

Decision No. 90007 FEB 27 1979

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of ALISAL WATER CORPORATION, a)
corporation, for authority to)
increase rates for water service. }

Application No. 57896
(Filed February 28, 1978)

Brobeck, Phleger, and Harrison, by Robert N. Lowry, Attorney at Law; and Robert T. Acceck,
For Alisal Water Corporation; applicant.
Francis H. Ferraro, interested party.
Ruston S. Dubash and Herbert R. McDonald, for
the Commission staff.

O P I N I O N

Applicant Alisal Water Corporation (Alisal) furnishes water as a public utility for domestic, commercial, industrial, and municipal purposes. Its service area is in the easterly portion of the city of Salinas and certain adjacent territories in Monterey County. Its source of supply is from seven wells located within the service area having a combined capacity of approximately 4,600 gallons per minute. The wells are equipped with turbine-type pumps driven by electric motors varying in size from 25 to 150 horsepower. In case of electric power failure, emergency service can be provided by two gasoline engine standby units. Pressures within normal operating limits are maintained by three steel hydropneumatic tanks having a total capacity of 30,000 gallons. The distribution system consists of approximately 170,988 feet of asbestos-cement pipe and 3,404 feet of plastic pipe ranging in size from 2 inches to 12 inches.

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As of December 31, 1977, service was furnished to 3,291 customers, all at meter rates; and fire protection was provided by 214 hydrants. Its presently effective rates were established by D.85792 dated May 11, 1976, in A.55489. Pursuant to Resolution No. W-2318, filed January 4, 1978, applicant's quantity rates were increased to \$0.314 per Ccf for all water delivered over 300 cubic feet. Applicant proposes to increase its readiness-to-serve charge by 20.7 percent and its charges for metered water by 18 percent for the first 300 cubic feet and 27 percent for all water delivered over 300 cubic feet. The overall increase averages 22 percent. No increase in fire protection service rates is being sought due to an agreement with the City of Salinas as prescribed in General Order No. 103, Section VIII, paragraph 4, which will eliminate the public fire hydrant service charges.

Under the proposed rates annual revenues from the readiness-to-serve charge would be increased by \$27,610 and the revenues from metered water would be increased by \$54,371 for a total increase of \$81,611 for the 1978 test year.

The following table shows a comparison of applicant's present and proposed rates.

<u>Meter size</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Increase</u>	
			<u>Amount</u>	<u>Percentage</u>
5/8 x 3/4-inch	\$ 2.65	\$ 3.20	\$.55	20.7
3/4-inch	3.70	4.45	.75	20.3
1-inch	5.30	6.40	1.10	20.7
1-1/2-inch	9.60	11.60	2.00	20.8
2-inch	16.00	19.25	3.25	20.3
3-inch	27.00	32.50	5.50	20.3
4-inch	43.00	51.75	8.75	20.3
6-inch	90.00	108.50	18.50	20.5
<u>Metered Water Rates</u>				
First 300 cu.ft.	\$.279	\$.33	\$.051	18.0
Over 300 cu.ft.	.314	.40	.086	27.0

Public hearing on the matter was held before ^{the assigned} Administrative Law Judge ~~Bernard A. Peeters~~ on August 14, September 18,^{1/} and October 4, 1978. Copies of the application had been served and notice of hearing had been published and posted in accordance with the Commission's Rules of Practice and Procedure. The matter was submitted on October 4, subject to the filing of a late-filed corrected Exhibit 19 and comments thereon by the staff due October 24, 1978 (Exhibit 20). Said late-filed exhibit and comments have been timely filed. all

The Evidence

Applicant's case was presented through its general manager and 17 exhibits. A joint Results of Operations Study and a rate of return recommendation was presented by two staff engineers. Two of applicant's customers appeared at and testified on the first day of hearing.

^{1/} Applicant requested the delay from August 14 to September 18, 1979 to prepare cross-examination relative to the staff exhibit (Tr. 92-93).

Both Alisal and the staff made numerous changes in their exhibits during the course of the hearing. It was agreed that these changes would be incorporated in a late-filed exhibit (Exhibit 19) with the staff having an opportunity to review and comment on the exhibit. The staff's comments were received as Exhibit 20. In Exhibit 20 the staff made further changes in its showing by adopting some of Alisal's figures based upon later information. Table I is a comparison of Alisal's and staff's estimates and the adopted results of operations.

TABLE I

ALISAL WATER CORPORATION

Revised Summary of Earnings

<u>Item</u>	Year 1978				<u>Adopted</u>
	<u>Applicant Present Rates</u>	<u>Estimated Proposed Rates</u>	<u>Staff Estimated Present Rates</u>	<u>Estimated Proposed Rates</u>	
	(Dollars in Thousands)				
Operating Revenue	\$349.5 ^{1/}	\$423.8 ^{2/}	\$347.5	\$421.2	\$372.3
<u>Operating Expense</u>					
Oper. & Maint.	166.5	166.5	146.5	146.5	144.4
Admin. & Gen.	105.9	105.9	90.0	90.0	96.4
Taxes Other Than Income	27.1	27.6	24.2	24.9	27.4
Depreciation	<u>32.0</u>	<u>32.0</u>	<u>34.1</u>	<u>34.1</u>	<u>32.0</u>
Subtotal	331.5	332.0	294.8	295.5	300.2
Taxes on Income	<u>.2</u>	<u>12.4</u>	<u>4.1</u>	<u>22.5</u>	<u>5.5</u>
Total Oper. Exp.	331.7	344.4	298.9	318.0	305.7
Net Oper. Inc.	17.8	79.4	48.6	103.2	66.6
Dep. Rate Base	687.8	687.8	679.1	679.1	679.5
Rate of Return	2.6%	11.5%	7.2%	15.2%	9.8%

^{1/} Revised to \$349,500 (Exhibit 19), \$340,900 set forth in application.

^{2/} Revised to \$423,800 (Tr. 159), \$422,500 set forth in application.

Operating Revenue

The staff estimated sales of 208.3 Ccf per customer for the 1978 test year. The staff did not use the 1977 sales data in its calculations because 1977 was the year of the drought and conservation was being practiced.

Applicant's witness estimated annual sales at 210.3 Ccf per customer but did not explain his basis of determination. Both applicant and staff agreed that the estimated number of customers for the 1978 test year should be 3,231. We shall adopt the staff's estimate of average sales per customer per year at 208.3 Ccf and the staff's revenues at present rates of \$347,500. During the hearing, applicant revised its revenue estimate at proposed rates to include private fire protection revenue and a slightly larger sales estimate; applicant's revised revenue estimate at proposed rates exceeded staff's by \$2,600. We shall adopt an operating revenue of \$372,300. This revenue amounts to a 7.4 percent increase over revenues produced at the present rates, as compared with a 23.9 percent increase proposed by Alisal.

Operation and Maintenance Expenses

The difference in estimates for operating expenses amounts to \$20,000; the differences are shown in Table II below.

TABLE II

<u>Item</u>	<u>Operation & Maintenance Expenses</u>		<u>Adopted</u>
	<u>1978 Estimated</u>		
	<u>Applicant</u>	<u>Staff</u>	
	<u>(Dollars in Thousands)</u>		
Purchased Power	\$ 62.0	\$ 51.5	\$ 46.0
Pumping O&M	26.0	23.8	25.4
Transmission & Distribution	32.5	36.2	32.0
Customer Accounts	<u>46.0</u>	<u>35.0</u>	<u>41.0</u>
Total O&M Expenses	166.5	146.5	144.4

Purchased Power - The staff testified that he used the water production, power consumption and power cost data of the 1976 calendar year as a basis to develop the 1978 test year purchased power costs. In its opinion, 1976 represented the most recent normal water use pattern because the 1977 data was distorted by the drought and conservation efforts. The staff developed the 1976 kilowatt-hour (kWh) cost, updated the cost with rate changes (increases in 1977 and decreases in 1978) granted PG&E through September 1978 and developed the 1978 purchased power expense as the product of the estimated annual power consumption of 1,034,385 kWh and the estimated cost of \$0.04975/kWh for a total of \$51,460.

The staff in developing the cost per kilowatt-hour for 1978 pointed out that the September 1978 power rate reduction was not completely annualized. We take official notice that power costs were again reduced by this Commission in October 1978. Adjusting the staff's unit rate cost to fully reflect both the September and October rate reductions of 3% and 4.1%, respectively, results in an annualized average unit cost of \$0.04447/kWh. Adjusting the staff's estimate results in a revised estimate of \$46,000.

The applicant's general manager testified that he developed the purchased power expense for the 1978 test year by using the recorded power consumption (kWh) for the first eight months of 1978, estimating the power consumption for the last four months and with the help of the PG&E staff developed an average unit cost of power (\$/kWh) for the entire test year based on power rate schedules effective September 11, 1978. As a basis for determining the power consumption for the last four months of 1978, the general manager calculated that, on the average, using the years 1974, 1975 and 1976, sixty-four percent of the annual power cost was incurred within the first eight months. He testified (Exhibit 8) that the percentage annual power cost of 64% was equated directly to power consumption

and on that basis concluded that the recorded power consumption for the first eight months also represented sixty-four percent of the total annual power consumption. The power consumption for the last four months was then extended in proportion to the calculated thirty-six percent annual power cost resulting in a total annual power consumption of 1,407,337 kWh. We cannot accept the applicant's estimate of annual power consumption for the test year 1978 because applicant's general manager used the actual recorded power consumption for the first eight months of the test year in which unusually large quantities of water were produced rather than developing a normalized test year (adjusted for variation in precipitation and temperature over an extended period of years) such as developed by the staff. Under cross-examination, the applicant's general manager testified that (TR 246) "This year (1978) we've done an excessive amount of flushing"; (TR 247) "we had two pumps that showed contamination and early this year, we attempted to revive them and we flushed a great deal out of those pumping stations trying to clear the contamination"; (TR 246) "As you know, we have one new pumping station that went into operation in 1976 that we're developing, and that's taking a considerable amount of water to develop that pumping station". Based upon the general manager's testimony we conclude that the water use for the first eight months of the 1978 test year was unusually high and cannot be considered as a normalized period for rate-making purposes. Further, applicant's method for developing power consumption estimates for the last four months of the test year is erroneous. Power consumption is only directly proportional to power cost if the cost of power remains constant for the entire period under consideration or if the effects of increases or decreases in power costs have been (annualized) taken into consideration. We note that, in the three-year period (1974 through 1976) used by applicant's general manager to develop the power cost percentages which he related directly to power consumption, PG&E was authorized by this

Commission to change its power rate schedule seven times. Three major increases occurred randomly throughout the period and were included in applicant's calculations without annualization. This has the effect of distorting power consumption and further invalidates applicant's estimate of power consumption for the four remaining months of the 1978 test year. Based on the record that the applicant did not use a normalized power consumption estimate for the first eight months of the test year and further used an erroneous method to estimate the power consumption for the last four months, we will reject the applicant's estimate of power consumption of 1,407,337 kWh and accept the staff's estimate of 1,034,385 kWh.

Applicant's general manager testified that with the help of PG&E's staff and using rate schedules effective in September 1978, he calculated the unit cost of power (\$/kWh) as shown in Exhibit No. 8 to be \$0.04438/kWh. Applying the October 1978 power rate reduction of approximately 4.1% reduces applicant's estimated unit cost to \$0.04256/kWh which is close to the staff's adjusted estimate of \$0.04447/kWh. Using staff's estimate of power consumption (kWh) and staff's adjusted estimate of unit cost of power (\$/kWh), we shall adopt $(1,034,385 \text{ kWh} \times \$0.04447)$ \$46,000 as a reasonable allowance for purchased power expense for the 1978 test year.

Customer Accounts - The major differences between the applicant's and staff's estimates of customer accounting expenses are the level of wages paid and number of personnel assigned to customer accounting. The staff testified that salary increases for 1978 which exceeded 7% were not included and that customer accounting costs of \$1.27 per bill were excessive when compared to California Water Service Company's cost of approximately \$0.74 per bill for its Salinas District. The staff used salary adjustments and a judgment of adequate personnel to do the job to include a customer accounting expense of \$0.90 per bill for a total of \$35,000.

.. Applicant initially requested \$49,000 for customer accounting expenses but later produced Exhibit No. 9, which included a \$3,000 annual savings which would be effected by hand delivering 76% of the water bills, and consequently reduced its request to \$46,000 (Exhibit No. 7). The applicant's general manager in his testimony did not identify the specific number of employees and corresponding salaries assigned to customer accounting. It is our judgment that more time has been charged to customer accounting than appropriate and greater accuracy and control in allocation of time to the various accounts should be exercised. We will adopt \$41,000 as a reasonable allowance for customer accounts.

We will adopt a total operation and maintenance expense of \$144,400.

Payroll

The record shows that the applicant, at the time of the hearings, employed eight full-time employees and on occasion hires several part-time employees. Several of the full-time employees and practically all the part-time employees are related to the Adcock family. The general manager and his three sisters own approximately 88% of the stock and the remaining 12% is held in trust under the control of the general manager's mother and sister. The staff, in its analysis of a reasonable payroll, testified that a reasonable annual salary for the general manager would be \$22,000 rather than the \$27,000 requested. This was derived by reference to the prior rate increase in 1976 (A-55489, D-85792), wherein the general manager's annual salary was estimated to be \$19,000. Using this as a basis, the staff increased it by 7% for 1977 and 1978 for a total of \$21,753 which was rounded to \$22,000 (Tr. 72). As a check on the reasonableness of this estimate, the staff referred to a salary survey published by the American Water Works Association

in 1974. The survey showed that the salary for an average quality manager for a water system serving a population of 10,000 to 25,000 (Alisal serves approximately 10,000) would be \$15,671. The staff also updated this survey by applying a 7% increase per year for a current 1978 salary of \$21,940 which agreed closely with the first estimate of \$22,000 (Tr. 72). The staff also disallowed the management consulting salary of \$7,400 per year for Mrs. Adcock who is the widow of the founder of this utility and the mother of the general manager. The staff did not believe the jobs performed by Mrs. Adcock could properly be classified as management consultant duties in accordance with Account No. 798 of the Uniform System of Accounts.

The applicant's general manager testified in support of his salary and his mother's management consulting salary. He testified that in June of 1978 (Tr.187) all employees received a 10% increase in salary and with the increase his salary was \$27,000 per year. However, when the Board of Directors, which consists exclusively of family members, reviewed the staff report (Exhibit 2) and saw that the staff deemed that \$22,000 was a reasonable annual salary for the general manager, the Board immediately reduced his salary. Applicant's general manager prepared a comparative study of salaries paid to other managers of similar utilities (Exhibit 10) and in his opinion justified a salary of \$27,000 for his position. The study compared only the salaries of persons who were owners or managers of 14 utilities ranging in size from 2,100 to 14,500 connections.

The average of all salaries shown was \$28,600. Under cross-examination the general manager stated that he considered salaries only and did not consider fringe benefits. Exhibit 10 shows, in some instances, that the management salary used in the comparison is not an individual salary but an allocation of the

salaries of two or more top management personnel to the comparative utility. Applying the same criteria to Alisal and combining the salaries of the two top management personnel (general manager plus part-time vice president) would result in a management salary of (\$22,000 + \$7,000) \$29,000 which is slightly above the average of the comparative study. In citing Washington Water and Light Co. as comparative, applicant's general manager was unaware that the general manager of Washington Water and Light Co. at a reported salary of \$32,000 also manages seven other subsidiaries or affiliates of Citizens Utilities Company of California, having approximately 30,000 customers. The general manager acknowledged that many of the managers in the analysis were also major stockholders, and the salary they chose to pay themselves would not necessarily be approved by the Commission as a reasonable rate-making expense. Considering the many fallacies of the comparative analysis (Exhibit No. 10), we will not use it as a measure to establish a reasonable annual salary for the general manager of Alisal. The staff's recommendation of \$22,000 for the general manager's salary is reasonable and will be adopted. The testimony of the general manager that his mother spends 12 to 15 hours a month at the company office reviewing payroll and performing public relations work does not convince us that her services should be classified as "management consultant" and we will disallow the \$7,400 requested for her salary. For the remaining employees the total payroll is based on salaries effective in June 1978 with adequate allowance for overtime and temporary help. We will adopt a total payroll of \$114,700 as shown in Table III.

TABLE III

Total Payroll

<u>Item</u>	1978 Estimated		<u>Adopted</u>
	<u>Applicant</u>	<u>Staff</u>	
	(Dollars in Thousands)		
General Manager and President	\$ 27.0	\$22.0	\$ 22.0
Management Consultant*	7.4	0	0
Office Manager	13.0	12.5	13.0
Vice President*	7.0	7.0	7.0
Operation and Maintenance	53.0	43.7	53.0
Administrative and Clerical	<u>19.7</u>	<u>14.6</u>	<u>19.7</u>
Total Payroll	127.1	99.8	114.7
Less: Capitalized Payroll	<u>24.1</u>	<u>11.4</u>	<u>24.2</u>
Payroll Charged to Expense	103.0	88.4	90.6

*Part-time

Administrative and General Expenses

The principal cause of the differences in estimates of the administrative and general expenses is due to the staff's salary and wage adjustments. Table IV shows the specific estimates and our adopted expenses.

TABLE IV

Administrative and General Expenses

<u>Item</u>	1978 Estimated		<u>Adopted</u>
	<u>Applicant</u>	<u>Staff</u>	
(Dollars in Thousands)			
<u>A&G Expenses</u>			
A&G Salaries	\$ 33.0 ^{1/}	\$23.4 ^{2/}	\$24.7
Office Supplies and Expenses	12.0	12.0	12.0
Insurance	12.6 ^{3/}	12.6	12.6
Employee Pensions and Benefits	17.4	14.0	16.2 ^{4/}
Other	30.9 ^{5/}	28.0	30.9
Total A&G Expenses	105.9	90.0	96.4

- ^{1/} Reflects a 10 percent increase in manager's salary over November 1975 level (RT 182, 204; Exh. 15).
- ^{2/} Reflects reduction in manager's salary and disallowance of any compensation for Kathleen L. Adcock (Exh. 2, p. 5).
- ^{3/} Recorded 1978 expense on a cash basis which understates near-term future insurance expense (RT 208-15; Exh. 15).
- ^{4/} As pension and benefits are a function of payroll (RT 163), this reflects difference in wage expense.
- ^{5/} Consists of regulatory commission expense of \$3,900 amortized over three years, miscellaneous general operating expenses (\$18,000) and general plant maintenance (\$11,600) (RT 205-06, 208; Exh. 15).

After reviewing Exhibit 19, the staff accepted Alisal's estimate for insurance as shown in staff Exhibit 20, thus, changing its estimate from \$10,700 to \$12,600. The differences in A&G Salaries and Employee Pensions and Benefits are due to the staff's salary treatment indicated above. Of the remaining expenses (Other) the staff accepted Alisal's estimate of \$3,900 for regulatory expense spread over three years, thus changing staff's estimate for other expenses from \$26,700 to \$28,000. The remaining difference between Alisal's and staff's estimates now is \$15,900 represented primarily by the staff's wage adjustments.

Taxes Other Than Income

Table V shows the comparison of estimates for taxes other than income and the amounts we adopt. After a review of Exhibit 19, the staff adopted Alisal's estimate of ad valorem taxes (Exhibit 20), thus changing staff's estimate from \$11,700 to \$13,200. The remaining differences are due to the staff's salary and wage adjustments previously discussed. The staff's franchise tax is lower due to lower revenue requirements.

TABLE V

Taxes Other Than Income

<u>Item</u>	<u>Applicant Estimated</u>		<u>Staff - Estimated</u>		<u>Adopted</u>
	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Present Rates</u>	<u>Proposed Rates</u>	
	(Dollars in Thousands)				
Ad Valorem	\$13.2	\$13.2	\$13.2	\$13.2	\$13.2 ^{1/}
Local, Franchise and Vehicle	4.3	4.8 ^{2/}	3.9	4.6	4.8
Payroll	<u>9.6</u>	<u>9.6</u>	<u>7.1</u>	<u>7.1</u>	<u>9.6</u>
Total	27.1	27.6	24.2	24.9	27.6

^{1/} Effective future tax rate was not determinable at time of hearing. Staff assumed 1.1 percent, and utility assumed 1.25 percent, applied to cash value. We are adopting the higher figure and will require Alisal to set up a Tax Initiative Account to adjust for any over-collections. Staff disallowed taxes on a well site held for near-term future use (RT 85, 97-99, 108, 196-200; Exh. 14), with which we do not agree.

^{2/} Reflects correction of overstatement by applicant of \$362 in local franchise taxes (RT 235-41; Exh. 14).

Computation of Taxes on Income

Table VI sets forth the computation of income taxes for the test year by the staff and Alisal after all changes reflected in the record were made on the basis of the adopted revenues and expenses.

TABLE VI
Income Tax Computation

<u>Item</u>	<u>Proposed Rates - 1978</u> <u>Estimates</u>		<u>Adopted</u> <u>Estimates</u>
	<u>Staff</u>	<u>Alisal</u>	
Operating Revenue	\$421.2	\$423.8	\$372.3
<u>Deductions</u>			
Operating and Maintenance Expense	146.5	166.5	144.4
Administrative and General Expense	90.0	105.9	96.4
Taxes Other Than Income	25.1	27.6	27.4
Interest and Miscellaneous Dep.	11.4	11.4	11.4
Subtotal	273.0	311.4	279.6
Taxable Income Before Dep.	148.2	112.4	92.7
Depreciation - State	34.1	32.0	32.0
State Taxable Income	114.1	80.4	60.7
State Income Tax	10.3	7.2	5.5
Taxable Income Before Dep.	148.2	112.4	92.7
Depreciation - Federal	52.2	52.2	52.2
State Income Tax	10.3	7.2	5.5
Sum Deductions	62.5	59.4	57.7
Federal Taxable Income	85.7	53.0	35.0
First 25,000 at 20%	5.0	5.0	5.0
Second 25,000 at 22%	5.5	5.5	2.4 ^{2/}
Balance at 48%	17.1	1.4	0 ^{2/}
Investment Tax Credit	15.4	7.7 ^{1/}	7.4
Federal Income Tax	12.2	4.2	0
Total Income Tax	22.5	11.4	5.5

1/ Reflects investment tax credit averaged over a five-year period.

2/ Although HR 13511 (Revenue Act of 1978) has become law, thereby reducing the corporate tax rate to 46 percent, it will not have an effect under our adopted rates because applicant will not have net taxable income in excess of \$50,000 and further, the investment tax credit will offset federal income tax.

Applicant used a straight line remaining life depreciation rate of 2.23 percent for rate-making and franchise taxes, but used an accelerated rate for federal income tax calculations. The staff reviewed the depreciation rates and found them reasonable for the 1978 test year. The staff's exhibit shows that the maximum investment tax credit available to Alisal for the test year is \$15,400. However, Alisal's total federal tax liability for 1978 is estimated to be only \$7,400. Therefore, in our "adopted" tax calculations we have included only \$7,400 investment tax credit to offset federal taxes. Alisal's total state tax liability is \$5,500.

Table VII, taken from Exhibit 19, shows the development of working cash allowance by both the staff and Alisal, including revisions made on the record. Both staff and Alisal used the simplified procedure for calculating working cash as set forth in Standard Practice U-16. Based on the adopted expenses, we will authorize \$36,200 as a reasonable allowance for working cash.

TABLE VII

Working Cash

	<u>As Shown In Application</u>	<u>Based On Data In Staff Report (Exh. 2)</u> (Dollars in	<u>Applicant's Revised Figures</u> Thousands)	<u>Adopted 1978 Test Year</u>
One Year's Expenses	\$269.3	\$233.3	\$272.4	\$240.8
One Year's Power Costs	72.0	51.5	62.0	46.0
Two Months' Average Operating Expenses	44.9	38.8	45.4	40.0
Less: One Month's Power Costs	<u>6.0</u>	<u>4.3</u>	<u>5.2</u>	<u>3.8</u>
Working Cash Allowance	38.9	34.5	40.2	36.2

Rate Base

Table VIII shows that there were no significant differences between applicant and staff in the aggregate rate base dollars. The staff testified that the reserve for depreciation was reduced by a net of \$5,997 due to the retirement in past years of three vehicles. The staff's estimates of the reserve for depreciation and advances for construction were uncontroverted. We shall adopt a rate base of \$679,500.

TABLE VIII

Rate Base, 1978 Test Year

Item	Staff	Applicant	Adopted
(Dollars in Thousands)			
Average Utility Plant	\$1,711.7	\$1,712.2	\$1,712.2
Materials & Supplies	5.2	4.0	4.0
Working Cash	28.8	40.2	36.2
Subtotal	1,745.7	1,756.4	1,752.4
<u>Deductions</u>			
Average Reserve for Depreciation	499.2	503.9	499.2
Average Advances for Construction	468.9	459.9	468.9
Average Contribution in Aid of Construction	83.2	83.2	83.2
Deferred Investment Credit	21.6	21.6	21.6
Total Deductions	1,072.9	1,068.6	1,072.9
Average Depreciated Rate Base	672.8	687.8	679.5

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Rate of Return

The application of Alisal seeks authority to establish increased rates for a 1978 test year which would provide net earnings of \$81,611 for a rate of return of 9.7 percent on an estimated rate base of \$687,950. This return would provide it with a stockholder's return on equity of 11.4 percent based on a capital structure of 32 percent long-term debt and 68 percent common equity.

After revising its showing during the hearing, Alisal now seeks a rate of return of 10.7 percent with a concomitant 12.87 percent return on stockholders' equity on an estimated rate base of \$687,800. Alisal made no revision of its proposed rates.

Alisal relies quite heavily on the 12.81 percent return on equity authorized for CWS's Salinas Division in D.89110, dated July 25, 1978, in A.57330, of which we take official notice. It presented Exhibit 17 which consists of various tables on rate of return presented by the staff in CWS's recent rate proceedings, particularly for the Salinas District. We note that the capital ratios for CWS in Exhibit 17 do not correspond with those used in D.89110. For purposes of the following table, we will use the ratios set forth in the decision rather than those used by Alisal. Exhibit 17 sets forth the capital ratio of CWS under an array of assumed earnings on equity. The various cost factors are developed, producing a resultant rate of return. A similar array is presented for Alisal using the capital ratios and cost of debt developed by

the Finance Division staff. Relying upon the 12.81 percent return on-equity adopted for CWS, a comparison table is set up between Alisal and CWS, as follows:

TABLE IX

Comparison of Capital Structures, Cost Factors, Weighted Costs, and Rates of Return - CWS and Alisal

<u>Capital Component</u>	<u>Capital Ratio</u>		<u>Cost Factor</u>		<u>Weighted Cost</u>	
	<u>CWS</u>	<u>Alisal</u>	<u>CWS</u>	<u>Alisal</u>	<u>CWS</u>	<u>Alisal</u>
Long-term Debt	51.90%	32.00%	8.02%	6.09%	4.16%	1.95%
Preferred Stock	6.65	0	7.18	0	.48	0
Common Stock Equity	<u>41.45</u>	<u>68.00</u>	12.80	12.88	<u>5.31</u>	<u>8.75</u>
Totals	100.00	100.00			9.95	10.70

Alisal's general manager testified that it is reasonable to compare rates of return with CWS's Salinas District because of similarity in the geographical location of both companies; that similar return on equity is reasonable for Alisal (12.88 percent) because Alisal's shareholders are carrying two-thirds of the burden of the capitalization. They are also carrying two-thirds of the risk and therefore are entitled to a better return on their investment than a lending company would be if it were financing two-thirds of the capital investment. In short, he states that the one financing the operation should be the one that is getting the

greatest return. This is an oversimplified argument and not correct. For example, in Table IX assume that CWS's capital ratios were: Debt, 68 percent; Preferred Stock, 6.65 percent; and Common Equity, 25.35 percent. The costs of debt and preferred stock and the rate of return remain the same. The cost of equity (return) is now 15.86 percent because of the leverage provided by the higher debt ratio. Thus, it does not follow that he who is financing the corporation should be the one that gets the greatest return. What is true is that the stockholder assumes a greater risk, since the debt holder is secured by a lien on the corporation's assets, and therefore is entitled to a higher return on his investment, commensurate with his risk. In measuring the risk to the common stockholder, consideration must be given to the capital structure of the company. The stockholders of a company with a high equity ratio, like Alisal with 68 percent, assume less risk than stockholders of companies with lower equity ratios, like CWS than 41.45 percent.

Alisal presented Exhibit 18 which is a letter dated August 8, 1978, from Pacific Mutual Life Insurance Co. (PML) to Alisal in response to a recent request for consideration to making another loan. PML is hesitant to make a loan commitment because of Alisal's inadequate earnings. If Alisal can demonstrate that it can earn an adequate return to provide a margin of safety over the additional interest expense requirements, PML would be willing to discuss a \$150,000 to \$300,000 loan based on an annual interest rate of 10 percent, maturing in 20 years, with a 2 percent annual sinking fund beginning after the second year of issuance. Other terms would be patterned after those in prior borrowings.

The staff presented no probative evidence on rate of return. It merely set forth a 9.45 percent rate of return recommendation based on the capital ratios and cost of debt which was given to the engineering staff by the Finance Division.

Table X sets forth both the staff's and Alisal's rate of return computations and those we are adopting.

TABLE I

Rate of Return

<u>Component</u>	<u>Capital Ratios</u>		<u>Cost Factors</u>		<u>Weighted Cost</u>		<u>Adopted</u>
	<u>Alisal</u>	<u>Staff</u>	<u>Alisal</u>	<u>Staff</u>	<u>Alisal</u>	<u>Staff</u>	
Long-term Debt	32%	32%	6.09	6.09	1.95%	1.95%	1.95%
Preferred Stock	0	0	0	0	0	0	0
Common Stock	68	68	12.88	11.00	8.75	7.50	7.85
Totals	100	100			10.70	9.45	9.80

We will adopt the capital ratios and cost of debt set forth above and we will adopt a rate of return of 9.8 percent which will provide an 11.5 percent return on equity.

We have determined that rates which will provide Alisal with net earnings around \$67,400 for a rate of return of 9.8 percent on rate base and a return on stockholders' equity of 11.5 percent will be just and reasonable. That corresponds generally to Alisal's request and in our judgment will provide earnings sufficient to cover service on debt, meet reasonable dividend requirements, and assure confidence in the financial integrity of the enterprise so as to maintain its credit and attract capital (Del Este Water Co. (1976) 79 CPUC 327, 343). There is no particular method for determining a reasonable return for a utility. It involves weighing many factors and making pragmatic adjustments to arrive at a total effect and end result in balancing the investor and consumer interests. Alisal's reliance on the showings made in the CWS Salinas division rate case in support of its request is somewhat misplaced. From Table IX it is readily determinable that the capital structures of the two companies are completely dissimilar. It would therefore be unrealistic to place much weight on such evidence in determining a just and reasonable return for Alisal. We do note that under Alisal's proposed rates an unduly high rate of return would result (Table I).

Service

One informal complaint was filed with the Commission during 1977. Forty-one complaints were filed with Alisal. The staff interviewed 23 customers and pressures were measured at these residences. The staff concluded that service was considered adequate and the water pressures were within the requirements of General Order No. 103.

Quality of Water

In January 1978 three samples out of 40 tested failed to meet the bacteriological standards as set forth in the California State Health and Safety Code. The water was retested at the locations represented by the bad samples and follow-up samples met all the standards as set forth under the California Domestic Water Quality and Monitoring Regulation. The staff reported that a representative of the State Health Department stated in June 1978 that Alisal had met all standards since January 1978.

Physical Condition of Plant

The staff reports that the water system is properly maintained. All construction of water mains in recent years has met the requirements of General Order No. 103. Approximately 20 percent of the existing water mains are 3 inches or smaller in size. The testimony of the two public witnesses dealt with the undersized water mains according to existing standards and fire flow protection required by General Order No. 103. A problem exists between the utility and these customers who wish to upgrade their present single residential lots to multiple units. They are unable to get the requisite building permits

until they can show their water source will meet city fire department fire flow requirements. Alisal's main extension rule does not cover the situation where present mains do not meet the current requirements of General Order No. 103 with respect to fire flow. Consequently, Alisal is in a quandary on how to resolve the situation and at the same time meet the request of its customers who do not believe they should be required to finance the upgrading of the water mains serving their property. Exhibits 4, 5, and 6 were introduced on this subject. Exhibit 4 is a copy of that portion of Alisal's Main Extension Rule pertaining to Extensions Designed to Include Fire Protection. Exhibit 5 is a copy of the Commission's Order Instituting Investigation in C.9902 dated April 15, 1975, and Exhibit 6 is a copy of the Comments of California Water Association Regarding Financing of Fire Protection Capacity submitted in C.9902. While the main extension rule is not an issue in this case, Alisal felt obligated to reply to the comments made by its customers and to point out that it is in a dilemma on how to apply its rule to a situation that is not specifically covered by it. Obviously, we cannot resolve Alisal's dilemma in this case. We do point out that on November 28, 1978, we issued D.89695 in C.9902 which is an order superseding inquiries previously ordered in C.9902. The staff was ordered to prepare a report to be distributed within 90 days to all respondents and interested parties. C.9902 is the vehicle wherein Alisal must look for the resolution of its dilemma. Finally, the staff recommended that Alisal be required to file the consultant's report or master plan of expansion and improvements ordered in D.77509, dated July 14, 1970, within 90 days after the effective date of the order in this matter.

Findings of Fact

1. Alisal is a public utility water corporation with 3,231 customers in a portion of the city of Salinas and certain adjacent territories in Monterey County.
2. Alisal seeks authority to increase its rates for general metered service to provide an increase of about 18 percent for the first 300 cubic feet and 27 percent for all water delivered over 300 cubic feet, and by 20.7 percent in its readiness-to-serve charge, to result in a net increase of \$81,611 for a rate of return of 11.5 percent on a depreciated rate base of \$687,800.
3. Public hearing was held on this application in Salinas on August 14, 1978, and in San Francisco on September 18 and October 4, 1978. There were no protests to the granting of the application.
4. Alisal's water quality and service are satisfactory.
5. Alisal is in need of additional revenues but the rates requested would produce an excessive rate of return.
6. An average depreciated rate base of \$679,500 is a reasonable test year estimate.
7. A rate of return of 9.8 percent on said depreciated rate base will provide Alisal with net earnings of \$66,600 return on common equity of 11.5 percent, which earnings and returns are sufficient to cover service on debt, provide for reasonable dividends to stockholders, and assure confidence in the financial integrity of the utility so as to maintain its credit and attract capital. Said returns and earnings are reasonable.
8. The proposed increased rates would provide a rate of return of 15.2 percent and a return on common equity of 19.49 percent which returns are excessive and unreasonable.

9. The adopted estimated results of operation set forth in Table I are predicated upon conditions known at the time of hearing and are reasonable estimates based on the record herein.

10. The schedule of rates in Appendix A should provide the gross revenue set forth under adopted rates in Table I. Said rates are the just and reasonable rates. To the extent that present rates are different from the rates prescribed herein, said rates are, and for the future will be, unjust and unreasonable.

11. Alisal's use of a 1.25 percent tax rate for ad valorem taxes is prudent and reasonable. However, since there may be an overcollection as a result of using this rate, Alisal should be ordered to establish a Tax Initiative Account pursuant to Order Instituting Investigation No. 19 dated June 27, 1978, and interim orders therein.

Conclusion

Alisal should be authorized to increase its rates as set forth in the ensuing order and in all other respects, the application should be denied.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, applicant is authorized to file the revised rate schedules attached to this order as Appendix A. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall be five 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 directed to establish a tax initiative account pursuant to Commission Order Instituting Investigation No. 19 issued June 27, 1978.

3. Applicant shall file with the Commission a copy of the consultant's report or master plan of the system expansion and improvements originally ordered in D.77509 dated July 14, 1970, within ninety days after the effective date of this order.

4. In all other respects the application is denied.

The effective date of this order shall be ~~thirty days~~ after the date hereof.

Dated at San Francisco, California, this 27th day of FEBRUARY, 1979.

John E. Bryan
President
George L. Stinson
Richard D. Howell
Clarence T. ...
Leonard H. James
Commissioners

APPENDIX A

Schedule No. 1

METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Alisal and vicinity, Salinas, Monterey County.

RATES

	<u>Per Meter</u> <u>Per Month</u>	
Service Charge:		
For 5/8 x 3/4-inch meter	\$ 2.70	(I)
For 3/4-inch meter	4.00	
For 1-inch meter	5.75	
For 1 1/2-inch meter	10.35	
For 2-inch meter	17.25	
For 3-inch meter	29.00	
For 4-inch meter	46.40	
For 6-inch meter	97.00	
For 8-inch meter	116.00	
For 10-inch meter	145.00	(I)
Quantity Rate:		
The first 300 cu.ft., per 100 cu.ft.	\$ 0.28	(I)
All over 300 cu.ft., per 100 cu.ft.	0.36	(I)

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