service in its MONTEREY PENINSULA DISTRICT.	Application 82-02-47 (Filed February 22, 1982)

(See Decision (D.) 82-09-020 for appearances.)

FINAL OPINION

I. Introduction

By Application (A.) 82-02-47 filed February 22, 1982, California-American Water Company (CalAm) requested authority to increase its rates in its Monterey district by $2,808,100 in 1982, with additional increases of approximately $922,000 in 1983 and $573,600 in 1984. This matter was originally to be submitted based on 1982 and 1983 test years, with rates effective on October 1, 1982. However, after four days of public hearing CalAm proposed that the schedule be changed to allow rates effective January 1, 1983, based on 1983 and 1984 test years, with an interim order addressing that portion of its request relating to CalAm's investment in its Lower Carmel Valley project. CalAm's motion was granted and is discussed further in the interim decision in this matter, D.82-09-020 (September 8, 1982). By D.82-09-020 CalAm was authorized to increase its rates by $436,200 annually.

One further day of hearing was held and the matter then submitted on concurrent briefs. CalAm offered the testimony of Roger Ward, its quality superintendent; Albert Bennett, its chief engineer; Larry D. Foy, its vice president of Operations; Richard Sullivan, manager of its Monterey district; John Barber, its assistant director of Rates and Revenues; Robert Bruce, its treasurer; and Donald R. Howard, a consultant from Stetson Engineers. The Commission Staff (staff) offered the testimony of Senior Engineer Mehdi Radpour, Associate Engineers Norman Low and Gregory A. Wilson, Research Analysts Linda Gori and Robert Mark Pocta, all of the Revenue Requirements Division. The Coalition of California Utility Workers (Union) offered the testimony of William Dixon, fifth region national representative for the Utility Workers Union of America. Briefs were filed by CalAm, staff, and the Union.

Prior to the public hearings, an informal public meeting was held in Monterey on April 22, 1982 to receive customer comments regarding water service. Notice of the meeting was mailed to ratepayers prior to the meeting. The meeting started at 7:00 p.m. About 30 customers attended the meeting including a city councilman (Mr. Mason) from City of Seaside.

Councilman Mason requested the Commission to consider the economy of the area and the effect of an increase on working people before approving any rate increase. He also requested that company books be available for inspection by the public. The councilman was informed that copies of workpapers submitted to the staff in this proceeding would be available to the public for inspection at the utility's district office.

A Dr. Vessel talked of water mains in Carmel Woods area being old and undersized and that he had been informed by the utility that the work on main replacement would commence in the month of May. In a letter of May 5, 1982 the utility informed the staff that the work had started on that date.

One customer (F. L. Martin) complained of bad taste in the water. The utility was requested to analyze a sample of the water at his residence and report the result to the staff. There were no other service complaints.

Few customers objected to the amount of increase. One customer stated that the utility is an efficiently run organization and merits the rate increase because of inflation.

II. Summary

By this decision CalAm is authorized to increase its rates by about $1,487,000 (18%) in 1983, by $387,100 (3.98%) in 1984, and $222,500 (2.18%) in 1985. Table 1 shows a comparison of CalAm and staff estimates at present rates and at proposed rates.

Table 1

California American Water Company
Monterey Peninsula District
Comparison of Applicant and Staff Estimates

	Test Year 1983		Test Year 1984	
	Utility	Staff	Utility	Staff
At Present Rates				
Operating Revenues	$7,039.2	$7,931.9	$7,093.0	$8,060.9
Operating Expense				
Purchased Power	906.3	808.6	915.2	805.2
Purchased Chemicals	66.6	45.2	73.6	49.9
Payroll - District	1,521.0	1,405.2	1,673.0	1,513.4
Customer Billings	215.3	192.7	235.7	194.2
Other O&M	659.9	625.7	720.1	668.4
Other A&G	916.2	724.0	1,022.7	814.4
Ad Valorem Taxes	264.4	248.4	275.5	261.4
Payroll Taxes	117.9	102.2	128.8	109.3
Depreciation	878.5	801.5	928.9	849.9
General Office Allocation	417.0	394.1	457.9	423.7
Subtotal	$5,963.1	$5,347.6	$6,431.4	$5,689.8
Uncollectibles	21.1	20.6	21.3	21.0
Local Franchise Tax	15.8	23.0	16.9	23.4
State Corporation Tax	(69.8)	85.7	(133.2)	31.1
Federal Income Tax	(380.6)	358.8	(657.8)	133.5
Total Operating Expenses	$5,549.6	$5,835.7	$5,678.6	$5,898.8
Net Operating Revenues	$1,489.6	$2,096.2	$1,414.4	$2,162.1
Rate Base	25,400.5	23,151.8	26,635.5	24,059.7
Rate of Return	5.86%	9.05%	5.31%	8.99%
At Proposed Rates				
Operating Revenues	$10,769.4	$11,314.8	$11,396.8	$12,081.4
Operating Expenses				
Subtotal	5,963.1	5,347.6	6,431.4	5,689.8
Uncollectibles	32.3	29.4	34.3	31.4
Local Franchise Tax	27.1	32.8	30.2	35.1
State Corporation Tax	286.1	408.7	278.3	415.0
Federal Income Tax	1,161.3	1,757.8	1,124.9	1,796.1
Total Operating Expenses	$7,469.8	$7,576.3	$7,899.1	$7,967.4
Net Operating Revenues	$3,299.5	$3,738.5	$3,497.7	$4,114.0
Rate Base	25,400.5	23,151.8	26,635.5	24,059.7
Rate of Return	12.99%	16.15%	13.13%	17.10%

(Red Figure)

Table 2 shows the adopted summary of earnings at present rates and at adopted rates.

Table 2

California American Water Company
Monterey Peninsula District
Adopted Summary of Earnings

	Test Year 1983	Test Year 1984
	(Dollars in Thousands)	
At Present Rates		
Operating Revenues	$ 8,260.2	$ 8,320.4
Operating Expenses		
Purchased Power	960.5	949.4
Purchased Chemicals	44.4	48.3
Payroll - District	1,545.6	1,709.1
Customer Billings	192.7	194.2
Other O&M	625.7	668.4
Other A&G	783.7	860.8
Ad Valorem Taxes	248.8	265.8
Payroll Taxes	113.0	123.8
Depreciation	805.1	859.4
General Office Allocation	403.5	440.6
Subtotal	5,723.0	6,119.8
Uncollectibles	21.5	21.6
Local Franchise Tax	24.0	24.2
State Corporation Tax	74.6	7.9
Federal Income Tax	339.0	63.6
Total Operating Expense	6,182.1	6,237.1
Net Operating Revenues	2,078.1	1,083.3
Rate Base	23,410.5	24,550.6
Rate of Return	8.88%	8.49%
At Adopted Rates		
Operating Revenues	$ 9,747.2	$10,203.7
Operating Expenses		
Subtotal	$ 5,723.0	$ 6,119.8
Uncollectibles	25.3	26.5
Local Franchise Tax	28.4	29.7
State Corporation Tax	216.6	187.7
Federal Income Tax	953.9	842.4
Total Operating Expenses	6,947.2	7,206.1
Net Operating Revenues	2,800.0	2,997.6
Rate Base	23,410.5	24,550.6
Rate of Return	11.96%	12.21%

A rate of return on rate base of 11.96% for 1983 and 12.21% for 1984 is found reasonable. The authorized return on equity is 14.50%.

For test year 1983, $297,200 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).

The effect of the rate change on a typical residential customer (using 10 Ccf per month) is as follows:

	Present Rates	Adopted Rates
Gravity Zone	$13.06	$15.43
1st Elevation Zone	14.31	16.91
2nd Elevation Zone	15.16	17.89

III. Background

CalAm, a California corporation, is a wholly owned subsidiary of the American Water Works Service Company, Inc. of Wilmington, Delaware, operating public utility water systems in portions of the counties of San Diego, Los Angeles, Ventura, and Monterey.

CalAm's Monterey District provides public utility water service to approximately 31,000 customers in the Cities of Monterey, Pacific Grove, Carmel-by-the-Sea, Del Rey Oaks, and Sand City; portions of the City of Seaside and unincorporated areas of Monterey County known as Carmel Valley, Carmel Highlands, Pebble Beach, and Robles Del Rio. Elevations vary from approximately sea level to 1,200 feet above sea level with topography that requires several lift zones in widely separated territories within the service area. Water supply is from the surface and subsurface flow of the Carmel River and wells in both the Carmel Valley and Seaside areas.

IV. Issues

A. Introduction

Although there is agreement between CalAm and staff on many issues, several major issues have been vigorously contested. These contested issues include average water consumption per customer for several customer classes, number of services per customer class, allocation of water supply, requests for two new employees, and various items of utility plant in rate base. Contested issues which involve significant policy issues include the wage escalation rate for the test years, the treatment of deferred debits, and rate of return.

B. Number of Customer Services

Disagreements exist between staff and CalAm concerning forecasts of the number of services in three classes of customers: residential, large business, and normal public authorities. Staff and CalAm are in agreement regarding forecasts for all the other classes.

Regarding the disputed categories, the positions of the parties are as follows:

	CalAm		Staff	
	1983	1984	1983	1984
Residential	26,189	26,338	26,370	26,610
Large Businesses	66	66	74	79
Normal Public Authorities	381	381	397	405

These differences result from significantly different methodologies. CalAm's estimates were made by its Monterey district manager and are based on his perception of economic and political conditions in the service territory. Specifically he cites the following factors as reasons why growth in the test years will be low:

1. The anticipated enactment of a revised Carmel Valley Master Plan which will limit growth in Carmel Valley to a maximum of 200 new homes per year for each of the next 20 years. Since 1980 a building moratorium pending passage of the new Master Plan has prevented creation of any new lots of record in Carmel Valley.

2. Voters in the City of Monterey recently defeated the Monterey II Plan which would have promoted significant new growth in an area adjoining CalAm's present service area. That "no growth" success has led to the placement on the countywide ballot of a growth management plan to be voted upon this November. The result of that initiative would be further governmental limitations on development within CalAm's service territory.

3. Existing governmental growth management tools now in place include the Coastal Commission, this Commission's limitation upon expansion of CalAm's service territory and the new connection surcharge, and the water allocation ordinances enacted and enforced by the Monterey Peninsula Water Management District.

4. The recent election of a growth-management/antigrowth aligned majority to the Monterey City Council.

5. The slow buildout of subdivisions started in 1979 and 1980 and the lack of progress on projected developments such as the replacement of the now abandoned San Carlos Hotel (450 rooms) in downtown Monterey.

6. The loss of significant customers like the San Carlos Hotel and three recent elementary school closings. None have been replaced. Similarly, there is the permanent loss of some 21 customers due to a street-widening project.

7. Significant golf course customers will eventually be lost (for all except domestic-type consumption) to a reclaimed water project.

8. The recent bankruptcy of the large Heritage Harbor Project near the Monterey Fisherman's Wharf (a complex of business shops directed at tourists) which now stands almost totally empty.

CalAm characterizes its showing as "overwhelming," while the staff's estimates are done without reference to or benefit of local knowledge or factual investigation.

Staff's estimates are based on its analysis of trends in recorded growth, using the period 1969-81 for residential services and 1977-81 for large business and normal public authority services. Staff states that it is not persuaded that the rate of growth actually recorded during the last four years will decline substantially.

Staff points out that CalAm defines the large business class in a manner different from other utilities. For CalAm, any business customer becomes a "large business" customer during any year when it consumes more than 4,800 Ccf of water. Thus, staff claims its forecasted increase in large business customers does not depend on the introduction of five new large businesses to the service territory; rather, staff anticipates that five businesses will expand their operations to cross the threshold into the "large business" category.

We are persuaded that CalAm has shown a sufficient basis for departing from the more typical statistical approach offered by staff. The economic and political conditions prevailing in CalAm's Monterey District provide a compelling justification for adopting a conservative posture regarding growth in numbers of customers.

Staff's point regarding the large business class is not conclusive. Staff has adopted CalAm's estimate for the normal business class. Thus, staff's estimate depends on an increase in the number of business customers and on five businesses expanding their operations and continued operations of the existing large business customers.

C. Use Per Customer

Regarding use per customer, CalAm and staff disagree regarding the Residential, Normal Business, Large Public Authority, and Normal Public Authority classes. The parties agree on staff's estimates for the Large Business, Industrial, and Golf customer classes. Their contested estimates are as follows, for 1983:

Average Ccf per Service

Class	Staff	CalAm Revised
Residential	114.0	105.0
Normal Business	353.1	328.0
Large Public Authority	30,647	28,184
Normal Public Authority	435.8	389

Consumption by certain classes of customers is generally highly sensitive in a predictable manner to annual variations in temperature and rainfall. Accordingly, rather than relying simply on actual historical usage, the Commission has adopted a technique whereby

historical consumption can be normalized with respect to the variables of temperature and rainfall. By use of this technique, actual trends in per customer consumption can be detected and reflected in revenue forecasts for the test years.

The Commission's standardized normalization practices are set forth in the "Guide to the Use of Computer Programs for Estimating Water Consumption and Revenues, Supplement to Standard Practices No. U-25" dated April 1, 1977. In the testimony it is generally referred to as "the Committee Method". In brief, this document prescribes specific analyses and treatment of data as the "basic procedure" that will be used in rate cases such as this. The document also provides that the user may use "other procedures" if the basic procedure "does not appear satisfactory." The Committee Method is the standardized method used to forecast future average water consumption not only by the staff, but also by such Class A water companies as SoCal Water and California Water Service.

Both parties employed the Committee Method multiple regression analysis for the Residential and Normal Business customer classes. Staff also used it for the Large Public Authority class. For the balance of all classes staff applied a simple averaging technique using a different number of years to average for each class; in contrast CalAm used a "best fit" trending analysis. CalAm also used the "best fit" analysis to supplement and check its multiple regression analysis for the Residential and Normal Business customer classes.

The first difference between CalAm and the staff analysis concerns the years chosen to be in the sample for analysis. Specific years were excluded because of highly anomalous characteristics due to

the drought which would bias the sample in an unrealistic manner. Both staff and the company excluded the drought years 1977 and 1978. Staff also excluded data for 1979 as anomalous whereas the company did not.

The second general difference between the company and staff concerns the length of historical span chosen for the sample.

The third general difference concerns forecasts for the test years. Staff followed the explicit direction of the Committee Method to take as the forecast for the two test years the value of normalized consumption for the last recorded year (1981) derived from the regression equation. In its application, CalAm also followed this procedure. However, at the hearings CalAm modified its methodology and now proposes as its forecasts the extrapolated continuation of trends derived from its analysis.

Staff contends that the trending methodologies used by CalAm rest on questionable assumptions, in particular that per customer demand for water is highly elastic over the range of consumption at issue. Staff claims that demand gets less and less elastic as consumption decreases below various thresholds of convenience, as shown during the drought. Staff argues that CalAm provided no adequate reason why an exception should be made from the Committee Method to allow trending of test year consumption per customer. Staff asserts that the Commission should conclude that whatever estimate of normalized consumption for the last recorded year is adopted, that value should apply for test years 1983 and 1984.

Regarding its use of average historic consumption data for four customer classes, staff contends that this method is appropriate because average consumption per customer in those classes has remained fairly steady in recent years at a plateau, rather than continuing to decrease as a linear regression such as the Committee Method would predict.

CalAm contends that there is a long-term and continuing downtrend in consumer water use which can and should be projected in a three-year rate case. CalAm's witness Howard used a trending approach both as a check on the regression analysis and for those classes where the Committee Method would not work. CalAm states that the principal virtue of this type of analysis is that it more accurately reflects the downtrend that is actually occurring than can a simple averaging technique. CalAm states that the goal is to seek a truly representative consumption projection and not simply a formulaic estimate to be used in all events, simply because it is efficient to do so.

CalAm argues that its evidence regarding the reduced growth projections for the conservation legislation and efforts by both the utility and the Monterey Peninsula Water Management District amply support the per capita consumption downtrend projected by Howard. CalAm claims that its consumption recommendations are the more "refined" estimates and urges that they be adopted.

We find staff's critique of CalAm's methods quite useful. We agree that CalAm's approach rests on questionable assumptions regarding elasticity. We find staff's approach more reliable. Therefore we adopt staff estimates.

We are especially concerned that CalAm's use of 1979 data introduces a bias into its results. We agree with staff that 1979 was anomalous, supporting staff's judgment to exclude such data from staff's normalized consumption calculations.

D. Allocation of Water Supply

The forecasted allocation of water supply between surface supplies and wells has a major impact on forecasts of purchased power and purchased chemical expenses. CalAm allocated 53% of total water production to surface supply; staff allocated 57%.

CalAm claims that it reached its figure in two independent ways: first, in connection with its original filing, by an analysis of CalAm's actual rainfall and production records performed by its operations manager, and second, by a "purely statistical" approach based on a 12-year average (excluding 1977 and 1978).

Staff's allocation is based on the average percentage of total water delivered derived from surface supplies during the four-year period 1978-81. Staff points out that its forecast is based on its forecasts of both number of services and average use per customer. Thus staff contends that if the lower numbers supported by CalAm are adopted in either of these categories, then it is even more likely that the percent of total water supply derived from surface sources will be at least 57% as forecasted by staff.

CalAm points out that the actual quantities of surface production estimated by staff have never been attained by the utility, even though it has an obvious profit incentive to maximize its use of the much cheaper surface water, consistent with its obligation to hold back adequate storage to serve upper Carmel Valley customers above its well fields and as a hedge against drought.

We agree with CalAm that staff's estimate of available surface water production is not supported by evidence, since there is no indication that CalAm has not maximized its surface water production in

the past. Thus there is no basis for concluding that CalAm can significantly exceed its historical maximum. However, this criticism is mitigated by the adoption of CalAm's forecast of the number of services. Thus we do not simply adopt CalAm's estimate.

Rather, we find that 55% is a reasonable figure to adopt for this purpose, because it is more representative of recent data. Further, we consider this area to be one of the most important in terms of a meaningful incentive for CalAm to minimize its costs, leading us to adopt an allocation factor that reflects the incentive.

Subsequent to the submission of this matter CalAm discovered and staff verified that CalAm has historically miscalculated its purchased power expense by omitting the amount of energy required to boost water to higher elevations. Using staff's estimates, the purchased power expenses are increased by $158,400 in 1983 and $161,500 in 1984. The corrected estimates are reflected in the adopted results of operations.

E. Wage Escalation Factor

One of the most controversial issues in this proceeding is the wage escalation factor to apply in the calculation of test year labor costs. CalAm proposes a wage escalation rate from 1981 levels for its district employees of 15.8% in 1982, 12.5% in 1983, and about 11% in 1984. For its headquarters employees CalAm proposes a rate of 10% each year above 1981 levels. Staff proposes a wage escalation rate of 8% per year above 1981 levels for all employees. The Union objects to the adoption of any escalation factors less than the factors embodied in its contract with CalAm.

The entire history of CalAm's contractual relationship with the Utility Workers Union of America (UWUA) is contained in the

record. The particular provisions that are presently at issue were negotiated in late 1981, with the contract signed on January 12, 1982. CalAm's proposed escalation factors for its union employees are contained in the contract.

Staff's proposed wage escalation factors are based on inflation forecasts, wage increases or decreases recently negotiated for union and nonunion employees in the United States, and economic conditions prevailing at the time of its forecasts. Staff estimates that inflation will be between 4 and 6% in 1982 and between 6 and 8% during both 1983 and 1984.

The Union argues that the Commission lacks jurisdiction to set rates based on any factors other than those contained in the collective bargaining agreement.

CalAm complains that staff's analysis is a blind application of a single statistical guidepost, without any reference to the unique facts of this particular application. CalAm states that the staff method ignores the following undisputed facts established in the record:

1. Since December 16, 1981 there has been an existing collective bargaining agreement in place and operating. Staff concedes that contract was bargained for stringently and in good faith.
2. Wages for nonunion employees, based upon a long-standing formula directly tied to the previously negotiated union contract, went into effect and have been operating since July 1, 1982.
3. The parties negotiated new union wages under the contract wage reopener clause in November and December, 1981 and could only have used cost of living and inflation data and forecasts available to them at that time.

4. This factual situation is unique. CalAm's employees have historically received wages substantially below comparable utility employees in the same geographical area. The negative impact such low wages have historically had on morale, turnover, and productivity are facts unchallenged by staff. The company and the union have been attempting to close that substantial gap in incremental steps over the past series of contracts. Inflation has made that goal unachievable. Before this latest contract was negotiated CalAm employees suffered an hourly wage differential ranging from $1.19 to $1.91 when compared to comparable jobs in comparable utilities. The existing contract still leaves CalAm's employees between $0.69 to $1.17 per hour behind their counterparts.

5. Recent wage increases by investor-owned water utilities in the same geographical area will increase or at least maintain the disparity which has existed in CalAm's wages. The gap remains between $0.69 per hour to $1.17 per hour below comparable wages at other utilities.

6. A wide range of statistical information available from a variety of sources including the United States Department of Labor, the Merchants and Manufacturers Association, an internally prepared survey of comparable utilities by Mr. Foy and similar materials not previously considered by the staff witness confirmed that CalAm's employees were in fact earning substandard wages whether measured on a local, regional, or statewide basis. That is the same type of information CalAm uses to

prepare for its union negotiations. Staff relied exclusively on national statistics and ignored wages at comparable companies in the same geographical area. Staff conceded that the statistics relied upon by CalAm in its Exhibit 11 were relevant and accurate.

7. The Federal Council on Wage and Price Stability (CWPS) specifically found that "wage rates in this unit have not kept pace with the pattern of wage increases for employees in similar categories in the surrounding geographic areas and that this has resulted in high turnover rates..." As a result, in order "to prevent a gross inequity," the December 15, 1979-December 14, 1982 Monterey District collective bargaining agreement was approved by CWPS.

8. Because of its historical lag in cost of living increases, CalAm has never been able to consider merit or longevity increases for outstanding employees.

CalAm argues that for the Commission now to undercut the carefully crafted catch-up program agreed to by the company and the UWUA would wreak havoc on CalAm's rate of return, on its expense budget, on its employee relationships and morale, and ultimately on its record of customer service.

Staff argues that CalAm has not made a convincing case that the Commission should adopt a higher wage escalation factor. Staff states that most of the turnover has been among entry-level employees, many of whom have left for reasons other than wages. Staff claims

that this turnover will presumably not be affected by the Commission's decision in this case, and that to the extent that turnover of other employees is reduced by the union contract, the savings in recruitment and training expenses can be used to supplement the 8% wage escalation factor recommended by staff.

Staff further contends that CalAm never tested its assumption that it would have to pay wages equal to those paid by firms in Los Angeles or San Jose to attract employees. Staff complains that CalAm never checked to see whether workers would be willing to accept lower salaries to work in such an attractive area. Staff argues that CalAm was highly selective in its analysis of wages paid by other utilities. For example, although CalAm relies on the negotiated contract between Del Este Water Company and its employees as justifying the reasonableness of the percentage increase, CalAm ignored Del Este in its comparison of wages for specific positions, even though staff claims that Del Este (in Modesto) is close to Monterey.

Finally, staff notes that wage escalation rates recently adopted by the Commission for other water utilities are substantially lower than earlier cases cited by CalAm. Staff points out that although Del Este agreed to a 10% increase for employees and 12% for officers, the Commission did not allow Del Este to recoup management salary increases in excess of 10% in 1982 and authorized for ratemaking purposes a wage escalation for all Del Este employees of only 6.4% for 1983. (Del Este Water Company D.82-09-061, September 22, 1982.)

The Union argues that the doctrine of federal preemption in the area of labor law prohibits state interference with collective bargaining and the terms of a collective bargaining agreement. Union states that the terms of a collective bargaining agreement between

parties subject to the jurisdiction of the National Labor Relations Board are historically and uniformly sheltered from government intervention by the application of the doctrine of federal preemption to the area of labor relations. Neither the National Labor Relations Board, nor the courts, nor the states, may dictate the terms of a collective bargaining agreement without violating the fundamental premise of the National Labor Relations Act--that the role of the government is to supervise the bargaining process without intervening in the substance of the agreement. Once agreement on a subject is freely arrived at by labor and management, that agreement is protected against even contrary state substantive regulations or legislation.

Applying that principle to this case, Union states that to say, as the staff argues, that allowing for a wage escalation factor less than that necessary to conform to a prenegotiated wage increase would not result in substantial interference with the collective bargaining process is in this case more a result of naivete and lack of familiarity with labor-management relations than it is a result of disingenuity. Though indirect, the effect of disallowing any wage increase over 8% for ratemaking purposes would be the same as a direct action by the Commission forbidding any increase over 8% whatsoever.

Further, Union argues that the specific contract is neither unreasonable nor an abuse of managerial discretion. Union cites a number of this Commission's decisions which it claims all conform to the standard that a contract must not be unreasonable and the determination of what is reasonable in conducting the business of the utility is the primary responsibility of management. Union argues that only if a contract is patently unreasonable, represents an abuse of discretion, or was not made in good faith, will it be disallowed for ratemaking purposes.

Union contends that the reasonableness of the wage escalation factors was demonstrated convincingly at the hearing. Union states that the parties have attempted to correct longstanding wage inequities for several years, a process which has been complicated by a spiraling rate of inflation which has compounded existing inequities. Union concludes that it would be hard to imagine a more vivid illustration of the wisdom in the Commission's deferring to the judgment and expertise of labor and management than that provided by the issue of the wage escalation factor in this case.

We reject Union's contention that federal labor law preempts our consideration of a reasonable test year wage escalation factor. As we have stated with regard to collective bargaining agreements generally:

> "The Commission will not view as sacrosanct in its rate-making process every element of a collective bargaining agreement when such affects rates and service to the detriment of ratepayers, who, we note, are not represented at the collective bargaining table and have only this Commission to protect them. The Commission will not shy away from examining the deleterious effect on service and rates of inefficient utility management. We reserve the right to order such changes - or disallow such costs - as we find necessary." (Pacific Gas and Electric Company, D.92489, p. 282, December 2, 1980.)

With regard to wage escalation factors specifically, we recently stated as follows:

> "With respect to applicant's question concerning our authority to refuse to recognize an existing expense item, we will simply state that merely to rubber stamp

> any increased expense over which a utility has control would be to abdicate our role as regulator. It is our duty not merely to examine actual incurred expenses, but to ratify or reject expenses on the basis of reasonableness in light of all relevant circumstances. This is especially true in connection with controllable expenses." (Del Este Water Company, D.82-09-061, p. 12, September 22, 1982.)

Nor are we persuaded that this result necessarily interferes with the collective bargaining process. Rather, we believe that our approach reinforces collective bargaining by providing a meaningful incentive for the utility to bargain.

However, we do find that CalAm has established the reasonableness of the wage escalation factors contained in the contract. Therefore we adopt CalAm's factors for purposes of test year calculations.

The reasonableness of the contract is appropriately evaluated in terms of the information available to the utility at the time the contract was made. Whatever the reliability of staff's estimates, those estimates reflect mid-year 1982 and beyond. These data are not dispositive of the reasonableness of a contract negotiated months earlier.

Staff's method also fails to address the unrebutted evidence that a "catch up" factor was reasonably reflected in the contract. Industry guidelines may be useful, but only where the matters are shown to be directly comparable.

The treatment of wage costs in this proceeding must be understood in terms of the differences between the status of district and headquarters employees and the length of the union contract. The amount of the attrition allowance for 1985 does not imply a judgment of the reasonable labor cost to be negotiated at that time.

F. Meter Reader

CalAm currently employs four persons in the position of meter reader in its Monterey District. It has proposed to hire a fifth person in this category in 1983. Staff believes that CalAm has not demonstrated a need to hire an additional person.

CalAm justified the new position in terms of the implementation of its new computerized Itron billing system, which is designed to reduce billing errors and customer costs. CalAm's witness explained that a total rerouting of meter readers will be required, as the meter readers will hand-deliver the bills, there will be materially increased customer contacts, and readings will be done daily with no "zero cycle." Benefits include elimination of substantial mailing expenses, enhanced bill accuracy and fewer high bill complaints, and an excellent five-year contract price for the system.

Staff compared the productivity of meter readers in CalAm's Monterey District with the productivity of meter readers in four California Water Service districts and the total service area of San Jose Water Works. From this study staff concludes that if CalAm operated at the same efficiency as California Water Service, CalAm would need only three meter readers rather than the five it seeks.

CalAm offered a comparison of the job description and work conditions of its meter readers and meter readers from San Jose Water Works. CalAm argues that when comparing utilities' meter reading or customer service operations one must take into account many variables including the terrain, turnover of customers, and duties assigned to personnel.

We find that CalAm has proven that an additional meter reader position is required. Its Itron billing system represents a significant investment that must be allowed to function effectively in order to generate the expected savings. The additional meter reader is necessary for the Itron system.

Staff has failed to show sufficient comparability between CalAm and other utilities regarding duties and other circumstances of employment to validate its statistical comparison, even if the Itron system was not being implemented. Any adjustment offered on the basis of statistical comparisons must be supported by a threshold showing that the matters are actually comparable.

G. Lab Technician

In its Monterey District CalAm currently employs three persons competent to do laboratory work--one water quality superintendent, one water quality operator, and one laboratory technician. CalAm proposes to hire another laboratory technician. Staff argues that CalAm has not proven the need for an additional technician.

Staff's position is based on a comparison of the productivity of personnel at CalAm's laboratory and at California Water Service's laboratory. Based on its study of necessary tests, including newly mandated water quality tests, staff concludes that another technician is not required.

CalAm contends that there are obvious differnces between the two utilities' lab operations that render the comparisons misleading. In particular, CalAm states that California Water Service operates a "high production lab" in which its lab people do not leave the laboratory to do any field testing and do not do any of the other nontesting tasks done by CalAm's laboratory staff such as responding to customer complaints.

CalAm further explained that one of its current lab people is a Grade 5 water treatment operator who is badly needed to return to the field and be replaced by the lab technician. The operator is needed in the field because CalAm's substantial new production and treatment plant additions require materially increased field sampling and testing, and because he is responsible for backflow prevention and cross-control supervision of all treatment plants, as well as other duties.

In this instance we find that CalAm has shown the need for an additional laboratory technician, based on the need to return the water treatment operator to the field. Since the result is to maintain the same number of people in the lab we do not mean to imply that staff's method was faulty in this instance. Perhaps this issue could have been avoided at the outset if CalAm had made clear that it really needed another field person, instead of another lab person.

H. Mt. Devon Tank

The Mt. Devon tank is an old redwood tank in the Carmel highlands that has seriously deteriorated. CalAm initially proposed spending $250,000 to purchase a new site and build an entirely new tank. At the hearings, Bennett of CalAm testified that it currently proposes not to construct another tank, but instead to lay new pipe from another existing tank in the Carmel highlands to an interconnection point previously served by the Mt. Devon tank. The cost of the new pipe installed is estimated at $200,000. CalAm asserts that construction of this new pipe will not only allow CalAm to continue serving those customers previously served by the Mt. Devon tank, but that it will also remove the alleged risks to life and property downslope from the Mt. Devon tank, and improve a preexisting problem with undersized piping in that part of the Carmel highlands.

Staff agrees that the Mt. Devon tank needs to be repaired or taken out of service. However, staff believes the tank can be repaired to adequate safety standards at far less cost than proposed by CalAm. Specifically, Wilson of the staff proposed that CalAm install a fiberglass liner inside the existing tank. Staff believes that this alternative is workable, will render the tank almost as good as new, and will cost only about $27,000, less than one-sixth the amount estimated for the new pipeline. Staff also pointed out that CalAm had no immediate plans to upgrade the pipeline in the Carmel highlands area until this became a justification for the proposed retirement of the Mt. Devon tank.

CalAm claims that basically this issue boils down to a dispute over whether the existing tank and site can be safely repaired or should be eliminated and replaced. Bennett, together with Foy, presented the engineer's and operator's point of view that the 30-year old redwood tank is irreparable and the steep hillside site increasingly dangerous to approximately 12 home sites below it and that the tank at that site should therefore be eliminated. An alternative solution was proposed by Bennett involving running a new pipeline to this area from a nearby existing large company tank. That solution would eliminate all need for use of the dangerous Mt. Devon site while providing adequate fire flow where it is now lacking and also eliminate earthquake concerns over the existing small pipeline.

CalAm argues that staff witness' recommendation is based exclusively upon one visit to the site in April, 1982 before the end of this past rainy season. CalAm contends that staff conducted no other tests and has no other basis upon which to disagree with the judgment of CalAm's operating personnel except to cite the fact that this leaky tank has survived 25 years.

CalAm claims that staff witness is simply in no position to disagree with the technical expertise of CalAm's witnesses on this issue. The risk is obvious and real, and both staff and CalAm are risking serious criticism if CalAm's concerns materialize in real injury to life and property below the Mt. Devon tank.

Staff responds that CalAm's testimony is not persuasive regarding the need to spend $200,000 on this problem. Staff points out that according to Bennett's own testimony, the rains last winter were especially heavy. Staff argues that the relatively light damage the tank suffered despite the heavy rains in fact vindicates the tank's durability rather than renders it questionable. Staff notes that CalAm had been willing to use this tank for about 30 years notwithstanding periodic mudslides and that CalAm had not yet even obtained a formal report from a soils engineer regarding the stability of the site.

Staff contends that CalAm's argument that staff's cost estimate is low is unsupported by the record, since staff witness Wilson testified in detail that the estimated price was obtained with the contractor being aware of all the relevant information about the site.

Further, staff argues that CalAm's appeal to the Commission's concern about safety is unwarranted in this instance, as staff witness Wilson testified that the resulting risk to downslope property after the tank had been lined with fiberglass would be acceptably small and less than the risk CalAm has assumed during the last 25 years the tank was in place without being lined.

While we are convinced that some repair action is necessary regarding the Mt. Devon tank, we are not persuaded that CalAm's proposed solution is the most reasonable. Therefore we adopt staff's recommendation.

We note that CalAm has already changed its mind once during the proceeding. This indicates that CalAm did not fully consider all alternatives before it made its proposal. Given the difference in cost we cannot reject staff's proposal without a more thorough analysis by CalAm.

We agree that CalAm's appeal to safety concerns is no substitute for an adequate showing. Staff appears equally concerned about safety. The ratepayers are entitled to expect that economic considerations are also factored in.

In these difficult economic times there is constant pressure on this Commission and the utilities to keep rates down. The ratepayers' ability to pay places real constraints on the improvements that can be made in the system. We cannot authorize investments on a marginal showing by the utility.

I. San Clemente Dam Gates

In 1980 CalAm commenced a multiyear project to replace the manually installed gates at San Clemente Dam (which date from 1927) with new, hydraulically operated gates. The project was designed by CalAm's own engineers and approved by the California Division of Safety of Dams. The project is half completed, and CalAm budgeted $120,000 for the installation of the remaining 12 gates in 1983. CalAm explained in detail the manipulation of the existing system of railroad timbers which it contends is potentially dangerous. Staff opposes this investment on the basis that there is a high risk that it would not be cost-effective, since the Monterey Peninsula Water Management District is seriously considering building a new, larger dam just downstream from the existing dam sometime in

the near future. The reservoir backed up by the new dam would be likely to inundate the existing San Clemente dam, rendering the flood control gates on the existing dam useless. The new dam might be completed as early as 1986.

Staff points out that CalAm estimates the annual cost of placing and removing the 12 wooden gates at the dam would be approximately $4,800 in 1983, $5,200 in 1984, and $5,700 in 1985, while operating costs for the new gates would be substantially less, resulting in a net gain of about $4,500 per year in operating costs. Thus, staff calculates that if the new dam is in operation in 1986, then CalAm will have spent $120,000 in order to save $13,500. Staff argues that this is clearly imprudent.

CalAm argues that the investment is reasonable now for operational reasons, even if the San Clemente dam is eventually inundated. The need for the dam is now being reconsidered and even if it is completed, CalAm points out that the utility must continue to operate the existing facility.

We agree with staff that these circumstances present a high risk situation that should be avoided on behalf of the ratepayers. The wooden gates have apparently worked for years. We see no reason why their use should not continue until the dam uncertainties are resolved. Again, CalAm raises a safety issue, but there is no indication that placement of the gates is now less safe than before.

J. Old Capital Tract

CalAm proposes to spend $100,000 to oversize the main to be extended to the Old Capital Tract, a proposed subdivision in downtown Monterey. This main would be located in the center of CalAm's

distribution system in the City of Monterey, which is described as the weakest point hydraulically in the transmission system in the downtown area. CalAm proposes to oversize the main to accommodate continuing growth in that part of its service area.

Staff recommends disallowing this expense as speculative, pointing out that the earliest time construction could start on the project is late 1983. No detailed architectural drawings have been prepared, funding may not have been acquired, and no contract schedule has been developed.

We agree with staff that a matter that is so uncertain should not be included in the test year. We are also unable to reconcile CalAm's position with its substantial showing regarding growth constraints in its service territory.

K. 1983 Main Replacement

CalAm proposes to increase its 1983 main replacement budget by $354,000. CalAm has had an accelerated main replacement program underway since 1979, following a comprehensive survey in 1977 and 1978 of the approximately 100 miles of aged two-inch mains throughout CalAm's system that are leaky and provide inadequate fire flows. CalAm's witness explained that the utility budgeted $578,000 for main replacements in 1982, but that amount was reduced to $210,000 by the Board of Directors. The reduction was the result of the cash flow impact of not having earnings on the entire lower Carmel Valley project in early 1982. The unexpended balance from the 1982 budget was deferred and added to the 1983 budget.

Staff stated that it recommends against including this amount in rate base because it doubts that CalAm will be able to accelerate its main replacement construction enough to accomplish this project in addition to the other construction planned for 1983.

CalAm responds that it uses outside contractors for this project, so that it will have no difficulty expending the $874,900 budgeted for 1983. CalAm points out that in prior years its main replacement expenditures very closely approximated its budget.

We are satisfied that CalAm is reasonably allowed to proceed with its 1983 main replacement schedule. Staff's concern about CalAm's ability to undertake the project is apparently unfounded. This kind of maintenance is important in providing basic service and should not be unnecessarily delayed.

L. Advances for Construction

CalAm proposes a figure of $200,000 per year for the test years. Staff estimates $220,000 for both years. The difference is the result of different estimating techniques.

Staff used a 5-year average of advances received by CalAm. The 5-year period was chosen because dramatic fluctuations in advances in recent years made trending the data inappropriate. Staff states that its forecast of advances is consistent with its forecast of new services.

CalAm argues that staff's method is flawed because it includes 1979, which was an aberration. CalAm points out that none of the other 4 years even approaches CalAm's estimate. CalAm further contends that there is no factual basis to support staff's recommendation in the face of CalAm's knowledge of anticipated growth.

We adopt CalAm's estimate. We agree that the 1979 data skew the averaging result. Also, each party connects its estimate to its own estimate of new services. Since we adopted CalAm's estimate of new services, we also adopt its estimate for advances.

M. Plant Retirements

CalAm proposes retirements of $136,800 in 1983 and $105,500 for 1984. Staff estimates retirements of $170,000 for each year. Again, staff used a 5-year average, while CalAm claims its estimates are based on a very detailed item-by-item analysis.

Staff contends that fluctuations in the data make a trending analysis inappropriate. The staff witness noted that CalAm appears to be using the same method of projecting retirements that it used in past cases, resulting in estimates less than 40% of actual retirements. During the last 4 years plant retirements have never dropped as low as CalAm's estimates for the test year.

We think that in this instance staff makes a telling point. CalAm has filed to explain why such a low level of retirements is anticipated, or why the Commission should rely on a method that has apparently missed so badly in the past. Therefore we adopt the staff estimate.

N. Contingency Funds

There is some confusion in the record regarding an allowance of $31,000 as a general contingency fund. Apparently CalAm revised its capital construction budget during the proceeding, and the revised version did not include a line item labeled general contingency as had previous budgets. Staff understood this omission to indicate that CalAm had included contingency funds elsewhere in its budget so that to include it again would allow double counting of the funds.

CalAm explained that the omission was inadvertent, occurring because of a change in the form. CalAm claims that the contingency has historically existed and is still required to cover unexpected emergencies that are not covered by the investment budget, such as a pump or well that must be replaced unexpectedly. Without the contingency fund some scheduled project would have to be deferred to make funds available to cover such an unscheduled replacement.

We agree that a contingency fund is reasonable. We are satisfied that CalAm has explained the budget item omission and adopt its method of calculation.

O. Deferred Debits

CalAm and staff disagree over the appropriate treatment of three items of unamortized expenses: rate case expenses, deferred maintenance on tanks, and start-up costs associated with the new computerized billing system. CalAm seeks to include the unamortized balance of each of these projects in rate base as part of the working cash allowance. The amount that staff proposes to disallow is $211,100.

The parties agree that this is a policy question for the Commission. CalAm argues that its position follows the policy applied in CalAm's last general rate case (D.93263, July 7, 1981, in its Coronado District). Using computerized billing as an example, CalAm argues that staff's approach creates a disincentive that can only work to the detriment of utility ratepayers by not allowing the utility to recoup the start-up costs associated with money-saving innovations. CalAm claims that all of the decisions relied on by staff involve expenses in connection with abandonment projects. CalAm points out that if staff's position prevails, CalAm's working cash allowances in the test years will be less than allowed in 1981.

Staff cites the cases of Southern California Gas Company (1980) 4 CPUC 2d 725 and Del Este Water Company, D.82-09-061 (September 22, 1982) in support of its position. In the former case the Commission did not allow the utility to put into rate base the unamortized portion of the expenses associated with an abandoned coal

gasification project for which the Commission did allow the recovery of expenses. In the latter case the utility sought to have the unamortized portion of its regulatory commission expenses in rate base. In denying this request we stated:

> "The fact of this entire proceeding working to the benefit of applicant argues for the traditional approach of recognizing only the actual rate case cost in the rate level without inclusion in rate base." (D.82-09-061 at 18 (Mimeo).)

Staff argues that CalAm has made no showing on why the facts regarding regulatory commission expenses in its case differ from Del Este.

Staff admits that the treatment of these costs in the Coronado decision does support CalAm's claim. However, staff explains that decision as the result of an oversight on the part of staff, not a change in policy by the Commission.

Staff also discounts CalAm's claim regarding the disincentive related to the implementation of computerized billing. Staff argues that a utility always has an incentive to reduce costs to improve relations with its customers. Staff further contends that CalAm will receive a direct financial reward for instituting the new billing system for quicker bill payments, only a portion of which is reflected in working capital.

Staff rejects as misleading CalAm's claim that it will receive less working cash in 1983 under staff's proposal than it did in 1981 in the last general rate case. Staff points out that this comparison completely ignores the agreed upon reduction in needed working cash resulting from the reduced revenue lag associated with the computerized billing system, even though this deficiency was pointed out by the presiding administrative law judge.

We are persuaded that staff has aptly applied appropriate precedents and has correctly stated Commission policy. The point of this policy is that it leaves the utility some incentive to control these costs.

P. Rate of Return

CalAm proposes a rate of return on rate base of 12.99% for 1983 and 13.15% for 1984, based on a 16% return on common equity. Staff recommends that CalAm be authorized a return on rate base in the range of 12.08 to 12.33% for 1983, increased by 25 basis points in 1984 and by 5 basis points in 1985 to offset the impact of financial attrition. The staff range is based on a range of returns on equity of 14.75 to 15.25%. The decision in this proceeding will directly affect 4 other pending CalAm applications.

CalAm states that it believes that its 16% recommended return on equity is low; if it were today filing this application it would seek a higher return that would be fully justified in today's economy. However, CalAm states that it is aware of recent Commission decisions on this subject and limited its argument in its brief to urge that the Commission adopt a return no lower than the high end of the staff's proposed range. CalAm offers the following reasons for such a result:

1. CalAm's Exhibit 27 demonstrates that there is more than one very rational way to analyze this complex subject.
2. Staff's own Exhibit 29 demonstrates beyond peradventure that CalAm's earnings and returns, while improving, remain at the bottom of the heap when contrasted with comparable utilities. For example, CalAm'searnings rates on both average total capital and on average

common equity, as well as its times interest coverage, are all well below even the low average of other California Class A water utilities and of regional water utilities. Similarly, CalAm's return on its net average plant investment is materially below the average for other California Class A water utilities.

3. CalAm's dismal earnings record is a long-standing one. All agree that CalAm's recent enormous investments in new plant are appropriate and that its overall operations are excellent. While this Commission will not allow CalAm to make up for poor returns in the past, it can to some degree rectify CalAm's history of low allowed returns and equally poor historical earnings by now adopting the high side of staff's rate of return recommendations.

4. Finally, and related to the last point, isthe undeniable fact CalAm has forever lost the significant income to which it was plainly entitled on the $2,680,000 investment in new wells and treatment plant in the lower Carmel Valley. That plant has been in service since March 31, 1982 but that $2,680,000 did not earn one cent of revenue until September 8, 1982 with the issuance of D.82-09-020 (9/8/82) in this proceeding. The Commission's refusal to allow the entire $5,037,285 into rate base by advice letter, as it had originally ordered (D.92241), has directly and significantly depressed CalAm's 1982 earnings.

The staff witness testified that her recommendation was based on an analysis of forecasted market conditions and a consideration of business and financial risks associated with CalAm relative to other California and regional water utilities. She noted the high average equity ratio of the company compared to other water utilities which represents reduced risk associated with stock in the company compared with other water utilities.

The staff witness further testified regarding relative risk. She stated that there is far less risk to the shareholder of a water utility than an electric utility and therefore the risk premium should be substantially less. The lesser risk with a water utility stock is the result of several characteristics of water utilities, specifically:

1. Water utilities are not as capital intensive as electric utilities. Construction programs are much smaller and are financed to a greater degree by advances for construction and contributions in aid of construction rather than by new debt issuances.
2. Water utilities do not have to capitalize interest on construction projects (AFUDC). Although CalAm chooses to capitalize such interest, it need not do so but could include such interest in rate base resulting in a better quality of earnings and better cash flow than is the case in a typical electric utility.
3. Water utilities can receive offset increases in rates for changes in costs associated with purchased power at the time new electric rates come into effect. Electric utilities in contrast face a lag between the time fuel cost increases are experienced and offsetting rates authorized.
4. Water companies are not faced to the samedegree with risks such as changes in fuel costs, changes in source of supply, unreliability of nuclear generation, or competition as are other utilities. Accordingly, staff concludes that an appropriate risk premium for CalAm for its common equity is 100 basis points over the company's long-term debt or 300 basis points over the average yield of long-term government bonds.

Staff also offered its own recommendations regarding the cost of new debt and the capital structure. Staff's analysis indicates that according to its latest capital budget, CalAm plans to obtain $1.3 million of interim financing in 1982, $4.6 million of interim financing in 1983, $6.8 million of long-term financing in 1984, and $1.1 million of interim financing in 1985. CalAm is able to obtain its short-term financing at the prime lending rate plus 0.50%. Staff estimates the company's cost in obtaining new interim financing as 14.00% in 1982, 15.75% in 1983, and 14.00% in 1985. Staff forecasts that the company will be able to issue bonds in 1984 at 14%. CalAm assumes that all its new debt financing will cost 15%.

Staff's forecasts of CalAm's new debt costs are based on a review of recent trends in interest rates and forecasts of interest rates published by Data Resources, Inc. During the period between the first hearings in July when Exhibit 29 was presented and the second hearing in September, the staff witness revised her estimates of financing costs during the test years based upon more recent trends and forecasts of interest rates. CalAm's forecasts appear to be based on financial information that is at least ten months older.
While we recognize the analytical content of the showings by the parties, there are several considerations that lead us to conclude that even the staff range is inappropriately high in this instance. Instead we find that a return on equity of 14.5% is reasonable.

Our decision is based largely on a comparison of returns authorized other water utilities recently. These recent decisions include the following:

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).

6. California Water Service was granted 14.5% on equity in November for its East Los Angeles district (D.82-11-058).

We find these directly comparable results compelling, since we find useful the concept that rates of return should be consistent, all other things being equal.

In this case we have discounted the risk analysis and recorded earnings testimony because of the error admitted by CalAm regarding its failure to accurately account for purchased power costs. An error of that magnitude obviously impacted recorded earnings and contributed to past attrition. Since the error was not discovered until after submission, the rate of return evidence proceeds from a false premise to the extent it relies on those data.

Staff's cost of debt evidence is much more current than CalAm's. Given the passage of time and changes in the cost of debt, we find staff's showing more reliable.

Based on the foregoing, the adopted rate of return is derived as follows:

	Capital Ratios	Cost Factors	Weighted Costs
1983			
Long-Term Debt	51.50%	9.58	4.93
Common Equity	48.50	14.50	7.03
	100.00%		11.96% Rate of Return
1984			
Long-Term Debt	51.50%	10.05	5.18
Common Equity	48.50	14.50	7.03
	100.00%		12.21% Rate of Return
1985			
Long-Term Debt	51.50%	10.15	5.23
Common Equity	48.50	14.50	7.03
	100.00%		12.26% Rate of Return

Q. Rate Design

CalAm proposes that the rate design be based on the principle that revenues from service charges should cover two-thirds of the fixed costs of operation, with the remainder of the gross revenues being collected through commodity rates. That method is described as consistent with a presentation made to the Commission by the California Water Association.

Staff recommends that the rate increase should be allocated between service charges and commodity rates in a manner such that the gross revenues derived from each category are increased in equal proportions. The staff recommendation is based on the policy of creating incentives for water conservation.

CalAm states that it disagrees that the staff method acts as an incentive for conservation.

We do consider conservation to be a major rate design consideration and we agree with staff that a greater proportion of the increase on the commodity rates provides a meaningful reward for conserving. The staff's method is the same method adopted in the interim decision. We see no reason to change, and adopt the staff method again.

V. Findings and Conclusions

Findings of Facts

1. CalAm's service is good; its conservation program is adequate.

2. CalAm's estimates of numbers of customer services better reflect conditions in CalAm's service territory.

3. Staff's estimates of use per customer are based on more reliable data.

4. Water supply costs are reasonably calculated based on an allocation of 55% surface supply based on recent data and the incentive to CalAm to maximize surface water production.

5. The wage escalation factors contained in the contract between CalAm and UWUA were reasonable at the time the contract was signed.

6. CalAm's formula for nonunion employees is reasonable.

7. CalAm needs an additional meter reader in order to implement its Itron billing system.

8. CalAm needs an additional lab technician in order to allow a water treatment operator to return to the field.

9. CalAm has not shown that the Mt. Devon tank can be repaired.

10. The remaining wooden gates at the San Clemente dam should not be replaced until the status of a proposed new dam is clarified.

11. The status of the Old Capital Tract is uncertain.

12. CalAm is able to undertake its budgeted main replacement program.

13. CalAm's estimate of advances is based on reliable data and is resonably related to its estimates of growth in customer services.

14. Staff's estimate of retirements is reasonable.

15. A contingency fund is reasonably included in test year results of operations.

16. Staff's treatment of deferred debits reflects Commission policy.

17. An adopted rate of return of 11.96% for 1983 and 12.21% for 1984, based on an authorized return on equity of 14.50%, is reasonable.

18. Staff's estimates of cost of debt and capital structure are reasonable.

19. The rate design proposed by staff is more likely to promote conservation.

20. Based on adopted rates, operational attrition is 0.52% and financial attrition is 0.02% for 1985.

21. The adopted estimates of operating revenues, operating expenses, rate base, and rate of return for test years 1983 and 1984 are reasonable.

22. 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.

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

Conclusions of Law

1. Revenue increases of $1,487,000 (18.00%) in 1983 and $387,100 (3.94%) are reasonable based upon adopted results of operations. A further increase of $222,500 (2.18%) in 1985 is reasonable based on operational attrition of 0.44%.

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

3. Because of the need for additional revenue and in order to allow the rate change to coincide with the start of the test year, the order should be effective today.

FINAL ORDER

IT IS ORDERED that:

1. California-American Water Company (CalAm) 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 the date of filing or January 1, 1983, whichever is later. The revised schedules shall apply only to service rendered on and after their effective date.

2. On or after November 15, 1983, CalAm 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 Monterey

District rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ending September 30, 1983, exceeds the lower of (a) the rate of return found reasonable by the Commission for CalAm during the corresponding period in the then most recent rate decision, or (b) 11.96%. 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.

3. On or after November 15, 1984, CalAm 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 Monterey District rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ending September 30, 1984, exceeds the lower of (a) the rate of return found reasonable by the Commission for CalAm during the corresponding period in the then most recent rate decision, or (b) 12.21%. 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.

4. Before January 31, 1983, CalAm shall send the bill insert in Appendix D to its Monterey District customers.

This order is effective today.

Dated DEC 30 1982, at San Francisco, California.

RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
Commissioners

Commissioner Priscilla C. Grew, being necessarily absent, did not participate

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

Joseph E. Bodovitz, Executive Director

APPENDIX A

Page 1

SCHEDULE No. MO-1

MONTEREY PENINSULA TARIFF AREA

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all water furnished on a metered basis.

TERRITORY

Monterey, Pacific Grove, Carmel-by-the-Sea, Del Rey Oaks, Sand City, and a portion of Seaside, and vicinity, Monterey County.

RATES

	Per Meter Per Month		
	Gravity Zone	1st Elevation Zone	2nd Elevation Zone
Service Charge:			
For 5/8 x 3/4-inch meter	$ 4.80	$ 5.10	$ 5.35
For 3/4-inch meter	6.80	7.40	7.90
For 1-inch meter	9.90	11.10	11.70
For 1-1/2-inch meter	16.80	17.90	18.50
For 2-inch meter	28.50	30.50	33.00
For 3-inch meter	51.00	55.00	60.00
For 4-inch meter	76.00	83.00	90.00
For 6-inch meter	119.00	137.00	155.00
For 8-inch meter	189.00	212.00	236.00
Quantity Rates:			
For the first 300 cu. ft., per 100 cu. ft.	$ 0.849	$ 0.967	$ 1.040
For all over 300 cu. ft., per 100 cu. ft.	1.154	1.272	1.345

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

The boundaries of the three zones in which the above rates apply are as set forth in the Preliminary Statement and delineated on the Tariff Service Area Maps filed as part of these tariff schedules.

SCHEDULE No. MC-4

MONTEREY PENINSULA TARIFF AREA

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

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

TERRITORY

The incorporated cities of Monterey, Pacific Grove, Carmel-by-the-Sea, Del Rey Oaks, and a portion of Seaside; and certain unincorporated areas in the County of Monterey, all as set forth on Service Area Maps on file with the California Public Utilities Commission.

RATES	PER MONTH
For each 4-inch connection	$11.80
For each 6-inch connection	$23.60
For each 8-inch connection	$35.40

The rates for private fire service are based upon the size of the service and no additional charges will be made for fire hydrants, sprinklers, hose connections or standpipe connected to and supplied by such private fire service.

SPECIAL CONDITIONS

1. The fire protection service and connection shall be installed by the utility or under the utility's direction. Cost of the entire fire protection installation excluding the connection at the main shall be paid for by the applicant. Such payment shall not be subject to refund.

2. The installation housing the detector type check valve and meter and appurtenances thereto shall be in a location mutually agreeable to the applicant and the utility. Normally such installation shall be located on the premises of applicant, adjacent to the property line. The expense of maintaining the fire protection facilities on the applicant's premises (including the vault, meter, detector type check valves, backflow device and appurtenances) shall be paid for by the applicant.

SCHEDULE No. MO-4H

MONTEREY PENINSULA TARIFF AREA

PRIVATE FIRE HYDRANT SERVICE

APPLICABILITY

Applicable to all water service furnished for private fire hydrant service.

TERRITORY

The incorporated cities of Monterey, Pacific Grove, Carmel-by-the-Sea, Del Rey Oaks, and a portion of Seaside; and certain unincorporated areas in the county of Monterey, all as set forth on Service Area Maps on file with the California Public Utilities Commission.

RATES	PER MONTH
Private Fire Hydrant Service Installed at Cost of Applicant:	
For each Fire Hydrant Installed	$5.30

SPECIAL CONDITIONS

1. The fire protection service and connection shall be installed by the utility or under the utility's direction. Cost of the entire fire protection installation excluding the connection at the main shall be paid for by the applicant. Such payment shall not be subject to refund.

2. The installation housing the detector type check valve and meter and appurtenances thereto shall be in a location mutually agreeable to the applicant and the utility. Normally such installation shall be located on the premises of applicant, adjacent to the property line. The expense of maintaining the fire protection facilities on the applicant's premises (including the vault, meter, detector type check valves, backflow device and appurtenances) shall be paid for by the applicant.

3. All facilities paid for by the applicant shall be the sole property of the applicant. The utility and its duly authorized agents shall have the right to ingress to and egress from the premises for all purposes relating to said facilities.

4. The minimum diameter will be 6 inches, and the maximum diameter will be the diameter of the main to which the service is connected.

APPENDIX A

Page 4

SCHEDULE No. MO-7

MONTEREY PENINSULA TARIFF AREA

STREET SPRINKLING SERVICE

APPLICABILITY

Applicable to water service furnished to municipalities on a metered basis for street sprinkling.

TERRITORY

The incorporated cities of Monterey, Pacific Grove, Carmel-by-the-Sea, Del Rey Oaks, and a portion of Seaside, and vicinity, Monterey County.

RATE

	Per Month
For all water used, per 100 cu. ft.	$1.097

(End of Appendix A)

Each of the following increases in rates may be put into effect on or after January 1, 1984 by filing rate schedules which add the appropriate increase to the rate effective on that date.

SCHEDULE No. MO-1

	Per Meter Per Month		
	Gravity Zone	1st Elevation Zone	2nd Elevation Zone
Service Charge:			
For 5/8 x 3/4-inch meter	$0.20	$0.20	$ 0.20
For 3/4-inch meter	0.30	0.30	0.30
For 1-inch meter	0.40	0.40	0.50
For 1-1/2-inch meter	0.70	0.70	0.80
For 2-inch meter	1.00	1.00	1.50
For 3-inch meter	2.00	2.00	2.00
For 4-inch meter	3.00	3.00	4.00
For 6-inch meter	5.00	5.00	6.00
For 8-inch meter	7.00	8.00	10.00
Quantity Rates:			
For the first 300 cu. ft., per 100 cu. ft.	$0.033	$ 0.039	$ 0.044
For all over 300 cu. ft., per 100 cu. ft.	0.045	0.051	0.056

SCHEDULE No. MO-4

RATES	PER MONTH
For each 4-inch connection	$0.50
For each 6-inch connection	$0.90
For each 8-inch connection	$1.40

SCHEDULE No. MO-4H

RATES	PER MONTH
Private Fire Hydrant Service Installed at Cost of Applicant:	
For each Fire Hydrant Installed	$0.20

SCHEDULE No. MO-7

RATE	PER MONTH
For all water used, per 100 cu. ft.	$0.043

Each of the following increases in rates may be put into effect on or after January 1, 1985 by filing rate schedules which add the appropriate increase to the rate effective on that date.

SCHEDULE No. MO-1

RATES

	Per Meter Per Month		
	Gravity Zone	1st Elevation Zone	2nd Elevation Zone
Service Charge:			
For 5/8 x 3/4-inch meter	$0.10	$0.10	$0.10
For 3/4-inch meter	0.20	0.20	0.20
For 1-inch meter	0.20	0.30	0.30
For 1-1/2-inch meter	0.40	0.40	0.40
For 2-inch meter	0.50	0.50	1.00
For 3-inch meter	1.00	1.00	1.00
For 4-inch meter	2.00	2.00	2.00
For 6-inch meter	3.00	3.00	4.00
For 8-inch meter	4.00	5.00	5.00
Quantity Rates:			
For the first 300 cu. ft., per 100 cu. ft.	$0.020	$ 0.023	$0.025
For all over 300 cu. ft., per 100 cu. ft.	0.027	0.030	0.032

SCHEDULE No. MC-4

RATES	PER MONTH
For each 4-inch connection	$ 0.30
For each 6-inch connection	$ 0.50
For each 8-inch connection	$ 0.80

SCHEDULE No. MC-4H

RATES	PER MONTH
Private Fire Hydrant Service Installed at Cost of Applicant: For each Fire Hydrant Installed	$ 0.10

RATE	PER MONTH
For all water used, per 100 cu. ft.	$ 0.025

(End of Appendix B)

APPENDIX C

ADOPTED QUANTITIES

Name of Company: California American Water Company

District: Monterey

1. Net-to-Gross Multiplier: 2.0598

2. Federal Tax Rate: 46%

3. State Tax Rate: 9.6%

4. Local Franchise Tax Rate: 0.291%

5. Uncollectibles Rate: 0.260%

Offset Items	Test Years 1983		1984
6. Purchased Power			
A. KWh/KCcf - Boosters	649.1		649.1
Wells	1885.5		1885.5
Surface	283.0		283.0
B. Authorized Productions (KCcf)			
Boosters 1/	10,075.9		10,142.2
Wells	3,105.6		3,126.0
Surface	3,795.7		3,820.7
C. Ratio of total booster water total produced (recorded 8/31/81)	1.46		1.46
1/ (3105.6 + 3795.7) x 1.46 = 1983 (3126.0 + 3820.7) x 1.46 = 1984			
D. KWhrs			
Boosters	6,540,267		6,583,302
Wells	5,855,609		5,894,073
Surface	1,074,183		1,081,258
Total Kwh	13,470,059		13,558,633
E. Present $/Kwh - PG&E (9/82)			
Boosters		$0.075293/Kwh	
Wells		0.073211/Kwh	
Surface		0.071519/Kwh	
F. Expense w/o adjustment for savings			
Boosters	$492,436		$ 495,677
Wells	428,695		431,511
Surface	76,824		77,330
Total	$997,955		$1,004,518
G. Purchased Power w/o adj. for savings			
Total	$997,955		$1,004,518
H. Power Savings due to repair of wells + boosters	(37,500)		(55,100)
Total Purch. Power Authorized	$960,500		$949,400

Offset Items (Cont'd)	Test Years 1983	1984
I. Kwh (Total)	13,470,059	13,558,633
J. Average Cost/Kwh	$0.071306	$0.070022
7. Ad Valorem Taxes	$ 248,800	$ 265,800
Effective Tax Rate	1.03818%	1.03818%

8. Number of Services:

	No. of Services 1983	No. of Services 1984	Usage-KCcf 1983	Usage-KCcf 1984	Avg.Usage-Ccf/Yr. 1983	Avg.Usage-Ccf/Yr. 1984
Residential-Metered	26,189	26,338	2985.5	3002.5	114.0	114.0
Business-Normal	4,580	4,650	1617.2	1641.9	353.1	353.1
Business-Large	66	66	716.8	716.8	10,860.0	10,860.0
Golf Courses	14	14	365.5	365.5	26,107.1	26,107.1
Industrial	8	8	44.0	44.0	5,500.0	5,500.0
Public Auth.-Normal	381	381	166.0	166.0	435.8	435.8
Public Auth.-Large	15	15	459.7	459.7	30,647.0	30,647.0
Subtotal	31,253	31,472	6354.7	6396.4		
Private Fire Protection	288	313				
Total	31,541	31,785				
Water Loss at 7.92%			546.6	550.3		
Total Water Produced			6901.3	6946.7		
Surface Supply @ 55%			3795.7	3820.7		
Pumped Water @ 45%			3105.6	3126.0		

ADOPTED SERVICE BY METER SITE

9. Adopted Service by Meter Size

Meter Size	1983 Gravity	1983 1st Elevation	1983 2nd Elevation	1984 Gravity	1984 1st Elevation	1984 2nd Elevation
5/8" x 3/4"	17531	7424	1834	17655	7471	1843
3/4"	1	-	-	1	-	-
1"	1966	960	332	1984	967	334
1 1/2"	473	175	28	476	177	28
2"	308	86	14	312	87	15
3"	30	12	3	30	12	3
4"	22	7	2	23	7	2
6"	18	5	3	18	5	3
8"	12	5	2	12	5	2
10"	-	-	-	-	-	-
Total	20361	8674	2218	20511	8731	2230

10. Metered Water Sales Used to Design Rates

Usage - Ccf

Range-Ccf	1983 Gravity	1983 1st Elevation	1983 2nd Elevation	1984 Gravity	1984 1st Elevation	1984 2nd Elevation
Block 1 0-3	674,537	307,224	72,776	679,406	309,280	73,178
Block 2 >3	3,902,025	1,122,617	275,569	3,927,948	1,129,928	276,774
Total Usage	4,576,562	1,429,841	348,345	4,607,354	1,439,208	349,952

ADOPTED TAX CALCULATIONS

		1983		1984	
		CCFT	FIT	CCFT	FIT
		(Dollars in Thousands)			
1	Operations Revenues	$9747.2	$9747.2	$10203.7	$10203.7
2	O&M Expenses	4609.7	4609.7	4927.0	4927.0
3	Taxes Other than Income	361.8	361.8	389.6	389.6
4	CCFT	.0	216.6	.0	187.7
5	Subtotal	4971.5	5188.1	5316.6	5504.3
6	Deductions from Taxable Income				
7	Tax Depreciation	1042.6	922.6	1133.3	973.1
8	AFUDC	104.1	104.1	85.5	85.5
9	Capitalized Overheads	48.0	48.0	54.6	54.6
10	Interest Expense	1320.7	1320.7	1654.1	1654.1
11	Debt Expense	4.3	4.3	4.3	4.3
12	Subtotal Deductions	2519.7	2399.7	2931.8	2771.6
13	Net Taxable Income for CCFT	2256.0		1955.3	
14	CCFT	216.6		187.7	
15	Total CCFT	216.6		187.7	
16	Net Taxable Income for FIT		2159.4		1927.8
17	Federal Income Tax		993.3		886.8
18	Investment Tax Credit		-31.9		-36.9
19	Fed Income Tax Before Adj.		961.4		849.9
20	Graduated Tax Adjustment		- 7.5		- 7.5
21	Total FIT		953.9		842.4

(End of Appendix C)

APPENDIX D

N O T I C E

$297,200 of the recent rate increase granted to California-American Water Company in its Monterey District was made necessary by changes in tax laws proposed by the President and passed by Congress in 1981. 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-adressed envelope to:

Consumer Affairs Branch
Public Utilities Commission
350 McAllister Street
San Francisco, CA 94102

(End of Appendix D)