

ORIGINAL

Decision No. 91915

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the matter of the application)
of LAGUNA HILLS WATER COMPANY for)
an order authorizing an increase)
in rates.)

Application No. 58440
(Filed October 27, 1978;
amended January 4, 1979
and May 29, 1979)

Arthur H. Burnett,
Complainant,

vs.

Rossmoor Water Company, a
corporation,
Defendant.

Case No. 10578
(Filed May 23, 1978)

Lawrence T. Solomon,
Complainant,

vs.

Rossmoor Water Company,
Defendant.

Case No. 10595
(Filed June 12, 1978)

A. L. Leyva Trust,
Complainant,

vs.

Rossmoor Water Company,
Defendant.

Case No. 10604
(Filed June 26, 1978)

A.58440, et al. ALJ/EA

Lawrence Solomon and Stanley Solomon,)
Complainants,)

vs.)

Rossmoor Water Company,)
Defendant.)

Case No. 10605
(Filed June 26, 1978)

Greenville Development Company,)
Complainant,)

vs.)

Rossmoor Water Company,)
Defendant.)

Case No. 10606
(Filed June 26, 1978)

Syd Carnine,)
Complainant,)

vs.)

Rossmoor Water Company,)
Defendant.)

Case No. 10607
(Filed June 26, 1978)

Stanley Solomon,)
Complainant,)

vs.)

Rossmoor Water Company,)
Defendant.)

Case No. 10610
(Filed June 27, 1978)

(Appearances are listed in Appendix A.)

SECOND INTERIM OPINION ON APPLICATION
NO. 58440 AND OPINION ON ADVICE LETTER NO. 33

Applicant/defendant, Laguna Hills Water Company, filed on October 27, 1978 Application No. 58440 seeking both interim and permanent rate relief. Cases Nos. 10578, 10595, 10604, 10605, 10606, 10607, and 10610, in which complainants seek payment of overdue refunds on main extension contracts from defendant, were consolidated with the application for hearing. Initial public hearings were held before Administrative Law Judge Main in Los Angeles on January 16, 17, and 18, 1979. The January 16 hearing was devoted to the complaint cases and resulted in those cases being kept open pending developments in the rate increase matter.

The remaining two hearing days were devoted to the request for interim rate relief. The evidence amply demonstrated that applicant was confronted by a financial emergency. By Decision No. 90006, dated February 27, 1979, an interim increase in rates, yielding an estimated increase of \$460,520, or 20.13 percent, in annual gross revenues, was authorized and made subject to possible refund.

On May 29, 1979 applicant filed an amendment to its application increasing the amount of permanent rate relief sought. The step rates proposed in the amendment would increase, according to applicant's estimates, gross revenues by \$392,300, or 14.3 percent, at the 1979 level of operations and by \$591,000, or 20.2 percent increase, at the 1980 level of operations, over those at the interim rates authorized by Decision No. 90006, supra.

After due notice, public hearing on the amended application was held before Administrative Law Judge Main on June 6, 1979 in Laguna Hills and on June 7, 13, 14, and 18-21, 1979 in Los Angeles. Several weeks before the June 6 hearing, approximately 20 of applicant's customers attended a public meeting jointly held by the staff

and applicant to explain the rate increase application and to focus upon any service or billing problems customers may be experiencing. At the June 6 hearing, several Leisure World residents, as well as several representatives of the protestant corporations, testified concerning service problems in the Phase IV area. A non-Leisure World resident testified that in his view the present rate structure unfairly penalizes single-family homes on individual meters and urged the adoption of some form of lifeline rate structure.

Applicant's witnesses included its vice president-general manager; vice president-controller; vice president-secretary; and a rate of return specialist. The Commission staff presentation was made through a financial expert and two engineers. Protestants sponsored a consulting engineer who testified on fair rate of return and prepared late-filed Exhibit 12 concerning service to the Phase IV area of Leisure World. At the conclusion of hearings on June 21, 1979, provision was made for filing concurrent opening briefs and concurrent reply briefs. At that time, provision was also made for applicant's filing a motion to keep this proceeding open in light of applicant's inability to satisfy the matters complained of in the consolidated cases.

On July 5, 1979 applicant filed a "Motion to Defer Submission of Proceedings to Permit a Consolidation With Yet to be Filed Applications and to Grant Applicant Partial General Rate Relief". Pleadings in opposition to applicant's motion were filed by the staff and by protestant on July 13, 1979 and applicant's reply was filed on July 25, 1979.

On July 26, 1979 applicant filed Application No. 59023 for authority to deviate from the uniform main extension rule (1) by having refunds based on rates for water service in effect at the time a given main extension (ME) contract was executed, and (2) by having the computation of the maximum contract repurchase price reflect the refunds required during the 21st through 25th year of the main...

extension contract. On July 30, 1979 applicant filed Application No. 59032 for authority to incur \$1.4 million in long-term debt, the proceeds from which would be used for repurchasing main extension contracts and paying refund obligations on main extension contracts, and to establish a rate surcharge for servicing the debt. On August 7, 1979 applicant filed Application No. 59051 for authority to deviate from the uniform main extension rule, which would permit a revision of an existing \$650,000 special facilities contract.

The application and cases in this proceeding, the applications described in the preceding paragraph, and certain other matters were consolidated for hearing by Ordering Paragraph 1 in Decision No. 91037^{1/} dated November 20, 1979 in Application No. 59140. That consolidation recognized, among other things, that a determination of a fair rate of return for applicant is linked to an assessment of the factors which have led to applicant's financial posture and also to the outcome of Applications Nos. 59023, 59032, and 59051, supra. In that regard the influence of such specific factors as managerial performance, prolonged delays in making operational two large new reservoirs because of problems encountered in their design and construction, the burgeoning main extension contract refund payment schedules and

^{1/} By Decision No. 91037 dated November 20, 1979 in Application No. 59140, Application No. 57548 was ordered reopened for reconsideration of Decision No. 87929 and consolidated for hearing with Application No. 58440, Cases Nos. 10578, 10595, 10604, 10605, 10606, 10607, 10610, 10757; and 10764, and Applications Nos. 59023, 59032, 59051, and 59140. Decision No. 87929 authorized Rossmoor Corporation to transfer, and Laguna Hills Utility Company to acquire, all of the outstanding common stock of Rossmoor Water Company and all of the outstanding common stock of Rossmoor Sanitation, Inc.

the inability to make refunds which are overdue, and proposals to obtain external financing should be examined. In addition, the consolidated record therein should be adequately developed to provide a basis for giving disposition to the formal complaints.

However, for reasons other than the consolidation it ordered, Decision No. 91037,^{1/} which served primarily to reopen Application No. 57548 for reconsideration of Decision No. 87929, was recently rescinded and Application No. 59140 dismissed as "a collateral proceeding in which Decision No. 87929, a final Commission order, shall be given conclusive effect." (Decision No. 91356 dated February 13, 1980 in Application No. 59140.) It is thus necessary to restore the consolidation of matters other than Application No. 57548 and Application No. 59140 ordered by Decision No. 91037 and our order herein will so provide.

At this stage the record herein provides an adequate basis for disposition of the issues in the rate case other than fair rate of return. Accordingly, in this interim decision we will provide a provisional fair rate of return pending further hearing and final determination and then proceed to decide the remaining issues of the rate case.

Background and Present Operations

Applicant was incorporated on May 24, 1962 as Rossmoor Water Company. At that time, it was a wholly owned subsidiary of Rossmoor Corporation. In Application No. 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 Decision No. 87929¹, effective October 4, 1977. On October 4, 1978, but made effective as of September 30, 1977, applicant, formerly Rossmoor Water Company, and Laguna Hills Sanitation, Inc. (LHSI), previously Rossmoor Sanitation, Inc., became wholly owned subsidiaries of LHUC, a publicly held company.

Applicant supplies water to customers in its service area which consists of portions of the communities of Laguna Hills, El Toro, and Mission Viejo in South Orange County, California. As of December 31, 1978, applicant served approximately 48,000 persons through 20,645 metered connections of which 19,953 were residential. Applicant maintains a network of more than 100 miles of distribution mains throughout its service area which is approximately 75 percent developed.

Present storage facilities consist of two steel tanks with a combined capacity of five million gallons. The completion of two additional reservoirs, which will double storage capacity, has been delayed due to structural and design problems. Construction of an additional 1.8 million gallon reservoir, needed to keep pace with future growth in the service area, is also planned.

As of June 1, 1978, applicant employed 43 people. These employees are also responsible for the operation of LHSI and charge that utility directly on a timecard basis when assigned to work for LHSI.

Rates

Applicant proposes to increase the rates for general metered service (Schedule No. 1), metered construction service (Schedule No. 9-MC), and unmetered service to tract houses during construction (Schedule No. 9-FC). Virtually, 98 percent of applicant's operating revenues is generated under its Schedule No. 1. In Table I on the next page a comparison is made of applicant's present and proposed general metered service rates and those authorized herein. An average commercial (business and residential) customer, in applicant's service area, will use about 17,550 cubic feet of water per year, or 14.6 Ccf (hundreds of cubic feet) per month. Under present rates, the monthly charge for an average commercial customer with a 5/8 x 3/4-inch meter is \$14.39. At the adopted rates, it will increase by \$0.17, or 1 percent, to \$14.56.

TABLE I

LAGUNA HILLS WATER COMPANY
Comparison of Monthly Rates

	<u>Present Rates*</u>	<u>Proposed Rates*</u>	<u>Adopted Rates*</u>
Service Charge:			
For 5/8 x 3/4-inch meter	\$ 3.15	\$ 3.30	\$ 3.20
For 3/4-inch meter	3.50	3.65	3.50
For 1-inch meter	4.75	4.95	4.80
For 1-1/2-inch meter	6.30	6.60	6.00
For 2-inch meter	8.50	8.90	9.00
For 3-inch meter	15.75	16.50	16.00
For 4-inch meter	21.40	22.45	21.00
For 6-inch meter	35.60	37.25	36.00
Quantity Rates:			
For the first 5,000 cu.ft., per 100 cu.ft.	0.770	-	0.862 ✓
For all over 5,000 cu.ft., per 100 cu.ft.	0.629	-	0.721 ✓

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

*Includes \$.078 per 100 cubic feet surcharge authorized by Resolution No. W-2586 dated January 8, 1980 pursuant to Advice Letter No. 32, and \$0.084 per 100 cubic feet increase authorized in Advice Letter No. 33.

Fair Rate of Return - Provisional

Applicant's rate of return witness testified that based on the Discounted Cash Flow and the Capital Asset Pricing Model Methods he employed, he would recommend a return on equity of 14 percent for a healthy company. However, in light of the actual financial condition of applicant, it is his recommendation that the 14 percent figure should be adjusted upward to the 15.4 percent to 16.9 percent range. Applicant seeks a 12.68 percent rate of return, which corresponds to lower end of that range, based on capital ratios and cost factors as follows:

Laguna Hills Water Company
Rate of Return Sought

<u>Capital Component</u>	<u>Capital Ratios</u>	<u>Cost Factors</u>	<u>Weighted Cost</u>
Long-Term Debt	41.23%	8.8%	3.63%
Common Equity	<u>58.77</u>	15.4	<u>9.05</u>
Total	100.00%		12.68%

The staff's rate of return witness recommends a 12.85 percent return on common equity for applicant. His recommendation was predicated on applicant's being a healthy company without either the high level of overdue refunds on its main extension contracts or the high proportion of advances financing its existing plant. His recommended rate of return on rate base is 11.28 percent based on capital ratios and cost factors as follows:

Laguna Hills Water Company
Staff Recommended Rate of Return

<u>Capital Component</u>	<u>Capital Ratios</u>	<u>Cost Factors</u>	<u>Weighted Cost</u>
Long-Term Debt	38.33%	8.76%	3.36%
Common Equity	<u>61.67</u>	12.85	<u>7.92</u>
Total	100.00%		11.28%

In the staff witness' opinion (which appears at least in some respects to have been a preliminary one in light of his later testimony) applicant's "current financial problems are a result of management's failure to address the problems when they arose. Any attempt to rectify the situation through rates would require a rate of return far in excess of what would be considered fair and reasonable." The thrust of his later testimony was that the staff had not undertaken the investigation necessary to assess the factors, including management's performance, which have led to applicant's financial posture.

Protestants' witness on rate of return employed a revenue requirement/discretionary income approach to arrive at his recommended rate of return of 10.5 percent on rate base. In this approach he does not rely upon the return on common equity as the basic determinant nor does he include criteria which would tend to restore applicant's financial viability.

As we indicated near the outset of this interim decision, a final determination on the fair rate of return issue is being deferred pending hearings delving further into the extraordinary problems encountered by applicant in order to provide a more comprehensive record on that issue. For the interim period, we will set provisionally the fair rate of return, which is to be applied to applicant's rate base, at 11.28 percent consistent with the return on equity, the capital ratios, and the cost factors used by the staff witness.

Quite apart from the chaotic conditions sporadically occurring in the financial markets, we are convinced that in these times generally the return on common equity for applicant should not be set lower, provisionally or otherwise, than the 12.85 percent recommended by the staff witness. That recommendation, as pointed out above, was structured for applicant by the staff witness as though applicant were a financially sound utility.

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 test years 1979 and 1980 applicant's operating revenues, operating expenses, and rate base. The staff's study of applicant's operating results (Exhibits 13 through 18) was based, in part, on later information than that available when applicant prepared its summary of earnings study appended to the amended application as Exhibit G. During the proceeding, the staff made some minor revisions in its estimates and applicant adopted many of the staff estimates. This narrowed substantially the differences in their showings. In Table 2, which follows, the results for test year 1980 of the respective studies by applicant and the staff, each modified as indicated above, and our adopted operating results have been set forth.

TABLE 2

LAGUNA HILLS WATER COMPANY

Summary of Earnings

Test Year 1980

Item	Applicant		Staff		Adopted				
	Present	Proposed	Present	Proposed	At Present	Advice Letter No. 32	At 11.28% Rate of Return	Advice Letter No. 33	At 11.28% Rate of Return
	(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)	(I)
(Dollars in Thousands)									
Revenues	\$2,973.1	\$3,518.8	\$2,973.1	\$3,518.8	\$2,973.1	\$ 318.6	\$3,344.4	\$ 343.4	\$3,687.8
O & M Expenses	1,550.5	1,551.6	1,550.5	1,551.6	1,550.5	318.0	1,868.6	339.4	2,208.0
A & G Expenses	352.9	354.0	311.1	312.2	305.8	.6	306.5	0.6	307.1
Amortization	5.5	5.5	5.5	5.5	20.9	-	20.9	-	20.9
Depreciation	311.2	311.2	311.2	311.2	301.9	-	301.9	-	301.9
Taxes-Except Income	113.2	113.2	113.2	113.2	106.9	-	106.9	-	106.9
Income Taxes	27.1	303.6	48.3	324.8	81.7	-	108.4	3.4	111.8
Total Expenses	2,360.4	2,639.1	2,339.8	2,618.5	2,367.7	318.6	2,713.2	343.4	3,055.6
Net Revenues	612.7	879.7	633.3	900.3	605.4	-	631.2	-	631.2
Rate Base	6,252.0	6,252.0	5,921.9	5,921.9	5,596.0	-	5,596.0	-	5,596.0
Rate of Return	9.80%	14.07%	10.69%	15.20%	10.82%	-	11.28%	-	11.28%

*Rates in effect prior to increase pursuant to Resolution No. W-2586 dated January 8, 1980 in Advice Letter No. 32.

A. SELLCO, et al. Atty/EA/oc/jn *

The principal differences between the estimates of applicant and the staff in Table 2 are in rate base and A&G expense. In addition, although there is agreement on the \$5,500 figure shown for amortization for test year 1980, they differ as to a proper starting date of the three-year period to which the amortization applies.

Protestants' position is in several respects at variance with that of both applicant and the staff. They take exception to the inclusion of Reservoirs R-3 and R-4 in the operating results. They also take exception to the inclusion of an allowance for pension expense and to the level of regulatory commission expense.

We will now address these differences. In so doing we will indicate the basis for our adopted operating results and also indicate how those results are calculated in relation to the staff estimates.

Rate Base

(a) Reservoirs R-3 and R-4

In November 1976, following the issuance of \$1.5 million in bonds, applicant awarded a contract for the construction of Reservoirs R-3 and R-4 to a general contractor. The reservoirs were scheduled to be in operation in 1977. However, structural and design defects not only delayed their completion but eventually resulted in rendering both reservoirs nonoperable. The contractor has agreed to tear down Reservoir R-3 and rebuild it according to a different design. The contractor has not admitted responsibility for the defects in Reservoir R-4. It thus appears that whatever has to be done with Reservoir R-4 must await either the contractor's agreeing to accept responsibility or the outcome of litigation. Applicant does not accrue interest on construction-work-in-progress.

Our adopted rate base includes Reservoir R-3, which is expected to be in service by the time this decision becomes effective. It excludes Reservoir R-4. It also excludes the sums expended for remedial work on these reservoirs. The latter matter will be dealt with further in our discussion of amortization expense.

To remove Reservoir R-4 from the staff estimate of operating results at present rates, rate base is decreased by \$492,900; depreciation expense is decreased by \$6,100; ad valorem tax is decreased by \$5,600; and income taxes are increased by \$44,200. The increase in income taxes arises from both an increase in taxable income and elimination of the investment tax credit pertaining to Reservoir R-4. The increase in taxable income results from eliminating the deductions for accelerated depreciation, ad valorem tax, and interest applicable to Reservoir R-4.

(b) Overdue MEC Payments

Overdue main extension contract payments are included in Account 230.1, Amount Due/MEC Refund Agreements, which is a subaccount to Account 230, Other Current and Accrued Liabilities. Interest accrues on the overdue payments at a rate of 7 percent per annum. It is applicant's position that the overdue MEC payments are the equivalent of short-term debt and, therefore, should not be deducted from rate base as a part of non-interest bearing advances for construction. It is applicant's further position that with timely and adequate rate relief it may have sufficient cash flow to meet its refund obligations for the test years.

It is the staff's position that \$284,000 of overdue MEC payments will remain unpaid. That amount should, therefore, be deducted from rate base as a component of advances for construction. Consistent with this position, the staff makes the following argument: Main extension contract refunds until paid "remain an advance to the utility. Advances for construction, generally, are not included in rate base since such funds do not represent a capital investment of the utility upon which the utility may earn a profit. Further, an advance becomes a capital investment only to the extent the advance is repaid and the facilities subject to the advance are 'repurchased' by the utility. To allow otherwise would require the ratepayers to pay for the rate of return on capital which has not been expended by the utility."

It is the protestants' position that amounts "advanced under MEC contracts are contributed or no-cost capital until paid."

Crucial to a rational resolution of this issue is whether overdue MEC payments simply retain their character as an advance or become debt. Applicant argues that it has absolutely no obligations with respect to MEC advances unless, and until, certain conditions of the main extension rule are met. Upon the occurrence of those conditions, a debt is created which applicant is obligated to serve in some fashion.

Applicant's argument is consistent with Buss v California Cities Water Company, Decision No. 83937 dated December 30, 1974, in which we held that main extension refunds not paid by the due date are equivalent to involuntary interest-free loans. This holding was reaffirmed in Levine Brothers Investments v Mesa Crest Water Company, Decision No. 85949 dated June 15, 1976, and in Burnett v Park Water Company, Decision No. 87019 dated March 1, 1977. We further held in the latter cases that refunds not paid when due

should bear interest at the rate of 7/12 percent per month until paid. Accordingly, the \$284,000 in overdue MEC payments, as of December 31, 1978, represents utility plant in service which must be serviced in some fashion by applicant during 1979 and 1980.

Applicant's options are few since it simply does not have the available cash or borrowing power to obtain the cash through conventional financing to make the overdue payments. Unless a utility is not making an effort in good faith to pay main extension refunds when due, the equities dictate that servicing of such special debt be accomplished through rates (i.e., including the overdue refunds in rate base).

Presently, as stated earlier in this decision, applicant is seeking, through Application No. 59032, special financing, to be serviced by a rate surcharge, to repay the MEC refund balance and repurchase the MECs. If that application is granted and the funds became quickly available, appropriate downward adjustments in both rate base and rates adopted herein should ensue. Either our final rate relief in this consolidated proceeding or the eventual decision in Application No. 59032, supra, would make any such needed adjustments.

In summary, the overdue refunds accrue interest which applicant is obligated to pay. To allow for recovery of this interest, the \$284,000 is included in the adopted rate base. Consistent with this treatment, the interest is taken as a deduction from taxable income in computing income taxes. It is necessary to adjust the staff's capital structure which we have adopted to reflect this

(c) Buy-Back of MECs
Presently Held by LHUC

Both applicant and the staff in their treatment of rate base assumed a buy-back of approximately \$985,900 of main extension contracts held by applicant's parent company, LHUC. According to staff Exhibit 13, applicant "proposes to issue 4,500 shares of common stock at \$100 a share to cover the estimated discounted price of \$353,500. The remaining \$96,500 from the sale of stock

would be used to pay accrued refunds and interest on the main extension contracts. The balance of \$985,900, less \$450,000, would be transferred to Contributions in Aid of Construction." The net effect on rate base of this assumed buy-back is an upward adjustment of \$450,000.

By Interim Decision No. 91236 dated January 15, 1980 in Application No. 58861, Laguna Hills Water Company was authorized to issue 3,440, instead of 4,500, shares of its \$100 par value to common stock to LHUC. 2,502 and 829, respectively, of the 3,400 shares represent the tentative buy-back cost and the refunds due exclusive of interest. A higher buy-back cost is being claimed by applicant and a public hearing will be held in Application No. 58861 to test the validity of that claim.

Interim Decision No. 91236 limits the appropriate upward adjustment in rate base associated with the buy-back to \$333,000 at this time instead of the \$450,000 used by applicant and the staff. (Relatedly, depreciation expense is adjusted by \$3,200.) Should the hearing in Application No. 58861 result in a higher valuation being placed on the buy-back, the corresponding adjustment to rate base and therefore rates could be made by further decision in either Application No. 58861 or in this consolidated proceeding.

In summary, our adopted rate base of \$5,596,000 is reached from the staff estimate of rate base of \$5,921,900 by deducting from the latter figure \$492,900 for the removal of Reservoir R-4 from rate base and \$117,000 for a lesser valuation on the buy-back of main extension contracts held by LHUC, on the one hand, and by adding to it \$284,000 for excluding interest-bearing overdue main extension contract payments from advances in aid of construction, on the other hand.

A&G Expenses

(a) Outside Services

The staff estimate of total A&G expenses is lower than applicant's by \$41,800, and the entire difference is within one account: Outside Services. In that account the staff made three basic adjustments to applicant's estimates. First, applicant allowed for inflation in using 1978 recorded costs for 1980 and the staff did not. Second, the staff disallowed \$22,500 for applicant's share of costs incurred by its publicly held parent company, LHUC, for financial reporting to the Securities and Exchange Commission (SEC). Third, the staff eliminated the overhead component in the charges of \$13,270 to applicant by Rossmoor Corporation for services. The elimination was made by dividing the \$13,270 by 2.25, the divisor being the overhead or burden factor that is applied to the hourly wage rate of Rossmoor Corporation employees rendering the services. Overhead or burden includes payroll taxes, benefits, secretarial assistance, and other costs attributable to the management services supplied by Rossmoor Corporation's executive staff.

In Decision No. 91182 dated January 8, 1980 in Application No. 58275, we said in regard to the appropriate ratemaking treatment of Laguna Hills Sanitation, Inc.'s share of LHUC's SEC-related expenses: "...the formation of a publicly held corporation as the parent to applicant, and its sister company, LHWC, 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 the 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 rate payer." With respect to the services

rendered by Rossmoor Corporation, there was no dispute as to those services or their direct cost; nor was the limited evidence on pertinent overheads challenged which tends to support a higher burden-loading factor (i.e., 3.26 instead of 2.25).

Our adopted estimate of Outside Services is \$20,600 higher than the staff's estimate and reflects appropriate allowances for SEC-related expenses as well as for charges by Rossmoor Corporation.

(b) Pension Plan

Included in both applicant's and the staff's estimates of pensions and benefits expenses is a \$25,900 allowance for a pension plan not yet implemented. This pension plan also involves Laguna Hills Sanitation, Inc. in that the sanitation company is operated by applicant's personnel.

During this proceeding, the staff witness took the position that applicant's share of the pension plan expense should be accorded the same treatment as that which would eventuate in Application No. 58275 of Laguna Hills Sanitation, Inc. In that regard, in Appendix C to Decision No. 91182, supra, we prescribed rate increments, which were designed to produce \$25,000 in annual gross revenues, to become effective upon the pension plan's actually being implemented. We will follow a similar procedure in this decision.

(c) Regulatory Commission Expense

The staff's estimate of \$16,700 for this category of expense was higher than applicant's original estimate by \$1,700. "The staff's estimates are based on a carry-over cost of \$19,600 (an additional expense incurred in Application No. 56299 mainly due to the prolonged hearing) and later data provided by applicant. Both the staff and applicant amortized the costs (\$50,100) over a three-year period." (Exhibit 13, page 5.)

Protestants contend that the carry-over cost component should be eliminated. Protestants further contend that applicant is not entitled to amortize any regulatory commission expense because it did not "toward the end of this proceeding provide any testimony or representations as to the approximate expenses incurred in this proceeding."

Regulatory expenses were not a point of contention between the staff and applicant. Protestants did not at any point submit figures they deemed to be reasonable regulatory expenses for this proceeding. Protestants' contentions lack merit. A reasonable allowance for regulatory commission expense for the test year is \$16,700.

In summary, our adopted A&G expenses of \$305,800 are reached from the staff estimate of A&G expenses of \$311,100 by deducting \$25,900 representing pension plan expense and by adding \$20,600 representing an increase in Outside Services expense.

Amortization

As of December 31, 1978, applicant's balancing account for purchased water and power and offsettable expenses showed undercollections of \$16,627. The staff proposed to amortize this amount over a three-year period, commencing in 1979, at \$5,500 per year. Applicant took issue with the 1979 commencement of amortization on the ground that this decision probably would not issue before 1980.

Clearly, applicant has a point. A more timely three-year amortization period is 1980 through 1982 and should be adopted.

Our adopted amortization for the test year is the sum of the above figure of \$5,500 plus \$15,400 representing the amortization over a three-year period of \$46,300 in remedial work of Reservoirs R-3 and R-4. The latter expenditures were made to determine whether the reservoirs could be safely employed for water storage. Because these expenditures were not imprudently incurred, we are permitting their recovery through rates, subject, however, to refund in the event applicant is reimbursed therefor by the contractor.

Whether the contractor could be ultimately held liable for the \$46,300 in remedial work is problematical. Clearly, however, applicant must pursue all available reasonable courses of action to obtain such reimbursement. Applicant will be required to report on the action taken.

Depreciation and Taxes Other Than On Income

The differences between the adopted estimates for these expense categories and those of the Commission staff are minor. They are attributable primarily to the removal of Reservoir R-4 from utility plant and to the lesser valuation placed on the buy-back of MECs presently held by LHUC.

We take official notice of Advice Letter No. 33 filed May 27, 1980, by which Laguna Hills Water Company requests authority under General Order No. 96-A, to increase water rates by \$343,000 to offset increases in purchased water and purchased power costs and to account for increase in the California Franchise Tax rate. The Revenue Requirements Division staff has reviewed the workpapers submitted with the advice letter and finds that the company's request regarding purchased water and purchased power costs to be reasonable as it merely offsets those additional costs on a dollar for dollar basis. According to the staff calculations, the company underestimated its tax liability by \$500. Therefore, a total increase of \$343,500 rather than the amount of \$343,000 sought in the above letter is reasonable. The adopted results of operation shown on page 13 (column I) reflect this increase in costs.

Wage and Price Guidelines

By Interim Decision No. 90006 (dated February 27, 1979), supra, a 20.13 percent increase in applicant's rates was authorized because of a financial emergency. A further 11.59 percent rate increase was authorized by Resolution No. W-2586 (dated January 8, 1980), supra, to offset increases in costs of purchased water and purchased power. Both of those rate increases were exempted, by virtue of their nature, from the guidelines.

By this decision, a 1.6 percent rate increase, yielding \$52,700 in additional annual gross revenues, is authorized. It is based on a 1980 test year in which a 7 percent wage increase is reflected in the estimated operating results. The voluntary standards of wage and price increases, where applicable, are thus being met.

Rate Spread

In staff Exhibit 13 the matter of lifeline rates was addressed as follows:

"Neither the staff nor applicant are proposing the introduction of lifeline rates. The issue of lifeline rates was discussed quite extensively in the proceedings in Application No. 56299, as referenced

by the following: Decision No. 87750, dated August 23, 1977, page 4, and Decision No. 88705, dated April 18, 1978, pages 4, 8, 9, and 13. The following discussion is taken from Decision No. 88705, pages 8 and 9:

"It is a matter of Commission policy that water rates should be designed to provide the residential user a reasonable amount of water necessary to meet minimum household requirements at the lowest reasonable cost, to discourage the wasteful use of water, and to promote conservation of water and the power required to deliver water. Under ordinary circumstances the residential customer is usually provided service through a 5/8" x 3/4" meter, and in those circumstances the staff has recommended and the Commission has prescribed lower rates for a prescribed amount of water based upon that type of meter and higher rates for the higher volumes of water that normally flow through the larger meters. Table I shows that over one-half of applicant's water sales is through large meters to multiple dwelling units within Leisure World and that the average consumption per dwelling unit therein is significantly less than the consumption per dwelling unit of condominiums and single-family homes outside Leisure World. The record also shows that the mutual housing corporations within Leisure World have taken actions at some expense to them to eliminate wasteful use of water and to otherwise promote conservation thereof. It also shows that to the extent that there may be any hardship on the part of any customers to pay increased rates for water, that it would be more likely to occur in connection with residents of Leisure World than outside thereof. Those circumstances indicate that a rate structure for residential customers within applicant's service area which would favor the customer served by the smaller meters would not only be unfair, but would not promote lifeline or conservation objectives.'

"Since the circumstances referred to in the above text still exist in the Laguna Hills Water Company, the staff position is not to propose a lifeline rate."

In Decision No. 88705, supra, we held that the design of the present rate structure "is not inconsistent with State policy regarding lifeline and conservation objectives" because of the singular circumstances regarding applicant's residential service. The record herein does not provide any basis with probative value to support a departure from that finding.

Increases for Schedules No. 9-FC and No. 9-MC proposed by applicant and supported by the staff, but modified to incorporate the surcharge pursuant to Resolution No. W-2586, supra, will be authorized herein. The increases are:

Schedule No. 9-FC, Unmetered Service to Tract Houses During Construction, increased from \$2.50 plus 10 percent surcharge to \$10 for the entire construction period.

Schedule No. 9-MC, Metered Construction Service, increased in the quantity rates by about 7 cents per 100 cubic feet and in the minimum charge by between \$11.55 and \$226 depending on the meter size.

The circumstances peculiar to applicant's service area affecting the suitability of lifeline rates continue to indicate, as they did in our earlier decisions, that "a rate structure for residential customers...which would favor the customers served by the smaller meters would not only be unfair, but would not promote lifeline or conservation objectives."

Accordingly, the staff recommendation to continue the two-block rate structure for general metered service with the

first consumption block set at 5,000 cubic feet is appropriate and we adopt it. The staff also recommended a rounding of the service charges which we likewise adopt. To implement these recommendations as well as the staff recommendations concerning Schedules Nos. 9-FC and 9-MC previously described utilizes about 35 percent of the \$52,700 total additional revenue requirement. As a result, the increase in the quantity rates for general metered service is limited to \$.008 per 100 cubic feet, as shown in Table I, hereinabove.

Pump Efficiency

Consonant with the Commission's efforts to have power conserved, the staff reported in Exhibit 13 on its monitoring of pump efficiencies as follows:

"There are 23 booster pumps in the system, of which 21 are electrically operated.

"Efficiency tests conducted by Southern California Edison Company in 1978 on 14 boosters indicate that 9 boosters rated from fair to excellent and 5 rated poor. Out of these 5 boosters, 3 have been modified recently to improve efficiency, one is now only used occasionally and the remaining one is designed for high demand and is expected to run at an excellent efficiency upon completion of reservoirs R-3 and R-4."

Service

With the exception of the Leisure World Phase IV area, service in applicant's service area has been satisfactory. The Phase IV area is situated on hillside terrain 550 feet to 700 feet in elevation where there are approximately 410 dwelling units in a series of three-story buildings representing about 2 percent

of applicant's total customers. Service there has been adversely affected by Reservoir R-4's not being available. However, applicant has taken a number of steps, as outlined in Exhibit II, to assure that the delays in constructing Reservoir R-4 will affect service in the Phase IV area to the minimal extent practicable. In fact, it now appears that a new control system for the Plant R-4 variable speed booster pump has brought pressures within this area to well within those mandated by General Order No. 103.

Findings of Fact

1. Applicant has been unable to satisfy the consolidated complaints seeking payment of overdue refunds on main extension contracts because of its financial condition.

2. To alleviate its financial problems, applicant has filed Applications Nos. 59023 and 59051 for authority to deviate from the main extension rule and Application No. 59032 for authority to incur long-term debt and to establish a rate surcharge for servicing the debt.

3. The fair rate of return issue in this general rate proceeding is linked to an assessment of the factors which have led to applicant's financial posture and to the outcome of Applications Nos. 59023, 59032, and 59051.

4. It is appropriate to establish provisionally, pending further hearing, the fair rate of return for applicant. Consolidation of this proceeding with Applications Nos. 59023, 59032, and 59051 as well as with complaint Cases Nos. 10757 and 10764 should provide an appropriate forum for a thorough examination of applicant's financial posture.

5. The provisional fair rate of return for applicant should be fixed at the staff-recommended level of 11.28 percent. That recommendation was predicated upon construing applicant to be a financially sound company (i.e., as though applicant has not experienced the financial adversity of two large new reservoirs not becoming operational and did not have either the high level of overdue refunds on its main extension contracts or the high proportion of advances financing its plant).

6. The adopted estimates, previously discussed herein, of operating revenues, operating expenses, and rate base for the test year 1980 reasonably indicate the results of applicant's operations for the near future.

7. A provisional rate of return of 11.28 percent on applicant's rate base for 1980 is reasonable. The related allowance for return on common equity is 12.85 percent based on the capital components set forth in Staff Exhibit 19.

8. To produce an 11.28 percent rate of return will require an increase of \$52,700, or 1.6 percent, in annual revenues for test year 1980. Such an increase is reasonable and justified.

9. The adopted rate spread is reasonable.

10. The pension plan proposed by applicant 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 the pension plan as provided for in Decision No. 91182 dated January 8, 1980 in Application No. 58275 of Laguna Hills Sanitation, Inc., applicant's sister company, are fair and reasonable.

11.a. It is reasonable for ratemaking purposes to amortize over a three-year period the \$46,300 applicant expended to determine whether Reservoirs R-3 and R-4 could be safely employed for water storage.

b. Applicant should pursue whatever reasonable courses of action available to obtain reimbursement of the \$46,300 from the contractor or any other party bearing a responsibility for the design or construction of Reservoirs R-3 and R-4; should report on the action taken; and, if reimbursed, should make the corresponding refund to its customers and rate reduction.

12. We take official notice of Advice Letter No. 33 filed May 27, 1980, by which Laguna Hills Water Company requests authority under General Order No. 96-A, to increase water rates by \$343,000 to offset increases in purchased water and purchased power costs and to account for increase in the California Franchise Tax rate. The Revenue Requirements Division staff has reviewed the workpapers submitted with the advice letter and finds that the company's request regarding purchased water and purchased power costs to be reasonable as it merely offsets those additional costs on a dollar-for-dollar basis. According to the staff calculations, the company underestimated its tax liability by \$500. Therefore, a total increase of \$343,500 rather than the amount of \$343,000 sought in the above letter is reasonable. The adopted results of operation shown on page 13 (column I) reflect this increase in costs.

13. 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. The final determination of the fair rate of return to be authorized for applicant in Application No. 58440 and the disposition of Cases Nos. 10578, 10595, 10604, 10605, 10606, 10607, and 10610 should await further hearings before this Commission and the following additional matters should be consolidated for such hearing: Applications Nos. 59023, 59032, and 59051 and Cases Nos. 10757 and 10764.

A.58440, et al. ALJ/jn * *

2. The application and Advice Letter No. 33 should be granted to the extent set forth in the ensuing interim order. ✓

3. Consonant with the authority granted, applicant should be directed to take certain actions.

4. The date of this order should be the date hereof because of applicant's urgent need for additional revenues.

SECOND INTERIM ORDER

IT IS ORDERED that:

1. Applicant, Laguna Hills Water Company, is authorized to file with this Commission, after the effective date of this order, the revised rate schedules attached to this decision as Appendix B. Such filing shall comply with General Order No. 96-A. The effective date of the revised tariff sheets 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. Once the revised rate schedules attached to this decision as Appendix B become effective, supplemental rate Schedules Nos. 1-S and 9-MC-S shall thereupon terminate.

3. Upon the execution of a pension plan as provided for in Decision No. 91182 dated January 8, 1980 in Application No. 58275, 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. Applicant shall make all reasonable efforts to obtain reimbursement of its expenditures incurred in determining whether Reservoirs R-3 and R-4 could be safely employed for water service. Commencing three months from the effective date of this order, applicant shall advise the Commission staff of the action taken and shall continue to advise the staff of the status of the matter until such efforts are concluded. Should applicant obtain a reimbursement of its expenditures in this matter, applicant shall advise the Commission staff and propose appropriate refunds and rate reductions.

5. Application No. 58440 and Cases Nos. 10578, 10595, 10604, 10605, 10606, 10607, and 10610 remain open and are consolidated with Applications Nos. 59023, 59032, and 59051 and Cases Nos. 10757 and 10764 for further hearing.

The effective date of this order is the date hereof.

The effective date of the revised rates shall be July 1, 1980. ✓

Dated JUN 17 1980, at San Francisco, California.

I dissent on the ground that, if the overdue refunds on advances are to be included in rate base and treated as short-term debt, the capital structure should be modified accordingly.

John E. Coyne

President
Lesmond L. Sturgeon

Richard D. Gravelle

Lawrence M. Jamieson
Commissioners

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

APPENDIX A

List of Appearances

Applicant: Latham & Watkins, by Michael C. Kelcy, Attorney at Law, for applicant and defendant.

Complainants: Simmons, Ritchie, Segal and Stark, by Frederick L. Simmons, Attorney at Law, for Lawrence T. Solomon, A. L. Leyva Trust, Lawrence Solomon and Stanley Solomon, Greenville Development Company, Syd Carnine, and Stanley Solomon; and Arthur H. Burnett, for himself.

Protestant: Martin E. Whelan, Jr., Attorney at Law, for Professional Community Management, Inc., Golden Rain Foundation, and Mutual Housing Corporations Inside Leisure World.

Commission Staff: Grant E. Tanner, Attorney at Law, and A. V. Garde.

APPENDIX B
Page 1 of 4

Schedule No. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all general metered water service.

TERRITORY

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

RATES

Service Charge:	Per Meter Per Month
For 5/8 x 3/4-inch meter	\$ 3.20 (I)
For 3/4-inch meter	3.50
For 1-inch meter	4.80 (I)
For 1-1/2-inch meter	6.00 (R)
For 2-inch meter	9.00 (I)
For 3-inch meter	16.00 (I)
For 4-inch meter	21.00 (R)
For 6-inch meter	36.00 (I)

Quantity Rates:

First 5,000 cu.ft., per 100 cu.ft.	\$ 0.862 (I) ✓
Over 5,000 cu.ft., per 100 cu.ft.	0.721 (I) ✓

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

APPENDIX B
Page 2 of 4

Schedule No. 9-MC

METERED CONSTRUCTION SERVICE

APPLICABILITY

Applicable to all measured water service furnished for general construction.

TERRITORY

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

RATES

Quantity Rates:	Per Meter Per Month
First 9,000 cu.ft. or less	\$ 69.00 (I) ✓
Over 9,000 cu.ft., per 100 cu.ft.	0.762 (I) ✓
Minimum Charge:	
For 2-inch meter	\$ 69.00 (I) ✓
For 3-inch meter	120.00
For 4-inch meter	203.00
For 6-inch meter	406.00
For 8-inch meter	650.00 (I)

APPENDIX B
Page 3 of 4

Schedule No. 9-FC

UNMETERED SERVICE TO TRACT HOUSES DURING CONSTRUCTION

APPLICABILITY

Applicable to tract houses being constructed as part of a total real estate development.

TERRITORY

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

RATE

For each single-family or multiple-family dwelling unit for the entire construction period \$10.00 (I)

SPECIAL CONDITIONS

1. This rate is available only to real estate developers who undertake the construction of all or a substantial portion of the houses in a tract as part of the tract development. It does not apply to builders of houses in tracts subdivided for lot sales.

2. The water service under this tariff schedule applies only to use of water for construction of residences. It does not include water use for slab flooding, for garden irrigation, for model homes, or for general tract improvement work.

3. All metered services to each and every dwelling unit of the development must be turned on if spacer service is to be rendered.

4. The \$10.00 charge shall be paid prior to construction of water facilities in the development. (I)

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Page 4 of 4

Schedule No. 9-FC

UNMETERED SERVICE TO TRACT HOUSES DURING CONSTRUCTION

SPECIAL CONDITIONS - Continued

5. Spacer service must be discontinued prior to the time the dwelling unit or units are occupied and at this time a meter will be installed.

6. The company may discontinue service under this schedule, if in the opinion of the company, spacer water is being misused or if the duration of spacer water usage exceeds a reasonable period of time. In this event, the company reserves the right to install meters in place of the spacers.

APPENDIX C

Laguna Hills Water Company

AUTHORIZED INCREASE IN RATES

Pursuant to Ordering Paragraph 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 METERED SERVICE

	<u>Per Meter</u> <u>Per Month</u>
All quantities per 100 cu.ft.	\$.006 (I)

Schedule No. 9-MC

METERED CONSTRUCTION SERVICE

	<u>Per Meter</u> <u>Per Month</u>
All quantities over first 9,000 cu.ft., per 100 cu.ft.	\$.006 (I)