

FEB 18 1981

Decision No. 92715

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of)
CALIFORNIA WATER SERVICE COMPANY, a)
corporation, for an order authorizing)
it to increase rates charged for water)
service in the Stockton District.)

Application No. 59664
(Filed May 16, 1980)

McCutchen, Doyle, Brown and Enersen, by
A. Crawford Greene, Attorney at Law,
for applicant.
Robert Cagen, Attorney at Law, Dana Gardner,
and Mehdi Radpour, for the Commission
staff.

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O P I N I O N

Statement of Facts

California Water Service Company (Cal-Water), a California corporation, with gross operating revenues in 1979 of approximately \$54,000,000, is owned by 7,700 shareholders. It has \$231,000,000 invested in utility plant (including plant under construction). Employing 495 persons statewide, it is engaged in the business of supplying and distributing water for domestic and industrial purposes to 305,000 customers in communities within the State of California.

Operating through 20 local districts, Cal-Water maintains its principal place of business in the city of San Jose. From there it provides centralized billing, accounting, engineering, and water quality control functions to its respective local districts. A central meter repair facility is located in the city of Stockton. Cal-Water's operating districts are not integrated one with another; and except for allocation of general office common expenses and rate base to the respective districts, the revenues and expenses of each district are not affected by operations in the other districts. For ratemaking purposes, therefore, each district is considered a separate entity, and it is the responsibility of this Commission to fix reasonable rates to be applicable to each district (Section 728 of the Public Utilities Code). Rates are reasonable when they provide sufficient revenues to cover the total costs (such as operating expenses, depreciation charges, taxes, and return on investment) properly incurred in furnishing the required service.

Asserting a necessity to offset increases in its operating expenses, rate base, and cost of money, on May 16, 1980, Cal-Water filed separate applications for six of its districts, including the instant application for the Stockton District, seeking authority to

increase its rates. In order to minimize the adverse effects of anticipated operational and financial attrition upon the company, Cal-Water proposed annual step increases over the next three years. In the Stockton District these step increases would increase annual gross revenues over those in effect at the time this application was filed by \$699,800 (8.2 percent) in 1981, and by an additional amount of \$196,400 (2.1 percent) in 1982, and \$210,800 (2.2 percent) in 1983.

Pursuant to provisions of the Commission's Regulatory Lag Plan (adopted by Commission Resolution No. M-4703 dated April 24, 1979) and following bill insert notices mailed to each utility customer in the district, an informal public meeting was conducted by our staff in Stockton on July 9, 1980. About thirty-five customers attended. Statements protesting the proposed increases were made by a county supervisor, a city councilman, a member of the local water district board, and several individuals.

On July 15, 1980 the San Joaquin County Board of Supervisors adopted a resolution expressing concern over the economic impact of the requested rate increases and stating its opposition to increased rates until a public hearing could be held in Stockton to allow all affected users opportunity to express their views. On July 14, 1980 the City Council of Stockton authorized the mayor to write in opposition to the proposed increases expressing concern at the different rates in effect vis-a-vis Bakersfield. Three letters were also received. One, citing the bad shape of the economy, urged denial of any increase. Another, noting that while the 1978 drought gave reason for the increase then granted, could not see why further increases were now required. The writer stated that utility-related increases will make it impossible for her to afford her home by the time she retires six years hence. The third writer urged removal of "excessive rate base" by use of the "saturation adjustment technique", stating that the surplus well problem is unique to Stockton and must be corrected.

In that the applications for all six district contained common issues relating to corporate general office expenses, corporate financing, and rate of return on common equity, the six applications were consolidated for hearing. After notice, public hearings were held in San Francisco on September 15, 16, 17, 19, and 22, 1980, and in Stockton on September 18, 1980, before Administrative Law Judge John B. Weiss (ALJ).

At the outset of the hearing on September 15, 1980, Cal-Water presented evidence of compliance with the requirements for notice, service, and publication as set forth in the Commission's Rules of Practice and Procedure relative to this class of application. During the hearings Cal-Water presented testimony and exhibits through its president, three vice presidents, and an assistant chief engineer. The staff of the Commission presented testimony and exhibits through a staff project engineer, a rate-of-return research analyst, and three utility engineers. At the very sparsely attended hearing in Stockton on September 18, 1980, four public witnesses presented testimony, and one presented an exhibit. Of these, a city councilman and two directors of Stockton East Water District (the latter two speaking for themselves, not for the district) spoke against the proposed increases, while the fourth, a local businessman (and also member of Cal-Water's board of directors) spoke in rebuttal. The matter was submitted at close of hearing September 22, 1980, with provision for an October 14, 1980, concurrent filing of closing briefs.

Discussion

Service Territory, System, and Service Quality

Cal-Water's Stockton District includes most of the incorporated city of Stockton and certain contiguous territory in San Joaquin County. About 150,000 people are served through 37,500 metered services. The area served is flat, and the transmission and distribution

system includes about 455 miles of mains ranging in size up to 42 inches. There are approximately 7.3 million gallons of storage capacity. A centralized remote control system provides primary control for the wells and boosters. A full-time operator has remote control of the pumps. Water is obtained primarily from treated surface water purchased from the Stockton East Water District.^{1/} Supplemental water comes from 64 company-owned wells ranging in depth from 232 to 603 feet. These wells are located throughout the service territory and production from all wells is delivered directly into distribution and storage.

During 1979 Cal-Water logged 1,620 complaints from customers. During the first four months of 1980, there were an additional 202 complaints. Sixty-five percent of the complaints pertained to water quality. According to our staff such complaints were investigated and resolved within a reasonable period after notification. Considering the single complaint raised on this issue during the instant proceedings, it would appear service is generally satisfactory in this district.

Conservation

Cal-Water presented evidence of its continuing efforts to promote conservation, and recorded data for the years 1977 through 1979 show the results of residual conservation from the 1977 drought period (approximately 4.2 percent). Responsibility has been delegated to the district manager to speak to school and civic groups. Conservation comic books in Spanish and English were made available to schools upon request. The district maintains a conservation display in its office and offers free water saving kits and information booklets. Apart from bill inserts featuring conservation messages, billing information is provided to enable customers to compare current usage with previous term usage.

^{1/} In 1979 Cal-Water disposed of 9.8 billion gallons of water. It obtained 81.5 percent of this from the Stockton East Water District and produced the remaining 18.5 percent from company-owned wells.

Pump efficiency reports were provided by Cal-Water to staff as required by Decision No. 88466 dated February 7, 1978 in Case No. 10114. These reports indicated that the Stockton District pumps are within or above the fair range established in that decision.

On balance, conservation efforts continue to be effective in Stockton. Nonetheless, the exhibit introduced and the nonspecific generalized testimony of Cal-Water's witness on the subject tend to indicate that the conservation program is now coasting. Accordingly, we urge that management pump renewed vigor into continuing implementation of this vital program.

Present and Proposed Rates

The last general rate increase authorized the Stockton District was in 1978 (Decision No. 89528 dated October 17, 1978 in Application No. 57328). Since then there have been one advice letter offset decrease, one step-rate increase, and an advice letter decrease authorized. The rates herein used as "present rates" are those filed under Advice Letter No. 735 made effective May 6, 1980 by Commission Resolution No. W-2635. Those rates include changes in purchased power costs incurred by reason of Pacific Gas and Electric Company's (PG&E) April 29, 1980 rate increase. Cal-Water's tariff for this district consists primarily of schedules for general metered service and private fire protection service. No increase is proposed for the latter. A comparison of monthly general metered service rates, present and proposed, follows:

TABLE A
CAL-WATER SERVICE COMPANY - STOCKTON DISTRICT
COMPARISON OF MONTHLY RATES - PRESENT AND PROPOSED

General Metered Service

<u>Service Charge:</u>	<u>Present 5/6/80</u> <u>Rates</u>	<u>Proposed Rates</u>		
		<u>1981</u>	<u>1982</u>	<u>1983</u>
For 5/8 x 3/4-inch meter	\$ 5.68	\$ 6.15	\$ 6.28	\$ 6.42
For 3/4-inch meter	8.28	9.00	9.25	9.50
For 1-inch meter	11.12	12.25	12.60	13.00
For 1 1/2-inch meter	15.18	17.25	17.75	18.25
For 2-inch meter	20.24	23.00	24.00	25.00
For 3-inch meter	37.44	40.00	43.00	45.00
For 4-inch meter	51.61	57.00	59.00	62.00
For 6-inch meter	86.02	92.00	95.00	98.00
For 8-inch meter	124.47	137.00	141.00	145.00
For 10-inch meter	153.82	170.00	175.00	180.00
<u>Quantity Rates:</u>				
For the first 300 cu.ft. per 100 cu.ft.	\$.330	\$.360	\$.370	\$.379
For the next 29,700 cu.ft. per 100 cu.ft.510	.552	.562	.573
For all over 30,000 cu.ft. per 100 cu.ft.370	.392	.399	.407

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. Service Charge rates include the Fire Protection Revenue Loss Surcharge.

Under Cal-Water's proposed rates, an average commercial (business and residential) customer with a 5/8 x 3/4-inch meter, using about 20 Ccf of water per month, would have had his monthly bill increased \$1.27 (8.3 percent) in 1981, \$1.60 (10.4 percent) in 1982, and \$1.96 (12.8 percent) in 1983. An average industrial customer, with a 4-inch meter, using about 1,200 Ccf of water per month, would have had his monthly bill increased \$37.75 (7.0 percent) in 1981, \$49.05 (9.1 percent) in 1982, and \$62.55 (11.6 percent) in 1983.

Results of Operations

As part of its application Cal-Water submitted summaries of operating revenues and expenses incurred in the Stockton District over the 5-year period 1975 through 1979. From these it projected estimates for the test years at issue, using the latest data available to it at the time. The staff analyzed these projections, examining both district and general office operations of Cal-Water, and then prepared its own exhibits introduced at the hearing. Cal-Water's original estimates were completed in March 1980. Between then and completion of the staff's exhibit changes took place. For example, the cost of purchased power went up. Instead of amending the estimated summaries of earnings previously submitted each time a change occurred, Cal-Water informed staff of the changes and furnished staff with the new or later data so that staff could reflect the changes in staff's exhibits. Therefore, when staff's exhibits were completed and submitted at the hearing, in some instances, based as they were on more recent data and information, they differed from those of Cal-Water. In other instances the differences were because staff arrived at other conclusions.

Cal-Water checked staff's proposed adjustments and considered staff's conclusions. In most instances Cal-Water took no issue and adopted staff's estimates. In some other instances Cal-Water does not agree, but to expedite this proceeding it elected not to contest staff's estimates. But in two major instances Cal-Water does not agree to staff's proposals. These relate (1) to estimated Public Authority sales and (2) to the so-called "saturation" adjustments staff would make regarding inclusion in rate base of a well on Waterloo Road and a 16-inch replacement main for Airport Way.

Table B which follows, sets forth the Summaries of Earnings originally espoused by each of the parties.

TABLE B
CAL-WATER SERVICE COMPANY - STOCKTON DISTRICT
COMPARISON - APPLICANT AND STAFF - SUMMARY OF EARNINGS

	<u>Test Year 1981</u>		<u>Test Year 1982</u>	
	<u>Applicant</u>	<u>Staff</u>	<u>Applicant</u>	<u>Staff</u>
	(Dollars in Thousands)			
<u>Present Rates</u>				
Operating Revenues	\$ 8,543.3	\$ 8,548.6	\$ 8,603.3	\$ 8,595.8
Operating Expenses				
Purchased Power	270.1	235.7	280.0	243.8
Purchased Water	3,149.7	3,149.7	3,152.4	3,152.4
Groundwater Charges	10.1	8.8	10.5	9.1
Purchased Chemicals	11.5	10.0	12.0	10.4
Payroll - District	864.1	864.1	937.5	937.5
Other O&M	347.4	347.4	366.1	366.1
Other A&G & Misc.	57.8	57.8	59.5	59.5
Ad Valorem Taxes - District	195.0	193.5	200.3	197.5
Payroll Taxes - District	63.6	63.6	68.8	68.8
Depreciation	517.1	513.4	535.9	530.6
Ad Valorem Taxes - G.O.	3.3	3.3	3.3	3.3
Payroll Taxes - G.O.	15.1	15.1	16.3	16.3
Other Prorates - G.O.	590.4	582.6	639.3	630.4
Bal. Acct. - Adj.	195.7	-	197.5	-
Subtotal	<u>6,290.9</u>	<u>6,045.0</u>	<u>6,479.4</u>	<u>6,225.7</u>
Uncollectibles	24.9	25.0	25.1	25.1
Local Franchise Tax & Bus. Lic.	41.7	41.5	41.9	41.7
Income Taxes Before ITC	572.3	751.3	484.5	668.2
Investment Tax Credit	(79.8)	(71.9)	(96.4)	(85.7)
Total Opr. Expenses	<u>6,850.0</u>	<u>6,790.9</u>	<u>6,934.5</u>	<u>6,875.0</u>
Net Operating Revenues	<u>1,693.3</u>	<u>1,757.7</u>	<u>1,668.8</u>	<u>1,720.8</u>
Rate Base	17,748.2	17,437.6	18,224.1	17,829.0
Rate of Return	9.54%	10.08%	9.16%	9.65%

(Red Figure)

TABLE B - Contd.

CAL-WATER SERVICE COMPANY - STOCKTON DISTRICT
COMPARISON - APPLICANT AND STAFF - SUMMARY OF EARNINGS

	<u>Test Year 1981</u>		<u>Test Year 1982</u>	
	<u>Applicant</u>	<u>Staff</u>	<u>Applicant</u>	<u>Staff</u>
	(Dollars in Thousands)			
<u>Proposed Rates</u>				
Operating Revenues	\$ 9,243.1	\$ 9,243.7	\$ 9,503.7	\$ 9,490.2
Operating Expenses				
Subtotal	6,290.9	6,045.0	6,479.4	6,225.7
Uncollectibles	27.0	27.0	27.8	27.7
Local Franchise				
Tax & Bus. Lic.	45.0	44.9	46.3	46.1
Income Taxes Before				
ITC	927.7	1,104.3	941.8	1,122.4
Investment Tax Credit	(79.8)	(71.9)	(96.4)	(85.7)
Total Opr. Expenses	<u>7,210.8</u>	<u>7,149.3</u>	<u>7,398.9</u>	<u>7,336.2</u>
Net Operating Revenues	<u>2,032.3</u>	<u>2,094.4</u>	<u>2,104.8</u>	<u>2,154.0</u>
Rate Base	17,748.2	17,437.6	18,224.1	17,829.0
Rate of Return	11.45%	12.01%	11.55%	12.08%

(Red Figure)

In reviewing the estimates making up these Summaries, the adjustments proposed by staff and adopted by applicant, and in resolving the remaining issues between applicant and staff, we will consider each component to the Summary in turn.

Estimates of Operating Revenues

The parties differed in estimating Operating Revenues for the test years. The most significant factors contributing to these disagreements were divergent underlying estimates of both the number of customers to be expected in the Commercial class, and the anticipated water consumption for all classes.

Except for the Commercial class staff accepted applicant's estimates of the average number of services, class by class, for each test year. But while both parties used the same forecasting method to determine the number of customers in the Commercial class, staff, doing its projection at a later time, had available and used an additional five months of later recorded data which indicated there would be more such customers than were indicated when applicant completed its earlier study.

In addition, after applicant's application was prepared, it was ascertained that the University of the Pacific had determined it would develop its own water system in 1981, cutting back its number of services from 10 to 2, and use applicant's water system only for supplemental fire protection and other emergency uses.

In the consumption side, staff forecasts higher consumption than did applicant for California Cannery and Growers, a large industrial account. However, the major area of disagreement here centers in the Public Authority class, where applicant forecasts average consumption per service of 2,957.6 Ccf in 1981 and 2,912.0 Ccf in 1982, while staff forecasts average consumption per service of 3,400 Ccf each test year. Applicant's estimates were obtained using a

least squares trending of recorded data for the period 1971 through 1979 except for use of a 2-year average figure for the housing authority (which applicant considers to be the most significant consumer in that class). Staff's estimate, on the other hand, was derived from an average of 10 years of recorded data (1970-1979), tempered by review of later acquired monthly consumption data through June 1980. The company argues that although recorded data showed consumption for the first 5 years of the 10-year period to be above staff's estimate, consumption for 4 of the last 5 years of the period was below staff's estimate, indicating a declining trend, and this should control. While we agree that applicant's depiction of the data is correct, we would further note that Public Authority consumption in each of the last 3 years (including or excluding the housing authority), while below staff's forecast for the test years, has been directly ascending (for example: 962.9 KCcf in 1977, 1,083.3 KCcf in 1978, and 1,173.5 KCcf in 1979)^{2/} From that we interpret the data as showing a cyclical trend, one about flat at this point, and supporting the staff's estimate. Accordingly, we adopt the staff's estimate of 3,400 Ccf per service for both test years.

At the hearing applicant adjusted its Operating Revenues projections modestly upward to reflect its adoption of the staff's projections of (1) slightly higher sales resulting from the additional Commercial metered customers anticipated, and (2) the higher level of sales to California Cannery and Growers. Applicant also adjusted its revenue estimates downward to reflect the substantial decreases in revenue resulting from the loss beginning in 1981 of the University of the Pacific patronage. However, this latter loss will be more than offset by the substantial upward adjustment in

^{2/} A trend that appears to continue. Later data for each 12-month period ending in the month indicated show: March 1980 - 1,180.8 KCcf; April 1980 - 1,172.1 KCcf; May 1980 - 1,179.1 KCcf; June 1980 - 1,163.1 KCcf; and July 1980 - 1,164.6 KCcf.

revenues representing the anticipated higher level of Public Authority sales as forecast by the staff and adopted by this Commission.

The end result of these adjustments to Operating Revenues is set forth in Table E, our adopted Summary of Earnings.

Estimates of Operating Expenses

Operating Expenses are those costs which are incurred by a utility in providing service to its customers. They include not only the operation and maintenance costs, administrative and general expenses, depreciation charges, and taxes paid by the district, but also a pro rata share of these same expenses which were incurred by the corporate facilities of the utility in support of the district. In the instant proceeding staff analyzed applicant's estimates of these expenses for both the corporate general office facilities and the district.

With minor exceptions and adjustments resulting in net lower prorations of \$7,800 in 1981 and \$8,900 in 1982, staff found applicant's general office estimates reasonable. Staff also verified that the Stockton District's share was properly allocated to the district in accordance with standard four-factor proration procedures accepted by this Commission. Applicant agreed to the staff-proposed adjustments and made appropriate adjustment to its Operating Expense forecasts at the hearing.

Turning next to the detailed operation and maintenance expense estimates submitted by applicant, we note that staff has analyzed these and finds them reasonable with certain exceptions, which derive primarily out of differing estimates on water consumption and differing assumptions as to the source of that water. The costs for purchased power, groundwater extraction charges, and purchased chemicals will vary depending upon the quantity of water to be

obtained out of the company wells. In its application the utility estimated that in 1981, for example, 13,701.6 KCcf of water overall would be required. Of this it planned to obtain 10,454.6 KCcf (or 22,000 acre-feet) from Stockton East Water District while pumping 3,247.2 KCcf from company wells. To pump and boost this quantity from the wells would require an estimated total power consumption of 3,488,673 kWh. At PG&E's rate prevailing February 18, 1980 of \$0.07741 per kWh, this would cost \$270,100 in 1981. The corresponding cost for 1982 would be \$280,000. On the other hand, staff's estimate was that 13,724.3 KCcf overall of water would be required in 1981, 22.7 KCcf more than applicant estimated. But staff would rely upon Stockton East Water District to furnish 10,889.9 KCcf (or 25,000 acre-feet) of that water, with only 2,834.4 KCcf to be obtained from the company wells.^{3/} This lower pumped water estimate is reflected in staff's lower estimates for purchased power, groundwater extraction

^{3/} During the hearing the ALJ took official notice of the contents of Decision No. 89528 dated October 17, 1978 in Application No. 57328. Therein the subject of water imports from the Stockton East Water District is discussed in some detail, and it was estimated that Stockton East Water District had the potential to deliver 27,000 acre-feet per year to applicant, but that it would require a few years for it to coordinate operations to permit optimum use of the treatment plant. That this shake-down phase has been accomplished appears evident, for, significantly, in 1979 the utility obtained 8,002 million gallons of water from the district, somewhat more than 25,000 acre-feet. Therefore, the ALJ concluded, and we agree, that staff's estimate of 25,000 acre-feet to be delivered each year in 1980, 1981, and 1982 is realistic.

charges, and purchased chemicals. Staff's estimate of the total power consumption to be required was 3,045,100 kWh, which at the February 1980 PG&E rate would cost \$235,700 in 1981. The corresponding cost for 1982 would be \$243,800.

At the hearing applicant accepted staff's assumption that Stockton East Water District could be expected to provide 25,000 acre-feet in both 1981 and 1982, and made commensurate downward adjustments in its estimates of purchased power, groundwater extraction, and purchased chemical costs attributable to that source shift.

But at the hearing applicant also accepted staff's adjustments relating to the additional consumption estimated for the Commercial class and California Cannery and Growers. And it adjusted for the loss of most of the University of the Pacific patronage. At the same time we adopted staff's estimate over applicant's lower estimate for Public Authority consumption. These adjustments, resulting as they do in a requirement for more pumped water from the company wells, concomitantly result in their turn in higher purchased power, groundwater extraction, and purchased chemical costs.

At the hearing staff also adjusted its purchased power estimates to cover the cost of the April 29, 1980 PG&E power increase from \$0.07741 per kWh to \$0.09080 per kWh. These adjustments added \$40,800 to staff's original purchased power estimates for 1981, and \$42,200 to staff's 1982 estimates.

The staff estimated Depreciation costs slightly less than those estimated by the utility in its original application. Both parties used essentially the same methodology, and the different results were primarily derived from differing estimates of plant additions. As is discussed elsewhere under Rate Base, applicant accepted staff's proposals on a number of proposed items. These

included making budget year exchange on three main projects, as well as deletions to nonspecific budget funds proposed for new well sites and reductions in budgeted funds for minor structures. On the other hand, not having adopted staff's proposals pertaining to the Station 79 Well or the Airport Way water main replacement, we cannot include that portion of the proposed depreciation expense reduction derived from those rejected proposals. Finally, we adopted staff's weighting percentage used to calculate the amount of net additions to be included in plant. Although both parties used the same 5-year average, staff excluded one abnormally high year figure.

Staff analysis of applicant's administrative and general expense for both 1981 and 1982 developed no issues. The staff concluded they were reasonable. Applicant withdrew its proposed Balancing Account adjustment.

No issues were developed in the staff's analysis of applicant's estimates of ad valorem and payroll taxes. Differing estimates of Uncollectibles, Local Franchise, and Income Taxes arise out of differing estimates of Operating Revenues derived from the various customer classes, as discussed above, rather than out of differing methodology or philosophy. Applicant's and staff's ad valorem tax estimates are both based on the 1979-80 full cash value shown on the utility's property tax bill. The recorded composite rate, 1.051 percent of the full market value, was used. The increased 9.6 percent state corporate franchise tax rate was used for both test years. Both parties used the full flow-through method of computing the depreciation deduction in calculating both federal and state income taxes. The investment tax credit was determined by using a 3-year average at a 10 percent rate for the test years. The net-to-gross multiplier estimated by staff was 2.0646.

Having earlier adopted staff's estimates of higher Operating Revenues to be derived from higher consumption than applicant estimated, we are now constrained to here adopt staff's conjunctive adjusted estimates pertaining to Operating Expenses except for the Depreciation items noted above. The net results of these adjustments to Operating Expenses are set forth in Table E.

Rate Base

Applicant used weighted average balances to develop its depreciated rate base projections for the test years under consideration. It based these projections on recorded data for a preceding 5-year period and upon preliminary construction budgets adopted for anticipated plant additions in the test years which would be financed by the utility. It included in its projections allocated pro rata portions of the corporate general operation's plant, and also made adjustments to incorporate applicable weighted average depreciation reserves. After analysis of these projections, staff for the most part found them reasonable. But staff also developed and sponsored certain adjustments. Some of these were acceptable to applicant; others of more significance were not. We will consider the latter first.

In analyzing applicant's existing plant in service and proposed additions in the test years, staff proposes two major deletions. First, from the 1980 beginning-of-year balance for plant, staff would remove \$60,440 for a well station that has been in service three years. Second, staff would include under plant additions proposed for 1980, 1981, and 1982, only one-third of the \$480,000 projected total cost to replace a large main in Airport Way in Stockton.

Staff makes these proposals in reliance on statements to applicant that we included in Decision No. 89528 dated October 7, 1978 in Application No. 57328. In that decision we cautioned that in Stockton:

"Applicant will be expected to critically evaluate system improvements and postpone those which are not immediately necessary to maintain tolerable service and/or which will not produce immediate operating economies greater than the increase in capital costs which the construction would produce."

To accomplish these two rate base adjustments, staff asks that we expand application of a corrective procedure proposed to us by the staff several years ago and adopted in Decision No. 89321 dated September 6, 1978 in Application No. 56543 (Washington Water and Light Company). In that proceeding we applied this new procedure which we named the "Saturation Adjustment Procedure" (SAP) to remove from the utility's rate base certain grossly excess facilities, one a filter not even used in the utility operations, and in another instance, a plant and a main far overbuilt beyond any reasonable requirement for domestic service and fire flow.^{4/}

But SAP is not a procedure we intended to be applicable in every instance where a facility has been constructed with immediate excess capacity. It is a procedure intended to be applied with great discretion to relieve rate base in situations where a utility has imprudently or injudiciously overbuilt a facility without a rational consideration of future requirements, with the result that in addition

^{4/} The filter, a diatomaceous filter, had not worked for four years. The Southport treatment plant and a 16-inch water main had been installed specifically to serve a 5,000-unit condominium project which had folded, leaving a grossly oversized pair of facilities to serve between 100 and 150 units with little prospect of additional use either now or in the future. In addition, the main had been designed beyond even the contemplated fire flow and consumption needs. These are clearly different circumstances, as will be discussed, from those applicable to the instant facilities.

to dubious prospects of full utilization in the near future there is a strong probability it will never be used to capacity.

The procedure was intended to promote prudent and judicious investment of construction funds that ultimately must be paid for by the ratepayer. It was never intended to limit construction to immediate short-term improvements. Such a limitation would only force the utility to choose between incorporating capacity for the future and not earning on a portion of its investment, or building only short-term requirements, thereby earning on its full investment all the time. The latter would mean a parade of almost continuous retirements and replacements as service needs expanded at far greater end cost to the ratepayer. A utility should not be penalized for construction of facilities which are prudently and judiciously sized to meet both present and rationally determined reasonable future needs.

Against this backdrop we turn to discussion of the two staff proposals:

Station 79 Well: The area northeast of urban Stockton (that quadrant of land lying east of Highway 99, northeast of the Stockton Diverting Canal, and bisected by Waterloo Road), although being a natural channel for the flow of future urban growth, in 1976 was but sparsely developed. Apart from the Stockton Inn (which had and still has its own independent water supply), there were about a half-dozen commercial and industrial structures in the area, mostly warehouses and service stations. The area was then served from the western approaches by applicant's mile-long 12-inch main which reached the area after dipping under the diverting canal. The theoretical capacity of this main (a mile west) was 1,700 gpm at 20 psi residual pressure. There were no alternate supply sources locally available.

At that time Anheuser-Busch was constructing a large distribution warehouse a mile down Waterloo Road and wanted utility service requiring a water flow of 2,000 gpm to meet fire-flow requirements of General Order No. 103. Accordingly Anheuser-Busch joined with land developers in the area to form the Waterloo Assessment District to bring in supplemental water. After analysis, applicant determined that rather than try to loop the existing system, attaching it at another point in the existing distribution system (which would not have added to the quantity of water available), or to enlarge the main already there (which would have involved the expensive crossing of the 250-foot wide diverting canal), it would be best to construct a new well in the area. Applicant considered this Waterloo extension would lead into a relatively new service area, somewhat remote from existing sources, and that it therefore was a prime example of an area which had to produce its own water supply from local groundwater. As constructed and operated, it not only supplies the Waterloo area but also exports water westward into the Stockton system as needed. And the area now has met the fire-flow requirements of General Order No. 103.

The staff's witness asserted that while it was a consideration, the fire-flow requirements of the General Order could not justify the well and that possibly additional water could have been obtained from Stockton East Water District to make up the fire flow. But this ignores the fact that Stockton East Water District's transmission line at its nearest point is about a mile away and that the District's water entry point into applicant's system is several miles to the west and has no effect on flows near Station 79 Well.

Staff also implied that Stockton Inn's water supply could have been used to augment applicant's then existing water supplies

to make up a 2,000 gpm flow to meet the requirements of General Order No. 103. But it produced no evidence that the private well Stockton Inn source had either the capacity or capability of producing sufficient water to make up the deficit. Nor did it explain how the Stockton Inn water would be gotten into applicant's system if and when needed. Significantly, however, Stockton Inn at the time did not consider it economically worth it and did not wish to extend to integrate into applicant's public utility system.^{5/}

Completed in 1977 and in service since, Station 79 Well cost \$120,000 to construct. Staff's argument is that since it serves at present only half or fewer of the customers it is designed to serve, only half the initial \$120,000 cost should now be allowed into rate base. The company points out the fallacy of this contention by noting that had it indeed sized the pump and electric facilities to deliver half the water, the cost would have been only about \$8,500 less at the time (since cost for the well hole, piping, building, driveway, landscaping, and site improvement costs would essentially have been the same). But then to retire the smaller pump and electric features and replace them with larger equipment when demand increased, as it must, would involve expenditure of approximately \$30,000 additional - in 1976 dollars.

After consideration of all the evidence we find that applicant in 1976 acted prudently and judiciously in constructing Station 79 Well when, where, and how it did, and that it would now be inequitable to apply SAP to this facility. Section 451 of the Public Utilities Code requires a public utility to furnish and maintain such adequate service as is necessary to promote the safety, health, comfort, and convenience of the public. Fire-flow requirements were established to set "minimum standards" to be observed in the design,

^{5/} Recently, experiencing maintenance problems with its private well system, Stockton Inn has initiated discussions with applicant relating to possibly joining applicant's system.

construction, and operation of water facilities. Additional water and an additional independent supply were clearly required under the provisions of the General Order. The well site was acquired under conditions advantageous to applicant from the area developers. To now apply a corrective measure retroactively when applicant at the time acted in full accord with the law and orders of this Commission would be wrong. Applicant adopted the option best suited to the circumstances and long-range interests of the ratepayers. To merely loop the system would have set up alternate sources but would have added no water volume. Similarly, to have enlarged the existing 12-inch main would mean replacing existing main from its source head a mile distant to the west as well as digging or boring a costly crossing under the 250-foot wide Stockton Diverting Canal. The nearest point from which Stockton East Water District's water could have been made available was a mile away. Applicant properly decided to draw upon abundant groundwater from the immediate area to be served, providing thereby an immediate source to handle existing and prospective development east of the canal along Waterloo Road. The latter area is a natural corridor for future light industrial and commercial development, being served by one of the few road bridges over the substantial barrier of the diverting canal. Adding pump capacity to handle another half-dozen large commercial or industrial customers in a warehouse development area with substantial potential at that time in 1976 cannot be said to be imprudent. Certainly growth in the area will resume as the depressed economic conditions of the past several years will again change. Station 79 Well is not a situation to which SAP should be applied.

Airport Way Replacement Main: The existing 12-inch steel water main under Airport Way, extending south from Charter Lane

toward the Stockton Municipal Airport, was constructed under special circumstances in 1940 at the behest of the U.S. Army to serve the airport. The construction process used proved unsatisfactory and subsequently it became necessary to add clamps to each joint for the entire length of the pipeline to stop leaks. The normal rated life of a steel pipe is 20 to 25 years. This pipe is now 40 years old. Although there were no leaks recently, records show that between 1973 and 1978, 17 leaks needed repairing.

In 1977 applicant had planned to replace the first 2,100 feet of the deteriorated line as part of a replacement program. These plans were deferred as a consequence of poor economic conditions in Stockton which led to this Commission's determination (see Finding 7 in Decision No. 89528 dated October 17, 1978 in Application No. 57328) that replacement was not necessary in order to maintain the merely tolerable levels of service that Stockton's customers were willing to accept and pay for.

However, since 1976 the situation has changed. The Stockton Chamber of Commerce, seeking new industry to alleviate high unemployment in Stockton, successfully attracted a new industry, Corn Products Company (Corn Products), to locate its large new \$60 million chemical plant in the southern Airport Way area.^{6/} The capacity of the existing

^{6/} During the last rate proceeding pertaining to this district, Decision No. 89528, supra, applicant had no knowledge of the negotiations between Corn Products and the Chamber of Commerce, etc. The negotiations resulted in a decision beneficial to Stockton's sagging economy, representing as it does a construction period payroll exceeding 200 persons, and a new permanent payroll for the area of 100 people.

12-inch main is 3,300 gpm.^{7/} Corn Products wanted an assured 700 to 800 gpm consumptive flow superimposed on a fire flow of 3,000 gpm. Although there is evidence that immediate demand in 1981 would be somewhat less than 700 gpm consumptive flow,^{8/} the total requirement in any case will be beyond the capacity of the existing main. While the existing main is looped to the west of Airport Way to a 12-inch main coming east in or near Industrial Drive (in turn connected to a 16-inch main coming south on McKinley), the mere fact of looping does not add to the flow available, it only makes for an alternate source for fire-flow protection. In addition, Corn Products anticipates that its consumption requirements should increase by about 50 percent over approximately the next 5-year period. The chemical company was also concerned over potential plant damage from any unexpected shutdown of water supply or prolonged curtailment (as in the event of a major leak in the main).

^{7/} As part of the previous water supply transported, the present 12-inch main, looped as it was, already carried all the water produced from nearby Well Station 8. Originally a booster station built when the extension was made to the airport for the army in 1940, this well was constructed about 10-15 years ago when the water was needed to provide a fire protection function for the Mohawk Rubber Company installation in the area. Its capacity is 400 gpm.

^{8/} At the hearing staff introduced a copy of an applicant's inter-office memo which tended to show that in providing preliminary estimate data on anticipated consumer consumption, applicant's field personnel had estimated Corn Products' 1981 consumption would be 300 KCcf. This works down to an average day-in, day-out consumption demand of about 450 gpm. But applicant's vice president chief engineer had testified that 700 gpm had been demanded. He explained the difference by stating that he had to allow for consumption peaking in designing capacity, not average loads.

While the Corn Products' development alone would require replacement of the existing main, there is a further development. Santa Fe Railroad's land development division is sponsoring a 500-acre residential and commercial development also located on Airport Way.^{9/} This is in the environmental impact statement stage now, and applicant anticipates it will have the first service requests to some part of this development within the next several years.

Considering these developments, and with the Corn Products' plant scheduled for operation in March 1981, applicant proceeded with a three-year program of replacing the 8,300 feet of 12-inch steel main in Airport Way. In 1980 it was installing the first 2,550 feet, using 16-inch asbestos cement pipe. The 16-inch pipe has approximately twice the flow capacity of 12-inch pipe. Nonetheless, while the full capacity of the new 16-inch main will be adequate to meet Corn Products' anticipated requirements for some period of time, and also provide for the initial needs of the proposed Santa Fe development, a still additional water supply over and beyond the capacity of the 16-inch main will be needed to meet full build-out requirements for the Santa Fe project when that occurs.^{10/}

^{9/} There is also a possible further development of the balance of the Western Pacific's industrial area. The Corn Products' site there covers only part of this area, and its proximity to the airport makes it particularly attractive.

^{10/} In its comments in the environmental impact statement prepared for the Santa Fe development, applicant assertedly stated that it would require still additional water supplies and sources beyond the capacity of the 16-inch replacement main were there further development. It stated it planned to obtain these by acquiring new well sites in that development area as any development arose and progressed. However, there are extreme drops in the water level in that area when wells are operated during the summer season, and the water produced has quality problems, so it is planned to use that well water mostly to meet peaking problems as they develop.

In view of the foregoing evidence of the almost immediate requirement for increased capacity beyond the capability of the 12-inch main, we cannot apply SAP to the Airport Way replacement program as staff proposes. Staff acknowledges that the existing main is quite old and that there are "proposals" to begin new constructions in the area served by the old main. It does not show, however, how Corn Products' requirements could be met without a new main. This despite the unrebutted testimony that Corn Products' consumptive requirements, when taken in conjunction with required fire-flow requirements, alone will shortly exceed the 3,300 gpm supply, quite apart from the existing consumptive requirements of the residential area to the north of the Corn Products' plant, the Mohawk Rubber Company plant, the Johns-Manville transit pipe factory, and the motor generator plant in the area. Staff merely asserts that the 12-inch existing main was "not fully utilized", and that the new 16-inch main "would obviously not be fully utilized at this time". But the Corn Products' chemical plant is not merely a "tentative" projection; it is a reality now. Staff would allow only \$58,300, or 1/3 of the estimated \$175,000 annual cost in both 1980 and 1981, and \$43,300, or 1/3 of the estimated \$130,000 cost in 1982, to replace the 12-inch main with the 16-inch main. (This even ignores the plain fact that had 2,550 feet of 12-inch pipe been installed instead of 2,550 feet of the 16-inch pipe actually installed, the 1980 cost would have been \$112,000, not \$58,300!)

Staff states that as water demands upon the new 16-inch main grow it would be perfectly willing to allow the percentage of the main fully utilized to be then included in future rate base. It does not suggest that it would have been acceptable were applicant successively to have installed larger sized mains from 12- to 16-inch,

each to be replaced by a slightly larger sized one as demand grew, thereby enabling applicant to earn on its full investment at all times, despite the vastly larger cost to the consumers as replacement succeeded replacement. Staff does not contend that a 16-inch replacement was excessively sized; rather it asserts that no replacement should have been made at all at this time. We cannot agree. The advent of the Corn Products' plant on the scene made it impossible for applicant to merely make do with the existing 12-inch main. And in providing through a 16-inch replacement for not only the Corn Products' plant requirements for the next five years, but also for the initial requirements of the probable Santa Fe development and possible further Western Pacific development, applicant acted prudently and judiciously. We will approve applicant's additions proposed to plant for this replacement project for the three years as proposed.

Other Proposed Adjustments: Next, we turn to staff-sponsored adjustments to applicant's estimates for the component accounts which go to make up the rate base calculations. These adjustments are those to which applicant, at the hearing, agreed to accept. First, we will examine the elements making up Weighted Average Plant in Service.

In its analysis staff noted that two of the Utility-Financed Additions scheduled for 1980, water main projects estimated respectively to cost \$29,270 and \$13,901, had been delayed to 1981. Accordingly, staff proposed to transfer both to the 1981 test year estimates. Conversely, a \$5,800 water main project scheduled for 1981 was completed in 1980. Staff would transfer the cost of that utility-financed addition to the 1980 accounts. Concerned with the order to minimize capital growth in the Stockton District, staff also proposed to delete from the 1980, 1981, and 1982 estimates, the amounts of \$5,000, \$4,800, and \$5,300, respectively. These were proposed by

applicant to make nonspecific land acquisitions. In addition, staff would reduce the Structures account to a maximum of \$1,000 for each test year.

In examining applicant's proposed Advances for Construction accounts, staff determined that at year-end 1979, \$137,700 of the \$390,300 in advances deposited that year with applicant had not yet been spent. Staff then checked back five years to find that over that time span approximately one-quarter of each year's deposits (for an average of \$26,400) remained unspent at year end. In effect this \$26,400 was a "bow wave" pushed forward each year to the next year's budget. Applicant had anticipated and forecast only \$11,900 as its "bow wave". Staff accordingly proposed we adopt \$26,400 each year.

Staff also proposed a higher estimate for new deposits than the \$95,800, \$99,400, and \$103,000 applicant estimated, respectively, for 1980, 1981, and 1982. Noting wide fluctuations in recorded data for past years, and wishing to avoid what it felt would be distortions if the least squares methodology were applied (as applicant had done), staff used a simple 5-year average to arrive at an estimate of \$104,600 to be applicable each test year for new deposits.

Staff accepted as reasonable the remaining other components constituting the estimates prepared by applicant to make up the Weighted Average Plant in Service.

Proceeding on with examination of the components which led to the differing rate base determinations arrived at by applicant and staff, we pass from the Utility Plant in Service to the following.

Under Working Capital, applicant and staff agree on estimates for Materials and Supplies, and Minimum Bank Cash Deposits, but differ on Working Cash allowances. In estimating the latter applicant used

the "lead-lag" method, but staff used its own figures for revenue, expenses, and rate of return. The paucity of evidence introduced on the differing estimates makes analysis difficult. However, applicant agreed to accept staff's estimates and we see no reason to disagree. Staff's estimates increase applicant's estimates by \$11,800 for 1981 and \$12,500 for 1982.

In determining Adjustments to Utility Plant, applicant and staff agree on Contributions in Aid of Construction, Reserves for Amortization of Intangibles, and General Office Allocated Rate Base, but differ on Customers' Advances for Construction. As noted earlier, staff estimated higher advances in each test year than did applicant. Again, applicant accepted these higher estimates and we have no reason to conclude otherwise. Accordingly, applicant's estimates of Advances for 1981 and 1982, respectively, will be increased by \$12,800 and \$16,300.

Finally, in computing estimated Depreciation Reserves, there were minimal differences between the determinations arrived at by the parties. Both used 1980 depreciation accrual rates and both used a weighting percentage of 53.9 percent in their calculations. Their differences derived out of differing underlying estimates for additional plant advances, and contributions. In that applicant at the hearing accepted staff's determinations and we earlier had adopted staff's higher advance estimates, we must also here adopt staff's higher determinations.

After the foregoing review we have found the above-described staff-sponsored adjustments to the test year Rate Base components, apart from the rejected SAP adjustments pertaining to Station 79 well and the Airport Way replacement main, to be reasonable and proper, and we will adopt them. Accordingly, applicant's estimated Rate Base figures for test years 1981 and 1982 are adjusted downward by \$80,200 to \$17,668,000, and by \$66,000 to \$18,158,100, respectively, as set forth in Table E.

Rate of Return

Historically, rates of return actually realized by this utility have consistently fallen short of the rates of return authorized by this Commission. The cause for this shortfall in recent years has been attributable to operational and financial attrition. Operational attrition, generally the largest source of any overall decline in earnings, is the deterioration experienced in a utility's realized rate of return on rate base between test periods. It is caused by reduced sales and revenues, increased expenses, and increases in rate base. Financial attrition is the deterioration in the return to common equity holders due to an increase in a utility's weighted cost of long-term debt and preferred stock. It can occur even when the rate of return on rate base remains constant. It is caused by

the issuance of new debt or the retirement of senior securities, and is also affected by change in the utility's capital structure.

Until 1979, financial attrition was primarily the concern of management. Extended period rates were designed and authorized by the Commission with the intent of dealing mostly with operational attrition. Step or averaged rates were uniformly designed to maintain a level rate of return on all investments, leaving utility shareholders to absorb the results of the increasing cost of embedded debt between test periods. Financial attrition between test periods was treated as part of the risk inherent in a regulated enterprise. However, in the last several years the relentless depredations of inflation have served to accelerate the upward movement in the cost of money, and financial attrition has assumed proportions which no longer can be left solely to the shareholders.

By Decision No. 90425 dated June 19, 1979 in Application No. 58093 (a decision involving 6 other districts of this utility), this Commission recognized the need to provide for predictable financial attrition. Departing from past practice, we adopted an innovative approach proposed by the staff, which, while holding a constant rate of return on equity, lets the return on rate base vary (in the instance of Cal-Water, total capitalization is the substantial equivalent of rate base). We also announced our intention of extending this approach to all of Cal-Water's other districts in future proceedings. The most recent such application was in Decision No. 91537 dated April 2, 1980 in Application No. 58781 (involving 5 additional districts of applicant). In this latter decision we made reference to our extensive discussion of the financial attrition problem in our preceding decision on this utility, and then, with minor modification, we proceeded with the new approach. In that latter decision we

determined that a constant 13.2 percent rate of return on common equity would be reasonable, and that it would result in a return on total capitalization of 10.28 percent in 1980, 10.46 percent in 1981, and 10.58 percent in 1982. Accordingly, increased revenues and rates to produce these revenues were authorized.

Having obtained rate relief in the above-mentioned decisions applicable to other districts, on April 1980 Cal-Water filed Notices of Intent for increased rates to be applicable in 6 additional districts, including the district at issue herein. In these filings, consistent with its past practice, the company used its most recently known interest rate on financing,^{11/} and projected its future indicated financing costs against the then known financial market. Over the period 1981-1983 the utility estimates that financial requirements will be \$67.6 million. It planned to generate \$24.6 million of this internally (\$9.2 million through retained earnings,^{12/} and \$15.4 million through depreciation provisions). The remaining \$43 million must be raised in the money market: \$7 million in 1981; \$5 million in 1982; and \$31 million in 1983.^{13/} It is applicant's intention, after discussions with its financial advisors, to finance this \$43 million through issuance of long-term debt. While preparing the Notices of Intent and subsequent applications early in 1980 it anticipated obtaining this financing at a cost of 12 percent.

^{11/} 10.14 percent was the effective interest rate of Cal-Water's Series X bonds, then its most current commitment.

^{12/} Based upon the assumption that it will be able to produce an average dividend payout ratio at 62-1/2 percent each year, a level that approximates recent company experience.

^{13/} Included in the \$31 million is \$25 million in Series T 8-3/4 percent bonds maturing November 1, 1983 which must be rolled over.

However, over the short span of months between starting work on the filings and the act of filing, the money market had drastically deteriorated, and by the time of our fall hearing matters were worse. Inflation rates had surged for several months as the economic outlook worsened. The now volatile bond markets fell into a state of disarray as the cost of money spurted higher, and the price of bonds fell. While on August 26, 1980 Cal-Water obtained a commitment on its planned 1980 issue of \$6 million of Series Y bonds for 13.1 percent; as October closed, new A-rated utility bonds were listed at 14.

The company's initial filing assumed that all financing during 1981-1983 would be achieved through issuance of 12 percent debt. At the hearing its vice president treasurer, while retaining the utility's request for a return on common equity of 15 percent, amended its position to project an increase in financing costs from 12 percent to 13.1 percent, using end-of-year amounts to determine costs, and reflecting the commitment cost of new debt for 1980 as represented by the Series Y bonds.

The staff's report (submitted at the hearing) had assumed issuance of preferred stock rather than debt for the 1981 external financing, and, using average capital costs (beginning and end of year rather than year-end costs), had assumed an effective interest rate of 12 percent on the 1980 bond financing, and a decline to 11 percent for the debt issues planned for 1982 and 1983. It also had assumed a fixed return on common equity of 13.2 percent, consonant with the return on common equity authorized in April, 1980 in Decision No. 91537. At the hearing the staff's rate of return and cost of capital witness, while amending the staff report to accept the 1980 financing of the Series Y bonds at the 13.1 percent cost, continued to assume an 11 percent financing cost for 1982 and 1983 financing.

Table C, which follows, is a comparison of applicant and staff positions on rate of return:

TABLE C
Rate Of Return Comparison

	<u>Applicant</u>			<u>Staff**</u>		
	<u>Capital Ratio</u>	<u>Cost Factor</u>	<u>Wgt'd. Cost</u>	<u>Capital Ratio</u>	<u>Cost Factor</u>	<u>Wgt'd. Cost</u>
1981						
Long-term debt	54.1%	9.32%	5.04%	50.0%	8.83%	4.42%
Preferred stock	4.3	6.50	.28	8.0	8.03	.64
Common stock	<u>41.6</u>	15.00	<u>6.24</u>	<u>42.0</u>	13.20	<u>5.54</u>
Total	100.0		11.56	100.0		10.60
1982						
Long-term debt	54.3	9.54	5.18	50.0	8.97	4.49
Preferred stock	4.0	6.46	.26	8.0	8.79	.70
Common stock	<u>41.7</u>	15.00	<u>6.26</u>	<u>42.0</u>	13.20	<u>5.54</u>
Total	100.0		11.70	100.0		10.73
1983						
Long-term debt	54.7	10.86	5.94	50.0	9.39	4.70
Preferred stock	3.7	6.42	.24	8.0	8.79	.70
Common stock	<u>41.6</u>	15.00	<u>6.24</u>	<u>42.0</u>	13.20	<u>5.54</u>
Total	100.0		12.42	100.0		10.94

*Staff assumed constant capitalization rates throughout the 3-year test period to allow step rates for financial attrition, based on an average for the 3 years.

The principal difference between applicant and the staff is the level of return to be allowed on common equity. However, there are also two subordinate issues which preliminarily we must address: first, whether preferred stock rather than debt financing should be imputed for the planned 1981 financing; and second, the projected cost of financing new capital in the test years.

Preferred Stock or Debt Financing: As was noted previously, applicant is faced over the next several years with the necessity of obtaining substantial external financing. Its ability to sell its bonds at competitive interest rates will depend to a substantial degree upon whether it will be able to retain the A-rating presently assigned it by the rating agencies.

One of the important yardsticks^{14/} commonly used by these agencies to determine the rating to be assigned a company is the ratio of interest coverage a company is able to maintain. Interest coverage is measured both before and after provision for taxes. Rating agencies use the pre-tax interest coverage figure. Applicant's financial witness testified that Standard and Poor's looks for before-tax coverage of 2 1/2 to 3 times before assigning an A-rating. Over the 1974 to 1979 period applicant's pre-tax coverage declined from 3.4 times to 2.63 times. For the most recent 12-month period, ending July 31, 1980, it was 2.46 times (this converts to 2.06 times after taxes. Hereafter, for ease of calculation, we will refer to after-tax coverage). Averaged over 1975-1979 post-tax coverage was 2.11 times.

^{14/} Other factors affecting bond ratings include management, financial history, service areas, future capital requirements, the utility's ability to secure prompt offset relief for increases in specific expenses and ability to obtain prompt general rate relief regularly.

Comparable period averages reported by staff for Class A California water utilities and regional water utilities were 2.61 and 2.22, respectively.^{15/}

Assuming that: (1) as planned, applicant relies on debt financing through the test period for all financing; (2) as anticipated, it must pay 13.1 percent for such debt financing; and (3) it were to be authorized the 15 percent rate of return on equity it asks; post-tax coverage is estimated at 2.29, 2.36, and 2.09, respectively, for 1981, 1982, and 1983.

On the other hand, staff observes that interest coverage can be improved in the short term other than by raising the return on common equity as applicant asks. Staff is concerned lest the Commission be put into a position where, in order to maintain Cal-Water's interest coverage to protect the utility's bond rating, it might have to authorize rates of return on common equity higher than those granted other water utilities. Staff argues that Cal-Water could revise its current external financing plans and substitute preferred stock for the \$7 million debt issue planned for 1981. According to the staff such a substitution would improve after the coverage from 2.29 to 2.40 times without any need to increase the return on common equity above the 13.2 percent authorized in Decision No. 91537, our most recent decision on Cal-Water. Staff is aware that the company disagrees strongly and while it does not ask that the utility be required to make the substitution, for ratemaking

^{15/} However, all the utilities compared are substantially smaller than Cal-Water. Of the California utilities, only 2 compare; of the regional utilities, only 4 compare. Five-year averages are:

Southern California Water Co.	2.23
San Jose Water Works	2.54
Hackensack Water Co.	2.01
Indianapolis Water Co.	2.55
Elizabethtown Water Co.	1.92

purposes only it does recommend that we impute issuance of preferred stock for the \$7 million involved in the 1981 external financing.

The company strongly disagrees. With some justification it contends that it would be grossly unfair to its stockholders for the Commission to constrain it to change its financing in mid-course. It points out that in the first two decisions in this trilogy round of Cal-Water general rate cases, we did not require or impute use of preferred stock over debt for the forthcoming 1981 financing although the financing requirements were then known. Rates of return were set predicated on use of debt financing and the company is locked in until the next general rate round. It argues that a 1981 \$7 million issue of preferred stock would carry a \$910,000 annual dividend requirement and that unlike its planned debt financing, this would result in no tax deduction since preferred dividends are not tax deductible as is bond interest. It points out that until such a dividend requirement could be built into the rate structure of all its 20 districts, common shareholders would have to carry the loss.

In turn this added drain would serve to sharply reduce the level of earnings now counted upon as a source for reinvestment to help meet forthcoming financing, thereby merely adding to the total external financing the company would have to seek.^{16/}

The staff accepts that under its approach the bond tax deduction would be lost, but argues that ratepayers would fare substantially better if preferred stock is issued rather than debt. It estimates that the difference in gross costs between the 15 percent

^{16/} The company depends upon the common shareholder reinvesting 37 1/2 percent of earnings in excess of dividends. But cash dividends now paid shareholders provide only an approximate 9 1/2 percent return (based on the current \$3.30 per share dividend on a market price of about \$34.50 per share). To add a dividend requirement on preferred stock would reduce earnings, further depressing market value of the company's stock, already selling at a 23 percent discount of book value.

return requested by the company and the 13.2 percent return recommended by the staff would be about \$814,000, assuming we were to authorize the full increase requested. The company's response is that this is an oversimplification and ignores other factors. It goes on to point out that the terms would be set by certain institutional investors (who comprise the best market for such a small preferred offering as would be involved) and would include a requirement for a sinking fund. This would result in a much shorter term for the issue, making it not a true permanent equity, and one offering less protection to First Mortgage bondholders. This would make the combination of interest and preferred dividend coverage requirements of considerable interest to investors, and in this instance it appears that the combination, if financing is done through bonds or preferred stock at the same assumed interest or dividend rate, would result in no difference.

The utility also disputes staff's assertion that over the near term Cal-Water cannot continue to issue long-term debt without severely straining interest coverage. It argues that its present high common equity ratio permits further reliance on issuance of long-term debt; that even at the end of 1983, under its planned financing, its long-term debt ratio would be only 54.7 percent. It presented testimony to the point that this is acceptable to rating agencies and investors; a conclusion derived from discussions with Standard and Poor's and Dean Witter, Reynolds and Company. The former reportedly would find a 55 percent debt ratio reasonable for water utilities. The latter would be satisfied with a bond ratio between 55 to 60 percent of total capitalization. In a corroboration of its view, the company compares its 5-year average 41.77 percent common

equity ratio with the 35.78 percent 5-year average reported for regional water utilities.

On balance, after full consideration of the detailed and able presentations provided by both parties to this proceeding, we do not conclude that a sufficient case has been made to induce us to resort to the drastic device of imputation to impose upon the management of this utility for ratemaking purposes the constraints of a financial program which management does not support, a program which places an unfair burden upon its shareholders, an uncertain burden upon its customers, and does not solve the coverage problem. While we are well aware of our responsibilities under the provisions of Section 816 et seq. of the Public Utilities Code to assure that a reasonable, prudent, and sufficient basis of financial responsibility underpins a utility under our jurisdiction, generally we believe that so long as it is not unreasonable, imprudent, or insufficient, the determination of what is appropriate in the financial structurization of the utility is the primary responsibility of its management. Imputation carries with it a legal attribution of censure.^{17/} But this applicant has an excellent record of service

^{17/} As precedent to impute a capital structure staff relies on the recent Pacific Telephone rate case, Decision No. 90642 issued July 31, 1979 in Application No. 58223. In that case, among many other matters, Pacific was concerned that its debt issues had been downgraded by recognized rating agencies over the past several years; that its after-tax interest coverage had declined to where it was the lowest in the Bell system; and that its debt ratio had risen, resulting in its having the lowest common equity ratio in the Bell System. Nonetheless, the company currently was proposing several additional long-term debt issues. The staff proposed, and we adopted, imputation of a common stock issue for one of the long-term debt issues in this unusual circumstance.

and a reputation for responsible management behind it. Where, as here, the applicant proposes to proportion its total capitalization structure for the immediate future within parameters which on their face cannot be said to be unreasonable, imprudent, or insufficient, and which clearly have been shown not to be out of line with those maintained by comparable regional water utilities, we will not intervene, absent exigent circumstances not present here, to induce the utility by the drastic device of imputation to substitute staff's judgment for its own. Certainly interest coverage is important, not only to the company, but also to the ratepayers; but as the company itself recognizes, the ultimate responsibility to maintain its rating must rest with management. While we will review the return on equity to see that interest coverage remains adequate and that common shareholders are receiving an adequate return compared to the returns required by bondholders, we will not, merely to protect a bond rating, authorize rates of return disproportionate to those we would authorize to other comparable utilities under similar situations. Here we will not impute.

Cost of Financing New Capital 1981-1983: In Decision No. 91537 we adopted estimates of financing costs for debt issues projected for 1980, 1981, and 1982, applying our judgment to the best

17/ (Continued)

This imputation, when related to the recommended rate of return, served to produce an improved after-tax interest coverage, maintained the existing long-term debt ratio, and was in accord with Pacific's stated goal of decreasing its long-term debt ratio. In determining the return on equity which we would approve, we made this unusual imputation, noting that despite being aware of the staff's recommendation and its own statements of its financial structure goals, Pacific had still proceeded to privately place issues of both long-term debt and preferred stock.

information available late in 1979. At the time applicant had filed its application in that matter, it projected bond financing to be at 9 3/4 percent. But thereafter the bond market together with the general economy declined. It became readily apparent that 9 3/4 percent was unrealistic. Shortly after the company was able to obtain a commitment at 10.14 percent for its Series X bonds. The staff then updated its estimate to 10 percent.^{18/} We adopted 10 percent for all financing projected for 1980, 1981, and 1982, as well as for the final attrition allowance adopted in Decision No. 91537.

Unfortunately in the intervening months leading to the instant application, increasing inflation and mushrooming interest costs took a far greater turn than anticipated by the earlier projections. Long-term bond markets fell into a state of disarray and bond prices dropped as interest rates soared. Earlier this year, the best Cal-Water could apparently do was obtain a commitment for its fall 1980 \$6 million Series Y bonds at 13.1 percent, a 31 percent higher cost for 1980 financing than that projected in Decision No. 91537.

In the instant application, Cal-Water based its original request on the assumption that new financing for the 1980-1983 period could be completed at 12 percent; but after obtaining the 13.1 percent commitment on the Series Y bonds and a review of economic trends, it revised its request, and assumed financing costs for 1981-1983 at 13.1 percent. However, staff continues to project 1981-1983 costs at 11 percent, the staff financial witness testifying that this

^{18/} The staff's financial witness testified that its recommendation of the 10 percent cost of financing adopted for the three-year period in Decision No. 91537 was merely a coincidence; that it does not look at the last coupon rate obtained by a utility and thereupon extrapolate a forecast interest rate. In that instance, the staff insists it was purely a staff judgment to recommend 10 percent.

largely is in reliance upon econometric-based forecasts from Data Resources, Incorporated, a Lexington, Massachusetts, economic research firm.^{19/}

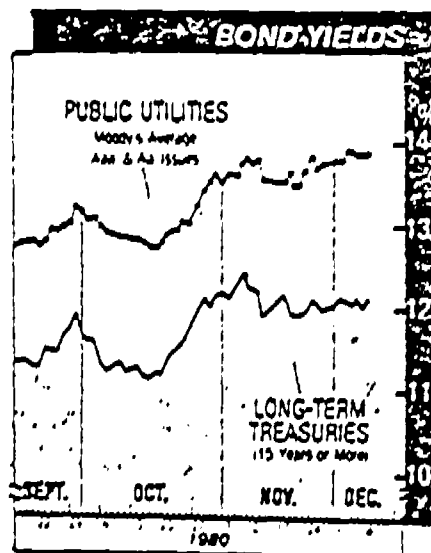
We fully appreciate the difficulties of projecting future interest costs in these times, but we are also aware that neither the company nor staff in their estimates for test years in rate cases since 1976 have adequately anticipated the degree of inflation and interest increases. Cal-Water's actual return on average common equity for the 12 months ending July 31, 1980 was 10.43 percent, a full 21 percent below the 13.2 percent return last authorized by

19/ Data Resources purportedly forecast interest rates for the period between 1980 and 1983 as ranging between 10 and 12 percent with a median forecast of 11 percent. Staff adopted this 11 percent. This is, however, an instance of economic reality overtaking economic projection in a period of rapid and unexpected deterioration of the bond market.

Otto Eckstein, Harvard economics professor and president of Data Resources, was quoted in the Wall Street Journal of October 29, 1980 as stating:

"You've got to realize that buying a bond is taking a gamble that the inflation rate will improve, and that isn't a gamble I would take."

The graph at the right, taken from the Wall Street Journal of December 9, 1980, depicts bond yields for the latter part of 1980.



this Commission in Decision No. 91537. Indeed, it was even lower than the 11.4 percent return found reasonable as far back as 1975. If we were to adopt staff's projection of future financing costs at 12 percent for 1980, and 11 percent for 1981 through 1983, and we approved the lesser amount recommended for financial attrition by the staff, the company would be unable to recover more than that amount even if interest rates continue above the 11 percent level, as they show every indication of doing for that period. We will adopt applicant's projection of financing costs at 13.1 percent for 1981-1983.

The Level of Rate of Return to be Authorized: With the preliminary issues disposed of, we return to a determination of the level of return on common equity which we should authorize. In this proceeding applicant and staff have supported their respective viewpoints with extensive presentations and testimony. The company seeks a 15 percent return on common equity. Authorization of this 15 percent would allow for an increase in the return on total capitalization from 10.43 percent as of July 31, 1980, to a return of 11.56 percent,

producing (after adjustment to reflect the fact that the 6 districts reflected in this application cover 44.8 percent of the total company rate base as of December 31, 1979) a total companywide return of 10.95 percent. On the other hand, the staff's 13.2 percent recommendation on common equity would allow only a 10.60 percent (adjusted to 10.52 percent companywide) return on rate base. The company argues that a 15 percent return on common equity would raise the combined interest and preferred dividend coverage to levels found reasonable in Decision No. 91537, whereas staff's recommended 13.2 percent would actually result in a slightly lower combined coverage. Applicant contends that the upward thrust in interest rates must result in some enhancement of earnings for common equity also. It points out that in Decision No. 91537 our 13.2 percent allowance on common equity provided approximately 320 basis points over the 10 percent cost of long-term debt at that time. Today the staff continues to recommend 13.2 percent, only 10 basis points over the 13.1 percent interest cost for long-term debt (the cost of Series Y bonds). The company notes that based on historical differences, a return on common allowance of at least 300 basis points over long-term interest rates would suggest a return on common allowance today in the 16 to 17 percent area. Nonetheless, the company asks for 15 percent, stating that it believes that level would provide a fair and reasonable return to the common shareholder vis-a-vis returns available in other forms of investment. Also, it notes, were it able to earn 15 percent on common stock, its common stock would sell close to book value (based on the average bid price in the third quarter of 1980, its shares are selling 23 percent below book value).

The determination of a fair rate of return necessarily is an imprecise art. It is aimed at attaining a viable balance between

the divergent interests of the utility's consumers and its investors. A fair rate of return depends upon the facts of the particular situation, and in the final reckoning, comes down to an application of informed judgment. Rates must be determined which protect the short-term interest of the consumer in obtaining the lowest possible charges, while assuring maintenance of good service over the long run. However, these same rates must also produce enough revenue to pay proper and reasonable operating expenses, maintain credit, attract capital, pay reasonable dividends, and provide reasonable additions to surplus. A reasonably economically healthy utility is essential. Risk capital undoubtedly will be required in the future, and risk capital is not only timid, but it is mobile. After consideration of all the evidence and arguments produced by the parties to this proceeding, we conclude that the company's proposed 15 percent return on equity would be too high, and that the staff's 13.2 percent would be too low. For these times and circumstances we have concluded that 13.7 percent return on common equity would be just and reasonable for this utility. As shown in Table D, a 13.7 percent return on common stock should produce an overall return on capitalization for 1981, 1982, and 1983, respectively, of 10.89 percent, 11.08 percent, and 11.50 percent, and commensurate after tax interest coverage of 2.21, 2.17, and 2.08.

TABLE D

Cal-Water Service Company - Adopted Rate of Return

<u>Component</u>	<u>Capitalization Ratio</u>	<u>Cost Factor</u>	<u>Wgt'd. Cost</u>	<u>After Tax Interest Coverage</u>
Average Year 1981				
Long-Term Debt	54.2%	9.07%	4.92%	2.21
Preferred Stock	4.2	6.50	.27	
Common Equity	<u>41.6</u>	13.70	<u>5.70</u>	
Total	100.0		10.89	
Average Year 1982				
Long-Term Debt	54.2	9.43	5.11	2.17
Preferred Stock	4.2	6.48	.27	
Common Equity	<u>41.6</u>	13.70	<u>5.70</u>	
Total	100.0		11.08	
Average Year 1983				
Long-Term Debt	54.2	10.20	5.53	2.08
Preferred Stock	4.2	6.44	.27	
Common Equity	<u>41.6</u>	13.70	<u>5.70</u>	
Total	100.0		11.50	

Assumptions:

- (1) To allow undistorted step rates and provide for financial attrition, we assumed a constant capitalization ratio for the 3-year period; computing it as the average of each year's average.
- (2) Average beginning and year-end capital costs were used.
- (3) Financing through long-term debt at 13.1% in the 1981-1983 period.
- (4) Return on common equity was held constant at 13.7%.

Authorized Revenue Increases

Table E, our adopted Summary of Earnings, follows. It reflects our resolution of the issues pertaining to operating revenues and expenses, including the impact of external financing through use of long-term debt at 13.1 percent, and sets forth operating revenues which would be provided at present rates and those which will be required to produce the 13.7 percent rate of return on common equity we are authorizing for the test years.

TABLE E
CAL-WATER SERVICE COMPANY - STOCKTON DISTRICT
ADOPTED SUMMARY OF EARNINGS

	<u>Test Year 1981</u>	<u>Test Year 1982</u>
	(Dollars in Thousands)	
<u>At Present Rates</u>		
Operating Revenues	\$ 8,548.6	\$ 8,595.8
Operating Expenses		
Purchased Power	276.5	286.0
Purchased Water	3,149.7	3,152.4
Groundwater Charges	8.8	9.1
Purchased Chemicals	10.0	10.4
Payroll - District	864.1	937.5
Other O&M	347.4	366.1
Other A&G & Misc.	57.8	59.5
Ad Valorem Taxes - District	194.8	199.9
Payroll Taxes - District	63.6	68.8
Depreciation	516.0	535.8
Ad Valorem Taxes - G.O.	3.3	3.3
Payroll Taxes - G.O.	15.1	16.3
Other Prorates - G.O.	582.6	630.4
Bal. Acct. - Adj.	-	-
Subtotal	<u>6,089.7</u>	<u>6,275.5</u>
Uncollectibles	25.0	25.1
Local Franchise Tax & Bus Lic.	41.6	41.9
Income Taxes Before ITC	682.0	581.2
Investment Tax Credit	(79.7)	(96.4)
Total Opr. Expenses	<u>6,758.6</u>	<u>6,827.3</u>
Net Operating Revenues	<u>1,790.0</u>	<u>1,768.5</u>
Rate Base	17,668.0	18,158.1
Rate of Return	10.13%	9.74%

(Red Figure)

TABLE E - Contd.
CAL-WATER SERVICE COMPANY - STOCKTON DISTRICT
ADOPTED SUMMARY OF EARNINGS

<u>At Rate Levels Adopted</u>	<u>Test Year 1981</u>	<u>Test Year 1982</u>
	(Dollars in Thousands)	
Operating Revenues	\$ 8,825.3	\$ 9,098.3
Operating Expenses		
Subtotal	6,089.7	6,275.5
Uncollectibles	25.8	25.6
Local Franchise Tax & Bus. Lic.	43.0	44.3
Income Taxes Before ITC	822.5	836.4
Investment Tax Credit	(79.7)	(96.4)
Total Opr. Expenses	<u>6,901.3</u>	<u>7,086.4</u>
Net Operating Revenues	<u>1,924.0</u>	<u>2,011.9</u>
Rate Base	17,668.0	18,158.1
Rate of Return	10.89%	11.08%

(Red Figure)

Contrasting the operating revenues set forth in Table E, it is apparent that the rates of return which we are authorizing will produce additional gross revenues of \$276,700 in 1981, an increase of 3.2 percent over the revenues which the existing rates would produce. In 1982 an additional \$227,400 will be produced, an increase of 2.6 percent. These authorized increases also provide for increased power costs derived from the April 29, 1980 PG&E increase. In conformity with our previously stated preference that districts of Class A water utilities not file general rate applications more frequently than once each three years, a third set of rates in the form of a step increase will be authorized for 1983 to allow for attrition, both operational and financial, after 1982. Following methodology used in our most recent decisions in similar applications (Decisions Nos. 92244 and 91537 in Cal-Water Livermore and Southern Cal-Water Metropolitan, respectively), the operations component, as indicated by the decline in the rate of return at present rates from 10.13 percent in 1981 to 9.74 percent in 1982 (see Table E) is 0.39 percent. The financial component is represented by the difference of 0.42 percentage points between the rates of return we adopted (see Table D) for 1982 and 1983, respectively, 11.08 percent and 11.50 percent. To offset this combined 0.81 percent (0.39 percent + 0.42 percent) operational and financial attrition we will authorize a 1983 step rate increase of \$303,700.^{20/}

On or after November 15 in the years 1981 and 1982, applicant will be authorized to file advice letters (with appropriate work papers) to justify implementation of the step rate increases herein postulated for each of these years. These supplemental filings will permit review of achieved rates of return before each step rate increase is authorized.

^{20/} Using the formula: Rate Base x Rate of Combined Attrition x Net-to-Gross Multiplier = Step Increase, we find:
\$18,158,100 x 0.81 percent x 2.0646 = \$303,700

Table E and Appendix C will provide a basis for review of these future advice letter requests. The purchased power rate utilized is the composite PG&E rate of 9.080 cents per kWh which became effective April 29, 1980. The purchased water rate used is the Stockton East Water District charge which became effective April 1, 1980. The composite effect of the assumed rates for purchased water and power and groundwater extraction charge is an average cost of \$0.230 and \$0.229 per Ccf of water sold during 1981 and 1982, respectively. The Stockton District effective ad valorem tax rate is 1.051 percent of estimated beginning-of-year net plant plus materials and supplies. The corresponding effective rate for prorated general office and ad valorem taxes is 1.109 percent of beginning-of-year net plant plus materials and supplies. The local franchise tax and business license rate is the 1979 rate of 0.487 percent of gross revenue. The income tax rates are the current 9.6 percent state, 46 percent (with intermediate steps) federal rates. The uncollectible rate used was 0.292 percent, and the net-to-gross multiplier was 2.0646.

Rate Design

In a rate proceeding after total revenue requirements are determined, the next step must be to provide for equitable distribution of the increases found necessary to the components of the rate schedules. In the Stockton District the accumulated revenue increases authorized since January 1, 1976 have exceeded 25 percent. Therefore, the increases we will authorize by this decision for 1981, 1982, and 1983 will be spread equally to all

three tiers of the quantity rate schedule, including the lifeline tier, and to the service charges.

No increases will be authorized to be applicable to either the Public Fire Hydrant Service or to the Private Fire Protection Service.

Appendix A to this decision sets forth the rate structure approved to be made effective and applicable to the year 1981. Appendix B contains the step increases in rates authorized for future years. Since rates are very likely to be revised through advice letter offsets during the interim period ahead, it is doubtful that schedules for 1982 and 1983 predicated upon rates to be authorized for 1981 would be the correct rates at the time the step rate filing is to be made. Therefore, the increases contained in Appendix B can be added to the rates that would otherwise be effective on the date the step increase is to go into effect in order to develop the appropriate rates for filing.

Other Issues

Elimination of Private Fire Protection Rates: Following the January 25, 1979 hearing in Marysville during which the local fire chief recommended elimination of private sprinkler protection

rates as a way to spur sprinkler installations,^{21/} by Ordering Paragraph No. 4 in Decision No. 90491 dated July 3, 1979 in Application No. 58094, we directed applicant to prepare a study into the equity and advisability of such a step.

Applicant complied with this directive, submitting a short but to the point study, Exhibit 5 in the instant proceeding. Therein applicant noted that while there is some public benefit to be derived from private systems, the principal beneficiaries would be the owners or lessees of the specific private structures protected. They would obtain free service.

But someone must pick up the cost, small as it may be (depending on size and ownership the charge varies from \$1.17 to \$3.00 per month per inch of diameter of service). Although if passed on to the general service customer, the additional charge would be small, ranging from 3 cents to 33 cents per month per customer; depending upon the nature (residential or industrial) of the service territory involved, equity does not justify general customers subsidizing private enterprise. Furthermore, current sprinkler water service charges are insignificant compared to the other considerations which determine the economic feasibility of installing sprinkler systems, namely installation costs and significant insurance savings.^{22/}

^{21/} Interestingly, Marysville had no ordinance or building code regulations requiring fire sprinkler systems. It appears to us that a more appropriate and effective way to induce installations than by giving free fire sprinkler water service would be to adopt the Uniform Building Code and/or the Uniform Fire Code, which in appropriate circumstances would require such installations.

^{22/} Net savings resulting from typical situation installations require from 8.1 to 13.2 years for the cumulative savings to pay for the investment, according to the study. Elimination of charges to the owner or lessee would shorten this period only to a range of 7.9 to 12.2 years.

As the study indicates, installation of sprinklers results in considerably lower fire insurance premiums. These savings are a much stronger incentive to install sprinklers than would be the elimination of charges for private fire protection service.

We conclude that it is equitable that private fire protection customers should continue to pay the present rates.

Wage and Price Standards: By Resolution No. M-4704 dated January 30, 1979, the Commission ordered all utilities requesting general rate increases to submit an exhibit to accompany their applications to show whether the requested increase complies with the voluntary Wage and Price Standards issued by the federal Wage and Price Stability Council. Applicant complied and its Exhibit No. 6 in this proceeding shows that (1) wage increases granted by applicant and (2) the requested rate increases, together with step increases in other districts, are within the established guidelines. However, in addition to approval of a major portion of the increases requested by the company in its application, at the recommendation of staff we are providing in our adopted rates for the additional costs of purchased power and water derived from the very significant April 29, 1980 PG&E energy increase. This pass-through of specific costs accords with Commission policy, and while it may serve to place applicant technically out of compliance with the general price declaration standards of the Council, not to approve the exception would result in gross inequity and could unreasonably and detrimentally handicap the utility in its critical forthcoming refinancing of large volumes of long-term debt.

Protestants' Contentions: The Board of Supervisors of San Joaquin County, concerned over the economic impact of rate increases, asked that public hearing be held in Stockton to give interested parties opportunity to express concern and investigate the adequacy and accuracy of the application. During the subsequent hearing September 18, 1980 in Stockton, the county counsel appeared to state that because of a series of commitments and unanticipated emergencies the Board was unable to be present. Leave was requested and granted to submit a brief written statement within one week. No such statement was received from the Board. However, one Board member, Jose L. Alva, on September 24, 1980 wrote the ALJ "on behalf of those citizens in my district who obtain water from the California Water Service Company." Supervisor Alva stated that any increase places the city of Stockton and the county in an uncompetitive position in trying to attract industry. He then went on to state that the effect of failure to retire Cal-Water's "numerous wells no longer necessary" creates a dual system, the cost of which is borne by the local consumer, in part the reason for high water rates.

The city council of Stockton authorized councilman Arnold I. Rue to appear to present its arguments to the point that a rate increase would in essence be unfair. On behalf of the council he asserted that applicant's Stockton rates are the highest in central California^{23/} and asked that these rates be equated with those of Bakersfield, or that all Cal-Water's

^{23/} The council and Rue offered into evidence, and the ALJ accepted, a bar chart graph dated June 1980 (essentially an update of a similar graph introduced in the proceedings in Application No. 57328) which purported to compare annual water costs to average customers of 17 water distributors, 12 of which are public agencies, 2 Cal-Water companies, and 3 privately owned utilities.

customers, wherever located in the State, pay the same rates. And finally, a local veterinarian, Doctor Joe Waidhofer, and a Mrs. Betty MacNear, both directors of Stockton East Water District, but speaking for themselves and their adherents, argued the unfairness of having to support two systems, Waidhofer concluding that applicant should be required to shut down 28 wells, thereby removing from rate base a "guesstimated" \$3 million and lowering rates.

These arguments are similar in thrust and content to those advanced back in 1977 during the hearing on Application No. 57328. In Decision No. 89528 in that matter we discussed at length these contentions. We pointed out that any comparisons based on the bar chart there presented were invalid, stating: "Unless the systems to be compared are selected for comparability, or unless adjustments are made for items such as purchased water and taxes, the comparisons would be as meaningless as a horse race where one of the horses must carry two riders."

Similarly, throughout the protests in the instant proceedings, there is threaded the idea that now that Stockton East Water District provides a duplicate flow of imported water,^{24/} applicant should be

^{24/} Prior to 1975 water for applicant's Stockton District was obtained from 66 company-owned wells located throughout the service area. In 1975 these wells produced 33,000 acre-feet of water, but the service area had developed to the point that water extraction exceeded replenishment with the result that saltwater trapped in the Delta islands was being drawn in. To alleviate the overdraft and saltwater intrusion, a master plan was drawn which expanded a local water conservation district formed in 1948 into the Stockton East Water District. The new district developed a surface water supply from the Calaveras River to supply Metropolitan Stockton using applicant's distribution system. After construction of a treatment plant, since March 1977 Stockton East Water District has become the major supply source to Cal-Water. A large proportion of the payment from applicant to Stockton East Water District covers fixed

(Continued)

forced, without compensation, to remove many of its wells from rate base, but that these same wells should in some manner be continued to be dedicated to public use against the contingency that they might again be needed. But these wells were prudent investments of capital when constructed and are in partial back-up status today only as a result of the construction of Stockton East Water District's facilities. Applicant's stockholders are therefore legally entitled to recoup their investment (see Sections 1501 and 1503 of the Public Utilities Code). There is no action this Commission can legally take which would relieve Stockton customers of the obligation to repay the undepreciated cost of duplicated plant. In Decision No. 89528 we fully explored the alternatives and indicated that it should be Stockton East Water District, not this Commission, which should determine which alternative payment method would be in the public interest.^{25/} We will not repeat those discussions here. In summary it suffices to say that there are constitutional prohibitions against confiscation of private property without compensation. Nor can Stockton customers be subsidized by customers in other areas.

24/ (Continued)

charges, therefore annual payments do not fluctuate much regardless of the water delivered. To lessen the production costs of water drawn from applicant's wells we require applicant to maximize the quantity of water received from the district. Essentially therefore, what has developed is that to some considerable degree a duplicate water supply facility has been developed in the Stockton East Water District's facility.

25/ Meanwhile applicant's customers will continue to pay in their rates for the undepreciated plant in periodic installments together with a return on the declining balance. These installments will continue until the wells, pumps, etc. are fully depreciated or until Stockton East Water District decides to purchase or condemn them.

Effective Date of Order: The rates of return found reasonable in this matter were determined and based upon the effect of the rate increase for full year 1981. Accordingly, in order to retain as much of that effect as possible, and since the only active participants as parties to this proceeding are applicant and the Commission staff, the resulting order should be effective on the date of signature.

Findings of Fact

1. Applicant's service territory is efficiently served with satisfactory results, and the water quality is satisfactory.

2. Applicant's conservation program has lost vigor and should be reinvigorated. However, its pump efficiency program meets or exceeds standards.

3. Applicant requires additional revenues, but the rates it proposes would produce an unjustified rate of return.

4. To avoid a duplicity of effort we provided in the rates we adopt herein for the additional purchased power and water costs derived from the April 29, 1980 PG&E increase.

5. Staff's projections of anticipated water consumption, class by class, insofar as they differ from those of applicant, are more reasonable than applicant's. Accordingly, staff's estimates of operating revenues and expenses at present and proposed rates, as derived from those consumption projections, should be adopted over those of applicant.

6. Other than adjustments proposed relating to Station 79 Well and the Airport Way replacement main, staff's estimates of rate base, totaling \$80,200 for 1981 and \$66,000 for 1982 less than applicant's estimates, are reasonable and should be adopted.

7. Applicant in 1976 acted prudently and judiciously in constructing Station 79 Well where, when, and how it did. Accordingly, it would be inequitable and unreasonable now to apply saturation adjustment procedures to the facility.

8. Location of a large new Corn Products' chemical plant with substantial initial and increasing consumption and fire-flow requirements on Airport Way made replacement of the existing 40-year-old 12-inch main necessary. Its additional requirements, plus pending development of the Santa Fe residential and commercial development in the area, and potential development of the balance of the Western Pacific industrial area, made replacement by a 16-inch main over a 3-year period a prudent and judicious investment. Accordingly, it would not be reasonable to apply saturation adjustment procedures to the replacement project.

9. The adopted estimates of operating revenues, operating expenses, and rate base for the test years 1981 and 1982, and a decline of 0.39 percent in rate of return into 1983 as a consequence of operational attrition at the present authorized rate level reasonably indicates the results of applicant's operations in the immediate future.

10. At this point in time applicant's capitalization structure and general financial circumstances do not preclude reliance upon long-term financing through the test period for all financing anticipated herein.

11. Applicant's estimate of 13.1 percent as the anticipated cost of such debt financing is reasonable.

12. Rates of return of 10.89, 11.08, and 11.50 percent, respectively, on applicant's rate base for 1981, 1982, and 1983 are reasonable. The related return on common equity each year is 13.7 percent. This will require an increase of \$276,700, or 3.2 percent in annual revenues for 1981, a further increase of \$227,400,

or 2.6 percent in 1982, and a further increase of \$303,700, or 3.3 percent in 1983.

13. The adopted rate design is reasonable.

14. 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.

15. The further increases authorized in Appendix B should be appropriately modified in the event the rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the 12 months ended September 30, 1981 and/or September 30, 1982, exceeds the lower of (a) the rate of return found reasonable by the Commission for applicant during the corresponding period in the most recent rate decision or (b) 10.89 percent for 1981 and 11.08 percent for 1982.

16. Applicant's private fire protection service rates do not act as a deterrent to the installation of fire sprinkler systems in private buildings, and it would be neither equitable nor reasonable to eliminate all private fire protection service rates with the resulting transfer in costs to applicant's general service customers.

17. The revenues authorized herein, pursuant to provisions of Commission Resolution No. L-213, incorporate the present public fire protection surcharges offsetting loss of fire hydrant revenues. No refund is necessary.

Conclusions of Law

1. The application should be granted to the extent provided by the following order, the adopted rates being just, reasonable, and nondiscriminatory.

2. The effective date of the following order should be the date of signature since there is an immediate need for the rate increase.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, applicant, California Water Service Company, is authorized to file for its Stockton District the revised rate schedules attached to this order as Appendix A. Such filing shall comply with General Order No. 96-A. The effective date of the revised schedules shall be four days after the date of filing. The revised schedules shall apply to service rendered on and after the effective date hereof.

2. On or after November 15, 1981 applicant is authorized to file an advice letter, with appropriate work papers, requesting the step rate increases attached to this order as Appendix B, or to file a lesser increase which includes a uniform cents per hundred cubic feet of water adjustment from Appendix B in the event that the Stockton District rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the twelve months ended September 30, 1981, exceeds the lower of (a) the rate of return found reasonable by the Commission for applicant during the corresponding period in the then most recent rate decision, or (b) 10.89 percent. Such filing shall comply with General Order No. 96-A. The requested step rates shall be reviewed and approved by the Commission prior to becoming effective. The effective date of the revised schedule shall be no earlier than January 1, 1982, or

thirty days after the filing of the step rate, whichever is later. The revised schedule shall apply only to service rendered on and after the effective date thereof.

3. On or after November 15, 1982 applicant is authorized to file an advice letter, with appropriate work papers, requesting the step rate increases attached to this order as Appendix B or to file a lesser increase which includes a uniform cents per hundred cubic feet of water adjustment from Appendix B in the event that the Stockton District rate of return on rate base, adjusted to reflect the rates then in effect and normal ratemaking adjustments for the twelve months ended September 30, 1982, exceeds the lower of (a) the rate of return found reasonable by the Commission for applicant during the corresponding period in the then most recent rate decision, or (b) 11.08 percent. Such filing shall comply with General Order No. 96-A. The requested step rates shall be reviewed and approved by the Commission prior to becoming effective. The effective date of the revised schedule shall be no earlier than January 1, 1983, or thirty days after the filing of the step rates, whichever is later.

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The revised schedule shall apply only to service rendered on and after the effective date thereof.

The effective date of this order is the date hereof.

Dated FEB 18 1981, at San Francisco, California.

John E. Burns
President
Michael D. Howell
Samuel M. Jones
Commissioners

A. 59664 RR/LT

APPENDIX A

SCHEDULE NO. 3T-1

Stockton Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Stockton and vicinity, San Joaquin County.

RATES

Service Charge:

	<u>Per Meter</u> <u>Per Month</u>
For 5/8 x 3/4-inch meter	\$ 5.85
For 3/4-inch meter	8.60
For 1-inch meter	11.50
For 1 1/4-inch meter	15.70
For 2-inch meter	21.00
For 3-inch meter	39.00
For 4-inch meter	53.00
For 6-inch meter	89.00
For 8-inch meter	129.00
For 10-inch meter	159.00

Quantity Rates:

For the first 300 cu.ft., per 100 cu.ft.	0.341
For the next 29,700 cu.ft., per 100 cu.ft.	0.526
For all over 30,000 cu.ft., per 100 cu.ft.	0.384

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.

APPENDIX B

Each of the following increases in rates may be put into effect on the indicated date by filing a rate schedule which adds the appropriate increase to the rate which would otherwise be in effect on that date.

<u>Service Charge</u>	<u>Effective Dates</u>	
	<u>1-1-82</u>	<u>1-1-83</u>
For 5/8 x 3/4-inch meter	0.15	0.20
For 3/4-inch meter	0.20	0.30
For 1-inch meter	0.35	0.40
For 1 1/2-inch meter	0.40	0.50
For 2-inch meter	0.50	0.50
For 3-inch meter	1.00	1.00
For 4-inch meter	2.00	2.00
For 6-inch meter	2.00	3.00
For 8-inch meter	3.00	5.00
For 10-inch meter	4.00	6.00

Quantity Rates:

For the first 300 cu.ft., per 100 cu.ft.	0.008	0.012
For the next 29,700 cu.ft., per 100 cu.ft.	0.013	0.018
For all over 30,000 cu.ft., per 100 cu.ft.	0.010	0.014

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California Water Service Company
Stockton District

ADOPTED QUANTITIES

	<u>1981</u>	<u>1982</u>
1. <u>Water Production:</u> Ccf(1000)	13,724.3	13,821.1
Wells:	2,834.4	2,931.2
Purchased Water:	10,889.9	10,889.9
2. <u>Electric Power:</u> 1.0743 kWh per Ccf	Supplier: PG&E	Date: 4/29/80
kWh:	3,045,100	3,149,000
Cost:	\$276,500	\$286,000
Cost per kWh:	\$ 0.0908	\$ 0.0908
3. <u>Purchased Water Expenses:</u>		
Purch. Water: (SEWD) <u>1/</u>	\$3,149,700	\$3,152,400
Grd. Water Chrg. (SEWD) <u>1/</u>	8,800	9,100
4. <u>Ad Valorem Taxes:</u>	194,800	199,900
Tax Rate:	1.051%	1.051%
5. <u>Metered Water Sales:</u>		

	<u>Range-Ccf</u>	<u>1981</u>	<u>Usage-Ccf</u>	<u>1982</u>
Block 1 (lifeline)	0-3	1,273,350	1,279,077	
2	4-300	7,288,803	7,294,223	
3	> 300	3,279,248	3,351,900	
	Total Usage	<u>11,841,401</u>	<u>11,925,200</u>	

1/ Stockton-East Water District

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California Water Service Company
Stockton District

ADOPTED QUANTITIES

6. Number of Services:

	<u>No. of Services</u>		<u>Usage-KCcf</u>		<u>Avg. Usage-Ccf/yr.</u>	
	<u>1981</u>	<u>1982</u>	<u>1981</u>	<u>1982</u>	<u>1981</u>	<u>1982</u>
Commercial-Metered	37,241	37,421	8,900.6	8,943.6	239.0	239.0
Comm. Large Metered	2	2	48.6	9.7	24,300.0	4,850.0
Industrial	84	85	535.0	549.0	6,369.0	6,458.8
Industrial-Large	14	14	1,140.0	1,202.0	81,428.6	85,857.1
Public Authority	283	284	962.2	965.6	3,400.0	3,400.0
Public Auth.-Lrg.	5	5	250.0	250.0	50,000.0	50,000.0
Other	4	4	5.0	5.0	1,250.0	1,250.0
Subtotal	37,633	37,815	11,841.4	11,924.9		
Private Fire Prot.	354	364				
Public Fire Prot.	35	35				
Total	38,022	28,214				
Water Loss 13.5%			1,882.9	1,896.2		
Total Water Produced			13,724.3	13,821.1		

7. Revenue

	<u>1981</u>	<u>1982</u>	<u>1983</u>
Metered	\$8,776,500	\$9,048,500	\$9,352,200
Public Fire Prot.	3,900	3,900	3,900
Private Fire Prot.	37,500	38,500	38,500
Misc.	7,400	7,400	7,400
Total	8,825,300	9,098,300	9,402,000

Attrition in Rate of Return: 0.81% \$303,700

1982 Rate Base (adopted): \$18,158,100

Net-to-Gross Multiplier: 2.0646

8. Usage and Bill (Commercial)

Average Usage: 239 Ccf/customer-yr.

Average Bill, monthly \$15.77 \$16.17

APPENDIX C
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California Water Service Company
Stockton District

INCOME TAX CALCULATIONS

	<u>1981</u>	<u>1982</u>
	(Dollars in Thousands)	
Operating Revenues	\$8,825.3	\$9,098.3
<u>O&M Expenses</u>		
Purchased Power	276.5	286.0
Purchased Water	3,149.7	3,152.4
Ground Water Charge	8.8	9.1
Purch. Chemical	10.0	10.4
Payroll	864.1	937.5
Other: OM. & AG.	405.2	425.6
Uncollectible at 0.292%	25.8	26.6
Local Franch. Tax at 0.487%	43.0	44.3
Payroll Taxes	63.6	68.8
Ad Valorem Taxes at 1.051%	194.8	199.9
G.O. Allocated Expenses	601.0	650.0
Transp. Deprec. Adj.	(31.4)	(33.8)
G.O. Deprec. Adj.	(8.5)	(8.7)
Payroll Taxes Capitalized	10.9	11.9
Interest	835.1	891.7
Total Deductions	6,448.6	6,672.7
State Tax Depreciation	768.5	792.2
Net Taxable Income	1,608.2	1,634.4
State Corp. Franch. Tax at 9.6%	154.4	157.0
Federal Tax Depreciation	751.4	774.6
State Income Tax	154.4	157.0
Preferred Stock Div. Credit	5.7	5.7
Net Taxable Income	1,465.2	1,489.4
Federal Income Tax at 46%	674.0	685.1
Grad. Tax Adj.	(2.4)	(2.4)
Adj. Invol. Conversion	(3.5)	(3.3)
Investment Tax Credit	(79.7)	(96.4)
Total Federal Income Tax	588.4	583.0
Net-to-Gross Multiplier: 2.0646		

(Red Figure)