

Decision No. 90659 AUG 14 1979

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application  
of the CALIFORNIA CITIES WATER  
COMPANY for an order authorizing  
an increase in water rates in  
its Los Osos District.

Application No. 57970  
(Filed March 31, 1978)

O'Melveny & Myers by Guido R. Henry, Jr., Attorney  
at Law, for Southern California Water Company  
(California Cities Water Company), applicant.  
Peter Fairchild, Attorney at Law, and Arthur A.  
Mangold, for the Commission staff.

O P I N I O N

The application alleges that it was filed to increase annual revenues during 1979 by \$125,800 or 52.2 percent over revenues provided by rates now in effect. The basic rates were last set by Decision No. 81462, dated June 12, 1973, in Application No. 53494. Additional offset increases were authorized by Resolution No. W-1736, dated June 8, 1975, Resolution No. W-1888, dated April 4, 1976, Advice Letter No. 59-W, dated February 9, 1977, and Resolution No. W-2454, dated November 28, 1978, which included an increase to cover rising power costs and a reduction to credit a decrease in real property taxes due to Proposition 13.

Applicant was a wholly owned subsidiary of Southern California Water Company (all of applicant's outstanding capital stock was acquired on April 14, 1976 under authority of Decision No. 85622, dated March 23, 1976, in Application No. 56311) until August 1978 when applicant was merged into its parent company. California Cities Water Company (Cal Cities) no longer exists as a corporate entity and its water system is operated as one of the districts of Southern California Water Company (SCWC).

SCWC, a California corporation, renders public utility water service in various areas in the counties of Contra Costa, Imperial, Lake, Los Angeles, Orange, Sacramento, San Bernardino, San Luis Obispo, Santa Barbara, and Ventura. It also provides public utility electric service in the vicinity of Big Bear Lake in San Bernardino County.

The Los Osos system is located in the unincorporated territory of San Luis Obispo County and consists of three units. Two are located two or three miles south of the San Luis Obispo Airport and serve 250 customers from three wells. The main system is 10 miles west of Highway 101 and serves about 2,100 customers. It has 92 fire hydrants and obtains water from six wells located within the system. It provides water of good quality, has adequate storage, and operates under a permit from the State Department of Public Health.

After due notice, public hearing was held before Administrative Law Judge Edward G. Fraser in San Luis Obispo on December 14, 1978 and the matter was submitted.

Testimony on behalf of SCWC was presented by its executive vice president, vice president of operations, manager of rate and valuation, and a rate analyst. The Commission staff presentation was made through a utilities engineer and a financial examiner. One utility customer appeared at the hearing and made a brief statement.

#### Summary of Earnings

The staff and the applicant were in agreement on most items prior to the hearing. The three areas in conflict will be individually discussed. Basic information on earnings is covered in the following table, the first two columns of which are from Exhibit 6 which brings an earlier staff exhibit (13) up to date and the third column of which shows our adopted estimates.

Los Osos District  
 CPUC Staff Functional Summary of Earnings  
 As Adjusted by Company<sup>1/</sup>  
 and Adopted Summary of Earnings  
 Test Year 1979 Estimated

	<u>Present Rates</u>	<u>Proposed Rates</u>	<u>Adopted Rates</u>
	(Dollars in Thousands)		
<u>Operating Revenue</u>			
Metered Water Sales	\$ 248.5	\$ 363.3	\$ 283.0
Flat Rate Service	3.8	3.8	3.8
Total Revenue	<u>252.3</u>	<u>367.1</u>	<u>286.8</u>
<u>Operating Expenses</u>			
Power for Pumping	38.9	38.9	36.2 <sup>2/</sup>
Labor - Direct	51.0	51.0	51.0
Common Cust. Acct.	5.2	5.2	5.2
Uncollectibles	0.6	0.6	0.6
Office Supplies	3.3	3.3	3.3
Injuries and Damages	8.1	8.1	8.1
Pensions and Benefits	7.0	7.0	7.0
Regulatory Commission	-	-	-
Dues, Memberships & Emp. Exp.	-	-	-
Depreciation & Amortization	43.0	43.0	43.0
Property Taxes	17.0	17.0	17.0
Payroll Taxes	3.6	3.6	3.6
Allocated General Office	12.6	12.6	12.6
Other Expenses	15.3	15.3	15.3
Sub-Total	<u>207.2</u>	<u>207.2</u>	<u>204.5</u>
Net Revenue before Income Tax	45.1	159.6	82.3
State Income Tax	(2.9)	7.4	0.5
Federal Income Tax before ITC	(13.8)	34.0	1.7
Investment Tax Credit	<u>(22.6)</u> <sup>2/</sup>	<u>(22.6)</u> <sup>2/</sup>	<u>(30.9)</u>
Total Income Tax	(39.3)	18.8	(28.7)
Total Operating Expenses	167.9	226.3	175.8
Net Operating Revenue	84.4	140.8	111.0
Rate Base	1,196.2	1,196.2	1,196.2
Rate of Return	7.06%	11.77%	9.28%

(Red Figure)

<sup>1/</sup> Columns 1 and 2.<sup>2/</sup> The entry on Investment Tax Credit noted above is based on a five-year average of expenses, as favored by applicant.<sup>3/</sup> Based on 883,500 kWh of energy consumption, 328.5 MG of water production, and power rates effective February 2, 1979.

Income Tax

The criteria used by both the staff and applicant to calculate income taxes were (1) liberalized depreciation using asset depreciation range for both state and federal taxes, (2) full flow through, including investment credit, (3) interest expense based on the composite cost of debt and rate base, and (4) a federal tax rate of 48 percent.

In 1978 the Congress approved and the President signed the Revenue Act of 1978 which, among other things, reduced the corporate tax rate from 48 to 46 percent effective January 1, 1979. Because this will reduce applicant's federal income tax liability, the results adopted herein reflect the new tax rate.

The staff and applicant differed on the treatment of Investment Tax Credit (ITC). ITC is an accounting process which permits a utility to deduct from income tax certain sums which were invested in new plant or equipment. It is applicant's position that ITC varies depending on gross improvements to utility plant and in this proceeding it should be a 10 percent credit on taxes. Applicant used a five-year moving average and the staff a three-year moving average in estimating ITC. Applicant started with 1974-1978 as a first five-year period, then 1975 through 1979, with the latter year estimated; the moving average is based on both five-year periods. Applicant's rate witness testified that applicant has always used the five-year period because it best avoids the extreme fluctuations which appear in short periods (two to three years). He further testified that the Commission has adopted the five-year period in other recent rate proceedings.

The staff expert testified that most major water utilities apply for a rate increase every three years and this prompted the staff to adopt this period for averaging on ITC for the first time this year. A second reason is the following table which shows applicant's plant additions (Exhibit 5, Table 8-1) over the past five years.

1973	-	\$ 28,780
1974	-	\$ 69,928
1975	-	\$ 96,455
1976	-	\$105,457
1977	-	\$213,816

Most of the plant construction completed by the applicant has been during the past three years. Applicant noted that it took over Cal Cities in April of 1976 when Cal Cities was in the Bankruptcy Court. It was necessary for applicant to invest extra money in plant improvements during the years noted due to the failure of its predecessor to spend funds for required construction of plant. We will adopt the three-year moving average in estimating Investment Tax Credit as recommended by the Commission staff.

Common Stock Equity Ratio and Rate of Return

Applicant has requested that a 15 percent rate of return be authorized on a common equity ratio of 35 percent. The staff recommends 12.85 percent on a ratio of 33.36 percent.

Applicant indicated that its common equity ratio has traditionally been 35 percent. The ratio dropped to 31 percent after applicant financed the acquisition of Cal Cities through debt financing. Applicant's Exhibit 10 lists applicant's common stock equity from 1968 through 1977.

Common Stock Equity

<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>	<u>1972</u>	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>
35.9	35.3	35.8	35.9	36.0	35.8	36.0	35.7	31.5	31.5

Exhibit 10 (Table 2) also reveals that applicant's before tax bond interest coverage has ranged between 4.6 and 3.6 from 1968 through 1975; in 1976 it dropped to 3.4 and to 3.1 in 1977. Applicant's witness testified that the 1978 figure had dropped again to 3.0. Applicant's financial expert testified that a ratio of 31 percent, or even the 33.36 percent favored by the staff is too low. He advised that applicant originally intended to issue a common stock for cash sale, buttsales of this type are very expensive and not favored by present stockholders. Applicant has issued debentures or preferred stock in the past at relatively low cost to the company since the issues had a conversion feature which permitted the holder to convert to common stock. None of the holders of this paper have bothered to convert, since it would cost them \$18.87 per share for stock which is presently traded at 13-3/4 - 14-1/2 on the market. In view of the problems involved applicant has decided to convert three low yield preferred stocks to common equity. The principal holder of the stock to be converted is a life insurance company which has been advised of the plan and has agreed to it. When the

principal holder converts applicant is convinced that those who own the remaining stock will also conform.

The resulting rise in equity ratio will encourage investors to buy SCWC securities, which is critical since applicant will soon request authority to issue \$5 million of first mortgage bonds to raise money. The witness noted that the Commission recently adopted a 35 percent common equity ratio for Southern California Edison Company and for Southern California Gas Company in separate proceedings.

The staff expert did not consider the proposed exchange of stock in his calculations. He testified that he first heard of the proposal in July of 1978, and there was no indication as to whether the Commission would grant the necessary authority. He further testified that applicant would receive no money in the process. It is a transfer of a preferred stock entry to common stock on the books of the corporation. It would improve the position of those who have invested in the company, but does nothing for the 200,000 customers of applicant. The latter would pay the additional cost of converting the stock, estimated at \$13,200. The staff witness noted that a 35 percent common equity ratio authorized for gas and electric utilities has no relevance to this application since gas and electric plants require a much greater capital outlay. The witness agreed on cross-examination that increased common equity would make applicant's bonds more attractive to investors.

The staff recommendation is based on the realization that SCWC's capital ratios are changing due to the conversion of subordinated debentures to common stock. The staff favors a rate of return escalating over two years, which will lessen the need for major utilities to file annually for major rate relief. Based on a 13.00 percent return on common equity (common stock equity of 34.01 percent in 1979 and 34.62 percent in 1980), the staff recommended a 9.28 percent rate of return on rate base for 1979 and 9.38 percent for 1980.

The following table compares the staff's recommended rate of return with that requested by SCWC:

SCWC's Requested Rate of Return

<u>Component</u>	<u>Capitalization Ratios</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-Term Debt	46.45%	6.80%	3.16%
Bank Loans or Other Debt	6.31	8.00	.51
Preferred Stock	12.24	7.15	.88
Common Stock Equity	<u>35.00</u>	15.00	<u>5.25</u>
Total	100.00%		9.80%

Staff's Recommended Rate of Return

	<u>1979</u>		
Long-Term Debt	51.61%	7.22%	3.73%
Bank Loans	2.41	11.00	.27
Preferred Stock	11.97	7.15	.86
Common Stock Equity	<u>34.01</u>	13.00	<u>4.42</u>
Total	100.00%		9.28%

	<u>1980</u>		
Long-Term Debt	52.12%	7.40%	3.86%
Bank Loans	1.81	11.00	.20
Preferred Stock	11.45	7.15	.82
Common Stock Equity	<u>34.62</u>	13.00	<u>4.50</u>
Total	100.00%		9.38%

We adopt the escalating rate of return over two years and the 13 percent return on common stock equity advocated by the Commission staff.

Attrition in Rate of Return

Applicant's Exhibit 5 (Chapter 11) reveals that rate of return has been declining and that the 10.80 percent requested will drop to an average return of 9.80 percent from 1979 to 1981.

For its consideration of decline in rate of return, the staff recommends that the rate of return be based on the test year 1979 and not on the 1979-1981 period. Applicant's Los Osos District has an annual revenue of less than \$750,000 and can apply for rate relief by advice letter under the provisions of General Order No. 96-A, as amended by Commission Resolution No. M-4701, dated August 8, 1978. By Resolution No. M-4705, dated April 24, 1979, we adopted a Regulatory Lag Plan (RLP) for all water utilities under our jurisdiction. The RLP was distributed to all water utilities by the Executive Director's letter of April 27, 1979, which advised all utilities that it is expected that the utilities or any district of a utility will not file a general rate increase request more often than once in three years. We foresee no hardship since the rates to be authorized herein include step rates for 1980. The staff analyzed the results of operation of the Los Osos District based on estimated 1978 and test year 1979. The staff recommends a return based on results from the test year 1979 and a 0.60 percent attrition. It also recommended that the utility be required to file an advice letter at the end of 1979 to justify a further increase in rate of return. The 0.60 percent operational attrition is based on a 9.28 percent rate of return for 1979.

Attrition in rate of return has two distinguishable independent additive components, operational and financial. The return of 9.28 percent in 1979 and 9.38 percent in 1980 effectively makes allowance for financial attrition resulting from change in capital structure. The 0.60 percent attrition factor recommended by the staff results from operational attrition. However, we believe that an allowance of 0.55 percent for operational attrition between 1979 and 1980 is reasonable.

The staff recommended 0.10 percent financial attrition factor and the 0.55 percent operational attrition factor are adopted in this proceeding.



Rate Design.

Applicant has designated the first 300 cubic feet of usage as a lifeline quantity. The rate structure adopted herein recognizes the lifeline principle and provides that lifeline rates will be less than charges for usage in excess of the lifeline quantity.

We have not adopted the usual two quantity rate blocks over lifeline because there are two areas in the Los Osos District which are presently charged different rates for water service. One district is charged more than the other, and if two rate blocks were adopted the higher-use customers would experience an excessive increase. This disadvantage is eliminated with a single rate block.

Findings of Fact

1. Applicant has been merged into SCWC.
2. Applicant operates a water utility system in the unincorporated area of San Luis Obispo County which supplies about 2,350 customers and 92 fire hydrants.
3. Applicant's basic rates were last set by Decision No. 81462 dated June 21, 1973. Offset increases were authorized in 1975, 1976, 1977, and 1978.
4. Applicant is in need of additional revenues for its Los Osos District, but the proposed rates set forth in the application are excessive.
5. The proposed rate of return of 9.80 percent on rate base, which would produce an estimated 15.00 percent return on common equity, is excessive.

6. The adopted estimates previously discussed herein of operating revenues, operating expenses, and rate base for the test year 1979 reasonably indicate the results of applicant's operations in its Los Osos District for the next two years.

7. A three-year moving average in estimating Investment (Income) Tax Credits for recent additions to utility plant and equipment, is reasonable.

8. A rate of return of 9.28 percent for 1979 and 9.38 percent for 1980 on the adopted rate base of \$1,196,200 is reasonable and will produce an estimated 13.00 percent return on common equity.

9. The increase in rates authorized for 1979 at the 9.28 percent rate of return is expected to provide increased revenues of approximately \$34,500, or 13.7 percent over revenues at present rates, for applicant's annual metered service and fire protection service during 1979.

10. The increase in rates authorized for 1980 at the 9.38 percent rate of return is expected to provide additionally increased revenues of approximately \$15,900, or 20.0 percent over revenues at present rates, for applicant's annual metered service and fire protection service during 1980.

11. The increases in 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.

12. The quality of service rendered by applicant in its Los Osos District is adequate.

13. Applicant's present and proposed plans for effecting water conservation generally comply with the requirements of Decision No. 86959.

14. The rates authorized herein will yield a rate of return of 9.28 percent for 1979 and a 13.00 percent return on common equity which are necessary to enable SCWC to sell securities necessary for capital improvements and are within the wage and price standards promulgated by the Council on Wage and Price Stability.

Conclusions of Law

1. The Los Osos general metered service schedule and the Edna Road general metered service schedule should be combined into one general metered service schedule.

2. Applicant should adopt a service charge to replace its minimum charge.

3. A single quantity block rate schedule should be adopted for all water used.

4. Service charges for the 3/4- and 1-inch meters should be rounded to the nearest 10 cents. Charges for meters larger than 1-inch should be rounded to the nearest dollar.

5. Since there is a demonstrated immediate need for this rate relief, the following order should be effective the date of signature.

ORDER

IT IS ORDERED that:

1. After the effective date of this order, Southern California Water Company is authorized to file 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 filing shall be four days after the date of the filing. The revised schedules shall apply only to service rendered on and after the effective date hereof.

2. On or before November 15, 1979, applicant is authorized to file step rates attached to this order as Appendix B or to file a lesser quantity rate increase in the event that the Los Osos District rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the twelve months ended September 30, 1979, exceeds 9.28 percent. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedule shall be January 1, 1980. The revised schedule shall apply only to service rendered on and after the effective date thereof.

The effective date of this order is the date hereof. ✓

Dated AUG 14 1979, at San Francisco, California.

John E. Boyson  
President  
Norman L. Sturgeon

Richard D. Gravelle  
James H. ...  
Commissioners

Commissioner Richard D. Gravelle, being necessarily absent, did not participate in the disposition of this proceeding. ✓

APPENDIX A

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SOUTHERN CALIFORNIA WATER COMPANY

Los Osos District

Los Osos and Edna Road Tariff Areas

Schedule No. LO-1

(C)

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Unincorporated areas in the vicinity of Los Osos and unincorporated areas south of the City of San Luis Obispo, San Luis Obispo County. (C)  
(C)

RATES

Per Meter  
Per Month

Quantity Rates:

For all water delivered, per 100 cu.ft. .... \$ 0.364 (I)(C)

Service Charge:

For 5/8 x 3/4-inch meter .....	\$ 4.75	(I)
For 3/4-inch meter .....	5.20	(C)
For 1-inch meter .....	7.00	
For 1-1/2-inch meter .....	10.00	
For 2-inch meter .....	13.00	
For 3-inch meter .....	24.00	
For 4-inch meter .....	32.00	
For 6-inch meter .....	54.00	

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. (C)  
(C)

Offset Cost Adjustment:

The Offset Cost Adjustment is a quantity charge per 100 cu.ft. added to each monthly bill for all water used over 300 cu.ft. The costs and revenues associated with the offset cost adjustment will be maintained in Balancing Accounts pursuant to Section 792.5 of the Public Utilities Code and Ordering Paragraph No. 4 of Commission OII 19.

<u>Offset Cost Item</u>	<u>Resolution No.</u>	<u>Advice Letter No.</u>	<u>Cost Per 100 Cu.Ft.</u>	
Power for Pumping	W-2454	74-W	4.0¢	(T)
Ad Valorem Tax	W-2454	74-W	(2.4¢)	(T)
Total Offset Cost Adjustment		74-W	1.6¢	

APPENDIX A

SOUTHERN CALIFORNIA WATER COMPANY

Los Osos District

Los Osos and  
Edna Road Tariff Areas

Schedule No. 10-4

PUBLIC FIRE HYDRANT SERVICE

APPLICABILITY

Applicable to all fire hydrant service furnished to municipalities, organized fire districts and other political subdivisions of the State.

TERRITORY

Within the established Los Osos District.

RATES

	<u>Per Hydrant Per Month</u>	
For each hydrant . . . . .	\$2.00	(C)

SPECIAL CONDITIONS

1. Water delivered for purposes other than fire protection shall be charged for at the quantity rates in the appropriate metered service schedule.
2. The cost of relocation of any hydrant shall be paid by the party requesting relocation.
3. Hydrants shall be connected to the utility's system upon the receipt of written request from a public authority. The written request shall designate the specific location of each hydrant and, where appropriate, the ownership, type and size.
4. The utility undertakes to supply only such water at such pressure as may be available at any time through the normal operation of its system.

APPENDIX B

SOUTHERN CALIFORNIA WATER COMPANY

Los Osos District

Los Osos and Edna Road Tariff Areas

Schedule No. LO-1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Unincorporated areas in the vicinity of Los Osos and unincorporated areas south of the City of San Luis Obispo, San Luis Obispo County.

RATES

Per Meter  
Per Month

Quantity Rates:

For all water delivered, per 100 cu.ft. .... \$ 0.385 (I)

Service Charge:

For 5/8 x 3/4-inch meter .....	\$ 5.00	(I)
For 3/4-inch meter .....	5.50	
For 1-inch meter .....	7.50	
For 1-1/2-inch meter .....	11.00	
For 2-inch meter .....	14.00	
For 3-inch meter .....	25.00	
For 4-inch meter .....	34.00	
For 6-inch meter .....	57.00	

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.

Offset Cost Adjustment:

The Offset Cost Adjustment is a quantity charge per 100 cu.ft. added to each monthly bill for all water used over 300 cu.ft. The costs and revenues associated with the offset cost adjustment will be maintained in Balancing Accounts pursuant to Section 792.5 of the Public Utilities Code and Ordering Paragraph No. 4 of Commission OII 19.

<u>Offset Cost Item</u>	<u>Resolution No.</u>	<u>Advice Letter No.</u>	<u>Cost Per 100 Cu.Ft.</u>
Power for Pumping		74-W	4.0¢
Ad Valorem Tax		74-W	(2.4¢)
Total Offset Cost Adjustment		74-W	1.6¢