

Decision No. 91182 JAN 8 1980

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of LAGUNA HILLS SANITATION, INC.,)
for an Order Authorizing an Increase)
in Rates.)

Application No. 58275
(Filed August 2, 1978;
amended January 25, 1979)

Latham & Watkins, by Michael C. Kelcy,
Attorney at Law, for applicant.
Martin E. Whelan, Jr., Attorney at Law,
for Professional Community Manage-
ment, Inc., Golden Rain Foundation,
and various mutual housing corpora-
tions inside Leisure World, pro-
testants.
Peter Fairchild, Attorney at Law, and
John Brown, for the Commission staff.

FINAL OPINION

Applicant, Laguna Hills Sanitation, Inc., filed on August 2, 1978 this application seeking both interim and permanent rate relief. Public hearing on the request for interim rate relief was held before Administrative Law Judge A. E. Main on November 8 and 9, 1978 in Laguna Hills and on December 5, 1978 in Los Angeles. The evidence amply demonstrated that applicant was confronted by a financial emergency. By D.90008 dated February 27, 1979 applicant's proposed interim rates were authorized subject to possible refund. The interim relief granted amounted to an increase of \$135,200, or 8.7 percent, in annual gross revenues.

On January 25, 1979 applicant filed an amendment to its application increasing the amount of permanent rate relief sought. By the amendment applicant also sought authority to establish a

balancing account for sludge hauling and disposal expenses. The rates proposed in the amendment would increase annual gross revenues by \$436,300 over those at the interim rates authorized by D.90008, supra.

After due notice, public hearing on the amended application was held before ALJ Main on February 7, 1979 in Laguna Hills and on February 8, 15, 16, 22, and 23, and March 8, 1979 in Los Angeles. Applicant's witnesses included its vice president-general manager; vice president-controller; a rate of return specialist; and a consulting engineer. The Commission staff presentation was made through a financial expert and an engineer. Protestants sponsored a consulting engineer who testified on fair rate of return and to a limited extent on sewer system flow measurements. Four of applicant's customers either testified or made statements at the February 7 hearing held in Laguna Hills. Two of these customers expressed concern over the high cost of effluent disposal and wanted an assessment of the economics of converting sludge to a soil amendment or fertilizer

and marketing such product. (Such a conversion is not, according to the subsequent testimony of applicant's consulting engineer, an economically viable option for applicant at this time.) After receiving late-filed Exhibits 20 through 24 and concurrent opening briefs, this matter was submitted May 22, 1979 upon the filing of concurrent reply briefs.

Background

Applicant was incorporated on July 31, 1963 as Rossmoor Sanitation, Inc. At that time, it was a wholly owned subsidiary of Rossmoor Corporation, which was developing a planned housing community and related commercial areas in southeast Orange County. During the early period of applicant's growth, single- and multiple-unit residences in its service area were financed by

loans from the Federal Housing Administration, which required the establishment of charges for sewer service through contracts in order to assure continuity of service. Those contracts established applicant's initial rates for sewer service.

Regulatory History

Following the adoption of amendments to the Public Utilities Code in 1970 and 1971 which conferred jurisdiction over sewer companies on the Commission, applicant, on July 1, 1972, became a public utility regulated by the Commission. In its first general rate proceeding before this Commission (A.54129 filed June 22, 1973), applicant's service extension practices, which were typical of those that had been utilized throughout the sewer industry by both publicly and privately owned systems, were examined at length. Under those practices applicant required both affiliated and nonaffiliated developers to contribute sewer plant that was constructed within their specific developments. In addition to contributions of such in-tract facilities, developers were required to pay applicant a connection charge, for each dwelling unit added to the system, for use by applicant to build backbone plant facilities, including treatment plant. D.84040 dated February 4, 1975 in A.54129 provided for a continuation of those service extension practices.

In A.57548 filed August 31, 1977 Rossmoor Corporation and Laguna Hills Utility Company (LHUC) sought Commission approval for LHUC to acquire and control Rossmoor Water Company and Rossmoor Sanitation, Inc. Approval of this transaction was granted in D.87929, effective October 4, 1977. On October 4, 1978, but made effective as of September 30, 1977, Laguna Hills Water Company (LHWC), formerly Rossmoor Water Company, and applicant, previously Rossmoor Sanitation, Inc., became wholly owned subsidiaries of LHUC, a publicly held company.

Service Area and Present Operations

Applicant's service area is within the boundaries of the El Toro and Moulton Niguel Water Districts. Three commercial services lying within the Los Alisos Water District are also served.

Applicant maintains a network of more than 105 miles of collection mains and transmission and trunk lines serving over 18,000 connections. Collected wastes are pumped to and processed at an activated sludge plant. It has three specially constructed lakes for temporary storage of surplus effluent water occupying approximately 20 acres of land. Solids are trucked away for disposal while effluent water, after processing, is used for irrigation of nearby farms and the 27-hole Leisure World golf course.

Applicant also owns a system of irrigation mains through which effluent water is distributed over 249 acres of leased land. Its sewer system is presently scheduled to connect to an ocean outfall pipeline in 1980, at which time this irrigation system is expected to be deactivated.

Applicant utilizes the employees of LHWC to perform the required operation, maintenance, and construction work. As of June 1, 1978 there were 43 employees of LHWC available to applicant, each of whom charges applicant on a timecard basis for work actually performed for applicant. The California Regional Water Quality Control Board, Santa Ana Region, has jurisdiction over the quality of effluent discharged by applicant for irrigation use and impoundments. The Department of Health of the State of California and the Orange County Health Department have jurisdiction over the bacteriological quality of the effluent discharged. Applicant is required to submit reports to these agencies at regular intervals giving both the mineral and bacteriological quality of the effluent produced.

Rates

For general residential sewer service (Schedule No. 1) the rates in effect at the time the amended application was filed (January 25, 1979), the interim rates presently in effect, and applicant's proposed rates are listed below.

Item	Per Dwelling Unit Per Month		
	of 1/25/79	(Interim) Rates	Proposed Rates
Unrestricted Family Residences	\$6.07	\$6.60	\$8.40
Restricted Family Residences	5.27	5.75	7.25

Applicant proposes commensurate rate increases (i.e., virtually the same percentage increase for each class of service) for commercial and industrial service (Schedule No. 2) and for sales of reclaimed water (Schedule No. 3).

Rate of Return

A public utility is constitutionally entitled to an opportunity to earn a reasonable return on its investment which is lawfully devoted to the public use. That return, when expressed as a percentage, typically represents the cost of capital utilized in providing utility service. Within this context, a fair and reasonable rate of return applied to an appropriately derived rate base quantifies the earnings opportunity available to the enterprise after recovery of operating expenses, depreciation allowances, and taxes.

Applicant contends the evidence in this proceeding clearly supports a rate of return on its rate base in the range of 11.43 percent to 12.0 percent and a return on common equity of 15.04 percent to 16.2 percent based on LHUC's consolidated capital structure, or 18.46 percent to 19.83 percent

based on applicant's separate capital structure. The Commission staff witness originally recommended a 10 percent rate of return which, based on applicant's separate capital structure, equates to a return on common equity of 15.04 percent. In light, however, of the extent that financial risk would be reduced by establishing of the effluent disposal balancing account, proposed by applicant, the staff in its reply brief argued that a return on applicant's separate equity of 13.84, equating to 9.50 percent on rate base, would more properly balance the interests of applicant and its customers. Protestants' witness also recommends a 10 percent rate of return.

Ultimately, the rate of return determination in this proceeding must represent the exercise of informed and impartial judgment by the Commission. That judgment must necessarily give equal weight to consumer and investor interests in deciding what constitutes a fair and reasonable rate of return. Such balancing of interests is directed toward providing utility service at the lowest rates practicable, consistent with the protection of the utility's capacity to function and progress in furnishing the public with satisfactory, efficient service and consistent with the utility's ability to maintain its financial integrity, attract capital on reasonable terms and compensate its stockholders appropriately for the use of their money.

A fundamental reason for applicant's filing this general rate increase application goes precisely to the "utility's capacity to function and progress in furnishing...satisfactory, efficient service" and to assure confidence in its financial integrity in order to attract capital on reasonable terms. Since 1971 applicant has experienced a net profit only in the years 1973, 1975, and 1978, and its financial condition has deteriorated to the point where its credit worthiness is seriously impaired. This impairment exists at a time when there is a critical need for outside financing.

In pursuit of such financing, applicant filed on July 30, 1979 A.59033, of which we take official notice, "for authorization to incur an indebtedness of \$1,400,000 and to service such indebtedness through a surcharge resulting in an increase in applicant's rates and charges for sewer service." The prospective indebtedness for which approval is sought is for financing, through the California Pollution Control Financing Authority, a \$1,400,000 project to repair and upgrade applicant's sewage treatment plant. The state agency will fund the project by selling state revenue bonds, the sole security for which will be the credit of applicant, plus such other collateral as the agency may require.

If applicant is successful in obtaining the above financing, its present need for outside financing will be satisfied. Applicant has, however, existing long-term debt of \$1,298,500 (as of December 31, 1978). It consists of 20-year first mortgage bonds due October 1, 1984 with sinking fund provisions and bearing 6 percent interest. Should applicant be unable to refinance this long-term debt, a cash obligation of \$1,174,900 will exist in October 1984. An adequate earnings record is usually a prerequisite to refinancing under terms not relatively unfavorable to those available to other borrowers. However, applicant's ability to have its earnings reach and maintain a fair rate of return level may be adversely affected by the inordinately large share of its utility plant funded by contributions.

As brought out earlier, applicant has, consistent with the established practice in the sewer industry and pursuant to D.84040, supra, required developers, as a condition of service, to contribute in-tract plant and to pay connection fees to finance backbone plant. Not only has this practice resulted in most of applicant's plant being contributed but, because it

represented a salient departure from regulatory policy established for the other types of utilities under our jurisdiction, has made the difficult task of determining fair rate of return for applicant more difficult by reducing applicant's financial comparability with the other types of utilities.

As of December 31, 1978, applicant's net utility plant was \$8,962,764 and its contributions in aid of construction were \$6,916,967. As of that date its long-term debt was, as previously brought out, \$1,298,500 and its common equity was \$806,910. Accordingly, its total capitalization, exclusive of contributions, was \$2,105,410 and the corresponding capital ratios were 38.33 percent common equity and 61.67 percent long-term debt. However, if contributions are included, the capital structure becomes 76.66 percent contributed plant, 8.94 percent common equity, and 14.39 percent long-term debt, a virtually unique capital structure among the regulated utilities in California.

To illustrate the effect of contributed plant on the stability of earnings, the staff drew a theoretical comparison in Exhibit 15-B between two companies, one of which has no contributions in aid of construction, and the other of which has 50 percent of its plant funded by contributions. In its opening brief applicant recast Exhibit 15-B to make the comparison, as set forth below, between two companies, one of which has no contributions and the other of which, approximately like applicant, has 75 percent of its plant funded by contributions. In each case, the debt/equity ratios are 60 percent debt to 40 percent equity. In the first year, both companies have an authorized rate of return on rate base of 10 percent and a related return on equity of 13 percent. Forty-four percent of the operating and maintenance expenses of both companies are assumed to be offsettable.

TABLE 1
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THEORETICAL COMPARISON

COMPANY A

(No Contributions in Aid of Construction)

Item	Rate Determination	7% Expense Increase	10% Expense Increase
Revenues	\$ 503,000	\$508,200	\$510,500
<u>Expenses</u>			
Operating & Maintenance (44% Offsettable)	170,000	181,900	187,000
Depreciation	20,000	20,000	20,000
Taxes - Other	100,000	107,000	110,000
Property Taxes	62,000	62,000	62,000
Operating Income	151,000	137,300	131,500
FIT - 50%	51,000	44,700	41,700
Net Operating Income	100,000	92,600	89,800
Return on Rate Base	10%	9.26%	8.98%
Return on Equity	13%	11.15%	10.45%
Rate Base	1,000,000		
8% Debt	600,000		
Equity	400,000		

TABLE 1
(Page 2 of 2)

THEORETICAL COMPARISON

COMPANY C

(75% Contributions in Aid of Construction)

Item	Rate : Determination	7% Expense : Increase	10% Expense : Increase
Revenues	\$328,500	\$333,700	\$336,000
<u>Expenses</u>			
Operating & Maintenance (44% Offsettable)	170,000	181,900	187,000
Depreciation	5,000	5,000	5,000
Taxes - Other	100,000	107,000	110,000
Property Taxes	15,500	15,500	15,500
Operating Income	38,000	24,300	18,500
FIT - 50%	13,000	6,100	3,200
Net Operating Income	25,000	18,200	15,300
Return on Rate Base	10%	7.28%	6.12%
Return on Equity	13%	6.2%	3.3%
Rate Base	250,000		
8% Debt	150,000		
Equity	100,000		

In the second year, as shown in the second and third columns of the theoretical comparison, 7 percent and 10 percent expense increases are made in operating and maintenance expenses and non-income taxes. All other expenses, except income taxes, remain the same for both years, and revenues have been increased in the second year to reflect the 44 percent of the increased operating and maintenance expenses which are offsettable by revenue increases from assumed advice letter filings.

With a 7 percent expense increase in the second year, Company A, which has no contributed plant, undergoes a decline in rate of return on rate base of approximately .74 percent and the related return on equity declines by approximately 1.85 percent. With a 10 percent expense increase in the second year, Company A's rate of return on rate base declines by 1.02 percent and its rate of return on equity declines by 2.55 percent.

With the 7 percent expense increase in the second year, Company C's rate of return on rate base declines by 2.72 percent and its rate of return on equity declines by 6.8 percent, a drop of more than 50 percent. With the 10 percent increase in expenses in the second year, Company C's rate of return on rate base declines by 3.88 percent, more than 33-1/3 percent, and its rate of return on equity declines by 9.7 percent, more than 66-2/3 percent.

Applicant's capital structure is substantially identical to that of Company C. Applicant's operating and maintenance expenses, if all balancing accounts applied for are approved, will be approximately 44 percent offsettable.

Even if all proposed balancing accounts are approved, the highly contributed nature of applicant's plant will subject applicant to a continuing risk of financial attrition, as this hypothetical comparison illustrates.

In its reply brief the staff, after observing that the true focus of the above theoretical comparison is on attrition in rate of return, argues:

"Matters regarding attrition in rate of return are most properly the subject of a separate and distinct allowance. Such an allowance is customarily provided in the form of a step rate to be instituted at the beginning of the second test year. That is, projected attrition in rate of return can be remedied by the provision of a rate increase for the second test year in an amount sufficient to yield the return authorized for the first. Thus, in the example suggested by Applicant, Company C would require an attrition allowance of 3.88 percent of rate base, or 9.70 percent of common equity, in order to generate the \$19,500 necessary to yield a return on common equity of 13.00 percent for the second test year. (Ibid. Note that in this example property taxes remain constant, federal income tax is 50 percent, and a net-to-gross multiplier of 2.00 is used.)

"But, if speculation is to be avoided, an allowance for attrition in rate of return must be based on a realistic projection of revenues, expenses, and rate base for the second test year. Applicant has presented no evidence, however, which would support a finding as to these items for the year 1980. As a result, the provision in the present proceeding of any allowance would necessarily prove arbitrary. Accordingly, none should be authorized. Instead, in addition to its request in the present proceeding, Applicant would be well advised to apply for a rate increase for a test year of 1980 and include with that application a request for a step-rate increase for the year 1981, based on projected revenues, expenses, and rate base for that year."

In its amended application, applicant stated, with respect to a change in test years, as follows:

"This amendment to the Application is based upon...the Company's reevaluation of its previous selection of a 1980 Test Year. At the time of the filing the Company believed that the Commission staff would require a 1980

Test Year despite the difficulty of projecting that far forward and despite the potentially significant changes in the Company's operations as a result of the anticipated tie-in with the Aliso Water Management Agency ocean outfall. The Company has now learned that the staff will not require a 1980 Test Year and, as a consequence, has elected a 1979 Test Year."

The foregoing indicates there were extenuating circumstances accounting, at least in part, for year 1980 estimated operating results not being a part of this record.

There was considerable controversy as to whether the consolidated capital structure (i.e., that of applicant's parent, LHUC) or applicant's separate capital structure should be used. From staff's Exhibits 15 and 15-A, we have drawn the following comparison of the capital ratios of LHUC and applicant:

	<u>Capital Ratios*</u>
<u>Laguna Hills Utility Company</u>	
Long-term debt	50.67%
Common Equity	<u>49.33</u>
Total	100.00%
<u>Laguna Hills Sanitation, Inc.</u>	
Long-term Debt	58.24%
Common Equity	<u>41.76</u>
Total	100.00%

*As estimated for December 31, 1979.

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1/8/80

The staff and protestants urge the use of applicant's separate capital structure while applicant favors the use of the consolidated capital structure. The difference in the capital ratios is caused by the inclusion of Laguna Hills Water Company in the consolidated capital structure of LHUC. We do not feel it appropriate to use either the capital structure of Laguna Hills Water Company or LHUC in determining a reasonable earnings allowance for applicant and, therefore, will use applicant's separate capital structure.

The staff witness testified that his recommended rate of return of 10 percent was associated with applicant's separate capital structure. He further testified that the corresponding computed earnings of 15 percent on applicant's common equity represented a point beyond which he could not go and still retain credibility, regardless of the level of contributions involved in this instance.

Notwithstanding their witness's recommending a 10 percent rate of return for applicant, protestants have suggested, in their opening brief, that applicant "in view of its past poor management record, is not entitled to any extraordinary rate of return, that its rate of return should not exceed that granted in the last proceeding, with appropriate calculation of equivalent equity on an unconsolidated basis." The last authorized rate of return for applicant was 9.00 percent and corresponded to a return on consolidated common equity of 10.34 percent (D.88079, supra). That same rate of return was subsequently found reasonable for LHWC (D.88705 dated April 18, 1978 in A.56299). To support their assertion of past poor management, protestants contend there has been (a) failure to seek timely reductions in property taxes; (b) failure to follow orders of the Commission; (c) misrepresentations regarding formal requests for offset increases; (d) misuse of connection fees; (e) failure to seek timely offset increases; and (f) failure to establish a schedule for plant replacement.

With respect to item (a) above, we quote from D.84040, supra:

"Counsel for Leisure World has called the matter of ad valorem taxes to our attention. The Orange County Assessor has imposed ad valorem taxes upon contributed plant as well as the plant financed by the capital invested in Rossmoor's operations. Of course, Rossmoor is not entitled to a return on contributed plant, and we have excluded contributed plant from rate base.

"The Los Angeles County Assessor does not impose taxes upon contributed plant, and substantial arguments may be advanced in support of such exclusion. However, the Orange County Assessor has rejected those arguments and the test year reflects the tax imposed on contributed plant. We cannot

determine the exact additional cost to customers of the ad valorem tax on contributed plant, but it appears to be in excess of \$50,000 for the test year 1973.

"We cannot, of course, predict the outcome of any informal or formal action Rossmoor may take regarding this tax matter. What is clear is that Rossmoor management cannot expect the Commission to recognize the very high annual cost to its customers of the present ad valorem tax situation unless Rossmoor has pursued all available reasonable appeals to reduce this cost. Rossmoor will be required to report on the action taken. Such report shall include proposed rate reductions if Rossmoor is able to obtain any substantial reduction of its present ad valorem tax expense."

In the next rate decision (D.88079, supra), we said:

"In the prior rate proceeding, this Commission ordered Rossmoor to make all reasonable efforts to obtain relief from the ad valorem taxes imposed by the county of Orange on contributed plant. The ad valorem taxes set out in Exhibit 3 show that although Rossmoor had initiated proceedings for such tax relief, it had not been granted as of January 1, 1976. Tax relief was granted and is reflected in both the staff report, Exhibit 8, and in Rossmoor's Exhibit 4 as the 1976-1977 tax statement with adjustments. Protestants' attorney cross-examined the witness for Rossmoor and the staff witness on methods used in determining the estimated reasonable ad valorem taxes for 1976. Protestants offered further testimony through their expert witness and Exhibit 11 to show that a further adjustment should be made to reflect a downward trend consistent with a correlation to rate base. We have reviewed the efforts of Rossmoor and find that its action has been effective in obtaining a substantial reduction in ad valorem taxes and that such a program of reviewing assessment records and tax code areas should be continued in the future. . . ."

In that second rate decision one of the findings was:

- "6. The operations of Rossmoor have been managed efficiently and prudently, and it has provided a good service to its customers."

With respect to items (b) and (d), applicant has accounted for contributions of in-tract plant and connection fees received from developers, both affiliated and nonaffiliated, as contributions in aid of construction and not as paid in surplus as required by D.84040, supra, but applicant has not accounted for interest income on advance deposits for construction as a credit to the contributions account as required by that decision. A proper accounting of the application of funds received as connection fees prior to September 12, 1977 is not available according to applicant's present controller. For funds received on and after that date an accounting is made of their application. As discussed herein under the heading Connection Fees, about 15 percent of those funds have been applied to meet operating expenses. Henceforth, the connection fees and accrued interest are to be expended only for (1) any taxes that may be imposed on such connection fees or interest and (2) those backbone plant facilities supporting applicant's connection fee tariff.

With respect to item (c) applicant filed advice letters for offset increases twice in 1978 without reflecting a decrease in ad valorem tax which had occurred. In its third advice letter filing in 1978 that decrease was finally reflected.

With respect to item (e) applicant's present controller testified that it is probable that throughout its history "the company did not pursue its -- it did not pursue offset requirements -- or offset applications on as timely a basis as it might have, although it's as I said, it's difficult for me to evaluate, since I was not with the sanitation company per se at the time."

With respect to the last item, applicant's controller testified in February, 1979, that a study forecasting plant replacement requirements had not been made. Since then applicant filed A.59033, supra, concerning a \$1,400,000 project to repair and upgrade applicant's sewage treatment plant.

Applicant made important changes in management personnel in early 1978.

In its reply brief, the staff recommended a lower rate of return than that recommended by the staff witness. Applicant moved to strike the portions of the staff brief pertaining to rate of return.

It is apparent that the staff reviewed its position in light of all of the recommendations and evidence introduced in the public hearings and, as a result, chose to present arguments in favor of a lower rate of return than that recommended by the staff rate of return witness. The principal argument advanced by staff counsel is that if certain effluent disposal costs are made the subject of a balancing account and become offsettable expenses, that factor would not have been accorded sufficient weight by the staff rate of return witness. Although it would be improper to introduce new evidence by way of a brief, it is perfectly appropriate to reassess one's position as the staff has done here, after consideration of all of the evidence introduced. Applicant's motion is denied.

We have carefully considered all of the evidence on rate of return. In light of, among other things, the need to meet the standards of capital attraction, credit maintenance, and comparable earnings laid down in the Hope and Bluefield decisions,

we find that a 10 percent rate of return is fair and reasonable for applicant. This rate of return gives adequate and fair compensation to the suppliers of capital without any unnecessary burden on the ratepayers.

The adopted capital ratios, cost factors, and the resultant earnings allowances on common equity are tabulated below on the basis of applicant's separate capital structure:

	<u>Capital Ratios</u>	<u>Cost Factors</u>	<u>Weighted Cost</u>
<u>Laguna Hills Sanitation, Inc.</u>			
Long-term Debt	58.24%	6.39%	3.72%
Common Equity	<u>41.76</u>	<u>15.04</u>	<u>6.28</u>
Total	100.00%		10.00%

Stipulation re Effluent
Disposal Expenses

Applicant, staff, and protestants have stipulated to the need for establishing a balancing account for certain effluent disposal expenses. The reasons given for the balancing account being needed are (1) the highly volatile nature of these expenses, (2) applicant's inability to accurately project these costs because of changes in operations planned for early 1980.

and (3) applicant's continuing effort to find less expensive effluent disposal methods.

As part of the rationale supporting the establishment of the balancing account, applicant, staff, and protestants proffered in Attachment A to Exhibit 23:

"Commission policy has established balancing accounts for other utilities for certain expenses which constitute a substantial portion of the utility's operating budget, which cannot be controlled by the utility because of its dependence on the product or service, and which are highly volatile. The major items in the proposed balancing account, sludge hauling and disposal, represent this type of expense.

"In an effort to minimize effluent disposal expenses, LRSI is continuing to investigate alternate sludge disposal methods and also plans to utilize regional facilities for effluent disposal in early 1980. Accurate estimates of these expenses cannot be made until operations begin in 1980. These changes in operations are expected to replace the present expenses involved with the spraying of effluent on land leased from the Irvine Company with monthly charges for the use of the regional facilities. This change in operations could result in major expense changes which would require filing of an application for a change of rates. By including these expenses in the balancing account, rate changes could be more easily achieved through the filing of an advice letter."

The effluent disposal expenses included in the adopted test year estimates which would be covered by the proposed balancing account pursuant to stipulation are:

Irvine Leases	\$ 74,100
Purchased Power	37,100
Rain for Rent	10,500
Sludge Hauling	112,300
Sludge Disposal	<u>150,000</u>
Annual Estimated Cost	\$384,000

Pursuant to the stipulation as set forth in Exhibit 23:

"The revenue attributable to those expenses would be determined by dividing the estimated \$384,000 by the total adopted revenues. That portion of each month's revenues would be added to the balancing account. Each month's expenses for the items listed above would be deducted from the balancing account. LRSI will submit this information for staff audit on an annual basis or other interval as may be ordered by the Commission.

"Applicant will adjust rates by an advice letter filing on and only on a semi-annual basis if the increase or decrease in expenses attributed to this balancing account is greater than 1% of estimated annual gross revenues. Rate adjustments will be calculated to maintain the ratio of unrestricted rates to restricted rates between 1.15 to 1.17, as adopted in Decision #88079.

"The sludge disposal expenses will not be directly affected by the connection to the AWMA facilities in early 1980. The expenses related to effluent disposal through the AWMA ocean outfall include \$5 per acre-foot of effluent, purchased power to pump to the line, and a portion of the monitoring and maintenance expense based on volume discharge through the outfall. At such time as expenses related to the AWMA facilities have stabilized, Laguna Hills Sanitation, Inc., will file an advice letter adjusting its rates to reflect changes in the cost of effluent disposal." 1/

Absent the adjustment mechanism of a balancing account, we are persuaded by the record that there would be excessive exposure to either substantial overcollection or undercollection of these expenses through rates. Accordingly, we will allow the

1/ The sludge disposal expenses referred to are: Sludge Hauling (\$112,300 for the test year) and Sludge Disposal (\$150,000 for the test year). AWMA stands for the Aliso Water Management Agency.

stipulation of the parties to be implemented. The Effluent Cost Adjustment Clause for applicant's tariffs prescribed in Appendix B to this decision is substantially the same as the one proposed in Attachment B to Exhibit 23.

Even with the adoption of this balancing account mechanism, because of the highly contributed nature of applicant's plant, applicant's earnings will continue to be subject to a significant risk of attrition. As of December 31, 1978, applicant's capital structure, including contributed plant, was 76.66 percent contributed, 14.39 percent long-term debt and only 8.94 percent common equity. Step rates appear particularly well-suited to address this problem. Although insufficient evidence was presented in this proceeding to provide a step rate increase, applicant would be well-advised to request such an increase in its next general rate application.

Results of Operation

Aside from the request for a higher rate of return, the general rate increase request is, according to the application, made necessary by across-the board increases in expenses. To evaluate the need for rate relief, witnesses for applicant and the Commission staff have analyzed and estimated for the test year applicant's operating revenues, operating expenses, and rate base. The staff's study of applicant's operating results (Exhibit 14) was based on later information than that available when applicant prepared its summary of earnings study appended to the amended application as Exhibit E. In Table 2, which follows, the results of those studies and our adopted operating results for the test year have been set forth:

TABLE 2

Laguna Hills Sanitation, Inc.

SUMMARY OF EARNINGS

Test Year 1979

Item	Applicant		Staff		Adopted ^{10.0%}	
	Present Rates*	Proposed Rates	Present Rates*	Proposed Rates	Present Rates*	Rate of Return
	(A)	(B)	(C)	(D)	(E)	(F)
Revenues	\$1,548.5	\$2,120.0	\$1,551.8	\$2,139.4	\$1,551.8	\$1,853.4
<u>Expenses</u>						
Oper. & Maint.	911.5	912.3	827.9	827.9	840.4**	840.4**
Admin. & Gen.	215.0	216.5	162.1	162.1	151.1**	151.1**
Payroll & Vehicles	325.7	325.7	313.9	313.9	313.9	313.9
Depreciation	77.0	77.0	77.0	77.0	77.0	77.0
Other Taxes	67.5	67.5	67.5	67.5	67.5	67.5
Income Taxes	.2	214.4	2.6	294.7	3.0	143.5
Total Expenses	1,596.9	1,813.4	1,451.0	1,743.1	1,452.9	1,598.4
Net Revenues	(48.4)	306.6	100.8	396.3	98.9	255.0
Rate Base	2,555.0	2,555.0	2,550.3	2,550.3	2,550.3	2,550.3
Rate of Return	-	12.0%	4.0%	15.5%	3.9%	10.0%

(Dollars in Thousands)

(Red Figure)

*Rates in effect as of January 25, 1979.

**Breakdowns:

Original Staff Operating & Maintenance	\$827.9
Staff Revision (See page 25)	12.5
Total	840.4
Staff Administrative & General	\$162.1
SEC-Expense Adjustment (See page 27)	(11.0)
Total	151.1

The staff witness increased his above estimate of operation and maintenance expenses in the amount of \$827,900 by \$12,500, in response to an indicated need for increased maintenance of pumping equipment, and decreased his estimate of interest expense, as a deduction from taxable income, by \$5,900, making both estimates, in his view, more representative of the test year. Applicant adopted the staff's estimates of operating revenues and operating expenses, as modified, primarily because they reflected later information and thus were more representative of the test year. Applicant also accepted the level of the staff's estimate of rate base but not its methodology in making that estimate.

Protestants accepted the staff estimates with two exceptions. One exception concerns rate base and the other concerns expenses associated with LHUC being a publicly held corporation. A discussion of the two exceptions follows.

Rate Base

Although applicant and staff used different methods in arriving at an estimated rate base, they are in agreement that rate base for the test year should be \$2,550,000. Protestants contend that this rate base figure should be adjusted downward by \$178,000 because funding of applicant's 1979 construction budget, as reflected in the staff's rate base estimate, would fall short by that amount.

It is true that the staff rate base calculation did not take into account a projected deficiency in funds to support the 1979 construction budget and the carrying of a typical amount of construction work in progress. But it is also true that the staff rate base calculation did not take into account \$305,000 of unexpended connection fees held in a segregated account but already credited to contributions in aid of construction and therefore deducted from utility plant in the rate base determination.

The rate base estimate made by applicant, which came out to \$2,555,000 or \$5,000 above the staff estimate, was structured to (a) exclude any portion of the 1979 construction budget likely to remain unfunded according to Exhibit 12 (Cash Flow Projections for 1979), and (b) adjust out the portion of contributions in aid of construction corresponding to the segregated connection fee account funds devoted to, but not yet used in, building plant. The rate base calculation carried out in this way makes it evident that the \$178,000 adjustment contended for by the protestants should be rejected.

A reasonable estimate of rate base for the test year is \$2,550,000.

SEC-Related Expenses

To function as a publicly held corporation, it costs LHUC an estimated \$54,000 annually. The costs so incurred are supportive of filings required by the Securities and Exchange Commission (SEC) and include accounting, legal, and other services. Of the \$54,000, it was estimated that approximately \$10,000 would still be expended if LHUC were privately held rather than publicly held. Both applicant and the staff have included \$27,000, in their respective estimates of test year Administrative and General Expenses, to be charged to applicant by its parent as applicant's share of the \$54,000.

Protestants opposed inclusion of \$22,000^{2/} of the \$27,000 in applicant's expenses for ratemaking purposes because:

(1) In the spin-off application (A.57548), it was represented that there would be no increased costs of management; and

(2) It is the shareholders that benefit from LHUC being publicly held.

Notwithstanding some contentions to the contrary by protestants, there is no question that SEC-related expenses are a legitimate expense ordinarily recoverable in ratemaking as an operating expense, nor is there a dispute as to the level of such expenses to be incurred in the test year. The fundamental question here is whether in the circumstances of this particular utility it would be unreasonable for the ratepayer to have to absorb such expenses through rates.

In this case the formation of a publicly held corporation as the parent to applicant and its sister company, LHUC, was an integral part of the Rossmoor Corporation reorganization and spin-off. Indeed, it may have been essential to the transaction to mitigate tax consequences. In that event its publicly held status was of clear and obvious benefit to LHUC's major stockholders. On the other hand, that status can provide access to a broader base of financing and have other advantages which may eventually redound to the benefit of the ratepayer.

A proper allowance for SEC-related expenses for applicant in the test year is \$16,000.

^{2/} Protestants also contended an adjustment should be made to applicant's common equity capital in the amount of the sums previously paid by applicant as its share of the cost of its parent being spun off by Rossmoor Corporation. Such share was accounted for as miscellaneous income deductions and has not been allowed by the Commission or requested by applicant for ratemaking purposes. The equity adjustment requested by protestants is thus not well founded and must be rejected.

Wage and Price Guidelines

The wage increases granted by applicant to its employees and executives may have exceeded the seven percent guideline by about \$6,000, an amount required in part to bring applicant's wage levels more in line with those of utilities in the area with which it competes for employees. With respect to the price guidelines, the Wage and Price Council has not issued detailed regulations to adapt its general guidelines for application to regulated sewer utilities. Under this circumstance, we can only assert our belief that this rate increase, being the minimum which could be justified under California law, complies with the spirit, if not the letter, of the guidelines.

Rate Spread

The design of applicant's proposed rates reflects (1) applying virtually the same percentage of increase to each class of service and (2) retaining the range of from 1.15 to 1.17 found reasonable in D.88079, supra, for the ratio of the rates for unrestricted family residences to the rates for restricted family residences. No exception was taken by any of the parties to spreading in the same manner whatever additional revenue requirement was found to be justified. The rates prescribed in Appendix A to this decision were so structured.

Pension Plan

An outline of the proposed retirement plan for employees of LHWC is appended to Exhibit 20. Applicant commented in Exhibit 20 upon the need for such a plan and the plan's status as follows:

"Laguna Hills Utility Company ("LHUC") is in the process of adopting a pension plan to provide retirement benefits for the employees of its wholly-owned subsidiary Laguna Hills Water Company ("LHWC") who also provide services, on a time card basis, for Laguna Hills Sanitation, Inc. ("LHSI"), a second wholly-owned subsidiary of LHUC.

"In meetings with the employees of LHWC, management learned that one of the principal sources of employee dissatisfaction and employee turnover was the absence of any long-term benefit program including particularly a retirement or pension plan. As a consequence, LHUC contacted Pacific Mutual Insurance Company for the purpose of exploring what alternatives were available to LHUC. That contact with Pacific Mutual led to the approval in concept by the Board of Directors of Laguna Hills Utility Company of a pension program to be funded at a level equal to approximately ten percent of the total wages paid the employees of LHWC. The pension plan itself is currently in the process of being drafted by counsel for LHUC. Attached hereto as Exhibit A is a description of the plan proposed to be adopted by LHUC.

"As can be seen from the description of the plan set forth in Exhibit A, the pension plan to be adopted by LHUC is intended to conform in all respects with the requirements of the Employee Retirement Income Security Act.

"Although the cost to LHUC of the pension plan, equal to approximately ten percent of the total payroll paid the employees of LHWC, is significant, LHUC believes that it will reap substantial benefits from the adoption of such a plan, both in improvement in its employee benefit program and an ability to attract employees who will be prepared to regard LHUC as a career opportunity and will further reap benefits in reducing the present high level of employee turnover and the resulting high training costs presently incurred by the company."

Applicant, staff, and protestants are in agreement that, until the execution of a pension plan that is binding upon the company and a determination of the amount to be contributed to such a plan by applicant, there should be no allowance for it in operating expenses for the test year. They are in further

agreement that once the plan is binding and its cost determined, applicant's share of the cost should be included as expenses for ratemaking purposes. In this latter regard protestants contend that such inclusion should not reflect any costs made retroactive to January 1, 1979. The cost to applicant of the proposed pension plan is expected to approximate \$30,000 annually at the present payroll level.

The evidence, including the agreements reached by the parties, clearly indicates that the pension plan is warranted and that, once in effect, its cost should be included as an expense for ratemaking purposes.

In Appendix C attached to this decision, we have prescribed certain rate increments designed to produce \$25,000 rather than \$30,000 in gross revenues at the 1979 test year adopted level of operations. (Using the lower figure permits prearranging in this way for its automatic flow-through into rates.) Applicant will qualify for these rate increments upon the execution of a pension plan substantially as outlined in the attachment to Exhibit 20.

Connection Fees

We have previously described applicant's service extension practices and indicated that connection fees are standard for the sewer industry. Under the part of such practices pertinent here developers are required to pay applicant a charge for each dwelling unit added to the system and a sewage-volume-related charge for each commercial or industrial establishment connected to the system. These fees are reflected in contributions in aid of construction and are to be used by applicant to build backbone plant facilities, including treatment plant.

The present level of connection fees are set forth in applicant's tariff sheets Nos. 107-55, 108-55, and 109-58, effective September 12, 1977. Since that effective date, \$881,000 in connection fees have been received from developers through

December 31, 1978. Of that amount, \$401,000 was expended for backbone plant, \$305,000 was on deposit in a special account, \$38,000 (which has since been repaid) was loaned to applicant's sister company, LHWC, and \$137,000 was used for operating expenses.

The latter two above uses are obvious misapplications of funds that must be avoided, notwithstanding applicant's financial problems. In that regard protestants, staff, and applicant have stipulated that the treatment of connection fees should be as follows:

"Applicant shall collect connection fees as provided in their tariffs as presently filed or as hereafter approved. These fees shall be segregated and treated in all respects as if held in trust solely for the purposes set forth below. The connection fees and accrued interest are to be expended only for (1) any taxes that may be imposed on such connection fees or interest, and (2) those backbone plant facilities supporting applicant's connection fee tariff as presently or hereafter approved. Applicant shall provide the Commission, attention of the Finance Division, two copies of an annual statement no later than March 31 of each year, detailing the amount of all connection fees received, interest earned, and withdrawals from the fund during the prior calendar year, together with the balance in the fund at the close of the year."

With regard to the \$137,000 of connection fees used for expenses, protestants claim that applicant's common equity should be adjusted downward by that amount, presumably as of December 31, 1978. This contention is without merit. The precepts of financial accounting dictate that the effects of such misusing of connection fees have already been flowed through to common equity. The proper assessment to be made of what is required in this situation is that, as soon as applicant's internal cash flow and/or its recourse to outside financing permits, applicant must restore the \$137,000 to the connection fee fund.

Sewage System Deficiencies

The sewage system currently collects, pumps, and treats flows of four million gallons per day (mgd). The main sewers and pump stations have a capacity for ultimate service area flows of 5.25 mgd. The treatment plant, however, only has a capacity of 3.5 mgd. As a result of this capacity limitation, the plant cannot meet standards for removal of organic pollutants.

Excessive quantities of chlorine are presently required to disinfect the discharge in order to safeguard public health. Reconstruction and upgrading of treatment plant facilities are thus projects of the highest priority. (See A.59033, supra.) As brought out earlier in this decision, the methods by which effluent is discharged and the quality of such effluent are regulated by the California Regional Water Quality Control Board and the state and county health departments.

Findings of Fact

1. Applicant's treatment plant facilities require reconstruction and upgrading. That project should proceed without delay.
2. Applicant is in need of additional revenues, but the rates it has proposed would produce an excessive rate of return.
3. The adopted estimates, previously discussed herein, of operating revenues, operating expenses, and rate base reasonably indicate the results of applicant's operations for test year 1979. Because of the relatively small rate base for a system of this size, applicant's operating results in the near future are susceptible to substantial departures from the test year results.

4. A rate of return of 10.0 percent on applicant's rate base is reasonable. The related allowance for return on common equity is 15.04 percent based on applicant's capital structure and 14.13 percent based on LHUC's consolidated capital structure.

5. To produce a 10.0 percent rate of return, an increase of \$166,100, or 9.8 percent, in applicant's annual gross revenues will be required. The increase is \$135,500 less than that indicated in Table 2 because the rates presently in effect are interim rates which became effective after this application was amended. (The interim rates were authorized by D.90008, supra.)

6. The adopted rate spread is reasonable.

7. Certain of applicant's effluent disposal costs, previously discussed herein, properly qualify as offsettable expenses. The Effluent Cost Adjustment Clause prescribed in Appendix B to this decision for inclusion in applicant's tariffs and a corresponding balancing account, as required by Section 792.5 of the Public Utilities Code, provide a means of implementing the increases or decreases in rates to offset the increases or decreases in these expenses which occur.

8. The pension plan proposed by LHWC for its employees fulfills an important need. The rate increments prescribed in Appendix C to this decision, for which applicant will qualify upon the execution of a pension plan substantially as outlined in the attachment to Exhibit 20, are fair and reasonable.

9. 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.

Conclusions of Law

1. An adjustment to applicant's common equity capital in the amount of the sums previously paid by applicant as its share of the cost of its parent being spun off by Rossmoor Corporation

should not be made, because such share was accounted for as miscellaneous income deductions and has not been allowed by the Commission for ratemaking purposes.

2. Henceforth, connection fees and the accrued interest thereon should be segregated and treated in all respects as if held in trust for the purpose of being expended only for (1) any taxes that may be imposed on such connection fees or interest and (2) those backbone plant facilities supporting applicant's connection fee tariff as presently or hereafter approved.

3. No later than March 31 of each year, applicant should send the Revenue Requirements Division of the Commission two copies of an annual statement providing a full accounting of the amount of all connection fees received, interest earned, and withdrawals from the connection fee fund during the prior calendar year, together with the balance in the fund at the close of that year.

4. No adjustment should be made to common equity by reason of the use of \$137,000 of connection fees for expenses, because as soon as applicant's internal cash flow and/or its recourse to outside financing permits, applicant must restore the \$137,000 to the connection fee fund.

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

6. Because of the use of a 1979 test year for establishing new rates and the volatility of applicant's earnings, the following order should be effective on the date of signature.

FINAL ORDER

IT IS ORDERED that:

1. After the effective date of this order, applicant Laguna Hills Sanitation, Inc. is authorized to file concurrently the revised rate schedules attached to this order as Appendix A and the Effluent Disposal Cost Adjustment Clause, as an added section

to the Preliminary Statement of its tariffs, attached to this order as Appendix B. Such filings 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 thereof.

2. Concurrently with any rates established under Ordering Paragraph 1, applicant shall maintain an Effluent Disposal Cost Adjustment Account, as the balancing account, for the types of effluent disposal costs and their related revenues specified in Appendix B. to this order.

3. Upon the execution of a pension plan substantially as outlined in the attachment to Exhibit 20, applicant is authorized to file revised rate schedules incorporating the rate increments set forth in Appendix C to this order. 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 thereof.

4. Connection fees collected by applicant and the interest accruing thereon shall henceforth be segregated and treated in all respects as if held in trust for the purpose of being expended only for (1) any taxes that may be imposed on such connection fees or interest and (2) those backbone plant facilities supporting applicant's connection fee tariff as presently or hereafter approved.

5. Applicant is directed to send, no later than March 31 of each year, the Revenue Requirements Division of the Commission two copies of an annual statement providing a full accounting of the amount of all connection fees received,

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interest earned, and withdrawals from the connection fee fund during the prior calendar year, together with the balance in the fund at the close of that year.

The effective date of this order is the date hereof.
Dated JAN 8 - 1989, at San Francisco, California.

John E. Bryan
President
James L. Stanger
Robert H. Steele
James T. ...
Thomas ...
Commissioners

APPENDIX A
Page 1 of 5

SCHEDULE NO. 1

GENERAL RESIDENTIAL SERVICE

APPLICABILITY

Applicable to General Residential Sewer Service.

TERRITORY

El Toro, Laguna Hills, Rossmoor Leisure World and vicinity, Orange County.

RATES FOR SEWER SERVICE

Unrestricted Family Residence	(U)	\$7.26 per month, per residential dwelling unit	(I)
Restricted Family Residences	(R)	\$6.29 per month, per residential dwelling unit	(I)

TERMS OF PAYMENT

All sewer charges are payable in advance on the first day of the period for which the bill is rendered.

ASSOCIATION, APARTMENTS, CONDOMINIUMS, AND OTHER MULTIPLE RESIDENCES

When more than one residential dwelling unit is connected to the system of Laguna Hills by service connections less in number than the number of residential dwelling units services, the rate per residential dwelling unit, as set forth above, shall be due and payable for each and every living or dwelling unit connected to the system.

APPENDIX A
Page 2 of 5

SCHEDULE NO. 2

COMMERCIAL AND INDUSTRIAL SERVICE

Applicability

Applicable to Commercial and Industrial service.

Territory

El Toro, Laguna Hills, Rossmoor Leisure World and vicinity, Orange County.

Service Charges to Commercial and Industrial Service

- (A) The service charge to commercial and industrial customers, hereinafter in this rule referred to as "customer", shall be based on the actual amount of sewage to be discharged into the Laguna Hills Sanitation, Inc. system.
- (B) The basic service charge shall be \$0.91 per 1,000 gallons of sewage to be discharged. The minimum service charge shall be the amount equal to the charge for single family residences, as set forth in Schedule No. 1 of Laguna Hills Sanitation, Inc. (I)
- (C) The actual amount of sewage so discharged shall be defined and determined by Laguna Hills Sanitation, Inc., in accordance with one of the following methods:

Method 1:

By the application of a water use factor to the amount of metered domestic water use of the customer's establishment.

The customer's establishment shall be classified as to the ratio between the rate of sewage discharge and the actual metered rate of domestic water use. Said ratio shall be determined by Laguna Hills Sanitation, Inc. and shall be termed "factor".

Example: Class 1 establishment.

Metered water use by customer's establishment for a two-month billing period - 20,000 gallons - Factor 0.9.

Service charge for the two-month billing period equals $20 \times 0.9 \times \$0.91 = \16.38 .

(I)

APPENDIX A
Page 3 of 5

SCHEDULE NO. 2 (Continued)

COMMERCIAL AND INDUSTRIAL SERVICE

Method 1 shall be used initially for all commercial and industrial establishments.

Laguna Hills Sanitation, Inc. may change said factor or estimated discharge rate from time to time on the basis of the increase or the decrease in the estimated sewage discharge rate.

Method 2:

By the actual measurement by meter of sewage discharge from the customer's establishment and the application of the service charge to the measured discharge.

Example: Measured total sewage discharge from customer's establishment for a two-month billing period - 22,000 gallons.

Service charge for the two-month billing period equals $22 \times \$0.91 = \20.02 (I)

This method shall be used only when requested by the customer, and only where metering of the sewage discharge is possible and practical. All metering shall be performed by or under the supervision of Laguna Hills Sanitation, Inc. and at the expense of the customer.

Method 3:

By the estimation by Laguna Hills Sanitation, Inc. of the sewage discharge rate from the customer's establishment.

The estimated sewage discharge rate shall be based on standard and accepted methods such as fixtures, unit count, etc.

Example: Estimated total sewage discharge for a two-month billing period - 22,000 gallons.

Service charge for the two-month billing period equals $22 \times \$0.91 = \20.02 (I)

This method shall be used only where no records of actual water use are available and where metering of sewage discharge is impractical.

Laguna Hills Sanitation, Inc. may change said factor or estimated discharge rate from time to time on the basis of the increase or the decrease in the estimated sewage discharge rate.

APPENDIX A
Page 4 of 5

SCHEDULE NO. 2 (Continued)

COMMERCIAL AND INDUSTRIAL SERVICE

(D) The basic rate of \$0.91 per 1,000 gallons for sewerage service shall apply where sewage discharged is equivalent in strength to ordinary domestic sewage. For the purpose of these rules ordinary domestic sewage shall be defined as sewage continually having a suspended solids concentration not exceeding 300 ppm, a 5-day B.O.D. of not more than 300 ppm, and having no unusual concentration of chemicals or minerals which would have an adverse effect on the Laguna Hills Sanitation, Inc. sewerage system. (I)

(E) Should sewage discharged by any commercial or industrial establishment be determined to have suspended solids of B.O.D. concentration in excess of 300 ppm for significant periods of time, the basic rate for that establishment shall be increased by the ratio between the determined actual B.O.D.- or suspended solids concentration and 300 ppm, whichever ratio is the larger.

Example: Determined B.O.D. - 400 ppm
Determined suspended solids concentration - 450 ppm

Service charge - $\frac{450}{300} \times \$0.91 = \1.365 per 1,000 gallons of actual sewage discharge (I)

(F) Should the sewage discharged by any commercial or industrial establishment be determined by Laguna Hills Sanitation, Inc. to have excessive concentrations of adverse chemicals or minerals, the basic rate will be increased by a factor established by Laguna Hills Sanitation, Inc. based on the effect of said concentrations on the Laguna Hills Sanitation, Inc. sewerage system. Laguna Hills Sanitation, Inc. may change said factor from time to time on the basis of analysis of sewage quality.

(G) In no case will Laguna Hills Sanitation, Inc. accept sewage having either B.O.D. or suspended solids concentrations in excess of 500 ppm for significant periods of time, or sewage having chemical or mineral concentrations which, for significant periods of time, will have excessive adverse effect on the Laguna Hills Sanitation, Inc. system. For further delineation of limitation of wastes see other sections of these Rules and Regulations.

APPENDIX A
Page 5 of 5

SCHEDULE NO. 3 (Continued)

SALE OF RECLAIMED WATER

- (6) The property upon which the water shall be used.
- (7) If, as a result of fire, earthquake, storm, rainfall, flood, Act of God, strikes, picketing, boycott, lockouts or other causes or conditions beyond the control of Utility, or because of damage or breakdown of any of Utility's facilities, Utility shall be released from its responsibility to deliver water during such periods of inability and shall have no liability to the customer during such period of time. (T)

Customer's Election

Service to a customer will fall under this category when the customer desires to receive the water at such times during the day and week as the customer shall elect, providing other customers of this class of service have not already contracted for all of the supply available.

Reclaimed water, for this class of service, shall be sold at the rate of \$67.00 per acre-foot. (I)

Utility's Election

Service to a customer will fall under this category when both of the following conditions are applicable:

- (1) The customer will receive water at such time during the day and week as the Utility shall elect.
- (2) The customer will use the same or a greater quantity of water each week* during the 9 months beginning October 1 and ending June 30, as that customer used during its week* of maximum consumption during the previous 3 months beginning July 1 and ending September 30.

There shall be no charge for water delivered under this class of service. There shall, however, be an annual contract renewal fee of \$100.

If at any time, Utility does not have enough water to supply all customers under this class of service, after providing all the water required by the "Customer Election", customers, the remaining supply shall be prorated between the customers under this class of service, in direct proportion to the total quantity of water each customer received during the previous 9 months beginning October 1 and ending June 30. (T)

* Week is defined as beginning on Monday morning at 12:01 a.m., and ending on Sunday night at 12:00 p.m.

APPENDIX B
Page 1 of 4

LAGUNA HILLS SANITATION, INC.

EFFLUENT DISPOSAL COST ADJUSTMENT CLAUSE

1. Purpose. The purpose of this account is to reflect that portion of revenues necessary to cover certain costs attributable to effluent disposal.
2. Applicability. Bills rendered under Rate Schedules No. 1, No. 2 and No. 3 shall include amounts reflected in this balancing account.
3. Revision Dates. The revision dates are January 1 and July 1 of each year. The effective date of such revised rates shall be on such date or as soon thereafter as the Commission may authorize. Applications by advice letter filing shall be filed semi-annually, but only if increases or decreases in expenses attributable to this account exceed 1% of the estimated annual gross revenues. Advice Letters shall be filed at least 30 days before the Revision Date.
4. Record Period. For the purposes of calculating any rate changes resulting from changes in effluent disposal costs, the Record Period shall be the six months ending two months prior to the revision dates.
5. Current Price.
 - a. The Current Price of purchased power shall be based on the latest tariffs in effect on or before the revision date.
 - b. The Current Price of sludge hauling shall be the contract rates in effect on or before the revision date.
 - c. The Current Price of sludge disposal shall be two times the Highest District Industrial User Charge for the Orange County Sanitation District's in effect on or before the revision date as provided in contract dated _____, 1979, by and between LHSI and Orange County Sanitation District No. 1.
 - d. The Current Price for the Irvine Leases shall be the Orange County ad valorem taxes on the property leased from the Irvine Company.
 - e. The Current Price for spray irrigation equipment shall be the annual rental on that equipment.
 - f. The Current Price for effluent disposal using the Aliso Water Management Agency (AWMA) facilities shall be based on the latest rates established by AWMA on or before the revision date.

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LAGUNA HILLS SANITATION, INC.

EFFLUENT DISPOSAL COST ADJUSTMENT CLAUSE (Cont.)

6. Current Cost. The Current Cost of effluent disposal shall be calculated as follows:
 - a. The Current Cost of purchased power shall be the Record Period quantity multiplied by the Current Price.
 - b. The Current Cost of sludge hauling shall be the recorded costs for the Record Period modified to reflect rates effective on or before the revision date.
 - c. The Current Cost of sludge disposal shall be the recorded costs for the Record Period modified to reflect rates effective on or before the revision date.
 - d. The Current Cost for the Irvine Leases shall be the recorded costs for the Record Period modified to reflect tax bills effective on or before the revision date.
 - e. The Current Cost for spray irrigation equipment shall be the recorded costs for the Record Period modified to reflect the rental rates effective on or before the revision date.
 - f. The Current Cost for effluent disposal using the AWMA facilities shall be the recorded costs for the Record Period modified to reflect AWMA rates effective on or before the revision date.
7. Base Rates. The Base Rates are those rates authorized by Decision No. 91182 effective January 8, 1980 of which 20.15% offsets the estimated 1979 effluent disposal cost of \$384,000. The Effluent Disposal portion of each Base Rate is shown in paragraph 11.
8. Effluent Disposal Cost Adjustment Account. The Company shall maintain an Effluent Disposal Cost Adjustment Account. Entries to be made to this account at the end of each month will be determined from the following calculations:
 - a. Monthly effluent disposal costs for purchased power, sludge hauling, sludge disposal and monthly amortization of Irvine lease and irrigation equipment rentals.

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LAGUNA HILLS SANITATION, INC.

EFFLUENT DISPOSAL COST ADJUSTMENT CLAUSE (Cont.)

b. Less: monthly recorded revenue computed based upon the current effluent disposal charges.

If the above calculation produces a positive amount (under-collection), such amount will be debited to the Balancing Account. If the calculation produces a negative amount (over-collection), such amount will be credited to the Balancing Account.

9. Calculation of Effluent Disposal Cost Adjustment Factor. The Effluent Disposal Cost Adjustment Factor shall be determined as follows:

- a. The Current Cost of Effluent Disposal shall be calculated according to paragraph 6.
- b. The Balance in the Effluent Disposal Cost Adjustment Account shall be added or subtracted to the current cost.
- c. The Cost Adjustment Factor shall be determined as follows: divide the sum of (a) and (b) by \$384,000, the estimated 1979 effluent disposal cost.

10. Calculation of Effluent Disposal Charge. The current Effluent Disposal Charges shall be determined as follows: multiply the Effluent Disposal Charges, as indicated in paragraph 11, by the Cost Adjustment Factor developed in paragraph 9.

11. Effluent Disposal Charges. A portion of all charges are necessary to cover expenses attributable to effluent disposal. The amounts listed below have been determined as the charges attributable to the estimated 1979 effluent disposal cost of \$384,000.

Effective Date	Schedule No. 1		Schedule No. 2		Schedule No. 3 Per A.F.
	Unrestricted Per Month	Restricted Per Month	Minimum Per Month	Per 1,000 gal. Per Month	
	\$1.51	\$1.31	\$1.51	\$0.187	\$13.97

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LAGUNA HILLS SANITATION, INC.

EFFLUENT DISPOSAL COST ADJUSTMENT CLAUSE (Cont.)

12. Application of Disposal Charges. The disposal charges shall be included in the rates shown on Schedules No. 1, No. 2 and No. 3. Any change in effluent disposal charges will be reflected on the appropriate schedules. The percentage of increase or decrease will be applied equally to each class of service, and the ratio of unrestricted residential charge to restricted residential charge shall remain between 1.15 and 1.17 as ordered in Decision No. 88079.

APPENDIX C

LAGUNA HILLS SANITATION, INC.

AUTHORIZED INCREASE IN RATES

Per Ordering Paragraph No. 3, each of the following incremental increases in rates may be put into effect, following the execution of a pension plan, by filing the rate schedules which adds the appropriate increase to the rates which would otherwise be in effect on that date.

SCHEDULE NO. 1

GENERAL RESIDENTIAL SERVICE

Unrestricted Family Residence (U)	\$0.11 per month, per residential dwelling Unit	(I)
Restricted Family Residences (R)	\$0.08 per month, per residential dwelling Unit	(I)

SCHEDULE NO. 2

COMMERCIAL AND INDUSTRIAL SERVICE

The basic service charge per 1,000 gallons of sewage to be discharged	\$0.01 per 1,000 gallons	(I)
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SCHEDULE NO. 3

SALE OF RECLAIMED WATER

Reclaimed water	\$1.00 per acre-foot	(I)
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