

Decision 93263 JUL 7 1981

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application)
of CALIFORNIA-AMERICAN WATER)
COMPANY for an order authorizing)
it to increase its rates for)
water service in its CORONADO)
DISTRICT.)

Application 60092
(Filed November 19, 1980)

Lenard G. Weiss, Attorney at Law, for
California-American Water Company, applicant.
Brian T. Cragg, Attorney at Law, Donald Yep,
David K. Fukutome, and Terry R. Mowrey, for
the Commission staff.

O P I N I O N

By this application, California-American Water Company (Cal-Am) seeks authority to increase rates for water service in its Coronado District to produce an annual revenue increase of \$556,700, or 18.9% in 1981. Additional revenue increases of \$120,400 or 3.7% and \$134,000 or 4.0% over 1981 are requested for the years 1982 and 1983, respectively.

On March 24 and 25, 1981, public hearing on this application was held in San Diego, California, before Administrative Law Judge Sara S. Myers. Copies of the application were served and notice of the hearing was published in accordance with this Commission's Rules of Practice and Procedure. The matter was submitted upon the filing of concurrent briefs on April 20, 1981.

During the hearing, three witnesses testified on behalf of Cal-Am, including Cal-Am's vice president of finance, Robert W. Bruce; Cal-Am's assistant director of rates and revenues, John S. Barker; and an independent consulting engineer, John E. Housiaux.

The Commission staff's (staff) testimony was presented by three members of the Commission's Revenue Requirements Division: Donald Yep and David Fukutome, both utilities engineers, and Terry R. Mowrey, a financial examiner.

The public hearing in this application was preceded by an informal public meeting held at the Coronado City Hall on January 15, 1981. The meeting, which was jointly sponsored by Cal-Am and the staff, was for the purpose of receiving customer comment on Cal-Am's water service. Notice of the meeting and the public hearing was provided by bill inserts mailed to each customer. At neither the informal meeting nor the public hearing were any complaints received concerning Cal-Am's water service in its Coronado District. Only one customer attended the informal meeting, providing no comment, and none appeared during hearing.

General Information

Service Area and Water System

Cal-Am, a California corporation, is a wholly owned subsidiary of the American Water Works Company, Inc. of Wilmington, Delaware. Cal-Am operates public utility water systems in portions of San Diego, Los Angeles, Ventura, and Monterey Counties.

In Cal-Am's Coronado District, public utility water service is provided to approximately 16,570 customers in the Cities of Coronado and Imperial Beach, a portion of the City of San Diego, and contiguous unincorporated areas. All of these areas are within San Diego County.

The total water supply for the Coronado District is purchased from the City of San Diego. By contract agreement, Cal-Am has the right to purchase from the City of San Diego all of the potable water required to serve its Coronado District customers.

Customer Service and Conservation

The staff investigation related to this application shows that during 1979 and 1980 customer complaints filed at the district office concerned high bills, leaks, low pressure, and water odor and taste. The staff is satisfied that all complaints, including 10 for disputed bills filed with the Commission's Consumer Affairs Branch, were properly handled and satisfactorily resolved. Although Cal-Am received more odor and taste complaints in 1980 than in previous years, this circumstance was largely due to a one-time water supply problem at the Otay Lakes Reservoir which has now been corrected.

The staff report also shows that Cal-Am has continued to promote its water conservation program. Water conservation kits are available from Cal-Am and customer relations remain conservation-oriented. According to the staff, the role of electric energy conservation in the Coronado District operations is minor. The entire water supply is purchased, and delivery is at sufficient pressure to make boosting unnecessary.

Based on the staff's report, we conclude that Cal-Am is providing a satisfactory level of service.

Rate Increase Request

In its application Cal-Am proposes rates which will increase its annual revenues by \$556,700 in 1981 and an additional \$120,400 in 1982 and \$134,000 in 1983. Each of these rate increases reflects a requested rate of return of 11.62% for each of the three years. This rate of return is based on an embedded cost of debt of 8.63% and a cost of common stock equity of 14.50%.

Discussion

During hearing, Cal-Am accepted the staff's estimates and recommendations on all of the issues related to its rate increase request except: (1) rate of return, (2) consumption estimates for

all classes of Coronado District customers, and (3) the proper rate treatment of the fee charged by Cal-Am's consultant, John Housiaux, for appearing during hearing. Cal-Am's stipulation resulted from staff estimates, included in Exhibit 12, 13, and 14, being based on later information and recorded data which were not available to Cal-Am at the time its application was prepared.

Rate of Return

The following table compares the rate of return requested by Cal-Am and that recommended by the staff:

TABLE 1

PROPOSED RATES OF RETURN

<u>Component</u>	<u>Capitalization Ratios</u>	<u>Cost</u>	<u>Weighted Cost</u>
<u>Cal-Am</u>			
Long-Term Debt	49.11%	8.63%	4.24%
Common Equity	<u>50.89%</u>	14.50%	<u>7.38%</u>
Total	100.00%		11.62%
<u>Staff (Average Year 1981)</u>			
Long-Term Debt	48.00%	8.74%	4.20%
Common Equity	<u>52.00%</u>	13.00%	<u>6.76</u>
Total	100.00%		10.96%

In support of its requested 14.50% return on equity, Cal-Am presented testimony by Robert W. Bruce, Cal-Am's vice president of finance. Bruce's oral testimony during hearing was supplemented by three exhibits. In Exhibit 2, Cal-Am's report on its results of operations, Cal-Am's cost of capital, recorded common equity, total adjusted capitalization, and weighted cost of capital was set forth along with a comparison of Cal-Am's recorded and authorized rates of return over the past 10 years. The two other exhibits sponsored by

Bruce included Exhibit 3 which listed the rates of return requested by 10 separate water utilities over the past two years as well as those recommended by the staff and ultimately granted by this Commission. An excerpt from one of the related decisions was also provided. The other exhibit, Exhibit 4, presented total company recorded rates of return and returns on common equity from 1970 through 1981 estimated. In both Exhibits 2 and 4, Cal-Am's recorded common equity had been adjusted "to reflect the elimination from common equity of the unamortized balance of the utility plant acquisition adjustment."

In addition to these exhibits, Bruce testified that the 14.5% requested return on common equity had been the one adopted by Cal-Am's board of directors as recommended to the board by Bruce. With respect to the analysis supporting that judgment, Bruce stated only that he took into consideration "the risk involved, the economic requirement, [and] expectations of the stockholders." (Transcript (Tr.) 23-23.) Bruce also indicated that Cal-Am's common equity ratio was presently 52%, and that if Cal-Am's Coronado District were able to earn the return on equity recommended by the staff (13%), Cal-Am would experience sufficient earnings for future financing. (Tr. 33.)

The staff's testimony presented by Terry Mowrey included a report providing an analysis of Mowrey's recommendation of a 13% return on equity (Exhibit 13) and oral testimony further explaining the report's tables and text. In reaching his recommendation, Mowrey gave consideration to Cal-Am's average, as opposed to year-end, capital structure; its average capital costs for the test year, its forecasted financing needs; and its ability to attract capital. (Exhibit 13.) It was Mowrey's opinion that the use of average year capital structure and average year capital costs was consistent with his recognition of financial attrition and his recommendation that

the rate of return be adjusted in 1982 and 1983 to reflect the attrition. According to Mowrey, the use of average year more accurately indicates Cal-Am's capital costs during the year that the rates are in effect. To use year-end capital costs together with a step rate increase for financial attrition would overstate those costs.

Staff's recommendation of 13.0% return on equity was based on an analysis of many factors which affect the cost of equity capital. In particular, Mowrey was guided by the following standards which have been developed in judicial and administrative proceedings:

- "a. The return to the equity holders should be commensurate with returns on investments in other enterprises having similar risks.
- "b. The return should be sufficient to enable the utility to attract capital at reasonable rates and to assure confidence in the utility's financial integrity.
- "c. The return should balance the interests of both the investors and ratepayers."
(Exhibit 13 at page 5.)

With respect to the influence of recent rates of return authorized by this Commission for other water utilities, Mowrey stated in his report:

"The returns authorized by this Commission [since May 1978] and especially those of the last two years, show an increasing trend as well as a wide range of returns. The increasing trend is to be expected given the surge and volatility that interest rates have demonstrated in the recent past. These higher borrowing costs have an impact on reasonable equity returns and thus we have seen higher rates of return as well as equity returns being authorized for California water utilities. The wide range of returns is also to be expected, in my opinion. Obviously no two companies are exactly the same. Capital structures vary,

financing needs are different, interest coverages vary depending on earnings, also interest requirements and many other factors are different. This is why staff recommendations as well as utility requested rates of return vary. All factors affecting a particular utility's risk must be analyzed, both historical as well as projected, before a reasonable rate of return can be established. To say that because one utility was authorized a particular return on equity that another utility should receive exactly the same equity return is to disregard all of the factors I have discussed, and in my opinion is unrealistic." (Exhibit 13 at page 6.)

Staff also pointed out that its recommendation would permit a rate of return on common equity 175 basis points over Coronado District's last authorized return on equity of 11.25%. (Decision (D.) 90925, October 23, 1979.) The recommendation is also 150 basis points over that found reasonable in Cal-Am's most recent rate increase applications which involved six of its other districts. That return on equity, 11.50%, was adopted by the Commission in D.91910 on June 17, 1980, and D.92238 and 92241 issued September 16, 1980.

While the determination of an appropriate rate of return requires considerable judgment, we have never dispensed with the evidentiary requirement that the basis for that judgment be fully demonstrated. In contrast to the staff's testimony which provided a detailed analysis and application of factors upon which the rate of return recommendation for this particular utility was based, Cal-Am's testimony primarily consisted only of Bruce's statement of three general factors which he considered in making his recommendation and a recitation of recently requested, recommended, and authorized rates of return. The opinion of staff witness Mowrey was reiterated by staff counsel in referring to Cal-Am's Exhibit 3 in his brief:

"It was unclear, however, if this exhibit was intended to show the rates of return which other California water companies have requested, which indisputably provide no material basis for the Commission's decision in this application (RT 23:27-24:10); the relation between staff's recommendations in other water company rate cases and the rates of return authorized by the Commission in those cases, which is likewise irrelevant to the issues of this application (RT 24:16-25); or the 'drift or trend' of the rates of return authorized by the Commission, which again is of doubtful pertinence to Cal-Am's specific financial needs in connection with its operation of the Coronado District (RT 26:3-8)." (Staff brief at page 2.)

Further, as also pointed out by staff counsel, the relevant figures of Exhibit 3 support staff's, not Cal-Am's, recommendation.

"First, it is clear from Exhibit 3 that the Commission has recognized that greater risk, as expressed by a relatively lower common equity ratio, should correspond with a higher authorized rate of return. Mr. Bruce endorsed this principle. (RT 29:27-30:5.) In the decisions summarized in Exhibit 3, a return on equity greater than the 13.0% recommended by staff was authorized for only those utilities with a lower common equity ratio than applicant. Applicant inconsistently asks the Commission to authorize it to earn a return on equity that would be the highest of any California water company, even though it maintains a relatively high equity ratio, and thus presents less risk to its investors. (RT 31:5-19.)

"Second, Exhibit 3 is useful to show the rates of return actually authorized by the Commission, rather than those requested by utilities or recommended by staff, in recent decisions. Using the same approach taken by applicant in comparing its request with those of other

utilities - an average which excludes recent rate decisions for Cal-Am's other districts - the mean authorized return on equity for the listed water utilities is 12.99%, only slightly less than the staff's recommendation in this case."

In support of its request for a 14.5% return, Cal-Am's brief, like the testimony of its witness, focuses not on an analysis of Cal-Am's specific risks, capital costs, and capital structure, but on the rates of return granted to certain other Class A water utilities. Emphasis is placed particularly on the dissenting opinion of the Commission's president in San Jose Water Works, D.92719 (February 18, 1981). That dissent, which is attached in full to Cal-Am's brief, critically examines the staff's methodology for determining rate of return under present economic conditions. Cal-Am's brief also notes Cal-Am's "severely depressed economic history over the past few years."

Although the staff's methodology may have been criticized in a recent dissenting opinion, in this particular case we have been presented with no other evidence or contrasting methodology supporting the adoption of a rate of return different from that recommended by the staff. Nowhere in the record did Cal-Am present the detailed analysis of this particular district that was provided by the staff. We also concur with staff counsel that the evidence presented by Cal-Am in fact provides further support for the adoption of a 13.0% return on equity. While it was Bruce's opinion that Southwest Suburban Water Company (Southwest Suburban), granted a 13.50% return on equity in February of this year (D.92666), was the most comparable to Cal-Am's Coronado District, Bruce offered no specific reasons to support this opinion. Further, Southwest Suburban's common equity ratio (48.50) is almost four percentage points less than Cal-Am's (52.00). We note also that the authorized return on equity for Southwest Suburban was 13.50%, not the 14.50% requested by Cal-Am.

There is no doubt that Cal-Am is in need of an increase in its return on equity. Cal-Am provides a good level of service to its customers and has an active conservation program. We believe, however, that a 13.0% return on equity, which even by Cal-Am's own admission would provide it with sufficient earnings to meet its indenture requirements and its financing needs over the test period, is appropriate. While Cal-Am's earnings in the past may have been poor, we concur with the staff that a rate of return recommendation is a statement of capital costs for the future and not a catchall for deficiencies in other areas. As stated in our decisions in Cal-Am's most recent rate applications, we believe the newly instituted Regulatory Lag Plan for water utilities, which provides for the introduction of a utility's newly authorized rates at the commencement of the test years, will provide Cal-Am with the opportunity to earn its authorized rate of return for those years. (D.91910, June 17, 1980.)

Based on the record in this proceeding, we find a return on common equity of 13.00% is reasonable to yield a rate of return of 10.96% developed as follows:

TABLE 2

ADOPTED RATE OF RETURN

<u>Component</u>	<u>Capitalization Ratios</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long-Term Debt	48.00%	8.74%	4.20%
Common Equity	<u>52.00%</u>	13.00%	<u>6.76%</u>
Total	100.00%		10.96%

Attrition

The purpose of an attrition allowance is to give recognition to costs occurring beyond the test year over which the utility has little or no control. Operational attrition is defined as the decline in the rate of return in the years following the test year caused by increases in expenses and rate base which are not offset by increases in productivity and/or revenue. For ratemaking purposes, financial attrition is the change in a utility's cost of long-term debt due to the issuance or retirement of senior securities. Financial attrition which will occur in the year following the test year can be estimated from the utility's projections of future financing. In this proceeding the staff recommends an allowance for both financial and operational attrition. In particular, the staff recommends that the rate of return be adjusted in 1982 and 1983 to recognize the impact of financial attrition and to allow Cal-Am a reasonable opportunity to earn a 13.0% return on equity in those years. The corresponding recommended rates of return on rate base are 10.98% for 1982 and 11.03% for 1983.

The staff also recommends step rates for the year 1983 based on an analysis of the operational attrition in rate of return between the test years 1981 and 1982. The staff's estimated rates of return at present rates indicate an operational attrition of 0.83% between the years 1981 and 1982. A 0.83% attrition allowance would provide an approximate increase in gross revenues for 1983 of \$91,700 based on staff's 1983 estimated rate base.

We adopt the operational and financial attrition allowances recommended by the staff. Cal-Am will be required to file an advice letter with supporting work papers on or after November 15, 1981, and November 15, 1982, to justify the step rate increases for the years 1982 and 1983, respectively.

Normalized Consumption

A major difference of opinion and result developed between Cal-Am and the staff with respect to their estimates of residential, commercial, and public authority consumption for the test years. Table 3 below shows recorded 1980 consumption per customer for these three classes as well as the staff's and Cal-Am's estimates for test years 1981 and 1982. Cal-Am's original estimates were revised during hearing based on more recent data.

TABLE 3

RECORDED AND ESTIMATED CONSUMPTION
(Per Customer - CCF/Cust./Yr.)

<u>Class</u>	<u>1980 Recorded</u>	<u>Average for Test Years 1980 and 1981</u>	
		<u>Cal-Am</u>	<u>Staff</u>
Residential	179.9	176.9	184.1
Commercial	1,116.0	1,140.0	1,123.0
Public Authority	3,886.0	3,824.0	3,877.0

Residential Consumption

The starting point for both Cal-Am and the staff in estimating residential consumption was the Modified Bean Method, described in Commission Standard Practice U-25. This basic methodology, which has since been modified by the Committee Method, is used to determine the normalized consumption. Normalized consumption is the average consumption per customer during an average year of temperature and rainfall. In the present application this multiple regression analysis was further modified to different degrees by both the staff's and Cal-Am's witnesses. In both cases, the changes were made primarily to give some recognition to the drought years (1976-1977) in estimating normalized residential consumption for test years 1981 and 1982. For the most part, however, the staff followed the basic Modified Bean methodology, while Cal-Am significantly deviated from that approach.

In its briefs in this application, both the staff and Cal-Am provided thorough discussions of the testimony in this proceeding and lengthy argument on their respective positions. From the hearing record and the briefs, the following conclusions can be reached:

1. In this case, as with Cal-Am's most recent rate cases, the method employed by Cal-Am's witness John Housiaux resulted in an estimate below the recorded use for the year prior to test year 1981, and a prediction of a downward trend in consumption despite a gradual upward trend since the drought year 1977. No external factors other than the results produced by Housiaux' methodology were introduced to explain this significant change in the recorded trend.
2. Housiaux' use of a "residual conservation factor" results in an exercise of judgment and has the effect of over-emphasizing the impact of the drought under circumstances in which normalized consumption is being estimated.

Of note is the following comparison provided by staff counsel of the different approaches to the drought taken by the staff and Cal-Am:

"The approach of staff's witness, Mr. David Fukutome, to the deviation from normal consumption patterns during the drought was to eliminate consumption data for 1977 and 1978 in the development of the regression equation. . . . Even though the Coronado area did not experience the drastic drop in rainfall that took place in much of the state and was not subject to mandatory

conservation, staff believed that the extraordinary emphasis on conserving water throughout the state had operated as an extraneous factor affecting consumption in the Coronado District. (RT 117:8-15; 119:24-28.) This belief was reinforced by the rapid drop in actual consumption which occurred in the Coronado District in 1977. (See Ex. 12, p. 43.) To include such eccentric data in the development of the regression equation, staff felt, would distort the forecast for the test years.

"The soundness of staff's approach is demonstrated in two ways. First, Mr. Fukutome testified that he tested staff's approach by including the 1977 and 1978 consumption data in the computation of forecasted consumption. With the drought data included, the projected consumption changed only slightly, but the coefficient of correlation declined. (RT 121:25-122:7.) Thus, excluding consumption data from the drought years resulted in virtually identical forecasted consumption and in improved statistical reliability. Second, the Commission in other water utility rate cases has accepted consumption forecasts which were developed using weather data which excluded drought year figures. (See D.92874 (April 7, 1981), mimeo. p. 14.)

"In excluding two years of consumption data, however, staff does not ignore the effect of the drought on consumption. The combination of staff's use of time as an independent variable and the inclusion of consumption data for the post-drought years of 1979 and 1980 accurately reflects the long-term conservation induced by the drought, as well as other economic and social trends and influences. (RT 117:16-20; 118:24-28; 120:15-19; 123:23-124:7.)

"Mr. Housiaux' attempt to accommodate the effect of the drought was his use of a 'residual conservation factor' as an independent variable in his forecasting equation. The factor has the value 1.0 in drought and post-drought years, and 0.0 in pre-drought years. (RT 74:17-21.) Thus, Mr. Housiaux' method assumes the same level of conservation for 1977, the middle of the worst drought in memory, as for the normal rainfall year of 1980 and for the test years of 1981 and 1982. The conservation factor was not based on data, but on Mr. Housiaux' judgment. (RT 69:3-5; 70:26-30.) Moreover, to call the conservation factor an independent variable is deceptive, since the only factual basis for the conservation factor is recorded consumption, which is the dependent variable in the regression equation used to develop Mr. Housiaux' forecasts. (RT 68:28-69:5. See RT 57:13-23; 72:29-73:3.)"

We believe that the staff's methodology has provided the most accurate estimate of future consumption and that that estimate is the most compatible with recorded year 1980. This consistency is significant since 1980 is the latest recorded year and reflects the consumption or use pattern which has actually developed since the 1977 drought. Accordingly, we will adopt as reasonable for both test years, 1981 and 1982, the staff's estimate of 184.1 Ccf per residential customer per year as shown in Exhibit 12.

Commercial and Public
Authority Consumption

Because commercial consumption and public authority consumption are less influenced by weather conditions than residential consumption, both Cal-Am and staff considered only time and recorded consumption in developing estimates for the test years. For the public authority class, staff used an average of recorded consumption for 1976 through 1980 as the estimate for the test years. For the commercial class, staff used the normalized

1980 recorded consumption per customer as the estimate for the test years. The difference in staff's approach to these two classes was based on an examination of the historical consumption data for each class. The method selected was the one most appropriate in light of consumption patterns in past years.

Cal-Am used the same approach for both the commercial and public authority classes. Recorded 1980 consumption figures were extrapolated on the basis of the normalized trend line to arrive at test year projections. (Exhibit 8, page 3.) Cal-Am's approach gives greater weight to recorded 1980 consumption and less to long-term consumption than staff's method.

In each case, the staff's estimate produced less drastic variations from 1980 recorded consumption. Therefore we adopt the staff's estimate for test years 1981 and 1982 of 1,123.0 Ccf per customer per year for commercial customers and 3,877.0 Ccf per customer per year for public authority customers.

Consulting Fee

Cal-Am agreed with all of staff's regulatory Commission expense estimates and recommendations with the exception of staff's elimination of the \$6,000 fee for consultant Housiaux' testifying on consumption estimates during hearing. Originally, the staff based this position "on information from the utility...that the consultant [would] not be called on to testify." (Exhibit 12.) While Housiaux did testify at the hearings, the staff maintained its position, but for different reasons.

In particular, staff witness Fukutome testified that the major differences between the staff's and Housiaux' methods of calculating consumption had already been considered in Cal-Am's five previous rate increase applications. It was Fukutome's opinion that Cal-Am should not have had Housiaux update the staff's report "using a method that had already been rejected by the Commission and to prepare his

testimony from that [methodology] and come here and testify on it." The staff did include approximately \$5,400 in its estimate of regulatory Commission expense "to cover expenses incurred in the preparation of the consumption study prior to all the decisions in the five previous rate cases." However, the staff believes "that any subsequent expense incurred after the decisions on the other districts was not prudent on the company's part." (Tr. 110.)

The cross-examination of the staff witness and direct testimony of Cal-Am's witnesses also demonstrated the following:

1. Cal-Am's indication that Housiaux might not be called to testify came prior to the issuance of the staff report. The reason for so indicating may have been based on the assumption that the differences between the two parties' consumption estimates might not be great.
2. Cal-Am never indicated a lack of faith in its consultant.
3. Cal-Am has never explored the possibility of using any other consultant, determined what the fees might be for comparable services, or fixed Housiaux' fees by contract.
4. Housiaux resides in and is headquartered in Chicago.
5. Housiaux has worked with Cal-Am since the prior Coronado District rate case.
6. The decision to continue to retain Housiaux was not necessarily based on his effectiveness in prior cases, but his access to and familiarity with the relevant data and Cal-Am's districts.
7. Housiaux did not revise his methodology as the result of the previous Cal-Am rate increase decisions, but made some changes as a result of staff objections.

8. After two of the rate decisions, Housiaux had an improved analytical system available to him.

Since the last Coronado District rate application, the methodologies used by Housiaux and the staff have been discussed in three Commission decisions relating to five Cal-Am rate increase applications. In some instances the staff's estimates were adopted for residential, commercial, and industrial consumption; however, in none of these cases did the Commission ever "reject" or "approve" either of the particular methodologies used by the staff or Cal-Am. In D.91910, at page 23a, we concluded:

"The witnesses for Cal-Am and the staff are both well qualified and experienced experts in estimating water consumption. However, it is apparent from the testimony that there is no formula which will yield a precise answer in estimating test year water consumption. It is also apparent that the Modified Bean Method, which worked reasonably well up to the time of the 1977 drought, should be used with some modification to reflect residual conservation following the drought, impact of utility conservation programs, changes in building codes, and growing conservation awareness by customers."

These recent decisions also include situations in which neither the staff's nor Cal-Am's specific estimates were used (D.91910 (industrial class consumption) at page 24) and others in which the parties were in agreement (D.91910 (public authority consumption) at page 25). At most, we concluded in those decisions that the results of Housiaux' methodology often did not produce results compatible with the recorded consumption of the year prior to the test year.

We note that Housiaux' method has undergone further refinement since the last Cal-Am rate application. Nevertheless, the results which it produced were again incompatible with recorded

results. We concur, however, with counsel for Cal-Am that there has been no specific rejection of Housiaux' method and that the elimination of his fee may have a chilling effect on attempts by utilities or the staff to explore improved analytical and forecasting methods. We also agree that a more appropriate challenge to Housiaux' fee would have been on the basis of the reasonableness of the charges. While staff's cross-examination did elicit testimony related to Housiaux' travel expenses and the absence of any comparison of other consulting fees for similar services, this testimony was not supportive of the staff's recommendation to eliminate the entire fee nor was the record sufficiently developed to justify elimination of particular portions of that expense.

We find that Housiaux' fee for testifying during hearing is a reasonable regulatory expense. However, we note for the future that we do not find staff's objections frivolous. The utility is put on notice that it must make a sincere effort to obtain consulting service at reasonable costs; either through a formal bidding procedure or some other method that will ensure that other consultants offering similar services are contacted.

Summary of Earnings

Tables 4 and 5 set forth the summary of earnings for each of Cal-Am's districts for test years 1981 and 1982, respectively, (1) at present rates using staff's, Cal-Am's, and the adopted rates of return and expense estimates, and (2) at the rates authorized by this decision. The authorized rates reflect our adoption of the staff's recommended rate of return and consumption estimates and the inclusion of Housiaux' consulting fee as a reasonable regulatory expense.

The authorized rates will increase annual revenues by \$320,800 or 9.91% for test year 1981, and will produce an additional increase of \$181,300 or 2.9% for test year 1982.

TABLE 4

CALIFORNIA-AMERICAN WATER COMPANY - CORONADO DISTRICTEstimated Results of Operations
Test Year 1981

<u>Item</u>	<u>Present Rates</u>			<u>Authorized</u>
	<u>Utility</u>	<u>Staff</u>	<u>Adopted</u>	<u>Rates</u>
		(Dollars in	Results	<u>Adopted</u>
		Thousands)		<u>Results</u>
Operating Revenues	\$2,947.1	\$3,238.4	\$3,238.4	\$3,559.2
<u>Operating Expenses</u>				
Operation & Maintenance	1,801.3	1,984.9	1,983.8	1,985.0
Administrative & General	326.7	307.4	309.4	309.4
General Office Prorated	161.4	156.8	156.8	156.8
Depreciation Expense	194.4	193.3	193.3	193.3
Taxes Other Than Income	96.6	89.7	89.7	89.7
Income Taxes	12.9	88.3	87.9	251.5
Total Operating Expenses	2,593.3	2,820.4	2,820.9	2,985.7
Net Operating Revenue	353.8	418.0	417.5	573.5
Rate Base	5,372.8	5,232.4	5,232.4	5,232.4
Rate of Return	6.59%	7.99%	7.98%	10.96%

Rate Design

Cal-Am did not take issue with the staff's rate design proposal. The staff recommendations include:

1. The staff agrees with Cal-Am's two-block rate structure. The staff recommends, however, that when final quantity rates are designed, the difference between the first and second blocks be reduced to 50% provided that no rate block receives a severely disproportionate increase in rates.
2. Because the accumulated revenues since January 1, 1976, have exceeded 25%, any further authorized increase should be applied to both lifeline and nonlifeline quantities.
3. Rates for private fire protection, private fire hydrant, and flat rate services should be increased by approximately the overall percent increase for each test year.

Findings of Fact

1. Cal-Am's water quality, conservation program, and service in its Coronado District are satisfactory.
2. Cal-Am is in need of additional revenues, but the rates requested would produce an excessive rate of return.
3. A rate of return on common stock equity of 13.0% and overall rates of return of 10.96%, 10.98%, and 11.03% for 1981, 1982, and 1983, respectively, are reasonable.
4. The staff's estimates of consumption, rate base, and operating expense, with the exception of the elimination of the \$6,000 fee for Cal-Am's consultant testimony, reasonably indicate the results of Cal-Am's Coronado District operations for the test years 1981 and 1982 and should be adopted. The estimated \$6,000 fee for the testimony of consultant Housiaux is a reasonable regulatory Commission expense.

5. An allowance of 0.88% in rate of return to compensate for operational and financial attrition in the year 1983 is reasonable. This allowance will require an increase of \$97,200 or 2.6%, in annual revenues for 1983. This step rate increase for 1983 should be adjusted so that the authorized 11.03% rate of return will not be exceeded for the 12 months ended September 30, 1982.

6. The staff's rate design proposal is reasonable.

7. The increases in rates and charges authorized in this decision are justified; the rates and charges authorized in this decision are reasonable; and the present rates and charges, insofar as they differ from those prescribed in this decision, are for the future unjust and unreasonable.

8. Appendix C contains information regarding adopted data for this proceeding.

Conclusions of Law

1. The application should be granted to the extent provided by the following order.

2. Because of the immediate need for the increased revenues, the effective date of this order should be the date of signature.

O R D E R

IT IS ORDERED that:

1. After the effective date of this order, California-American Water Company (Cal-Am) is authorized to file for its Coronado District the revised rate schedules attached to this order as Appendix A. Such filing shall comply with General Order 96-A. The effective date of the revised schedules shall be the date of filing. The revised schedules shall apply to service rendered on and after the effective date of this order.

2. On or after November 15, 1981, Cal-Am 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 Coronado District 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, exceeds the lower of (a) the rate of return found reasonable by the Commission for Cal-Am during the corresponding period in the then most recent rate decision, or (b) 10.98%. Such filing shall comply with General Order 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 30 days after the filing of the step rate, whichever is later. The revised schedule shall apply to service rendered on and after the effective date thereof.

3. On or after November 15, 1982, Cal-Am is authorized to file an advice letter, with appropriate work papers, requesting the step rate increases attached to this order as Appendix B and 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 Coronado District 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, 1982, exceeds the lower of (a) the rate of

return found reasonable by the Commission for Cal-Am during the corresponding period in the then most recent rate decision, or (b) 11.03%. Such filing shall comply with General Order 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 sooner than January 1, 1983, or 30 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.

This order is effective today.

Dated MAY 7 1981 , at San Francisco, California.

*I will file a
concurring opinion.
John E. Byers*

John E. Byers

President
Richard D. Gravelle

William C. Davis

William C. Davis

Commissioners

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

APPENDIX A
Page 1

Schedule CO-1

Coronado District Tariff Area

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water service.

TERRITORY

Coronado, Imperial Beach, and portions of San Diego, and vicinity,
San Diego County.

RATES

Per Meter
Per Month

Service Charge:

For 5/8 x 3/4-inch meter	\$ 1.80	(I)	(N)
For 3/4-inch meter	2.00		
For 1-inch meter	3.25		
For 1 1/2-inch meter	6.00		
For 2-inch meter	14.00		
For 3-inch meter	25.00		
For 4-inch meter	45.00		
For 6-inch meter	60.00		
For 8-inch meter	95.00		

Quantity Rates:

First 300 cu.ft., per 100 cu.ft.	0.419	(I)	(N)
Over 300 cu.ft., per 100 cu.ft.	0.635	(I)	(N)

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 A
Page 2

Schedule CO-4

Coronado District Tariff Area

PRIVATE FIRE PROTECTION SERVICE

APPLICABILITY

Applicable to all water service furnished for privately owned fire protection systems.

TERRITORY

Coronado, Imperial Beach, and portion of San Diego and vicinity, San Diego County, all as set forth on Service Area maps on file with the California Public Utilities Commission.

RATES

Per Month

Private Fire Protection Systems:

For each 4-inch connection or smaller	\$11.00	(I)
For each 6-inch connection	22.00	
For each 8-inch connection	33.00	
For each 10-inch connection	49.00	
For each 12-inch connection	71.00	(I)

The rates for private fire service are based upon the size of the service and no additional charges will be made for fire hydrants, sprinklers, hose connections, or standpipe connected to and supplied by such private fire service.

APPENDIX A

Page 3

Schedule CO-4H

Coronado District Tariff Area

PRIVATE FIRE HYDRANT SERVICE

APPLICABILITY

Applicable to all water service furnished for fire hydrant service.

TERRITORY

Coronado, Imperial Beach, and portion of San Diego and vicinity, San Diego County, all as set forth on file with the California Public Utilities Commission.

RATES

Per Month

Private Fire Hydrant Service Installed at Cost
of Applicant.

For each Fire Hydrant Installed	\$6.50	(I)
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APPENDIX A
Page 4

Schedule CO-6

Coronado District Tariff Area

FLAT RATE SCHEDULE

APPLICABILITY

This rate is available only to a subdivider building a minimum of 5 homes within a tract approved by the County of San Diego, the Cities of Coronado, Imperial Beach, and a portion of San Diego, in the area served by the Coronado District.

TERRITORY

This rate shall apply within the Cities of Coronado, Imperial Beach, and portion of San Diego and vicinity, San Diego County, all as set forth on Service Area maps on file with the California Public Utilities Commission.

RATES

Monthly Charge per Water Connection \$10.00 (I)

(END OF APPENDIX A)

APPENDIX B

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

Effective Dates
1-1-82 1-1-83

Schedule CO-1

Quantity Rates:

For the first 300 cu.ft., per 100 cu.ft. ..	\$0.013	\$0.018
For all over 300 cu.ft., per 100 cu.ft. ...	0.019	0.019

Schedule CO-4

For each 4-inch connection or smaller	\$1.00	\$0.0
For each 6-inch connection	3.00	0.0
For each 8-inch connection	4.00	0.0
For each 10-inch connection	6.00	0.0
For each 12-inch connection	9.00	0.0

Schedule CO-4H

For each Fire Hydrant Installed	\$0.50	\$0.0
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APPENDIX C
Page 1

ADOPTED QUANTITIES

Company: California-American Water Company
District: Coronado

	<u>1981</u>	<u>1982</u>
1. <u>Water Production:</u> Ccf(1000)	5,240.8	5,369.6
<u>Purchased Water:</u>	5,240.8	5,369.6
Wells:	0	0
2. <u>Purchased Water</u>		
Cost:	\$ 1,467,400	\$ 1,503,500
\$ / Ccf:	0.280	0.280
(City of San Diego)		
(Jan. 1, 1981 rate)		
3. <u>Purchased Power</u>		
Cost:	\$ 100	\$ 100
4. <u>Ad Valorem Taxes:</u>	\$ 58,500	\$ 59,500
Tax Rate:	1.1132 %	1.1132 %

APPENDIX C
Page 2

ADOPTED QUANTITIES

<u>5. Number of Services-Meter Size:</u>		<u>1981</u>	<u>1982</u>
5/8 x 3/4		14,125	14,420
3/4		0	0
1		1,772	1,815
1 1/2		303	310
2		290	296
3		30	30
4		27	27
6		18	18
8		4	4
Total		<u>16,569</u>	<u>16,920</u>

<u>6. Metered Water Sales:</u>		<u>1981</u>	<u>1982</u>
<u>Range-Ccf</u>		<u>Usage-Ccf</u>	
0 - 3		573,100	585,300
Over 3		<u>4,407,400</u>	<u>4,517,900</u>
Total Usage		<u>4,980,500</u>	<u>5,103,200</u>

	<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>
Comm. Resid. Metered	15,009	15,304	2,763.2	2,817.5	184.1	184.1
Comm. Busin. Metered	1,391	1,445	1,562.1	1,622.7	1123.0	1123.0
Public Authority	169	171	655.2	663.0	3877.0	3877.0
Other	-	-	14.0	14.0		
Subtotal	<u>16,569</u>	<u>16,920</u>	<u>4,994.5</u>	<u>5,117.2</u>		
Private Fire Prot.	82	93				
Total	<u>16,651</u>	<u>17,013</u>				
Water Loss: 4.7%			<u>246.3</u>	<u>252.4</u>		
Total Water Produced			<u>5,240.8</u>	<u>5,369.6</u>		

<u>8. Revenue</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>
Metered	\$ 3,524,300	\$ 3,703,200	\$ 3,799,500
Private Fire Prot.	14,200	16,000	16,400
Misc.	<u>20,700</u>	<u>21,300</u>	<u>21,800</u>
Total	3,559,200	3,740,500	3,837,700
Attrition: 0.88%			\$ 97,200

<u>9. Average Residential Usage: 184.1 Ccf/customer-yr.</u>	
Average Monthly Bill:	\$ 10.68 \$ 10.94

APPENDIX C

Page 3

INCOME TAX CALCULATIONS

	<u>1981</u>	<u>1982</u>
	(Thousands of Dollars)	
Operating Revenues	\$ 3,559.2	\$ 3,740.5
O&M Expenses:		
Purchased Water	1,467.4	1,503.5
Purchased Power	0.1	0.1
Payroll	421.1	473.5
Postage	17.2	17.5
Other: OM. & AG.	375.4	417.2
Uncollectible @ 0.37%	13.2	13.8
Payroll Taxes	31.2	34.8
Ad Valorem Taxes @ 1.1132%	58.5	59.5
General Office Allocated Expenses	156.8	170.7
Payroll Taxes Capitalized	21.7	24.6
Interest	231.1	236.0
Total Deductions	<u>2,793.7</u>	<u>2,951.2</u>
State Tax Depreciation	222.7	232.8
Net Taxable Income	542.8	556.5
State Corp. Franch. Tax @ 9.6%	52.1	53.4
Federal Tax Depreciation	238.7	249.3
State Income Tax	52.1	53.4
Net Taxable Income	474.7	486.6
Federal Income Tax @ 46%	218.4	223.8
Less: Grad. Tax Adj.	2.8	2.8
Investment Tax Credit	16.2	15.8
Total Federal Income Tax	199.4	205.2

Net to Gross Multiplier: 2.0561

(END OF APPENDIX C)

Commissioner Bryson, Concurring

I concur with the Commission's decision today to grant California-American Water Company (Cal-Am) a rate increase producing a return on equity of 13%. I reach this conclusion not because I believe 13% reflects the company's current cost of equity capital, but because the company in its application did not present evidence in support of a higher return. Had the company presented a case based on current capital market costs, I would have supported a higher return.

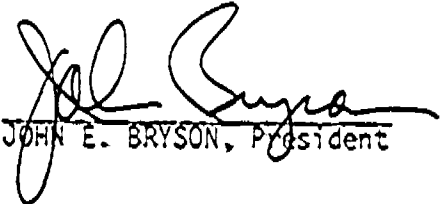
The company's only exhibit in this case relating to rate of return was a one-page presentation of recent Commission water company decisions compared with company requests and staff recommendations. The only conclusion I can glean from this table is that the staff recommendation of 13% is roughly equivalent to recent water company decisions, and that Cal-Am's request would result in the highest return we have authorized for a water company. This is hardly a compelling showing for Cal-Am.

While I concur in the decision based on the record before us, other evidence not presented would lead me to conclude that the 13% return is too low. Treasury notes due at the end of 1983 (the period covered by the decision) currently yield 13.79%. While water companies are not particularly risky businesses, I could readily be persuaded that Cal-Am should be allowed to earn at least as much on equity as do treasury bills backed by the U.S. government. I would also expect that the company's current debt costs would provide persuasive evidence that the company's equity return should be higher.

In a dissenting opinion in the San Jose Water Works rate case (D.92719), I asked the staff to fundamentally rethink its methodology in reaching rate

of return recommendations and to make recommendations which reflect current market conditions. I would suggest today that utilities also should present evidence in their applications about current market conditions and how utility equity returns should compare with returns on other available investments to make the most persuasive case to the Commission. By relying on historical Commission decisions, Cal-Am in this case did not make a persuasive case for a higher return authorization.

San Francisco, California
July 7, 1981


JOHN E. BRYSON, President