

Decision 83 06 034 JUN 29 1983

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of KERNVILLE DOMESTIC WATER)
COMPANY, a California corporation,)
to borrow funds under the Safe)
Drinking Water Bond Act, and to)
add a surcharge to water rates to)
repay the principal and interest)
on such loan.)

Application 82-11-34
(Filed November 18, 1982)

John Foth, Frank Forsberg, and Robert P.
Jones, for Kernville Domestic Water
Company, applicant.

James M. Windsor and Gunter A. Redlin, for
California Department of Health Services;
Edward L. Crandall, for State of California
Department of Water Resources; and Lorna
Charlton, for North Kern Property Owners
Association; interested parties.

C. Frank Filice and Albert Arellano, Jr., for
the Commission staff.

O P I N I O N

By Application (A.)82-11-34, Kernville Domestic Water Company (the company or applicant) requests the Commission to issue an order granting it authority, under Public Utilities (PU) Code Section 818, to enter into a California Safe Drinking Water Bond Act of 1976 (SDWBA) loan contract (Water Code Sections 13850 et seq.), payable over a period of 35 years at an interest rate of approximately 8-1/2% per annum, with the California Department of Water Resources (DWR). The loan is not to exceed \$412,000. Also,

the company requests authority from the Commission to add a surcharge to water rates to repay the principal and interest on such loan. The money is to be used to make various improvements to the company's system to achieve compliance with our interim opinion in Decision (D.)82-07-019 (A.61021). Specifically, the company proposes using the money to drill at three new potential well sites; to construct an iron and manganese removal facility and adjacent small holding tank; to lay collecting lines from five wells to the treatment plant; and to erect a 300,000-gallon storage tank which is already at the site but remains unassembled. In addition, the company proposes to increase source capacity by 200 gallons per minute (gpm) either from the new wells or by exchanging highly mineralized well water with Kern River water.

The SDWBA states, among other things, that water utilities failing to meet California Health and Safety Code standards and which cannot otherwise finance necessary plant improvements may apply to the DWR for low-interest loans. The California Department of Health Service (DHS) is required by SDWBA to analyze the public health issues and determine plant improvements needed to meet water quality and quantity standards. DWR assesses financial need and acts as the lending agency and fiscal administrator. Before a loan is granted, the applicant must demonstrate to DWR its ability to repay the loan and show that it

has taken steps to maximize water conservation. Under the provisions of PU Code Sections 816 through 851, public utility water companies must obtain authorization from the Commission to enter into any long-term loan. PU Code Section 454 requires a public utility water company to obtain Commission approval for rate increases.

The DHS has reviewed the company's loan proposal and has set forth a summary of construction to be undertaken with the loan proceeds. By letter dated August 9, 1982, DWR informed the company of its eligibility for a loan under the SDWBA.

The items of construction and estimated costs as proposed by DHS are detailed as follows:

<u>Description of Item</u>	<u>Estimated Cost</u>
1. Drill and equip three new wells	\$117,000
2. Construct and equip a 400-gallon per minute capacity treatment plant and adjacent holding tank	140,000
3. Install well manifolding for collecting and connecting lines from Wells 2, 3, 4, 7, 9 and any of the three new wells which prove productive, to the treatment plant	64,000
4. Erect a 300,000-gallon storage tank	<u>42,000</u>
Subtotal	\$363,000
Other Contingency Costs	37,000
DWR Administrative Fee 3%	<u>12,000</u>
Total	<u>\$412,000</u>

The proposed loan from DWR will provide for a 35-year repayment schedule with equal semiannual payments of principal and interest, at an interest rate of 8-1/2% per annum.

Because of strong public concern about the activities of the company, a public witness hearing was held in the Kernville Elementary School auditorium before Administrative Law Judge Colgan

on Wednesday, February 9, 1983. A formal hearing, under PU Code Section 819, was held on the same date and place immediately after the conclusion of the public witness segment. The matter was submitted that same evening.

Public Witness Testimony

Approximately 100 members of the community attended the public witness part of the hearing. After an explanation of the planned project by a representative of the company, an explanation of the loan procedure by a representative of DWR, a description of the present quantity and quality problems by a representative of the DHS, and a statement supporting the proposal from an economic standpoint by a representative of our staff, eight people from the community made statements. Of these speakers, one represented the North Kern Property Owners Association, and one was a member of the County Board of Supervisors. Both these speakers expressed support for the concept. The others spoke for themselves. Only one person voiced opposition to the loan claiming that the hearing was a sham and that the Commission has already decided the issue. Another reminded the Commission to consider the application in light of the ballot proposition to form a community service district which will be voted on in June.^{1/} The rest ✓ generally acknowledged the need for the loan but expressed concern over the following:

^{1/} On June 7, 1983 the ballot proposition was defeated. ✓

- .The amount of the surcharge proposed;
- .The necessity for careful monitoring of how the money is spent;
- .The need for the Commission to establish a date by which the company must decide whether to exchange river water or rely solely on well water (most speakers strongly preferred the exchange concept);
- .The speedy end to the building moratorium imposed in Kernville by DHS;
- .The possibility of the company increasing its loan commitment without community input;
- .The reason why the company plans to tear down one storage tank and build a new one rather than keep two; and
- .The reason why the ratepayers, rather than company stockholders, should pay, by way of increased rates, the property tax increases which will result from these improvements.

Formal Hearing

Each of the concerns listed above was addressed by one or more participants in the formal hearing.

Mr. Filice of the staff explained that the surcharge (\$6.65 per month for a regular residential meter) was calculated based on an estimated loan of \$412,000 at 8.5% interest, and reminded everyone that the amount actually borrowed could be less or more and that the interest rate figure is an estimate based on present DWR loans.

Witness testimony and exhibits showed that the revenue to meet the semiannual payments on the SDWBA loan will be obtained from surcharges on all metered connections. The total amount of revenue from the proposed surcharge will exceed the loan repayment requirements by approximately 10%. In accordance with DWR requirements, this surcharge including the overcollection will be deposited with an independent fiscal agent to accumulate a reserve of two semiannual loan payments over a 10-year period. Earnings on funds deposited with the fiscal agent, less charges for the fiscal agent's services, will be added to the fund. Net earnings of the fund will be used, together with rate surcharge amounts collected from customers, to meet the semiannual loan payments.

Filice explained that the Commission reserves the right to review the manner in which the fund is invested and to direct that a different fiscal agent acceptable to DWR be selected. He also explained that all sums collected by the company through the rate surcharge must be recorded in a separate "balancing account" which also would be used to record payments of the principal and interest on the SDBWA loan and that the rate surcharge should be adjusted periodically to reflect actual cost of servicing this debt.

We agree with the community that excess amounts should not be collected, and that the company should review this rate surcharge annually and adjust it particularly if the related amount in the balancing account becomes unreasonably high. The witness from DWK explained that his agency would closely monitor the use of the loan funds as well as the accounting practices. In addition, the Commission staff witness testified that DHS would monitor the progress of the company's construction plans. As a result, we think the program can be adequately monitored.

The annual requirement for debt service for the company's customers is estimated to be \$40,733. The amount of the surcharge to repay principal, interest and necessary reserve on the SDWBA loan will be in direct proportion to the capacity of each customer's meter. For example, for each residential customer with a 5/8" x 3/4" inch meter the surcharge will be approximately \$6.65 per month. This estimate is based on an interest rate of 8-1/2%. However, as the witnesses explained, an average interest rate for all SDWBA loans will be determined after all SDWBA bonds have been sold. Then the rate on each outstanding loan will be adjusted to reflect that average rate.

If the actual construction costs of the company's water system improvements exceed the presently estimated costs, and if the Commission authorizes the company to increase the amount of the SDWBA loan to cover such additional costs, it may also be necessary to adjust the monthly rate surcharge accordingly. ✓

Using present estimates the surcharge schedule will be as follows:

Kernville Domestic Water Company, Inc.

Surcharge Schedule

<u>Size of Meter</u>	<u>Monthly Surcharge^{1/}</u>
5/8" x 3/4"	\$ 6.65
3/4"	10.00
1"	16.70
1-1/2"	33.25
2"	53.20
3"	99.75
4"	166.25

- (1) This surcharge is in addition to regular charges for water service.

The company's present rates were authorized by Commission D.82-07-019 effective July 22, 1982 pursuant to A.61021, as amended. The estimated annual gross revenues for 1982 at present rates exclusive of the surcharge will be approximately \$128,220. The \$40,733 yearly increase resulting from the SDWBA loan surcharge thus would increase the company's revenues by approximately 32%.

With regard to the timing of the company's choosing between pursuit of an exchange agreement for Kern River water and reliance solely on well production, we agree with the position taken by several public witnesses, as well as DHS, that a contract for Kern River water should be obtained without delay. At the same time, we think it is prudent for the company to complete its three test drillings in an attempt to supplement the groundwater supply. As the DHS witness explained, a 200-gpm increase in source capacity is necessary before the DHS-imposed building moratorium could safely be lifted. He stated that such an increase would allow for 10% more development in Kernville (about 45 to 50 lots). He further stated that an exchange agreement for Kern River water would have the same effect as a 200-gpm increase even without additional amounts of water, if the agreement permitted the company to deposit well water and withdraw river water on a schedule which would assure adequate reserves at all times.

The company's witness testified that the company had been negotiating with the watermaster of the Kern River for just such an arrangement and it appeared that an agreement could be reached. A draft agreement is presently being prepared. The watermaster, it should be noted, is a person appointed by the DWR upon request of those persons lawfully entitled to divert water

from the river. The watermaster is an employee of DWR whose duties include enforcing the laws regulating water rights in the service area. (See California Water Code Section 4000, et seq.) However, even if an exchange agreement were reached, there remains a need for sufficient quantities of surface water for exchange. And, as the company and DHS witnesses indicated, the present sources may not always be reliable. Thus, in an area as arid as Kernville, it is prudent to attempt to have at least one backup source if the costs do not outweigh the reasonably foreseeable benefits. We believe the proposed drilling costs for three test wells balance in favor of proceeding. Such action will better assure some alleviation of the building moratorium and better assure future source reliability.

As to the question which arose regarding the company increasing its loan commitment, DWR's witness explained that a complete new application procedure with a recommendation for approval by DHS and another approval by the Commission would precede any such occurrence. These safeguards assure the community that the loan amount will not be increased without independent review and approval.

With respect to the water storage tank issue, applicant's president explained that the company had to tear down the present tank and erect the new one in its place because the company does

not have sufficient space to do otherwise, as the rest of the adjacent area is landfill and a storage tank cannot legally be erected on such terrain. No one indicated that this action would have any adverse effect on water availability. Thus, while we would prefer to see the company keep a backup storage tank, rather than raze it, it does not seem reasonable under the circumstances.

Finally, regarding the question of who should pay for future property tax increases resulting from these SDWBA improvements to the system, the witnesses testified that any increased property taxes resulting from these improvements increasing the company's property valuation would be considered as normal operating expense and thus be paid by the ratepayers. The rates the company is authorized to charge are set out in the tariffs adopted in D.82-07-019. They can only be changed upon application to the Commission and notification to customers of that application. The present application does not request any change in rates beyond the surcharge to repay the proposed SDWBA loan. So, at the present time, any increase in property tax will have to come from the presently authorized rates.

In addition to addressing those issues raised by customers, witnesses testified without contradiction to the following:

DWR is the sole source available for such a loan; the company was turned down by a regular lending institution;

The amount of the SDWBA water system improvements cannot be added to rate base; therefore, they cannot be used as a basis for future increase in rates requested by the company;

The water treatment plant would be essentially the same but with need for less chemicals if the company uses Kern River water rather than presently available, highly mineralized groundwater;

Leasing water rights to the river water would cost \$140 per acre-foot and require a substantial rate increase;

The loan provides funding for reasonable expansion but not ultimate expansion. The primary purpose is to serve the present users, not to aid development;

These loans are coadministered by DWR and DHS. DWR's function is to analyze the applications and determine if the costs are reasonable. DHS approves the proposed project plans and specifications and monitors the project.

Taking all these factors into account we conclude that this application should be granted and the company should be authorized to enter into a contract with DWR for a SDWBA loan not to exceed \$412,000, to permit the company to engage in the various improvements specified in its application. Also, the company

should be authorized to institute a surcharge on customer's bills to repay the SDWBA loan.

As to the vacant or undeveloped lots, the Commission staff recommends that the company institute a service fee for new service. The amount of the service fee would be the accumulated total of the SDWBA loan rate surcharge since its inception until the time of hook-up to a maximum of \$1,000. The staff believes that a larger fee would inhibit future development. The owner of the vacant lot would make a lump sum payment of the accumulated service fee upon connection, and thereafter pay the monthly surcharge. We will adopt the staff recommendation.

To ensure adequate accountability of SDWBA loan construction funds advanced by DWR to the utility, such funds should be deposited by the company in a separate bank account. All disbursements of such DWR loan funds should also pass through this bank account.

The DWR has expressed a clear preference for the surcharge method of financing SDWBA loans, in lieu of rate base treatment, because the surcharge method provides greater security for its loans. The Commission considered this issue of surcharge versus rate base in A.57406 of Quincy Water Company,^{2/} wherein it

2/ (D.) 88973, dated June 13, 1978 (mimeo).

concluded that the surcharge method, which requires a substantially lower initial increase in customer rates, is the most desirable method of financing SDWBA loans.

By adopting this surcharge method of accounting, the Commission does not imply that SDWBA-financed plant should be treated any differently in the event of condemnation by a public agency than if such plant had been included in the utility's rate base and had been financed in some other manner.

The SDWBA loan repayment surcharge should be separately identified on customers' bills. The utility plant financed through the surcharge should be permanently excluded from rate base for ratemaking purposes and the depreciation on this plant should be recorded in memorandum accounts for income tax purposes only.

The company should establish a separate balancing account to be credited with revenue collected through the surcharge, and with interest earned on funds deposited with the fiscal agent. Surcharge revenues should be deposited with the fiscal agent within 30 days after collection. The balancing account should be charged with payments of principal and interest on the loan, and for the services of the fiscal agent. The surcharge should be adjusted periodically to reflect changes in the number of connections and resulting overages or shortages in the balancing account. Such changes in future rates should be accomplished by normal advice letter procedures.

The SDWBA rate surcharge authorized will cover only the cost of the loan incurred to finance the added plant and will not preclude the likelihood of future rate increase requests to cover rising costs of repair materials, wages, property taxes, power bills, or other operating expenses that may be incurred in the future.

According to staff, in order for the surcharge to produce enough revenue to meet the initial payment of interest on the SDWBA loan due in July 1984, it is necessary for the company to place the surcharge into effect beginning October 1983. This will enable the utility to meet the initial payment and make the regular semiannual payments thereafter.

Findings of Fact

1. The improvements proposed to be made by applicant are reasonably required to improve service, produce a healthful, reliable water supply, and to comply with our interim order in D.82-07-019 (A.61021).
2. The improvements proposed to be accomplished with the proceeds of this loan cannot be, in whole or in part, reasonably chargeable to operating expenses or to income.
3. The proposed indebtedness is payable more than 12 months after it commences and must, therefore, be authorized by this Commission pursuant to PU Code Section 818.

4. The SDWBA loan provides low-cost capital for the needed water system improvements and is a prudent means of acquiring an estimated \$412,000 including a 3% administrative charge by DWR.

5. The establishment of a reserve equal to two semiannual loan payments is required by DWR administrative regulations.

6. Deposits of the SDWBA surcharge funds should be made with the fiscal agent within 30 days after collection from customers.

7. The proposed surcharge will generate approximately \$40,733 per year, approximately 10% of which will remain on deposit with the fiscal agent approved by DWR, in order to accumulate, over a 10-year period, a reserve equal to two semiannual loan payments.

8. The establishment of a separate bank account by applicant is required to ensure adequate accountability for deposits and disbursements of SDWBA loan funds advanced by DWR to the utility.

9. The rate surcharge will increase applicant's annual gross revenues by approximately \$40,733 and increase the water rates by approximately \$6.65 per month for an average residential customer with a 5/8-inch by 3/4-inch meter. Water rates of customers with larger meter capacities would be increased proportionately.

10. The rate surcharge established to repay the SDWBA loan should last as long as the loan. The rate surcharge payment should not be intermingled with other utility charges, and such repayment surcharge should be separately identified on customers' bills.

11. The utility plant financed through this SDWBA loan should be permanently excluded from rate base for ratemaking purposes.

12. Applicant should establish a separate balancing account to be credited with revenue collected through the surcharge, and with interest earned on funds deposited with the fiscal agent. The balancing account should be reduced by payments of principal and interest on the loan and with any charges for the services of the fiscal agent.

13. The rate surcharge should be reviewed annually and adjusted as necessary to reflect changes resulting in overages or shortages in the balancing account.

14. This surcharge should be placed in effect beginning October 1, 1983 to meet the initial payment due in July 1984.

15. An average interest rate for all SDWBA loans will be determined after all of the State of California Safe Drinking Water bonds have been sold. At that time the interest rate on each SDWBA loan outstanding will be adjusted to reflect the average rate.

16. Undeveloped lots will benefit from the expenditures being made from the proceeds of the SDWBA loan. The benefits include the availability of water furnished by a public utility which meets health standards.

17. It is reasonable to establish a service fee for new connections pertaining to vacant or undeveloped lots since these lots will benefit from these improvements.

18. A maximum lump sum service fee of \$1000 payable by vacant lot owners upon connection is reasonable.

19. In order to best assure continued adequate water supplies, the company should enter an agreement, without delay, for the exchange of its highly mineralized groundwater with Kern River water.

20. In order to best assure continued adequate water supplies, the company should also pursue the test drilling of three potential well sites in the community.

Conclusions of Law

1. The increased rates are just and reasonable, and the application should be granted to the extent set forth in the following order.

2. This order should be effective today to allow the earliest possible implementation of these necessary SDWBA water system improvements.

O R D E R

IT IS ORDERED that:

1. On or after the effective date of this order, Kernville Domestic Water Company, (the company) is authorized to file the revised rate schedules attached to this order as Appendix A. Such filing shall comply with General Order 96-A. The revised rate schedules shall apply only to service rendered on or after October 1, 1983.
2. The company is authorized to borrow \$412,000 from the State of California, under the Safe Drinking Water Bond Act of 1976 (SDWBA) administered by the California Department of Water Resources (DWR), to execute the proposed loan contract, and to use the proceeds for the purposes specified in the application.
3. To assure repayment of the loan, the company shall deposit all rate surcharge revenue collected with the fiscal agent approved by DWR. Such deposits shall be made within 30 days after the surcharge monies are collected from customers.
4. The company shall establish and maintain a separate balancing account in which it shall record all billed surcharge revenue and interest earned on deposits made with the fiscal agent. The balancing account shall be reduced by payments of principal and interest to the DWR and by any charges for the services of the fiscal agent.

5. A separate statement pertaining to the surcharge shall appear on each customer's water bill issued by the company.

6. The company shall review its balancing account annually. If the number of ratepayers or other relevant factors have changed so that an amount in excess of the reserve required by DWR exists in the account, the company shall reduce the surcharge, notifying the Commission and its ratepayers of the reduction. If the amount in the balancing account is less than the amount required by DWR, the company shall file an advice letter requesting that the surcharge be increased.

7. Plant financed through the SDWBA loan shall be permanently excluded from rate base for ratemaking purposes.

8. The company shall file with the Commission a copy of the loan contract with DWR and a copy of the agreement with the fiscal agent, within 30 days after these documents have been executed.

9. The company shall establish and maintain a separate bank account, to ensure adequate accountability for deposits and disbursements of SDWBA loan construction funds advanced by DWR to the utility.

10. The company shall enter into an agreement with the Kern River watermaster to exchange groundwater for Kern River water.

The authority granted by this order to issue an evidence of indebtedness and to execute a loan contract will become effective when the issuer pays \$824, set by Public Utilities Code Section 1904(b). In all other respects, this order becomes effective today.

Dated JUN 29 1983, at San Francisco, California.

LEONARD M. GRIMES, JR.
President

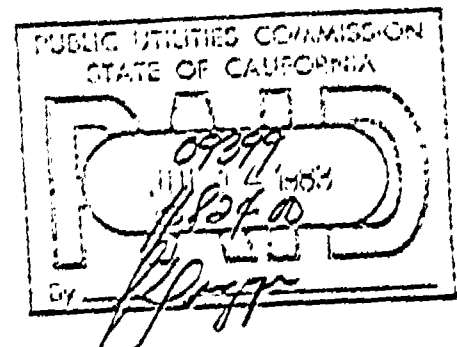
VICTOR CALVO

PRISCILLA C. GREW

DONALD VIAL

WILLIAM T. EAGLEY

Commissioners



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

Joseph E. Bodovitz
Joseph E. Bodovitz, Executive Director

APPENDIX A
Page 1
Schedule 1

METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Kernville and vicinity, Kern County.

RATES

Quantity Rates:

	<u>Per Meter Per Month</u>
First 300 cu. ft., per 100 cu.ft.	\$ 0.800
Over 300 cu.ft., per 100 cu.ft.	1.074

Service Charge:

	<u>Per Meter Per Month Charge</u>	<u>Per Meter Per Month Surcharge</u>	(N)
For 5/8 x 3/4-inch meter.....	\$ 6.50	\$ 6.65	 (N)
For 3/4-inch meter.....	7.15	10.00	
For 1-inch meter.....	9.75	16.70	
For 1-1/2-inch meter.....	13.00	33.25	
For 2-inch meter.....	17.55	53.20	
For 3-inch meter.....	32.50	99.75	
For 4-inch meter.....	44.20	166.25	

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.

METERED SERVICE SURCHARGE

NOTE: This surcharge is in addition to the regular monthly metered water bill. The total monthly surcharge must be identified on each bill. This surcharge is specifically for the repayment of the California Safe Drinking Water Bond Act loan as authorized by Decision (a).

(a) Insert Decision Number in Application 82-11-34 before filing tariff.

APPENDIX A
Page 2
Schedule No. 2

FLAT RATE SERVICE

APPLICABILITY

Applicable to all water service furnished on a flat rate basis.

TERRITORY

Kernville and vicinity, Kern County.

	<u>Per Service Connection Per Month Charge</u>	<u>Per Service Connection Per Month Surcharge</u>	(N)
1. For a residence without bath facilities, for household use only	\$ 6.20	\$ 6.65	
a. Additional for bath facilities.....	2.50	2.70	
2. For a hotel or motel, including manager's living quarters and one rental unit.....	8.00	8.60	
a. For each additional rental unit.....	6.20	6.65	
3. For yard irrigation during the months of March through October, inclusive.....			
First 7,500 sq. ft. or less of irrigated area.....	3.70	4.00	
Over 7,500 sq. ft., per 1,000 sq. ft....	1.25	1.35	
4. For a service station or garage.....	12.60	13.50	(N)

SPECIAL CONDITIONS

1. All service not covered by the above classifications will be furnished on a metered basis.
2. Irrigation will not be permitted through open hoses.
3. Meters may be installed at option of utility or at option of customer where the flat rate or the combined flat rate for above classifications equals \$8.00 or more per month, in which event service will thereafter be furnished only on the basis of Schedule No. 1, Metered Service.

FLAT RATE SERVICE SURCHARGE

NOTE: This surcharge is in addition to the regular charge of \$6.20 per service connection, per month. The total monthly surcharge must be identified on each bill. This surcharge is specifically for the repayment of the California Safe Drinking Water Bond Act loan authorized by Decision (a).

- (a) Insert Decision Number in Application 82-11-34 before filing tariff. (N)

APPENDIX A
Page 3
Schedule No. 3

STATE BOND ACT LOAN FEE FOR UNDEVELOPED LOTS

APPLICABILITY

1. Applicable to undeveloped lots within the service area of Kernville Domestic Water Company as of the effective date of Decision _____ (a) -

(N)

TERRITORY

Kernville and vicinity, Kern County.

RATES

A service fee to provide for reduction of the SDWBA loan surcharges is chargeable to customers requesting future services to undeveloped lots.

The service fee shall be the accumulated total of the monthly surcharge provided for in Schedules 1 and 2, as applied to the property being furnished water service from the effective date of Decision _____ (a) to the date of the connection. The maximum service fee shall be \$1000. The service fee shall be due and payable upon connection of water service to the lot. The surcharge authorized by the Commission, as contained in the Utility's filed tariffs, will apply thereafter.

The monthly surcharge established by the Public Utilities Commission in Decision _____ (a) is subject to periodic adjustment. The calculation of the accumulated surcharges shall take into account such periodic adjustments.

(a) Insert Decision Number in Application 82-11-34 before filing tariff.

(N)

(END OF APPENDIX A)

on Wednesday, February 9, 1983. A formal hearing, under PU Code Section 819, was held on the same date and place immediately after the conclusion of the public witness segment. The matter was submitted that same evening.

Public Witness Testimony

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• On June 7, 1983, the ballot proposition was defeated.

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