

Decision No. 89762 DEC 19 1978

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of California-American Water Company, a corporation, for authority to raise rates in its Duarte District.

Application No. 57879
(Filed February 21, 1978)

Gray, Cary, Ames & Frye, by Eugene L. Freeland, Attorney at Law, for applicant.
Elmer J. Sjostrom, Attorney at Law, and Francis S. Ferraro, for the Commission staff.

O P I N I O N

Applicant, California-American Water Company, seeks authority to increase rates for water service in its Duarte District. The proposed rates would increase annual revenues from \$785,100 to \$954,800, an annual increase of 21.6 percent or \$169,700. The applicant contends that in its test year 1979 its rate base will be \$1,888,700. Its proposed rates are designed to yield 11.11 percent on that rate base and to yield a 13.5 percent return on common equity.

After proper notice a public hearing was held in Duarte on September 12 and 13, 1978 before Administrative Law Judge James D. Tante. The parties were authorized to present argument in the form of letters to the hearing officer on or before September 22, 1978, and the case was submitted on the latter date. The applicant's letter presenting argument was received on September 22, 1978.

Applicant, a California corporation, is a wholly owned subsidiary of the American Water Works Company, Inc. of Wilmington,

Delaware, and operates public utility water systems in portions of the counties of San Diego, Los Angeles, Ventura, and Monterey. The applicant's Duarte District provides public utility water service to approximately 5,960 customers in a service area which lies at the northern edge of the San Gabriel Valley and extends into the foothills of the San Gabriel Mountains, providing domestic water service to the cities of Bradbury and Duarte, and portions of Irwindale, Monrovia, and vicinity, Los Angeles County. Sixty-six customers (1.1 percent) are residents of the city of Bradbury (Bradbury), who are also irrigation service customers.

The source of water supply for the irrigation service has historically been the diversion of surface water from the San Gabriel River and Fish Canyon. In times of extremely low river flow, water from wells has also been delivered to the irrigation customers. Raw water from the surface is not suitable for domestic use.

Elevations within the service area range from 375 feet above sea level on the southwest to 1,000 feet at the northern edge. The domestic system is supplied by seven wells which feed directly into the distribution pipeline system.

Six letters were received protesting the application for rate increase.

A physicist who is a member of the Planning Commission and the Water Committee for Bradbury; a person engaged in property management and development who is a former planning commissioner and a member of the City Council and who is now a member of the Water Committee of Bradbury; the mayor who is also a member of the Water Committee of Bradbury; the president of the Bradbury Estates Association; a person who is an employee of and resides with his employer, a resident of Bradbury, and who also is an advisor for Los Duardenos, a Mexican-American association; and a retired real estate developer who resides in Bradbury, made statements

concerning the impact of the proposed rate increase on Bradbury and the surrounding community. An electronic technician who lives in Monrovia, a resident of Duarte, and a retired real estate developer in the Duarte area made statements concerning the requested rate increase and the service of the applicant.

The applicant's vice president, who is also treasurer and secretary, testified on its behalf. A financial examiner testified for the Commission staff.

Following is a summary of exhibits presented in this proceeding:

Exhibit 1, a statement concerning the effect of the proposed rate increase on Bradbury, was marked for identification only. Exhibit 2, the necessary proof of service by publication, bill insert, and posting at the headquarters of the applicant of the making of the application and the date, time, and place of hearing; Exhibit 3, the staff report of results of operation; Exhibit 4, the applicant's report of the results of operation and revenue requirements; Exhibit 5, the recorded and pro forma income and rate of return for the 12-month period ending December 31, 1977; Exhibit 6, the recorded and pro forma income and rate of return for the 12-month period ending December 31, 1978; Exhibit 7, the recorded and estimated coverages, including the times interest earned ratio during 1970 to 1977, and ending June 30, 1978; Exhibit 8, a letter dated July 22, 1977 to the Commission from Pacific Mutual Life Insurance Company and a reply thereto dated July 28, 1978; Exhibit 9, a letter dated December 23, 1977 to the Commission from the applicant; Exhibit 10, a chart of common stock dividends paid by the applicant; Exhibit 11, a calculation showing the applicant's percentage return on common equity; Exhibit 12, an explanation of the differences in the statement of results of operation of the Commission and the applicant; Exhibit 13, rates of return on rate base necessary to yield certain returns on common equity; and Exhibit 14, the staff report concerning the cost of capital and rate of return. Exhibits 2 through 14 were received in evidence.

Rates

The present rates^{1/} and proposed rates for general metered service are as follows:

Item	Per Meter Per Month	
	Present Rates	Proposed Rates

Quantity Rates

First 500 cu.ft. or less.....	\$ 3.27	\$ 3.27
Next 2,000 cu.ft.; per 100 cu.ft..	.406	.533
Next 7,500 cu.ft.; per 100 cu.ft..	.291	.383
Over 10,000 cu.ft., per 100 cu.ft..	.241	.317

Minimum Charge

For 5/8 x 3/4-inch meter.....	\$ 3.27	\$ 3.27
For 3/4-inch meter.....	4.00	5.25
For 1-inch meter.....	6.30	8.25
For 1 1/2-inch meter.....	9.60	12.60
For 2-inch meter.....	12.80	16.80
For 3-inch meter.....	17.00	22.30
For 4-inch meter.....	28.00	36.80
For 6-inch meter.....	40.00	52.50
For 8-inch meter.....	61.00	80.00

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

1/ After filing this application, the applicant reduced its rates due to reduced ad valorem taxes in connection with Article XIII-A of the State Constitution, but the reduction does not appear in the above tabulation or the tabulation for measured irrigation service.

The present rates and proposed rates for measured irrigation service are as follows:

Item	Per Meter Per Month	
	Present Rates	Proposed Rates

Quantity Rates

Pressure service all water, per 100 cu.ft.	\$.135	\$.165
Gravity service all water, per 100 cu.ft.	.084	.103

Service Charge

For 5/8 x 3/4-inch meter.....	\$ 4.45	\$ 5.40
For 3/4-inch meter.....	5.55	6.80
For 1-inch meter.....	8.90	10.90
For 1 1/2-inch meter.....	13.50	16.50
For 2-inch meter.....	18.00	22.00
For 3-inch meter.....	25.00	30.00
For 4-inch meter.....	40.00	49.00
For 6-inch meter.....	55.00	67.00
For 8-inch meter.....	85.00	104.00

The Service Charge is a readiness-to-serve charge applicable to this service and to which is to be added the monthly usage charge computed at the Quantity Rate.

Results of Operation

Table 1-A of Exhibit 3 and Exhibit 12 set forth the summary of earnings at present rates for test year 1979. In addition, Exhibit 12 states the reasons the applicant believes account for the differences in estimates between it and the Commission staff. Exhibit 3, Table 1-B, sets forth the staff's summary of earnings at proposed rates for test year 1979.

For the purpose of this hearing and for the reasons set forth in Exhibit 12, the applicant has accepted the staff's results of operation at present rates and at proposed rates for test year 1979 as set forth in the following table. For comparison, this table also shows the results of operation at rates authorized herein. The adopted test year results of operation estimates are reasonable.

President Carter signed into law Revenue Act of 1978 (HR 13511). The Act reduces the corporate tax rate from 48 percent to 46 percent effective January 1, 1979, and provides for lower tax rates for the first four \$25,000 increments of taxable income. The Act will thus reduce the utility's federal income tax liability beginning January 1, 1979. Therefore, our adjusted results for the test year 1979 will reflect the Revenue Act of 1978 corporate tax rate.

Table 1
Estimated Results of Operation
 (Test Year 1979)

Item	Present Rates		Proposed Rates		Authorized Rates:
	Applicant:	Staff	Applicant:	Staff	Adopted Results:
	(a)	(b)	(c)	(d)	(e)
(Dollars in Thousands)					
Operating Revenues	\$ 785.1	\$ 746.2	\$ 954.8	\$ 947.0	\$ 789.7
<u>Operating Expenses</u>					
Oper. & Maintenance	387.3	358.9	388.2	359.7	359.1
Administrative & General	122.1	121.6	122.1	121.6	121.6
Allocated Depr. Exp.	.8	1.7	.8	1.7	1.7
Depreciation Expense	83.5	80.8	83.5	80.8	80.8
Taxes Other Than Income	73.0	35.1	73.0	35.1	35.1
Franchise Tax	(1.2)	.1	14.0	18.1	4.0
Federal Income Tax	(10.3)	(8.0)	63.4	79.3	9.9
Total Expenses	655.2	590.2	745.0	696.3	612.2
Net Operating Revenue	129.9	156.0	209.8	250.7	177.5
Average Rate Base	1,838.7	1,849.4	1,888.7	1,849.4	1,849.4
Rate of Return	6.88%	8.44%	11.11%	13.56%	9.60%

1/Based on Revenue Act of 1978.

(Red Figure)

Customer Service

The staff report (Exhibit 3) states:

"A review of the Commission's customer complaint records for 1976 and 1977 indicates that eight informal complaints for disputed bills were filed against the applicant and that all complaints were satisfactorily resolved."

The staff investigation reports on various leaks and customer complaints for 1976 and 1977 reveal that the complaints were satisfactorily resolved. At the hearing there was a statement concerning the service of the applicant relating to low water

pressure. A memorandum dated September 19, 1978 to the Administrative Law Judge from an associate utilities engineer with the Commission staff sets forth that he has discussed the complaint with personnel of the applicant and has been assured that the matter will be investigated and an effort will be made to rectify the problem.

Rate of Return

The applicant's vice president referred to Exhibit 7 which shows that the available earnings (before taxes on income) ratio to the interest on long-term debt declined from 1.84 in 1970 to .57 in 1977, and for the first six months of 1978 further declined to .46. He referred to Exhibit 10 which shows the common stock dividends paid by the applicant from 1966 through 1977, but shows no payment of such dividend in 1976 or 1977 because the applicant operated at a loss during those two years. He referred to Exhibit 11 which shows that the 12-year average return on common equity for the three other largest Class A water utilities in California was 9.9 percent, 10.0 percent, and 10.5 percent, respectively, but only 3.5 percent for the applicant. He testified that the applicant's earnings are only .46 times its interest expense, and such earnings should be 1.75 times its interest expense in order for it to borrow additional sums should it become necessary to do so to satisfactorily maintain public utility service. It is not necessary that the applicant borrow additional funds at the present time.

The applicant contends that based on its capital structure as of December 31, 1979 consisting of 46.96 percent debt and 53.04 percent adjusted common equity and its embedded cost of debt of 8.70 percent, the fair rate of return is 11.11 percent on rate base which would result in a return on equity of 13.24 percent. To support its contention, the applicant points to recent decisions by the Commission involving 12.82 percent average return on common equity authorized for Southern California Water Company and California Water Service Company.

The Commission staff contends that 9.30 to 9.60 percent is a reasonable range in rate of return to be applied to the applicant's rate base.

The appropriate rate of return for the applicant's operations is discussed in detail in D.88875 dated May 31, 1978, the decision on A.57087 relating to its San Marino District. In that decision, we concluded that a 9.60 percent return on rate base and 10.60 percent return on common stock equity strike a reasonable balance between consumer and investor interests which comports with the applicant's equity ratio being higher than that of other major water utilities under our jurisdiction as well as with the presence of a parent/applicant relationship.^{2/} In that case the capital structure consisted of 50 percent debt and 50 percent adjusted common equity; now it is 46.96 percent debt and 53.04 percent adjusted common equity. Table 15 of Exhibit 14 shows that a 9.60 percent return on rate base would produce 10.39 percent return on adjusted common equity based on the applicant's estimated capital structure as of December 31, 1979.

After careful consideration of the entire record, we adopt as reasonable a rate of return of 9.6 percent which will provide a return on adjusted common equity of approximately 10.39 percent.

In setting a reasonable rate of return, we take cognizance of the fact that the current economic reality of attrition can serve to erode the ability of a utility to earn a meaningful and reasonable rate of return.

^{2/} In D.88876 dated May 31, 1978 and in D.89114 dated July 25, 1978, we determined that a 9.60 percent return on rate base was reasonable for the applicant's Village and Baldwin Hills Districts, respectively.

As we stated in Decision No. 88761 dated May 2, 1978, in Southern California Water Company's Application No. 57271:

"One method of allowing for attrition is the establishment of rates sufficiently high to produce the authorized rate of return on the average over a specified period of time. Another method of counteracting the effect of rate of return attrition is the use of step rates. Such rates provide the utility the opportunity to earn the authorized rate of return on a uniform basis and are considered more equitable to the customers in that they do not pay any excesses during the first years to offset future anticipated deficiencies. Another advantage to step rates is that they afford an opportunity of a review of future changes in rate of return and initiation of appropriate action if a reduction in rates is indicated."

In its judgment, this Commission will assume that applicant's future rate of return is subject to a maximum 0.50 percent attrition. To insure applicant the opportunity to achieve and realize the rate of return of 9.60 percent authorized herein, we will authorize step rate increases to offset the maximum 0.50 percent attrition in rate of return.

This order will provide for the authorization for applicant to file, on or before November 15, 1979, an advice letter with appropriate work papers, requesting an attrition offset not to exceed \$18,900, which represents 0.50 percent attrition in rate of return based on the adopted rate base.

Rate Design

The following are the staff's recommendations on rate design for the Duarte District based on the applicant's proposed annual increase of \$169,700.

- "A. Convert the present minimum charge rates to a service charge rate structure.

"B. A three-block quantity rate structure be developed as follows:

0-500 cubic feet
600-10,000 cubic feet
Over 10,000 cubic feet

"C. The second block quantity rate should be higher than the first block quantity rate.

"D. The third block quantity rate should be established at a rate in between the first and second block rates.

"E. To meet lifeline conditions with the applicant's proposed rate increase, the proposed quantity rates and the service charge rate for the 5/8 x 3/4-inch meter should be set so that the charge for the lifeline consumption of 300 cubic feet be no more than a 7% increase over the present rate charge.

"F. The service charges for the larger size meters should be determined by multiplying the 5/8 x 3/4-inch meter charge by approximately 50% of the sum of the present minimum charge equivalent meter ratio and the standard service charge equivalent meter ratio as found in Standard Practice U-25.

"G. To accept the applicant's proposal to increase the Irrigation Schedule, a service charge type schedule, by 22%."

The annual increase in estimated operating revenues authorized is from \$746,200 to \$789,700, or \$43,500 (5.8 percent). ✓
This is approximately 25.6 percent of the \$169,700 requested by the applicant.

Rate schedules based upon the original staff rate recommendations and the authorized annual revenue increase of \$43,500 would result in inequities in the cost of water service to various customers. To remove such inequities the original staff rate recommendations are modified as follows for purposes of preparing Appendix A hereto:

1. The applicant's present irrigation schedule is increased by 6 percent instead of 22 percent.
2. The three-block quantity rate structure is developed as follows:
 - 0 - 500 cubic feet
 - 600 - 2,500 cubic feet
 - Over 2,500 cubic feet
3. The third block quantity rate is established at a rate lower than the second block.

Findings

1. The applicant's water quality, conservation program, and service are satisfactory.
2. The applicant is in need of additional revenues.
3. The adopted estimates, previously discussed herein, of operating revenues, operating expenses, and rate base for the test year 1979 reasonably indicate the estimated results of the applicant's operations for the future.
4. A rate of return of 9.60 percent on the applicant's adopted rate base for 1979 will produce a return on common equity of approximately 10.39 percent and will represent an increase of \$43,500 or 5.8 percent in gross operating revenues. Such an increase is reasonable and justified.
5. Attrition in the rate of return of approximately 0.50 percent should be recognized in the authorized rates. A further step increase not to exceed \$18,900 should be authorized as of January 1, 1980 to offset the 0.50 percent decline in rate of return. The step increase 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 for the 12 months ended September 30, 1979, exceeds 9.60 percent.
6. The rates authorized herein, which also yield a 9.60 percent rate of return, are based on staff-recommended rate design, with modifications. The rate design as modified is reasonable.

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

8. A reasonable estimate of results of operations for test year 1979 is contained in the "adopted" column of Table 1 in the discussion section of this decision. This estimate includes the tax effects of the Revenue Act of 1978 (HR 13511).

9. The applicant is authorized to file for its Duarte District the revised rate schedules attached to this order as Appendix A on or after the effective date of this order. The revised tariff schedules shall become effective four days after filing but shall in no event be effective earlier than January 1, 1979.

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

O R D E R

IT IS ORDERED that:

1. On or after the effective date of this order, applicant California-American Water Company is authorized to file for its Duarte District the revised rate schedules attached to this order as Appendix A, and concurrently to withdraw and cancel its presently effective schedules. 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 but shall in no event be effective earlier than January 1, 1979. The revised schedules shall apply only to service rendered on and after the effective date of the revised schedules.

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2. On or before November 15, 1979, California-American Water Company is authorized to file an advice letter, with appropriate work papers, requesting attrition offset not to exceed \$18,900 which represents 0.50 percent attrition in rate of return based on the adopted rate base. The increase will be in a uniform cents-per-hundred-cubic-foot of water adjustment for consumption in excess of 500 cubic feet from the rates shown in Appendix A. In the event that its rate of return on rate base, adjusted to reflect the rates then in effect on (1) a pro forma basis using recorded sales and (2) a pro forma basis with normal ratemaking adjustments for the twelve months ended September 30, 1979, exceeds 9.60 percent a lesser increase shall be allowed. Such filing shall comply with General Order No. 96-A. The staff will evaluate this request and, if appropriate, prepare the necessary resolution for the Commission's consideration.

The effective date of this order shall be the date hereof.

Dated at San Francisco, California, this 19th day of DECEMBER, 1978.

Robert Bateman
William J. ...
Veronica L. ...
Robert D. ...
Clare J. ...

APPENDIX A
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Schedule No. DU-1

Duarte District Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all general metered water service.

TERRITORY

Bradbury, Duarte, portions of Irwindale, Monrovia, and vicinity,
Los Angeles County.

RATES

	<u>Per Meter</u>	
	<u>Per Month</u>	
Quantity Rates:		
First 500 cu.ft., per 100 cu.ft.	\$ 0.30	(I) (c)
Next 2,000 cu.ft., per 100 cu.ft.389	(I) (c)
Over 2,500 cu.ft., per 100 cu.ft.231	(I) (c)
Service Charge:		
For 5/8 x 3/4-inch meter	\$ 2.00	(c)
For 3/4-inch meter	2.30	(c)
For 1-inch meter	3.40	(c)
For 1 1/2-inch meter	5.00	(c)
For 2-inch meter	7.00	(c)
For 3-inch meter	10.00	(c)
For 4-inch meter	15.00	(c)
For 6-inch meter	24.00	(c)
For 8-inch meter	40.00	(c)

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

(c)
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(c)

APPENDIX A
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Schedule No. DU-3M

Duarte District Tariff AreaMEASURED IRRIGATION SERVICEAPPLICABILITY

Applicable to all measured service for irrigation purposes as defined in the special conditions below. Applicable only to premises serviced under Schedule No. DU-3M on a continuous basis on and after January 1, 1969.

TERRITORY

Bradbury, Duarte, portions of Irwindale, Monrovia, and vicinity, Los Angeles County.

RATES

	Per Meter Per Month	
Quantity Rates:		
A. Pressure service all water, per 100 cu.ft.	\$.121	(I)
B. Gravity service all water, per 100 cu.ft.067	(I)
Service Charge:		
For 5/8 x 3/4-inch meter	\$ 4.70	(I)
For 3/4-inch meter	5.90	
For 1-inch meter	9.40	
For 1 1/2-inch meter	14.00	
For 2-inch meter	19.00	
For 3-inch meter	27.00	
For 4-inch meter	42.00	
For 6-inch meter	58.00	
For 8-inch meter	90.00	-(I)

The Service Charge is a readiness-to-serve charge applicable to this service and to which is to be added the monthly usage charge computed at the Quantity Rate.