

ORIGINAL

Decision 93588 October 6, 1981

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of LAGUNA HILLS)
WATER COMPANY for authority)
to alleviate the effect of)
financial attrition by)
increasing Applicant's rates)
and charges for water.)

Application 60635
(Filed June 8, 1981)

INTERIM OPINION

Laguna Hills Water Company (LHWC) seeks authority to increase its rates to alleviate financial attrition. According to the application, the necessary revenue increase would be \$95,800, or 2.6%, with reference to the test year 1980 operating results adopted in LHWC's general rate increase decision, Second Interim Decision (D.) 91915 dated June 17, 1980 in Application (A.) 58440, and related matters. ✓

Professional Community Management, Inc., Golden Rain Foundation, and Mutual Housing Corporations Inside Leisure World have requested a hearing on this matter. The interim character of this decision and the conditions imposed, however, render a public hearing unnecessary at this stage. A hearing will be held only when, and if, this application is amended to seek specific rate relief as contemplated in Finding 10 and Conclusion 2 of this order. ✓

By a decision being issued today in A.60490 and A.60491, LHWC is authorized to obtain a \$500,000 loan and to issue 5,000 shares of its \$100 par value common stock. The proceeds are to be used to repurchase approximately 40% of main extension contracts (MECs) and to pay refunds overdue on LHWC's MECs.

In Exhibits C and F to the application, a pro forma cost of debt and an overall rate of return for LHWC were developed as follows:

Pro Forma Embedded Cost of Long-Term Debt
1980

	<u>Par Value</u>	<u>Net Proceeds</u>	<u>Annual Charge</u>	<u>Effective Rate</u>
Series A Bonds @ 6%	\$ 980,400	\$ 936,968	\$ 60,994	
Series B Bonds @ 10%	<u>1,320,000</u>	<u>1,289,772</u>	<u>134,015</u>	
As Adopted in D.91915	2,300,400	2,226,740	195,009	<u>8.76%</u>
New Debt Assumed @ 19.5% (1)	<u>500,000</u>	<u>500,000</u>	<u>97,500</u>	
Pro Forma	<u>\$2,800,400</u>	<u>\$2,726,740</u>	<u>\$292,509</u>	<u>10.73%</u>

(1) LHWC anticipates United California Bank will require an interest rate 1% over the prime rate on a floating basis.

Overall Rate of Return
Including Effect of A.60490 and A.60491
1980

	<u>Balance December 31, 1980</u>	<u>%</u>	<u>Cost</u>	<u>Weighted Cost</u>
<u>As Adopted D.91915</u>				
Long-Term Debt	\$2,300,400	38.33%	8.76%	3.36%
Common Equity	<u>3,700,445</u>	<u>61.67</u>	12.85	<u>7.92</u>
Total	<u>\$6,000,845</u>	<u>100.00%</u>		<u>11.28%</u>
<u>Actual</u>				
Long-Term Debt (1)	\$2,300,400	37.44%	8.76%	3.28%
Common Equity	<u>3,844,388</u>	<u>62.56</u>	12.85	<u>8.04</u>
Total	<u>\$6,144,788</u>	<u>100.00%</u>		<u>11.32%</u>
<u>Pro Forma Including A.60490 & A.60491</u>				
Long-Term Debt	\$2,800,400	39.20%	10.73%	4.21%
Common Equity	<u>4,344,388</u>	<u>60.80</u>	12.85	<u>7.81</u>
Total	<u>\$7,144,788</u>	<u>100.00%</u>		<u>12.02%</u>

(1) Excludes debt encompassed by A.59748 and A.60149.

In Exhibit G to the application, LHWC's pro forma operating results are developed as follows:

Pro Forma Summary of Earnings
1980

	(A) Decision 91915 Adopted	(B) (Debt) Application 60490	(C) (Equity) Application 60491	(D) Applications 60490 and 60491
Revenues	<u>\$3,687.8</u>	<u>\$3,771.0</u>	<u>\$3,705.1</u>	<u>\$3,783.6</u>
O&M Expenses	2,208.0	2,208.0	2,208.2	2,208.2 ✓
A&C Expenses	307.1	307.1	307.2	307.3
Amortization	20.9	20.9	20.9	20.9
Depreciation	301.9	(4) 287.2	301.9	(4) 287.2
Taxes - Except Income	106.9	106.9	106.9	106.9
Income Taxes	<u>111.8</u>	<u>111.8</u>	<u>120.4</u>	<u>120.4</u>
Total Expenses	<u>3,056.6</u>	<u>3,041.9</u>	<u>3,065.5</u>	<u>3,050.9</u> ✓
Net Revenues	<u>631.2</u>	<u>729.1</u>	<u>639.6</u>	<u>732.7</u>
Rate Base	<u>5,596.0</u>	<u>6,096.0</u> (5)	<u>5,596.0</u>	<u>6,096.0</u> (5)
Rate of Return	<u>11.28%</u>	<u>11.96%</u> (1)	<u>11.43%</u> (2)	<u>12.02%</u> (3)

(1) Net-to-gross multiplier of 1.00.

(2) Net-to-gross multiplier of 2.0567, including uncollectibles .213%, franchise requirement .186%, and federal income taxes 46%, as proposed in Exhibit 13 to A.58440, modified by increase in California franchise tax rate to 9.6%.

(3) Reflects net-to-gross multiplier of 2.0567 on column (C), net revenue requirement, and net-to-gross multiplier of 1.00 on remaining revenue requirement.

(4) Reflects reduction of depreciation expense by \$14,700 based on contributed plant of \$734,000.

(5) The \$500,000 increase in rate base over that shown in column (A) reflects the proposed repurchase of MECs.

According to testimony in the March 1981 hearings in the A.58440 and related matters proceeding, a prerequisite to obtaining this \$1 million in debt and equity financing is its timely incorporation into LHWC's capitalization structure for ratemaking purposes. Notably, the record in that proceeding also clearly establishes that the result of LHWC's recorded 1980 operations was a rate of return of 12.8%. This recorded result compares with the presently authorized rate of return of 11.28% and the overall rate of return requested in the instant application of 12.02%.

After obtaining the proposed \$1 million in new financing and upon repurchasing the MECs and paying the overdue MEC refunds, LHWC should forthwith be entitled to have its authorized rate of return increased to the 12.02% level and test year 1980 rate base increased to \$6,096,000. The 12.02% rate of return and the \$6,096,000 rate base could then be used in testing whether flowing through into rates changes in offsettable expenses, such as in the cost of purchased water, would cause the authorized rate of return to be exceeded. ✓

Upon a proper showing in the instant application, if it is amended, that the earnings level at the then current rates would be below the 12.02% rate of return, further rate relief, beyond that anticipated in the preceding paragraph for offsettable expenses, to alleviate the financial attrition could be justified.

Decisions are also issued today in A.60490 and A.60491 (financing proceedings) and in A.58440 (rate increase applications). The combined record in these proceedings shows there is not only an

adequate basis for granting interim rate relief applicable to testing offsets as described above, but a need to demonstrate that further rate relief to alleviate the financial attrition attributable to the new financing will be forthcoming upon a proper showing.

Findings of Fact

1. In D.91915 dated June 17, 1980 in A.58440, an 11.28% rate of return was authorized for LHWC based on a capital structure of 38.33% debt and 61.67% common equity, a debt cost of 8.76%, and a return of 12.85% on equity.

2. Upon incorporating the \$1 million new debt and equity financing covered in A.60490 and A.60491, LHWC's pro forma December 31, 1980 capital ratios become 39.20% debt and 60.80% equity and its cost of debt increases to 10.73% based on \$500,000 of new debt at a cost of 19.5%. Holding the return on equity constant at 12.85% yields a new overall rate of return of 12.02%.

3. The 19.5% interest rate applied to the \$500,000 in new debt in Finding 2 above is reasonable for use in determining rate of return. It is anticipated that this new debt will carry an interest rate 1% over the prime rate on a floating basis.

4. In D.91915, supra, a rate base of \$5,596,000 was adopted. Upon LHWC's repurchasing MECs as proposed, its test year 1980 pro forma rate base becomes \$6,096,000.

5. Having increases in rate of return and rate base specified in Findings 2 and 4 above authorized are prerequisites to obtaining the new debt and equity financing.

6. After obtaining the \$1 million in new financing and upon repurchasing the MECs and paying the overdue MEC refunds as proposed in A.60490 and A.60491, the fair rate of return should be adjusted from 11.28% to 12.02% and the test year 1980 rate base increased to \$6,096,000.

7. The result of LHWC's recorded 1980 operations was a rate of return of 12.8%.

8. In light of Finding 7 above, the 12.02% rate of return and \$6,096,000 rate base supported by this application have not been shown to justify an increase in rates at this time.

9. Upon the conditions set forth in Finding 6 above being met, a proper application of the 12.02% rate of return and \$6,096,000 rate base will be in determining the extent changes in LHWC's off-settable expenses are allowed to flow through into its rates under advice letter filings.

10. Upon a proper showing that LHWC's earnings level at present rates would be below the 12.02% rate of return, rate relief beyond that anticipated in Finding 8 above may be justified. ✓

Conclusions of Law

1. Upon the conditions set forth in Finding 6 above being fulfilled, the rate of return authorized for LHWC should be increased from 11.28% to 12.02% and the 1980 test year adopted rate base increased from \$5,596,000 to \$6,096,000 to afford LHWC an opportunity to earn the 12.85% return on common equity authorized by D.91915.

2. An interim decision in this matter is appropriate in order to afford LHWC an opportunity to amend the application to incorporate a showing consistent with Finding 10 above.

3. An adequate basis exists through the A.58440 and related matters proceeding and the contents of the instant application to render an interim decision in this matter without public hearing.

INTERIM ORDER

IT IS ORDERED that upon the conditions set forth in Finding 6 above being fulfilled, the rate of return authorized for Laguna Hills Water Company (LHWC) in Decision 91915 dated June 17, 1980 in Application 58440 is increased from 11.28% to 12.02%, and the 1980 test year adopted rate base is increased from \$5,596,000 to \$6,096,000. Specific rate relief and rate levels will be determined after public hearing when and if this application is amended, and when LHWC's results of operations are cast in light of the higher return and rate base. ✓

This order is effective today.

Dated October 6, 1981, at San Francisco, California.

JOHN E. BRYSON
President
RICHARD D. GRAVELLE
LEONARD M. GRIMES, JR.
VICTOR CALVO
PRISCILLA C. GREW
Commissioners

*I certify that this decision
was approved by the above
Commissioners today.*

John E. Bryson