

Decision No. 88271 DEC 20 1977

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application )  
of San Gabriel Valley Water )  
Company for authority to increase )  
rates charged for water service )  
in its Fontana Water Company )  
Division. }

Application No. 56714  
(Filed August 25, 1976)

John E. Skelton, Attorney at Law, for  
applicant.  
James S. Rood, Attorney at Law, Chester  
O. Newman, and I. B. Nagao, for the  
Commission staff.

O P I N I O N

San Gabriel Valley Water Company (SG) seeks authority to increase water rates in its Fontana Water Company Division (FD). Exhibit 2 shows that test year 1977 net operating revenues for FD would increase from \$242,738 to \$490,233 at proposed rates, which would increase the rate of return on the 1977 rate base from 4.37 percent to 8.80 percent. SG also seeks step rates to offset attrition in rate of return for the years 1978 and 1979.

After notice, public hearings were held in the city of Fontana on May 9, 1977 and in the city of Los Angeles on May 10 and 11, 1977 before Administrative Law Judge Jerry J. Levander. The matter was submitted on May 11, 1977.

Service Area and Water System

SG has systems for the production, distribution, and sale of water in its El Monte and Whittier Divisions in Los Angeles County, and a system for the distribution and sale of water in its FD in San Bernardino County, California. SG's general office and shops are located in the city of El Monte. FD includes portions of the cities of Fontana and Rialto and adjacent unincorporated territory in the county of San Bernardino.

The Fontana Union Water Company (Fontana Union), a mutual water company, which secures its water from Lytle Creek surface flow, the Grapeland Tunnel, wells, and the Chino Basin Municipal Water District, supplies SG with all of the water used in the FD. SG owns approximately 4,608 shares of Fontana Union stock which entitles it to a constant flow of 1,151.75 miner's inches. During periods of peak use, this basic allowance may be doubled, subject to limiting conditions. Water storage is supplied by Fontana Union. SG treats and boosts the water in its system. Water treatment consists of a link-belt traveling screen, chlorination, and diatomaceous earth filtration of gravity waters from Lytle Creek at one point, microstraining and chlorination of Colorado River water at two points, and chlorination at additional points.

Water for distribution to over 15,200 customers in the FD is taken at 24 primary and secondary service points, and is delivered to three pressure zones by gravity flow and by boosting. Distribution is made to customers through approximately 1,430,000 feet of mains ranging in sizes from 2 inches to 30 inches in diameter.

Rates

SG proposes to: (1) change from a minimum type rate metered schedule to a service charge type of rate schedule in its FD; (2) establish initial rates for service rendered prior to January 1, 1978; (3) incorporate two annual step increases to offset attrition in its rate of return caused by substantial increases in major expense items and for increases in rate base for which rate relief cannot be obtained by a regular offset procedure (e.g., an offset for increased purchased power costs); (4) increase private fire protection rates from \$2.00 to \$2.50 (25 percent) per inch of diameter; and (5) simplify one of the two applicable public fire hydrant rates. The tabulation on the following page sets forth SG's present<sup>1/</sup> and proposed metered service rates for the FD.

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<sup>1/</sup> These rates were authorized by Resolution No. W-1886. The quantity rates per 100 cubic feet for the second and third rate blocks have subsequently been increased to 0.268¢ and to 0.230¢ to offset an increase in purchased water costs from 5¢ per miner's inch hour (MIH) to 5.5¢ per MIH (see Advice Letter 145). A surcharge of 0.03¢ per Ccf for monthly consumption in excess of 500 cubic feet has also been authorized (see Advice Letter 147) to offset an increase in purchased water costs from 0.055¢ per MIH to 0.07¢ per MIH and an assessment increase on Fontana Union stock from \$3.50 to \$7.00 per share.

Fontana Division Rates

Item	Present Rates	Proposed Rates		
		Before 1/1/78	After 1/1/78	After 1/1/79

Quantity Rates

First 400 cu.ft. or less	\$ 3.62	\$ -	\$ -	\$ -
First 500 cu.ft., per 100 cu.ft. ....	-	0.26	0.266	0.272
Next 4,600 cu.ft., per 100 cu.ft. ....	0.260	-	-	-
Over 5,000 cu.ft., per 100 cu.ft. ....	0.221	-	-	-
Next 19,500 cu.ft., per 100 cu.ft. ....	-	0.329	0.342	0.355
Over 20,000 cu.ft., per 100 cu.ft. ....	-	0.29	0.304	0.318

Type of Charge	Minimum <sup>a/</sup>	Service <sup>b/</sup>		
5/8 x 3/4-inch meter .....	3.62	3.60	3.65	3.70
3/4-inch meter .....	4.20	4.00	4.05	4.10
1-inch meter .....	5.55	5.50	5.60	5.70
1-1/2-inch meter .....	9.00	7.65	7.85	8.05
2-inch meter .....	12.85	9.85	10.10	10.35
3-inch meter .....	22.20	18.25	18.75	19.25
4-inch meter .....	34.00	25.00	26.00	27.00
6-inch meter .....	94.00	41.00	42.00	43.00
8-inch meter .....	159.00	61.00	62.00	63.00
10-inch meter .....	242.00	76.00	78.00	80.00

a/ The Minimum Charge will entitle the customer to the quantity of water which that minimum charge will purchase at the Quantity Rates.

b/ The Service Charge is a readiness-to-serve charge applicable to all metered service and to which is to be added the quantity charge computed at the quantity rates.

SG requests authority to file a revised and simplified public fire hydrant service schedule, applicable in a portion of its FD, which would result in an estimated total increase for test year 1977 of \$21. It also seeks authorization to revise the special conditions in its public fire protection schedule to reflect current operating conditions.

Three customers stated they were opposed to the magnitude of the proposed increase. One customer had a service complaint caused by SG's failure to contact her prior to a scheduled service interruption. SG states that procedures have been instituted to prevent a recurrence of the latter situation.

#### Results of Operations

Table 1 compares the summary of earnings estimates of SG and the staff for 1976 and 1977 at present rates (the rates authorized by Resolution No. W-1886) and at SG's proposed rates, and shows the adopted summary of earnings for test year 1977.

#### Operating Revenues

Both SG and the staff utilized the modified-Bean method to correlate water usage with rainfall and temperature for commercial bi-monthly and public authority monthly customers. The staff based its test year customer growth projections on a six-year historical trend. SG based its customer growth estimate on a three-year trend.

We will adopt the staff estimates for commercial sales (residential and business) since later customer growth and usage data became available to it. There has been a downtrend in average sales for industrial and public authority classifications. We will adopt SG's estimates for the industrial and public authority sales which are more indicative of current and immediate future usage trends than the staff estimates.

#### Water Conservation

An SG witness reviewed the extensive and comprehensive water conservation plan being implemented by SG (see Exhibit 4). He testified that part of the present program has been in effect for several years but that a much more intensive effort has been made to encourage all types of conservation since June 1976. SG believes that its programs are reducing average water use per customer.

Table 1

## SAN GABRIEL VALLEY WATER COMPANY

Summary of Earnings for Fontana Division  
(Estimated Years 1976 and 1977)

Item	1976		1977		1977 Adopted
	SG	Staff	SG	Staff	
	:Estimate :Exh. 2	:Estimate :Exh. 6	:Estimate :Exh. 2	:Estimate :Exh. 6	

(Dollars in Thousands)

At Rates Authorized by Resolution No. W-1886

Operating Revenues	\$1,840.4	\$1,858.6	\$1,849.7	\$1,874.3	\$1,860.1
<u>Operating Deductions</u>					
Operating Expenses	1,150.0	1,215.4	1,254.0	1,240.7	\$1,240.7
Depreciation and Amortization	152.2	154.7	158.3	159.6	159.6
Taxes Other Than Income	158.3	152.3	167.0	156.8	156.8
Income Taxes	62.4	46.0	27.7	38.6	31.1
Total Deductions	1,523.1	1,568.4	1,607.0	1,595.7	1,588.2
Net Operating Revenues	317.3	290.2	242.7	278.6	271.9
Deprec. Rate Base	5,363.5	5,395.1	5,554.9	5,524.6	5,599.5
Rate of Return	5.92%	5.38%	4.37%	5.04%	4.86%

At Proposed Rates

Operating Revenues	\$2,371.6	\$2,405.8	\$2,383.8	\$2,426.3	\$2,385.0
<u>Operating Deductions</u>					
Operating Expenses	1,161.1	1,226.4	1,265.1	1,251.8	1,251.4
Depreciation and Amortization	152.2	154.7	158.3	159.6	159.6
Taxes Other Than Income	158.3	152.3	167.0	156.8	156.8
Income Taxes	336.5	328.5	303.2	323.7	302.0
Total Deductions	1,808.1	1,861.9	1,893.6	1,891.9	1,869.8
Net Operating Revenues	563.5	543.9	490.2	534.4	515.2
Deprec. Rate Base	5,368.1	5,395.1	5,568.5	5,524.6	5,599.5
Rate of Return	10.50%	10.08%	8.80%	9.67%	9.20%

Operating Expenses

The adopted purchased water expense of \$440,300 reflects the adopted sales volumes and unaccounted for water, a commodity cost of 0.055¢ per MfH, and a Fontana Union assessment rate of \$3.50 per share. This will permit reallocation of the revenue requirement associated with Advice Letter 145 to usage above 5 Ccf per month (rather than the present allocation to usage above 4 Ccf per month) and will permit establishment of a uniform commodity rate for the first 5 Ccf per month.

SG and the staff used similar methodologies in estimating power consumption for boosting and for water treatment. The adopted purchased power expense of \$69,600 relates to purchased water volumes and to the more recent consumption per unit used by staff for boosting water and for water treatment. This power has been priced out at the Southern California Edison Company (Edison) rates in effect as of September 13, 1977.

Neither SG nor the staff reflected the current 12¢ pre-sort first class postage rate in their estimates. The staff used the current 13¢ first class rate. We adopt the staff estimate, reduced by \$1,600, to reflect SG's ability to make use of the current pre-sort postal provisions.

SG's president testified that pension costs, recently determined by SG's actuary, would be \$11,205 greater than estimated by SG and staff, and that this would result in additional expense applicable to the FD of \$2,800. This increase in estimated pension costs for 1977 should be adopted.

A staff accountant recommended that SG be instructed to properly record expenditures made for donations for social and for charitable purposes. SG concurred and agreed to this recommendation. A \$100 adjustment to the staff's administrative and general expense estimate should be made to reflect the latter adjustment.

The staff estimate of payroll expense was lower than SG's because the staff reduced budgeted payroll to reflect SG's experience with unfilled vacancies. This adjustment was partially offset through staff use of more recent payroll data than used by SG. The staff estimate is reasonable.

#### Other Differences in Estimates

SG and staff used similar methodologies in preparing their respective estimates for: (a) utility plant, (b) reserve for depreciation, (c) depreciation expense, (d) materials and supplies, (e) payroll taxes, (f) ad valorem taxes, (g) injuries and damages, (h) chemical expenses, and (i) other minor differences in expense estimates.

We will adopt the staff estimates, which generally incorporate more recent data (including later tax data) than SG, and we will discuss other matters considered. The staff considered past differences between budgeted and recorded plant installations in its estimate. The staff estimate for materials and supplies used a 60-month period and SG used a 16-month period to determine direct and allocated inventory to FD. The staff study reflects a smaller inventory actually stored in the FD than that contained in SG's estimate.

#### Advances for Construction

A staff accountant recommends that estimated amounts received as advances for construction should be initially recorded in Account 241, Advances for Construction, rather than in Account 242, Other Deferred Credits. SG waits until



construction has been completed and actual costs have been determined before recording the advance in Account 241. We concur with this staff recommendation. He also recommends that monies received from customers for the installation and removal of temporary facilities should be recorded in Account 241. The amounts collected are subject to full refund if the customer's status becomes permanent or to partial refund if the amount received exceeds the cost of installing and removing the necessary facilities. He testified that the cost of plant paid for by others is not includable in rate base and recommended a FD rate base deduction of \$8,269 by increasing Account 241. SG and the staff have included the \$8,269 in utility plant. A staff engineer adopted the accounting adjustments and made a further adjustment decreasing Account 241 to reflect a higher level of refunds based upon later data. We will adopt the total of rate base adjustments described in this paragraph. The Uniform System of Accounts for Water Utilities states in part:

"241. Advances for Construction

"This account shall include such advances for construction..."

The amounts deposited for temporary facilities include estimated construction costs and the estimated cost of removal. The appropriate accounting treatment would be to record amounts received for the installation and removal of temporary facilities in a clearly labeled subaccount of Account 242 (e.g., Account 242a, Deposit for the Installation and Removal of Temporary Facilities - Deduct from Rate Base). The credit deposits for temporary service should not be deducted from rate base.

Water Stock Adjustment

SG's stock investment in Fontana Union, which was acquired for obtaining water, is capitalized as Other Intangible Plant and is included in rate base. The Commission included all of the Fontana Union water stock assessment charged to SG as a portion of SG's water cost in D.45024 dated November 21, 1950 in A.30341. In D.57326 dated September 10, 1958 in A.39866 the Commission determined that the actual operating costs of Fontana Union were below the sum of water charges and assessments. Excess charges were used to finance capital improvements and to retire debt. The Commission reduced SG's operating expense by the portion of the assessments, less applicable tax savings in excess of operating costs, for ratemaking purposes.<sup>2/</sup> The expense reductions were considered as additional investment by SG and its rate base includes \$123,262 for such additional investments. Fontana Union has experienced losses in recent years and no further rate base adjustments have been made by SG. A staff witness testified that in 1969, Fontana Union formed Fontana Devore Corporation (Devore) as a wholly owned subsidiary for the purpose of selling certain parcels of land owned by Fontana Union; that in 1974 Fontana Union distributed all shares of Devore to its shareholders in the form of a dividend and Devore instituted liquidation procedures in anticipation of the pending sale of its assets; that the liquidation was completed in 1976, resulting in a SG capital gain net of taxes of \$83,713; that SG accounted for this gain by crediting Account 526, Miscellaneous Non-operating Revenues, a "below-the-line" account; that the major portion of the liquidation was received in 1975; and that he recommends that the \$83,713 gain be treated as a reduction in rate base because

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<sup>2/</sup> This procedure was followed in D.64574, D.69489, and D.75263.

SG's ratepayers have been providing a return on this additional investment and should now get the benefits of the gain.

SG's position on this issue is that the property owned and sold by Devore was not operative utility property for Devore and would not have been classified as such had Fontana Union been a regulated utility; that the staff ignored additional assessment expenses paid by SG to cover Fontana Union's operating losses in recent years for which no expense or rate base adjustments had been made; that SG never earned the 7.7 percent return authorized in D.81870 in 1973 and would not have realized that rate of return for 1974 through 1976 even if the \$83,713 gain had been included in its earnings. SG further contends that even if this property had been included in rate base, the tax basis of the property involved was only \$9,681; that since the property was the non-operating property of Fontana Union since before the turn of the century and remained as such until its transfer to Devore in 1969, it cannot be considered as a rate base item; that it would be inappropriate to decrease rate base as the result of a non-operating capital gain or to increase it to offset a non-operating capital loss; that Devore was formed to avoid tax problems affecting its mutual status; that most of the non-operative land was condemned and subsequently the remaining small portion of Devore's land was sold and the company was liquidated; and that Kaiser Steel owned 45 percent of Fontana Union stock and it owned approximately four-fifteenths of the stock.

When SG purchased Fontana Union stock it purchased a package including the right to obtain water deliveries and non-operative lands. A portion of SG's intangible plant included this non-operative land. A portion of SG's purchased water costs was for expenses associated with the land ownership, e.g., ad valorem taxes, less any revenues associated with the

land. If SG had held direct title to the non-operative land we would have excluded the original cost of the land from rate base and would not have considered expenses or revenues related to the land as a part of SG's operations. When Fontana Union distributed the Devore stock to its shareholders the need for SG's indirect investment in non-operative land to obtain water was eliminated and SG should have transferred the \$9,681 original cost of land to a non-operative account. The adopted rate base reflects this adjustment. The remaining amount in intangible plant reflects SG's investment to obtain its water supply.

The adopted income taxes reflect current tax laws and the other adjustments described above. The working cash allowance incorporated in the adopted rate base is based on adopted revenues and expenses.

#### Rate of Return

SG and staff witnesses presented testimony supporting their respective recommendations of a reasonable rate of return. SG requested an 8.80 percent rate of return which would result in a 13.50 percent return on an estimated three-year average of (1977, 1978, and 1979) common stock equity. A staff witness recommended a rate of return range of from 8.20 percent to 8.50 percent which would yield 12.31 percent to 13.06 percent on his estimate of December 31, 1977 common stock equity. The staff brief recommends the adoption of the midpoint of this range.

SG, a closely held corporation, has not had to secure new, privately placed long-term debt or preferred stock for several years. SG had approximately \$9,476,000 of long-term debt and \$1,000,000 of preferred stock outstanding and common stock equity of \$6,657,000 as of December 31, 1976. SG's outstanding preferred stock is being redeemed at a \$37,500 annual rate and its outstanding long-term debt is being reduced by \$2,500 per year.

SG sold a portion of its Whittier Division system to the city of Pico Rivera for \$6.4 million realizing an extraordinary gain of about \$5.3 million before income taxes. Under rules pertaining to involuntary conversions, approximately \$2 million of income taxes related to the gain may be deferred provided that the seller reinvests the proceeds in similar utility property by December 31, 1979. The proceeds derived from the sale have been temporarily reinvested by a trustee in short-term government obligations yielding about 5 percent. About \$1.5 million of these funds may eventually be applied to a contemplated five-year water quality improvement project in the FD scheduled to begin in late 1977. The staff estimates an end-of-year 1977 capital structure of 46 percent debt, 5 percent preferred stock, and 49 percent common stock equity if the \$3.3 million after tax gain from the Pico Rivera sale is considered.

The staff witness felt it appropriate to eliminate the temporary cash investment of equity funds in order to reflect properly the proportions of debt and equity invested in water utility operations. The staff adjusted capital structure for test year 1977 of 54.49 percent debt, 5.54 percent preferred stock, and 39.37 percent common stock equity is reasonable.

SG's president sponsored Chapter 12 of Exhibit 2 and Exhibit 3 in support of SG's request for an 8.8 percent rate of return and for two annual step increases of approximately \$75,800 to offset a modified attrition rate<sup>3/</sup> of 0.63 percent per year. He testified that the 8.80 percent rate of return requested is less than those rates of return authorized for similarly capitalized Class A utilities and that SG's future

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3/ Eliminating expense changes which have been offset by the Commission.

financing requirements, including funds to implement the Fontana Water Quality Improvement Project for which funds have been applied for under the California Safe Drinking Water Bond Law of 1976 and for refinancing by 1980 its Series C and D First Mortgage Bonds,<sup>4/</sup> justified the requested rate of return.

A staff accountant sponsored Exhibit 7. He testified that his recommended rate of return range is reasonable because it provides for servicing of SG's fixed charges and allows earnings for common stock equity which should result in moderate increases in retained earnings after payment of dividends and that the main factors considered in his recommendation are: (a) SG's ability to generate sufficient internal funds to meet the major portion of its construction needs and cash requirements; (b) the availability of temporary cash investments for possible use in financing applicant's share of the water quality improvement project in the FD; (c) the improvement in SG's capital structure and its overall financial position; (d) the funds available from advances, from contributions in aid of construction, and from other sources; (e) a comparison of applicant's earnings with the earnings experience of other water utilities; (f) trends in interest rates and coverages for applicant's senior securities; (g) general economic conditions; and (h) equitable treatment of consumers as well as investors.

We find that a rate of return of 8.5 percent is reasonable for setting the rates contained in Appendix A. In addition to the above described testimony we have considered the quality of service provided by SG, a potential drop in sales flowing from SG's excellent water conservation program, and the revenue effect of not recapturing a portion of fixed costs inherent in the adopted lifeline rate design due to conservation.

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<sup>4/</sup> \$710,000 and \$750,000 of 3-3/8 percent coupon rate bonds.

The adopted rate of return of 8.50 percent strikes a reasonable balance between the consumer's short-term interest in obtaining the lowest rates and his long-term interest in ensuring the maintenance of good service, and in preserving SG's ability to obtain acceptable financing for necessary capital improvements.

Trend in Rate of Return

SG estimates an average annual decline of 0.48 percent per year in rate of return at present rates and of 0.63 percent at its proposed rates, even if offset rate changes were authorized for changes in wages, taxes, purchased water, and purchased power. The corresponding staff estimates are 0.34 percent at present rates and 0.41 percent at proposed rates.

We have advised SG that payroll offset relief will not be authorized. After modification of the 1976 results of operation consistent with the 1977 test year changes, the attrition rate would be 0.54 percent at present rates, 0.66 percent at proposed rates, and 0.64 percent at authorized rates. These attrition rates do not reflect changes in purchased water and purchased power rates.

In order to reduce the frequency of SG's general rate relief filings, under the circumstances of this case, we will authorize two-step increases of \$77,300 to offset a 0.64 percent decline in rate of return. The step increase approach results in a better matching of the consumers' interests compared to setting a high initial rate which would yield an adopted three-year average rate of return because of changes in customers from 1977 when initial rates are set to 1979 and because the step-increase method more closely matches costs with revenues. The supplemental filings which we will require of SG will permit further review of achieved rates of return in subsequent test years.

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The authorized rates contained in Appendix A attached to this decision should result in FD revenues of \$2,299,700 in 1977, an increase of approximately \$439,600, 23.6 percent over present rates. The amount of this increase has been designed to yield an 8.50 percent return on the adopted 1977 rate base.

Further step increases of \$77,300 should be authorized as of January 1, 1978 and January 1, 1979 to offset the 0.64 percent attrition rate. These offsets would increase revenues by 3.4 percent in 1978 over those derived from 1977 rates and would increase revenues by 3.3 percent in 1979 over those derived from 1978 rates. The offset increases authorized in Appendix A should be modified in the event that the normalized rate of return earned for the twelve months ended October 31, 1977 and October 31, 1978 exceeds the authorized rate of return. The October 31 date was selected to permit timely filing by December 1 and to provide an adequate review of the advice letter filings requesting the step increases authorized herein.

In the event the return on rate base adjusted to reflect the rates then in effect and normal climatic conditions for the twelve months ended October 31, 1977 or October 31, 1978 exceeds the authorized rate of return, the step increases authorized in Appendix A should be appropriately reduced. The rates shown in Appendix A include \$0.029 based on 0.03¢ per 100 cubic feet surcharge for consumption over 500 cubic feet filed in Advice Letter 147. The step increases should include a uniform cents-per-100-cubic-foot increase for consumption over 400 cubic feet.



Rate Design

SG's present general metered service rates for the FD include minimum charges and quantity rates. Under this form of rates, no charges are added to the minimum charge until the customer has used more water than the minimum charge will purchase at the quantity rates. Under this rate form there is no billing penalty for use up to the amount the minimum charge will cover. To the extent that the potential cost-free use increases with meter size, this type of billing does not encourage conservation. SG's proposed general metered service rates include service charges and quantity rates. Under this form of rates all use is paid for at the quantity rates.

Under the service charge rate form the customer who conserves water and thus makes SG's expenses lower will always pay less than a customer who does not for any given meter size, and the customer who receives service through a smaller meter requiring less plant investment will always pay less than a customer with a larger meter for any given monthly consumption.

An SG witness testified that: (a) 1976 sales data indicates a drop in industrial sales below his 1977 estimate; (b) he was aware that SG's rate proposal would increase industrial billings by 36 percent but he wanted to avoid elimination of industrial sales because local industries were part of the community and many FD residential customers work for local industries; (c) there was a danger to local sales and employment if too much concern were shown for water charges for the first 4 to 5 Ccf per month; (d) five offset increases were authorized in the FD since the last general rate increase (D.81870) on October 7, 1973 which resulted in a 10¢ (2.8 percent)

increase to \$3.62 for the first 4 Ccf,<sup>5/</sup> a 3¢ per Ccf (13.0 percent) increase to 26¢ per Ccf for the next 46 Ccf, and a 3.1¢ (16.3 percent) increase to 22.1¢ per Ccf for consumption over 50 Ccf; (e) SG's proposed rates would increase charges for the first 5 Ccf to \$4.90, a 39.2 percent increase over that authorized in D.81870, would increase commodity rates for the next 195 Ccf to 32.9¢ per Ccf, and would increase commodity rates for a large customer to 29¢ per Ccf, which are increases, within those rate blocks, of 43.0 percent and of 52.6 percent over the rates authorized in D.81870; (f) a comparison (Exhibit 11) of the present and proposed FD monthly charges for the 5 Ccf lifeline quantity with three publicly owned and seven investor-owned utilities shows that its present charges are lower than any other charges and its proposed charges are lower than most of the other charges; (g) one function involved in a general rate increase is a review of rate design which must consider increases in fixed costs; and (h) if fixed costs are not considered, the adopted rates would be discriminatory.

A staff witness initially recommended continuation of a minimum charge rate design with no increase for the first 400 cubic feet of use through a 5/8 x 3/4-inch meter. After cross-examination the staff position was modified and the staff witness prepared Exhibit 12 recommending a service charge type rate structure. He prepared two rate designs, one to yield the \$2,426,300 in operating revenues requested by SG and a 9.67 percent rate of return based upon the staff's summary of earnings for 1977, and the other to yield \$2,286,500 and an 8.5 percent

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<sup>5/</sup> Inclusion of subsequent offsets granted in Advice Letters 145 and 147 do not further change rates for the first 4 Ccf. These advice letters increased commodity rates for the next 1 Ccf, for the next 45 Ccf, and for consumption over 50 Ccf by 0.8¢, by 3.8¢, and by 3.9¢ per Ccf, respectively, which are 16.5 percent, 29.6 percent, and 41.2 percent above the rates authorized in D.81870.

rate of return. He adopted the same quantity blocks proposed by SG. The staff rates are tabulated below.

Staff Proposed Rate Designs

Item	Rates Designed to Produce:	
	Rate of Return of	
	9.67%	8.5%

Quantity Rates:

First 500 cu.ft., per 100 cu.ft. ...	\$ 0.25	\$ 0.24
Next 19,500 cu.ft., per 100 cu.ft. ...	0.373	0.342
Over 20,000 cu.ft., per 100 cu.ft. ...	0.368	0.341

Service Charges:

For 5/8 x 3/4-inch meter .....	\$ 3.00	\$ 3.00
For 3/4-inch meter .....	3.30	3.30
For 1-inch meter .....	4.50	4.50
For 1-1/2-inch meter .....	6.00	6.00
For 2-inch meter .....	8.10	8.10
For 3-inch meter .....	15.00	15.00
For 4-inch meter .....	20.00	20.00
For 6-inch meter .....	34.00	34.00
For 8-inch meter .....	50.00	50.00
For 10-inch meter .....	62.00	62.00

He testified that (a) his rate design goals were to assign the first 25 percent of the increase over present rates to consumption over 5 Ccf per month and to spread the remaining increase uniformly over all use to minimize increases for small users served through 5/8 x 3/4-inch meters, (b) in the past larger users had the advantage of lower unit rates, (c) in order to encourage conservation a larger increase for the larger customer was appropriate, and that (d) larger users could pass on their increases to their customers.

In rebuttal SG's witness testified that: (a) the staff rate design<sup>6/</sup> (yielding an 8.5 percent rate of return) would increase the charge for 5 Ccf by 12 percent and would increase the charge for 400 Ccf by 73 percent over the rates authorized in D.81870; (b) he could not explain the decline in large user sales which include sales to motels, hospitals, mobile home parks, poultry farms, and schools; (c) he did not know if these large users could pass along water rate increases; and (d) increased charges for large users could affect the homeowner expenses in unexpected ways, e.g., the local school district, the largest customer in the FD, could either stop watering school lawns or raise property taxes to pay for a 55 percent increase in water bills under the staff design, and the Kaiser Foundation Hospital, the largest customer supplied through one meter, could pass through increases to its subscribers.

Rate Design Discussion

Most of the costs of meeting fluctuating demands on the FD system are absorbed by Fontana Union. The FD revenue requirements are primarily for meeting commodity and customer related costs. Adoption of a service charge rate form with a lifeline allowance is reasonable. There was no justification made for establishing a declining quantity block rate beyond the lifeline allowance. We will adopt a service charge for the 5/8 x 3/4-inch meter of \$3.00, a lifeline quantity rate of 27¢ per Ccf, and a quantity rate for consumption over 4 Ccf of 34.3¢. The remaining service charges

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<sup>6/</sup> The staff rate design designed to yield 9.67 percent would increase the charge for 5 Ccf by 13.3 percent and would increase the charge for 400 Ccf by 86.8 percent over the rates authorized in D.81870.

will be closer to SG's than to the staff to permit recovery of a larger portion of customer charges in the service charge. This rate design gives consideration to the arguments of SG, of the staff, and to potential revenue losses related to SG's water conservation efforts.

SG estimates average annual commercial customer (business and residential) use of about 27,600 cubic feet, or 23 Ccf per month. For a customer supplied through a standard 5/8 x 3/4-inch meter, the charge for that quantity of water at present rates is \$8.56 per month. At SG's proposed rates for the year 1977, the corresponding monthly charge would be \$10.82, or 26.4 percent higher than at present rates. At SG's proposed rates for 1978, the corresponding monthly charge would be \$11.14, or 30.1 percent higher than under present rates, and for 1979 the corresponding monthly charge would be \$11.45, or 33.8 percent higher than under present rates. At the rates authorized herein, the corresponding monthly charges for 1977 will be \$10.60, or 23.8 percent higher than under present rates.

SG's requested increase from \$2.00 to \$2.50 per inch of diameter for private fire protection service per month is reasonable. The changes in the public fire protection service schedule proposed by SG are reasonable.

#### Future Tax Liability on Contributed Plant

The Internal Revenues Service (IRS), by Revenue Ruling 75-557, effective February 1, 1976, issued a ruling which would have included in gross utility income all contributions in aid of construction. A staff accounting witness testified that the Tax Reform Act of 1976 carved out a major exception to the revenue ruling negating the need to add the amount of potential tax liability to the plant contribution. In Exhibit 8 SG cites Subsection (b)(3)(A) of Section 2120 of the Internal Revenue Code (Code), amending Section 113 of the Code which states

that "'contribution in aid of construction'...shall not include amounts paid as customer connection fees (including amounts paid to connect the customers property to a water main or sewer line...)" (emphasis added) and in Exhibit 9 SG cites the report of the staff of the Joint Committee on Taxation which states that "nontaxable treatment is not accorded to customer connection fees. Customer connection fees include any payments made by a customer to the utility for the cost of installing the connection between the customer's property and the utility's main water or sewer lines (including the cost of meters and piping)..." (emphasis added).

A SG witness contends that: (a) payments received for the installation of private fire protection services clearly constitute customer connection fees as defined above; (b) this collection of potential taxes is only required for potential taxes on contributed plant included in the definition of customer connection fees; (c) this course of action is the only prudent one for SG to follow; and (d) it should be allowed to continue this practice.

SG agrees to return the amounts collected with 6 percent interest if the tax is not required to be paid. It contends that: (a) the procedure it has adopted is not only the prudent one but is equitable from the standpoint of its ratepayers; (b) ratepayers should not be burdened with the income taxes payable on the cost of private fire protection services required by others; and (c) the taxes on such contributions, if they must be paid, should be paid by the beneficiaries of that service. SG states that it will vigorously oppose the levying of income taxes on the affected contributions in its next IRS audit and if necessary through appeals. SG's current practice is reasonable and prudent. The only modification we will make is to increase the annual interest rate for potential tax refunds from 6 percent to the legal rate of 7 percent.

Findings

1. A reasonable estimate of SG's FD results of operations for test year 1977 at present (authorized by Resolution W-1886) and at proposed rates is contained in Table 1.

2. The rates proposed by SG would yield FD operating revenues of \$2,385,000, an increase of \$524,900, or 28.2 percent over present rates, and result in a rate of return of 9.20 percent on our adopted 1977 rate base of \$5,599,500. This rate of return is excessive.

3. SG is in need of additional revenues in its FD but the proposed metered service rates are excessive.

4. The proposed rates for SG's FD private fire protection service are reasonable.

5. SG's request to revise the rates and special conditions related to public fire protection service results in a \$21 increase in rates for test year 1977 and is reasonable.

6. A rate of return of 8.50 percent on the adopted 1977 FD rate base is reasonable. Attrition in the rate of return of 0.64 percent should be recognized in the authorized rates.

7. The staff's estimated capital structure as of December 31, 1977 is reasonable. An 8.50 percent rate of return on the December 31, 1977 capital structure would yield 13.06 percent on SG's common stock equity which is reasonable. For rate-fixing purposes SG's capital structure should relate to utility plant investment and should not include the temporary investment of the gain from the sale of facilities to the city of Pico Rivera.

8. The service charge type of rate is more desirable for the FD than is the minimum charge type of rate structure. It is reasonable to retain the current 0 to 400 cubic feet rate block as a lifeline allowance.

9. The authorized rates contained in Appendix A attached to this decision together with existing unchanged rates should result in full year revenues of \$2,299,700 for 1977, an increase of \$439,600, or 23.6 percent.

10. Further step increases of \$77,300 should be authorized as of January 1, 1978 and January 1, 1979 to offset a 0.64 percent attrition rate. These offsets would increase revenues by 3.4 percent in 1978 over those derived from 1977 rates and would increase revenues by 3.3 percent in 1979 over those derived from 1978 rates. The offset increases authorized in Appendix A should be appropriately modified in the event the rate of return on rate base adjusted to reflect the rates then in effect and normal climatic conditions for the twelve months ended October 31, 1977 and/or the twelve months ended October 31, 1978 exceeds 8.50 percent, in the manner described in the opinion.

11. The rates authorized by Schedule No. FO-1 in Appendix A include \$0.029 based on the \$0.03 per 100 cu.ft. surcharge applicable to metered usage over 500 cu.ft. included in rate Schedule FO-1S filed by Advice Letter No. 147 and authorized by Resolution No. W-2223 (effective August 20, 1977). Therefore, Schedule No. FO-1S should be cancelled concurrent with the effective date of Schedule No. FO-1.

12. The increases in rates and charges authorized by this decision are justified and are reasonable; and the present rates and charges, insofar as they differ from those prescribed in this decision, are for the future unjust and unreasonable.

13. The water conservation program of SG is deemed excellent. It should result in reductions in water use. This effect has been considered in the rate of return determination and in rate design.

14. SG's books of account should reflect the treatment of temporary facilities, advances for construction, dues, donations and contributions, and of intangible plant described in the opinion.

15. SG should be authorized to continue to collect potential income taxes related to contributed plant included



in the Code definition of customer connection fees until the issue has been finally resolved. The potential federal income tax burden related to this plant should be borne by the developers requiring the facilities rather than SG's ratepayers. Interest payments on any refunded amounts should be calculated at the legal rate of 7 percent per annum.

Conclusions

1. The application should be granted to the extent set forth in the order which follows.
2. Step increases to offset attrition in rate of return should be authorized in the manner set forth in Finding 10.
3. The Commission concludes that the effective date of this order should be the date on which it is signed because there is an immediate need for rate relief.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, San Gabriel Valley Water Company (applicant) is authorized to file the initial revised tariff schedules attached to this order as a portion of Appendix A. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall be four days after the date of filing. The revised schedules shall apply only to service rendered on and after the effective date of the revised schedules.
2. Applicant is authorized to file on or before December 1, 1977 the first attrition step increases attached to this order as a portion of Appendix A or to file a lesser increase which includes a uniform cents-per-hundred-cubic-foot of water increases for consumption over 400 cubic feet per month in the event that the Fontana Division rate of return on rate base adjusted to reflect the rates then in effect and normal climatic conditions for the twelve months ended October 31, 1977 exceeds 8.50 percent. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall be January 1, 1978. The revised schedules shall apply only to service rendered on and after January 1, 1978.

3. Applicant is authorized to file on or before December 1, 1978 the second attrition step increase attached to this order as a portion of Appendix A or to file a lesser increase spread on a uniform cents-per-hundred-cubic-feet of water basis for consumption over 400 cubic feet per month in the event that the Fontana Division rate of return on rate base adjusted to reflect the rates then in effect and normal climatic conditions for the twelve months ended October 31, 1978 exceeds 8.50 percent. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall be January 1, 1979. The revised schedules shall apply only to service rendered on and after January 1, 1979.

4. Applicant shall implement the accounting practices described in Finding 13.

5. Applicant shall follow its present policy related to contributions for customer connection fees as described in Finding 14 until the issue has been finally resolved. Applicant shall promptly notify the Commission of any status changes affecting the disposition of the issue by filing an original and a Finance Division copy of its report. Applicant

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shall pay interest calculated at 7 percent per annum of any refunded amounts.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 20th day of DECEMBER, 1977.

*I direct.*  
*William Gunn, Jr.*

*Robert Batimich*  
President

*Vernon L. Sturgeon*  
*Robert D. Howell*

Commissioners

Commissioner Claire T. Dedrick, being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A  
Page 1 of 6Schedule No. FO-1  
FONTANA WATER COMPANY  
METERED SERVICEAPPLICABILITY

Applicable to all metered water service.

TERRITORY

Portions of Fontana, Rialto, and vicinity, San Bernardino County.

<u>RATES</u>	<u>PER METER PER MONTH</u>		
	Before <u>1-1-78</u>	<u>1-1-78</u> Through <u>12-31-78</u>	After <u>12-31-78</u>
Quantity Rates:			
First 400 cu.ft., per 100 cu.ft.	\$ 0.270	0.280	0.290
Over 400 cu.ft., per 100 cu.ft.	.343	.354	.365
Service Charge:			
For 5/8 x 3/4-inch meter	3.00	3.10	3.20
For 3/4-inch meter	3.60	3.70	3.80
For 1-inch meter	5.20	5.40	5.60
For 1-1/2-inch meter	6.90	7.10	7.30
For 2-inch meter	9.30	9.60	9.90
For 3-inch meter	17.00	18.00	19.00
For 4-inch meter	23.00	24.00	25.00
For 6-inch meter	38.00	39.00	40.00
For 8-inch meter	57.00	59.00	61.00
For 10-inch meter	71.00	73.00	75.00

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

Note: The above Quantity Rates include \$0.029 based on the \$0.03 per 100 cu.ft. surcharge applicable to metered usage over 500 cu.ft. as indicated on Schedule FO-1S filed by Advice Letter No. 147 and authorized by Resolution No. W-2223 and effective August 20, 1977. Therefore, Schedule FO-1S is cancelled concurrent with the effective date of this tariff.

APPENDIX A  
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Schedule No. FO-4

FONTANA WATER COMPANY

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service furnished for private fire protection purposes.

TERRITORY

Portions of Fontana, Rialto, and vicinity, San Bernardino County.

RATES

	<u>Per Service</u> <u>Per Month</u>
For each inch of diameter of fire protection service	\$2.50

SPECIAL CONDITIONS

1. The customer will pay, without refund, the entire cost of the fire protection service.
2. The fire protection service shall be installed by the utility or under the utility's direction and shall be the sole property and subject to the control of the utility, with right to alter, repair, replace and the right to remove upon discontinuance of service.
3. The minimum diameter for fire protection service will be 4 inches. The maximum diameter shall not be larger than the diameter of the water main to which the fire protection service is attached unless said main is circulating, in which case with the approval of the utility the maximum diameter may be larger by not more than 2 inches than the diameter of said circulating main.
4. If a water main of adequate size is not available adjacent to the premises to be served, then a new main from the nearest existing main of adequate size will be installed by the utility at the cost of the customer. Such cost shall not be subject to refund.
5. The fire protection service facilities will include a detector check valve, backflow prevention device, or other similar device acceptable to the

(Continued)

APPENDIX A  
Page 3 of 6

Schedule No. PO-4

PONTANA WATER COMPANY

PRIVATE FIRE PROTECTION SERVICE

SPECIAL CONDITIONS - Contd.

utility which will indicate the use of water. The facilities may be located within the customer's premises or within public right of way adjacent thereto. Where located within the premises, the utility and its duly authorized agents shall have the right of ingress to and egress from the premises for all purposes related to said facilities.

6. No structure shall be built over the fire protection service and the customer shall maintain and safeguard the area occupied by the service from traffic and other hazardous conditions. The customer will be responsible for any damage to the fire protection service facilities whether resulting from the use or operation of appliances and facilities on customer's premises or otherwise.

7. Subject to approval of the utility, any change in the location or construction of the fire protection service as may be requested by public authority or the customer will be made by the utility following payment to the utility of the entire cost of such change.

8. The customer's installations must be such as to separate effectively the fire protection service from that of the customer's regular domestic water service. Any unauthorized use of water through the fire protection service will be charged for at the applicable tariff rates and may be grounds for the utility's discontinuing fire protection service without liability.

9. There shall be no cross connection between the systems supplied by water through the utility's fire protection service and any other source of supply without the specific approval of the utility. The specific approval, if given, will at least require at the customer's expense, a special double check valve installation or other device acceptable to the utility. Any unauthorized cross connection may be grounds for immediately discontinuing fire protection service without liability.

10. The utility will supply only such water at such pressure as may be available from time to time as a result of its operation of the system. The customer shall indemnify the utility and save it harmless against any and all claims arising out of service under this schedule and shall further

(Continued)

APPENDIX A  
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Schedule No. FO-4

PONTANA WATER COMPANY

PRIVATE FIRE PROTECTION SERVICE

SPECIAL CONDITIONS - Contd.

agree to make no claims against the utility for any loss or damage resulting from service hereunder.

11. The customer shall be responsible for the periodic testing of backflow prevention devices as required by public authority or the utility. Any repair or replacement of such devices or of any other facilities installed to provide fire protection service shall be done at the customer's expense. Any refusal to comply with the above requirements may be the grounds for the utility's discontinuing fire protection service without liability.

APPENDIX A  
Page 5 of 6

Schedule No. PO-5

FONTANA WATER COMPANY

South of Baseline Road

PUBLIC FIRE HYDRANT SERVICE

APPLICABILITY

Applicable to all fire hydrant service furnished to duly organized or incorporated fire districts or other public agencies.

TERRITORY

The areas of the Fontana Division south of Baseline Road.

RATES

Per Month

For each fire hydrant connected to a main 8 inches in diameter or larger . . . . .	\$1.50
For each fire hydrant connected to a main 4 inches in diameter to 7.99 inches in diameter . . . . .	1.25
For each fire hydrant connected to a main less than 4 inches in diameter . . . . .	.75

SPECIAL CONDITIONS

1. The utility will supply only such water at such pressure as may be available from time to time as a result of its normal operation of the system.

2. The district or agency shall indemnify the utility and save it harmless against any and all claims arising out of service under this schedule and shall further agree to make no claims against the utility for any loss or damage resulting from service hereunder.

3. Fire hydrants can be attached to the utility's distribution mains for public fire protection only upon receipt of proper order of the district or agency.

4. Public fire hydrant service is furnished with the understanding that such hydrants are to be repaired, maintained, painted and inspected at the expense of such district or agency.

(Continued)



APPENDIX A  
Page 6 of 6

Schedule No. FO-5

FONTANA WATER COMPANY

South of Baseline Road

PUBLIC FIRE HYDRANT SERVICE

SPECIAL CONDITIONS - Contd.

5. The cost of relocation or modification of any hydrant shall be paid by the party requesting such relocation or modification.