ALJ/JBW/mrj **Mailed 3/18/99**

Decision 99-03-032 March 18, 1999

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Apple Valley Ranchos Water Company, for authority to increase rates by $1,295,453 or 15.1% in 1999; and 279,216 or 2.8% in 2000; by $280,577 or 2.7% in 2001.	Application 98-03-024 (Filed March 16, 1998)

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OPINION

I. Statement of Facts

A. Background

Apple Valley Ranchos Water Company (AVR), a wholly owned subsidiary of Park Water Company (Park), is located in and adjacent to the Town of Apple Valley, East of Victorville and Interstate Route 15 in San Bernardino County. Following the merger (Decision (D.) 95-12-028 issued January 1, 1997) of Park owned Jess Ranch Utilities, Inc. into AVR, AVR has been providing water and sewer services to the adjacent retirement community of Jess Ranch. With the acquisition in 1989 of the majority of assets of Apple Valley Resources Co., Inc., AVR also serves 2 small adjacent districts. At the close of year 1997, AVR was serving approximately 13, 505 customers in this high desert area. It provided 14,887 acre feet of water from its 21 wells (all located in the Mojave River Ground Water Basin), distributing this water through 1,847,211 lineal feet of mains. All customers are metered.

B. Application (A.) 93-03-024

On March 16, 1998, AVR filed A.98-03-024 seeking general rate increases for water service. The increases sought over the present rates are $1,295,453 or 15.1% for 1999; an additional $279,216 or 2.8% for 2000 above revenues generated by the rate proposal for 1999; and an attrition step increase for 2001 of $280,577 or 2.7% above the 2000 revenue requirements. It is estimated that the requested increases would produce a rate of return on equity (ROE) of 11.50%, and a return on the estimated rate base for test years 1999 and 2000 of 10.40% and 10.30%, respectively.

AVR states the increases are necessary because present rates are insufficient, unjust, and unreasonable in that they do not provide the applicant a fair, just, and reasonable return on present, and to be invested, capital devoted to provision of utility services. Additionally, AVR stated it was seeking to recover additional costs resulting from increased water replenishment assessments and water rights lease costs arising out of adjudication of the Mojave River Basin, inflationary pressures, infrastructure improvements, a decrease in water consumption, and shortfalls in anticipated customer growth.

Pursuant to provisions of Rule 6.1 of the Commission's Rules of Practice and Procedure (Rules), by Commission Resolution ALJ 176-2989 adopted March 26, 1998, the application was preliminarily designated as "ratesetting" with a hearing indicated. Commissioner Josiah L. Neeper and Administrative Law Judge (ALJ) John B. Weiss respectively, were designated as the Assigned Commissioner and ALJ.

C. Protest

On April 7, 1998, the Ratepayer Advocacy Section of the Legal Division advised that the Ratepayer Representation Branch (RRB) of the Water Division would participate as protestants in the proceeding. Pursuant to provisions of Rule 6.2 of the Rules, Commissioner Neeper set a Prehearing Conference (PHC) for May 8, 1998. Following this PHC, on May 18, 1998, the Commissioner issued his Scoping Memo and Ruling setting a schedule for the proceeding, providing for a public participation hearing (PPH) and Evidentiary

Hearings (EH), and designated ALJ Weiss as the principal hearing officer for the proceeding.

Public Participation Hearing

In excess of 200 customers attended the afternoon and evening sessions of the June 1, 1998 PPH in the Apple Valley City Hall. Twenty seven made statements for the record in the afternoon, and another 30 in the evening. Eighteen indicated they were retired. While generally AVR had complied with the Commisson Rule 24 notice requirements, the notices contained an error. In the notice portion stating the impact of the proposed increases on the bi-monthly bill of the average customer, the stated amounts failed to include 1 of the 2 month's readiness to serve charges.[1] Detected too late for a mailed correction before the June 1, 1998 PPH, copies of a corrected notice were made available at the PPH as ordered by the ALJ. Two of the customers who spoke at the PPH sessions asked the ALJ to cancel these hearings, adjourn, and reset a PPH for another later date. But noting the large turnout and the tightness of both the proceeding schedule set forth by the Scoping Memo and the Commission General Rate Case Plan, ALJ Weiss determined to proceed as scheduled.

Almost uniformly the speakers, both long and short term resident consumers, many retired on fixed income, opposed any increase in rates. Underlying the comments was the contrast between rates before Park and after. Some contrasted the stability of low rates before and the frequency and size of increases since. One speaker compared his 1978 $6 monthly bills to his present $100/month bill; another his 1983 bi-monthly $35 bill to today's $300 bill. Also

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[1] For 1999: $90.65 vs. $75.15; for 2000: $93.13 vs. $77.15; and for 2001: $95.65 vs. $78.95. The present average bi-monthly bill was also understated: $78.85 vs. $64.18.

singled out was the size of the readiness to serve charge; one speaker contrasting his 1988 $8.27 charge to today's $27.80 charge.

Speakers ridiculed AVR's reasons for seeking an increase, noting the very low inflation being experienced; contrasting the sought for 11.50% return on equity to their 2% return on bank accounts, and questioning the costs for water as a result of the Mojave Basin adjudication. Park was assailed for "inefficient management" and disregard for the interests and limitations of local residents. Both old timers and relative new comers deplored the necessity of having to give up lawns and trees to rock gardens because of the ever increasing cost of water. One stated that the cost of water is to the point that the town is blowing away or will burn up soon because of all the vegetation not being watered. Several said their lawns once were a cool oasis in summer but no more.

Most speakers hammered on the great disparity between AVR's high rates and the low rates of nearby communities, specifically Victorville and Hesperia. Some wondered why the 14 separate local water purveyors in the general area could not be merged into a single provider with lower rates.[2]

Some speakers, providing specific location information, related repeated examples of ruptured or leaking pipes that AVR dug up, patched, and covered up, only for the process to be repeated, one for 10 years, before the pipe was replaced. There was expressed the general feeling that Park had bought AVR very reasonably at a time when the anticipation was for astronomical growth projections, anticipations which just have not materialized. It seems also to be the view that Park didn't realize or check out before buying just how bad a shape the distribution infrastructure was in. And the speakers argued that they

[2] It appears that most of these lower charging water purveyors are municipalities, water districts, or other governmental entity suppliers.

should not be made to pay since Park made a bad investment. A number of speakers denounced the Commission for not protecting them and favoring Park.

Letters to the Commission on the Application

Apart from the input of the PPH speakers, the Commission received 61 individually written letters, 9 form letters, and a letter with a 20-signature petition attached. Only a small number appear to be from PPH speakers. But all opposed any rate increase and many voiced the same feelings as were expressed at the PPH.

D. Report of the Ratepayer Representation Branch

Following the June 1, 1998 PPH in Apple Valley, and after review of the comments at the PPH and the letters that followed, RRB completed its analysis of AVR's application, and on July 2, 1998, issued 2 reports. The first report addressed Results of Operations, and the second addressed Cost of Capital and the Rate of Return. Respectively, these reports are Exhibits 18 and 3 in this proceeding.

The Results of Operations Report of RRB for virtually all expense categories projected lower amounts than those set forth in AVR's application. When combined with RRB's recommended lower 8.20% ROE for the period here at issue, and RRB's recommended return on rate base of 8.48% for Test Years 1999 and 2000, and 8.47% for attrition year 2001, the result was RRB's recommendation for a reduction in AVR's revenues of $1,090 million (11.9%) for 1999; an increase of $96,400 (1.2%) for 2000, and a reductin of $25,000 (0.3%) for 2001.

The major differences between RRB's analysis recommendations and the estimates in AVR's application centered in:

1. RRB's higher estimates for residential consumption applicable to each of the Test Years;

2. RRB's estimates of lower unaccounted for, or lost water;
3. RRB's lower estimates of operating expense, applicable to both operations and maintenance, and administrative and general, and
4. RRB's calculation of a lower rate base each year than those estimated in AVR's application.

The Prehearing Rate Base Issues

Because of different estimates of accumulated depreciation, advances for construction, contributions in aid of construction, common plant, and working cash, AVR and RRB produced different estimates of Rate Base. Before the EH, the parties had reconciled their differences and settled upon a total Rate Base of $20,764,637 for Test Year 1999, and $21,961.747 for Test Year 2000. Their initial component estimates and the final resolution appears in the following Table A comparison of Rate Base Issues, with the exception of the working cash component.

Table A

Apple Valley Ranchos Water Company

Comparison of Rate Base Issues

	AVR	1999 STAFF	SETTLEMENT	AVR	2000 STAFF	SETTLEMENT
PLANT IN SERVICE	34,047,627	33,372,600	34,394,584	35,952,019	34,930,400	38,659,718
WORK IN PROGRESS	182,648	179,900	364,381	0	0	320,985
MATERIALS & SUPPLIES	117,968	118,000	117,968	119,395	119,400	119,395
WORKING CASH	624,976	625,000		588,897	588,900	
SUBTOTAL	34,973,218	34,295,500	34,876,923	36,638,311	35,616,700	37,100,095
LESS:						
DEPRECIATION RESERVE	8,660,210	8,681,200	8,702,335	9,469,189	9,469,600	9,528,871
ADVANCES	4,997,785	5,058,600	5,058,592	5,021,576	5,080,800	5,080,834
CONTRIBUTIONS	1,592,719	1,573,400	1,573,442	1,517,680	1,498,100	1,498,113
UNMORTIZED TC	124,303	124,300	124,303	119,466	119,500	119,438
DEFERRED INCOME TAX	2,263,791	2,259,100	2,256,672	2,451,674	2,435,400	2,443,269
SUBTOTAL	17,638,808	17,696,600	17,715,344	18,579,485	18,603,400	18,667,553
PLUS						
METHOD & ADJUSTMENT	46,409	46,400	46,409	43,107	43,100	43,107
NET DISTRICT RATE BASE	17,380,819	16,645,300	17,207,988	18,101,933	17,036,400	18,475,649
MAIN OFFICE ALLOCATION	936,805	936,800	936,805	936,805	936,800	936,805
APPLE VALLEY IRRIGATION	409,792	409,800	409,834	397,495	397,500	397,536
TOWN OF APPLE VALLEY	2,210,010	2,210,000	2,210,010	2,151,757	2,151,800	2,151,757
TOTAL RATE BASE	20,937,426	20,201,900	20,764,637	21,587,990	20,542,500	21,961,747

Note: Both parties included the plant associated with the Town of Apple Valley negotiations for purchase of a water system and sale of a sewer system being consummated in 1998 in their additions to plant estimates and their settlement.

The Cost of Capital and Rate of Return Report of RRB accepted the AVR capital structure proposed in AVR's application of 42.27% debt and 57.73% common equity as applicable for the Test Years. But RRB disagrees with the rate of return of 11.5% requested by AVR. While the respective estimates of the cost of debt differ only by a single basis point (0.01%) and AVR accepted RRB's cost factors for long term debt, the recommendation of RRB for the return on common equity of 8.20% differs from AVR's requested 11.50%, by 330 basis points (3.30%).

RRB's recommendations were based upon its quantitative analysis of the expected returns by investors in the water industry. The analysis was done using financial models, with data extracted from a group of 11 water companies it considered had comparable risk. RRB concluded that Park, AVR's parent, was an average risk Class A water company, leading to the 8.20% ROE recommendation.

E. Stipulated Issues

During the interval before the EH, the parties engaged in negotiations over their differences. These negotiations resulted in resolution in principal of all their differences except those relating to residential consumption, regulatory expense, and ROE. While the ingredients of the stipulations were stated in some detail on the first day of EH (8/18/98), the memorialized product was not achieved and signed until August 27, 1998, and as agreed upon with the ALJ, the parties filed their motion for adoption of the stipulation on September 8, 1998.

The stipulation is attached to this decision as Appendix A. Table B which follows sets forth the original positions of AVR and RRB, and also the stipulated settlement.

Table B

Apple Valley Ranchos Water Company

Comparison Of O&M And A&G Expenses

	YEAR 1999			YEAR 2000		
Consolidated Items	**AVR**	**RRB**	**Settlement**	**AVR**	**RRB**	**Settlement**
O&M Payroll	732,528	660,600	708,744	780,288	872,200	749,210
O&M Other	1,111,434	998,700	1,109,030	1,098,370	1,005,400	1,094,005
A&G Payroll	529,642	485,300	512,446	556,019	494,600	533,874
A&G Office Expense	137,783	122,800	136,472	141,928	124,800	139,747
Outside Services	123,876	95,600	122,625	127,592	96,100	125,568
Misc. General Exp.	20,330	13,700	20,125	20,940	13,800	20,808
Injuries & Damages	250,193	235,600	235,643	260,339	243,100	243,142
Benefits	335,211	225,000	323,216	374,024	230,800	359,778

The most significant aspects covered by the stipulation's are discussed below.

Payroll

To achieve their stipulations for payroll, applicable to both O&M and A&G, the parties revised their initial positions. Using total payroll allocated to the various expense categories, numbers were developed to incorporate charges from the main office. The stipulations used RRB's 5-year averages of percentages to Capital and Clearing Accounts. A vacancy adjustment to eliminate ½ of a position was adopted. RRB's May 1998 escalation factors were used in place of the AVR application and RRB Report factors.

Purchased Power

Purchased Water

Replenishment Charges

The stipulation adopts purchased power costs based upon revised average unit cost dollars per acre foot in calendar year 1997 instead of AVR's earlier base, applying Southern California Edison's rates. No reduction is included because of the uncertainties in restructuring of the electric industry, and differences between adopted and actual expenses will be tracked in AVR's balancing account. The stipulation provides that the consumption adopted by the Commission, after resolution of residential usage, will determine the adopted expenses for the Test Year. RRB's $65 per acre foot cost for pumping and for leasing any additional water rights is adopted.

Operation and Maintenance Expense, Other

Administrative and General Office Expense

Outside Services

Miscellaneous General Expense

For these non-labor expenses, review of averaging methodology revealed that some of the recorded years had not included expenses for the Jess Ranch operation. Recalculation of averages using Jess Ranch allowed use of AVR's original budget numbers employing RRB's more recent May 1998 escalation factors.

Injuries and Damages

The parties stipulated to use RRB's estimates which were based upon a quotation from AVR's insurance provider.

Pension and Benefits

The parties stipulated to use AVR's estimates with revisions incorporating actual 1998 changes to the medical insurance premium and the group pension expense. Benefit categories were adjusted to be consistent with payroll adjustments, and medical insurance was also adjusted to reflect the payroll vacancy adjustment adopted. A 13.22% increase for each Test Year was agreed upon to provide for the past underfunding of AVR's pension plan.

Unaccounted for Water

On the assumption that AVR will be spending an additional $500,000 in 1998 and each test year replacing mains, the stipulation bases unaccounted for water on 9% of total demand as adopted by the Commission for this proceeding.

Plant

The stipulation provides for adoption of AVR's proposed capital expenditures each year, but that each year 10% would not close to plant in that year, but would remain in Construction Work in Progress (CWIP). Current CWIP is assumed to close to plant in the year originally assumed, and the $500,000 main replacement currently in progress would also close in the year originally assumed. These assumptions are reflected in the Depreciation Expenses and Accumulated Depreciation adopted by the stipulations for the Test Years.

F. Evidentiary Hearing

EH on the application was held before ALJ Weiss in San Francisco on August 18 through 21, 1998. These hearings were confined to receipt of evidence on the amount to be adopted of forecasted sales to residential customers, the appropriate regulatory expense to be allowed for the application proceeding, and the cost of equity.

AVR presented its evidence through witnesses Leigh Jordan, Sr. Vice President of Park, Donald R. Howard, President of Howard Consulting Engineers, Inc., Dr. Thomas M. Zepp, Vice President of Utility Resources, Inc., and Jack R. Clarke, Manager of AVR. RRB submitted its evidence through witnesses James R. Wuehler, Financial Examiner, Victor D. Moon, Associate Utilities Engineer, and Martin G. Lyons, Program and Project Supervisor.

After receipt on August 27, 1998 of the parties' Joint Motion for Adoption of Stipulations, both parties submitted Opening and Reply Briefs. Upon receipt of Reply Briefs on September 14, 1998, the matter was submitted for decision.

II. Discussion

A. Consumer Comment and Opposition

Once again the Commission is asked by numerous customers of AVR who attended the PPH in Apple Valley on June 1, 1998, and others who wrote letters and signed petitions, not to grant any increase to AVR. Much of the argument against any increase essentially is based in assertions that as Park made a bad deal in acquiring AVR (assertedly not having sufficiently checked out the infrastructure before buying), the customers today should not have to continue to pay for the repairs and replacements needed to bring the system into compliance with standards.

But for any understanding of much of AVR's present infrastructure problems, some review of background information is essential.

Prior to its acquisition by Park, AVR had a turbulent history stretching back from its 1945 incorporation as a mutual by Newton Bass and Bernard Westlund, land developers who also owned Apple Valley Building and Development Company (later renamed Apple Valley Ranchos, Inc. (Ranchos).

On June 1, 1947, AVR was certificated as a water public utility (D.40427). In 1948, Ranchos became the corporate parent of AVR. In 1966, Reserve Oil and Gas Company (Reserve) acquired both Ranchos and AVR. Reserve exercised control over AVR through Ranchos. Ranchos was the major subdivider and developer in the extensive area AVR had established as its territory.

Initially, AVR's extensive service area was sparsely developed. In many instances, transmission mains to tracts were installed, but the construction of the in-tract facilities was deferred until needed to serve homes as they were later built in these tracts. The sources for funds for these in-tract facilities were advances for construction and contributions in aid of construction paid to AVR. AVR put these advance funds for facilities not built into certificates of deposit. But AVR's early owners used the water company to promote their subdivision and land sales activities, followed unauthorized main extension practices, installed extensive lengths of substandard main, and deviated repeatedly from the Uniform System of Accounts. Water rates were kept low to facilitate land sales, and there were few replacements as the substandard steel mains began leaking. Meanwhile, Getty Oil Company acquired Reserve's assets including AVR, and in 1979 Getty was authorized to acquire control of AVR (D.93675). In 1984, Texaco Producing, Inc., a wholly owned subsidiary of Texaco, acquired AVR. There was little replacement, only patching, while leaks were increasing through the approximate 70 square miles of AVR's service territory.

It was in the public interest to get AVR out of the hands of land developers and oil companies. No matter who owned and operated AVR, the system had to be brought to standards set by the Commission's General Order No. 103. After experience with the prior owners, it was preferable that a Class A water utility willing to undertake the task be authorized to acquire it. But there is no free ride. No public owned entity stepped forward to take over the ailing system. Privately owned public utilities are in the water business, not only to provide reasonable service, but also to earn a profit. Park was willing to undertake the task of rehabilitating the AVR system and was authorized by the Commission to do so.

Since Park acquired AVR, it has been engaged in a large main replacement program, identifying the worse areas, and repairing or replacing as required. Between 1992 and 1997, actual expenditures on main replacement exceeded the authorized budget amounts by about $1,078,000 ($600,000 in 1966 alone.)[3] With this replacement ongoing there has been a reduction in leaks from approximately 3,100 to 2,400 units. Park has agreed to spend an additional $500,000 each Test Year on main replacements. But the ratepayers pay in the end for all these expenses. The United States Supreme Court as long ago as 1923, set guidelines. While recovery of all reasonable and required operating expenses and interest on debt takes precedence over dividends to common stockholders, rates that are set must also provide a return on the value of the property a public utility employs to provide service to its customers (See Bluefield Water Works and Improvement Co. v West Virginia Public Service Commission (1923) 262 U.S. 679, 692-693. Also, see Federal Power Commission v. Hope Natural Gas Co. (1944) 30 K.S. 591, 603)

AVR was criticized at the PPH for having all new vehicles. At the EH hearing it responded to the ALJ's questions on the issue by describing its vehicle replacement program. With 18 general purpose vehicles plus 2 dump trucks, it has this fleet on a 9-year life cycle, and replaces 2 vehicles each year. Its

[3] With approximately 340 miles of main in its 70 square miles service territory, approximately 210 miles are substandard. Under Park's ownership approximately 70 miles have been replaced, using PVC to replace the steel mains.

vehicles range in age from 1989. This program assertedly was recommended by RRB and reasonably reflects industrial practice.

B. Acceptance of the Stipulations

Turning to the stipulations, we conclude that RRB has conducted a thorough analysis of the protested estimates, and that in their negotiations leading to the stipulations, both AVR and RRB have rechecked and reconsidered their positions after exchange of additional data. On some issues, AVR has persuaded RRB on its position, and in others RRB has shown AVR that a change was necessary. The changes are set forth in the stipulations. We have analyzed the stipulations vis a vis the application estimates and the RRB Report recommendations and find them reasonable resolutions of the differences initially held.

The stipulations satisfy the requirements set forth in *San Diego Gas & Electric Company's General Rate Case* D.92-12-019 in that:

1. The Stipulations command the sponsorship of the only 2 active parties to the proceeding;

2. Each active party was adequately represented by both competent counsel and responsible witnesses. RRB adequately represented the interests of the ratepayers;

3. Both parties assert that no terms of their stipulations contravene any statutory provision or any decision of the Commission, and our independent review has disclosed none, and

4. These stipulations with their tables, together with the record in the proceeding, convey to the Commission sufficient information to permit the Commission to discharge its future regulatory obligations with respect to the parties involved and to the affected ratepayers. By adopting these stipulations

we are assisted in fulfilling our primary obligation of setting just and reasonable rates.

Accordingly, we will approve the motion for adoption of stipulations as presented by the signatory parties as being a complete resolution of all issues in the proceeding except for residential consumption, regulatory expense, and return on equity. The motion and stipulations are attached as Appendix A to the order that follows.

C. The Residential Consumption Issue

For its application filing in March of 1998, AVR used the Time Series process (TSP) econometric forecasting program using DOS. For its July 1998 Report on the application, RRB used E-views with Microsoft Windows, another econometric forecasting program.

In its application AVR forecast residential consumption of 302.1 Ccf for year 1998, and 295 Ccf for year 2000. RRB in its Report forecast this consumption at 350.2 Ccf for both 1999 and 2000. The different projections were due to use of different variables by the parties in their projections, and slightly different periods covered.

At the request of RRB, and before the EH, AVR prepared a series of 8 runs, the first 3 using AVR's 10-year period, and the final 5 runs using RRB's 8-year period. Each run was done using different variables as RRB requested, and all were done using the E-Views program of econometric forecasting.

The second of the 8 AVR runs obtained the best statistics, and used the 10-year period 1988-1997. AVR adopted the second run as its hearing position and introduced that run as Exhibit 27 in the EH. Exhibit 27 forecast residential consumption of 306.65 Ccf for year 1998, and 288.91 Ccf for year 2000.

During the EH, on cross-examination it developed that RRB's Report projection, introduced as Exhibit 15, was flawed. At that point (August 19,1998, the second day of EH). RRB withdrew portions of its July 2, 1998 Report, dropped reliance upon Exhibit 15, and introduced a new exhibit, Exhibit 16 which is RRB's residential consumption forecast for this proceeding. Exhibit 16 forecasts consumption of 349.7 Ccf for 1999. And the RRB witness adopted the same forecast for year 2000. RRB testified that using E-views, it had developed Exhibit 16 by taking AVR's second run (Subsequent Exhibit 27) but with Time removed as a variable.

AVR challenged RRB's methodology. It pointed out that RRB's witness earlier had testified that the appropriate methodology was to start with all variables included, and in making runs by trial and error eliminate undesirable variables as the statistics developed indicated, and thus arrive at a final acceptable product. But as AVR stressed, in developing RRB's Exhibit 16, its final product, RRB did not follow its stated methodology. It did not try all the variables before eliminating those found undesirable. It skipped steps by taking the AVR Run 2 (Exhibit 27) as a starting point, and then reran it without Time as a variable. When AVR developed Exhibit 27, it first ran the model with all the variables. Only when it got a bad sign in Run 1 for price, did it drop Price and rerun 1 as Run 2, getting good statistics for all the remaining variable including Time, and also good Adjusted R2 and Dusbin-Watson Statistics. AVR's expert witness insisted that by skipping steps and starting with AVR's Run 2 (where Price already was eliminated) and also dropping Time without checking whether there was a statistical reason to also eliminate Price, RRB erred.

Therefore, AVR took RRB's Exhibit 16 run, excluding Time as RRB insists should be eliminated, but added Price as a variable, and obtained Exhibit 28. AVR's witness testified that you cannot eliminate both Time and Price variables. But Price, because it has continually increased, does to some degree take into account Time. Thus, AVR's witness believes that if for any reason you leave out Time, you should go back and put Price in. But he prefers to use Time which takes into account Price and all of the other things that might go with the passage of time. When AVR ran Exhibit 28, it obtained a residential consumption forecast of 323.01 Ccf for year 1999, and 318.87 Ccf for year 2000.

Recorded residential consumption for 1997 was 350.2 Ccf. It is AVR's contention that consumption is dropping and will continue to do so. RRB's contention is that essentially it has leveled off. To support its decreasing contention, AVR introduced Exhibit 25 which provided more current indication figures. The Exhibit showed August 1996 through July 1997 recorded consumption per service of 356.88 Ccf. But the corresponding August 1997 through July 1998 consumption was 301.63 Ccf. <u>This was a 15.51% drop.</u> Despite this evidence, the RRB witness insists that the trend is actually to increase consumption, although RRB's Exhibit 16 appears to maintain the <u>status quo.</u>

The evidence results are summarized as follows:

Recorded						**Forecasts**	
			AVR Ccf.			**RRB Ccf.**	
Period	Ccf		3/98 App.	Exh. 28	Exh. 27	7/2 Report	Exh. 16
1996	364.7						
8/96 - 7/97		356.99					
1997	350.2						
8/97 - 7/98		301.63					
1998			308.0				
1999			302.1	306.63	323.01	350.2	249.7
2000			295.5	299.91	318.87	350.2	249.7

The issue then, is where will residential consumption per unit go in years 1999 and 2000?

The entire tenor of the June 1998 public participation hearing in Apple Valley attended by over 200 people with 57 speaking (and being solidly applauded after each presentation) was to the point that despite the obvious extensive curtailments of the recent past in landscaping and residential use, further efforts would have to be initiated, particularly if price increases were forthcoming for water. The evidence in Exhibit 25 shows that present consumption has dropped below the 350.2 Ccf of 1997. This recorded consumption data when added to the vocal comments of the public participation hearing, and the very evident "greyness" of the area, with lawns replaced by rock gardens, etc., all serves to cast doubts upon the RRB Exhibit 16 forecast of the "status quo" of 1997 holding for 1999 and 2000. But we are also troubled by AVR's insistence of including time as a variable in its Exhibit 27 forecast. It leads to the lowest consumption rates in almost 30 years for Apple Valley. Use of time as a dependent variable in the econometric model can have a positive or a negative influence, and here is used mainly to pick up trends. It can produce a bias effect accentuating the forecasted variable to what is not considered reasonable. Whether or not the past two years trend to less usage can be even maintained is a question. The quality of life and our surroundings is bound to sooner or later influence what we decide to spend our money for. It is difficult to see how landscaping can be further cut back in Apple Valley from what has already been obtained.

For these reasons, we are more comfortable with the results of AVR's Exhibit 28, which dropped time, but used the price variable to provide some accounting for the time span and the price increases, and the effect of both time and price over the 10 years of the model's data. As between RRB's Exhibit 16 forecast and the AVR Exhibit 28 forecast, comparison of the statistical data indicates that the statistics for Exhibit 28 are better for R-squared, Adjusted R-squared, the Standard Error, the Sum of the Squared Residual, and the Log Likelihood. The Durbin-Watson is not as good, but as Exhibit 16's methology is also at issue (excluding both Time and Price) this is not conclusive. And for Exhibit 16 the AR(1) variable is larger. If a variable is omitted the AR(1) adjustment must be larger to compensate for the omitted variable.

We will adopt the forecast results of Exhibit 28 as our forecast of residential consumption. Both parties during the EH agreed that when the Commission determined the consumption estimates for years 1999 and 2000, a 2.10 Ccf reduction should be made to account for Jess Ranch. Accordingly, the adopted residential consumption per customer unit for 1999 is 323.01 - 2.10 = 320.91Ccf, and for 2000, 318.87 - 2.10 = 316.77 Ccf.

A graphic depiction of the parties' proposed estimates and the adopted estimate contrasted with historic data follows as Table C.

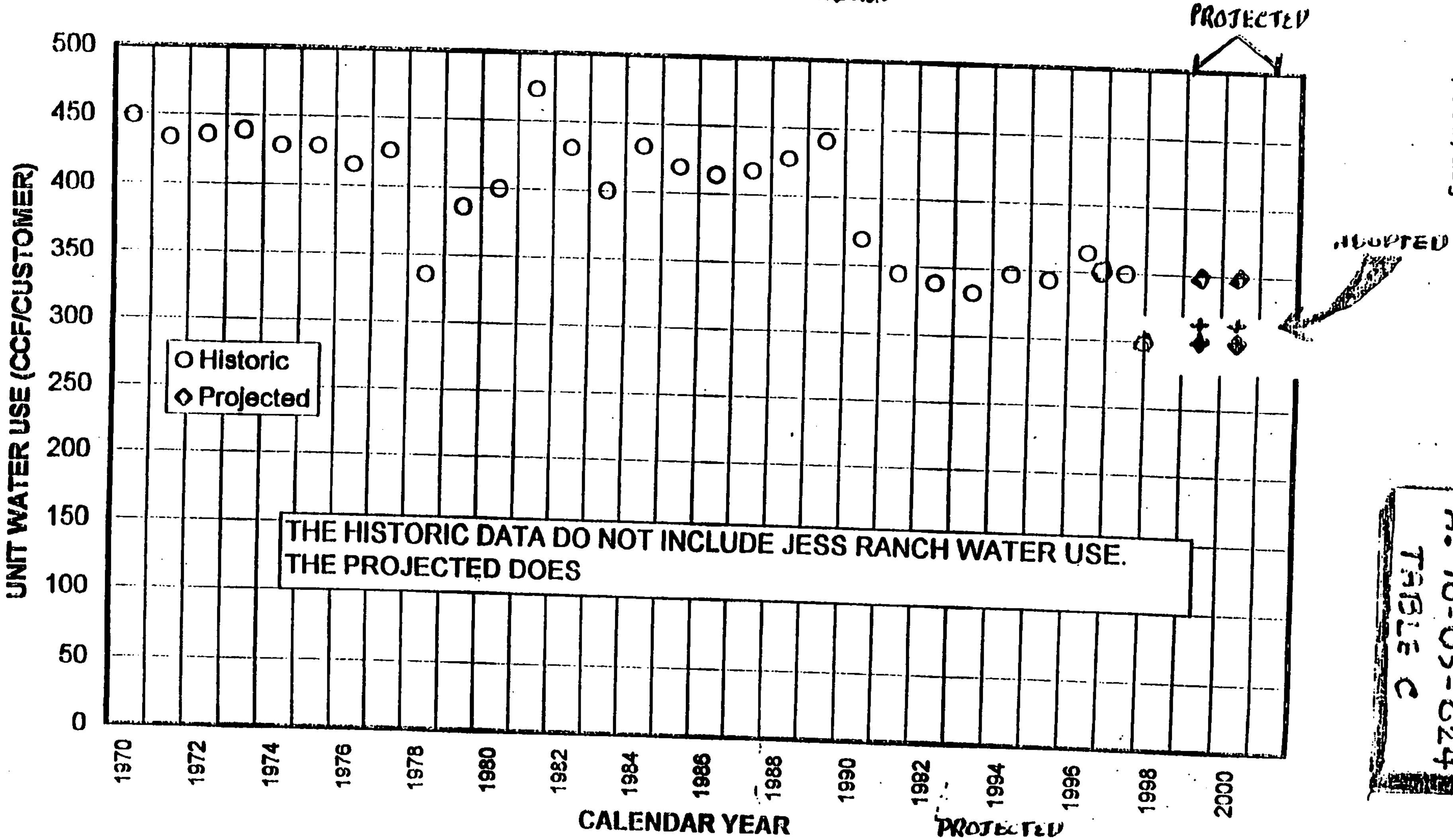
Table C

Apple Valley Ranchos Water Co.

Residential Water Use

Table C

APPLE VALLEY RANCHOS WATER CO.
RESIDENTIAL WATER USE



PROJECTED

◇ 344.7 Ccf RRB Exh. 16

✚ 320.9 Ccf AVR Exh. 28 ✱

◈ 306.7 Ccf AVR Exh. 27

✱ ADOPTED ESTIMATE

D. Regulatory Expense

In this proceeding, A.98-03-024, Park seeks a total of $140,000 for Regulatory Expense. It would amortize this over three years at a rate of $46,667 per year. Park determined this projected expense by taking the $100,000 allowed by the Commission for its Regulatory Expense in its <u>last contested</u> rate case, the 1992-93 Santa Paula Water Works subsidiary proceeding. The 1992-93 allowed $100,000 was then escalated to 1998 by applying the increases in rates charged by the attorney and consultants involved, and by non-labor escalation for miscellaneous items.

In its July 2, 1998 reply to the application, RRB merely made a projection of the numbers of hours it had concluded Park's attorney should require, priced these at $200per hour, and added its estimates of mailing and printing, and publication costs, to arrive at a total of $35,100, which total would be amortized over a three-year period at $11,700 per year. There was no provision for any other services, consultants, travel or per diem expense for attendance at hearings. It appeared that RRB's conclusion was that all technical consultants, etc., would be provided in-house by Park. This despite the fact that for over 12 years Park has used an outside consultant, Howard Consulting Engineers, Inc., in its rate proceedings, and in this instance, that RRB personnel had worked with the consultant before issuance of RRB's reply report.

During data exchanges and settlement discussions, it became apparent that while a number of operating and administrative and general issues could be stipulated, there would be no agreement or settlement of Residential Consumption, Regulatory Expense, or Cost of Capital and Rate of Return issues. These had to be left for resolution through litigation.

Park's experience has been that actual costs incurred on Regulatory Expense issues always substantially exceeded the amounts Park accepted in settlements. For example, Park's last rate case, its Central Basin proceeding (D.97-11-061), was not litigated, and Park had settled for $46,000. It developed that its actual Regulatory Expense were in excess of $150,000. Thus, Park decided that the settlement process was lengthy beyond necessity, and from past experience results in "capped" figures far lower than the expense incurred.

The record shows that by the end of July, almost three weeks before start of the evidentiary hearing, Park assertedly had already incurred Regulatory Expense of $74,000. And these did not include costs to prepare for hearing, attendance at hearings, preparation of closing and reply briefs, exhibits, per diem and travel expenses, and much of the cost of expert witnesses. Park testified that its in-house rate department consists of three people and a secretary who have other responsibilities as well. Rather than incur the payroll expense of in-house analysts to obtain the expertise needed, Park relies upon outside consultants for much of its technical analysis and testimony. It has utilized the services of the Howard firm for over 12 years, and Park's predecessor also used the Howard firm. As RRB was aware early on, Howard prepared all Park's TSP multiple regression analysis runs for water consumption projections as well as the E-Views runs requested by RRB. In addition, for the hearing Howard provided Park's expert testimony in opposition to that of RRB's two expert witnesses on the critical Residential Consumption issue. For the important Cost of Capital and Rate of Return issues, Park employed the services of Dr. Zepp, an outside consultant, to analyze RRB's Quantative Analysis, and to provide rebuttal to RRB's expert witness on the issue. As Park stated, they do not have the expertise available to the Commission Staff, so if Park cannot go outside and get consultants they are going to get out-gunned every time.

During hearing, RRB was critical of Park's use of Ebershoff because of his $360 per hour billing rate from a Los Angeles law firm. Park responded that Ebershoff has been doing its rate cases for the past 12 years and is thoroughly familiar with its California operations; that any savings obtained in terms of the rate would probably be used up in the additional time required to become familiar on each rate case so as to do as good a job as Ebershoff does.

RRB would limit legal compensation to the rate of $260 per hour authorized intervenors in D.96-07-046. But Park objects to that comparison, noting that while intervenors must make a "substantial contributions," another standard, that of providing the "burden of proof," applies for applicants.

Park's estimates for Regulatory Expenses were not based upon expected costs in this proceeding. Rather they were based upon the actual costs Park incurred in its last contested rate case. Accordingly, Park introduced no consultant, attorney, or expert witness invoices in this proceeding, although in response to RRB request it did provide those invoices it had received as of June 2, 1998, and these were introduced into evidence by RRB as Exhibit 30. They totalled $16,512.50, approximately 1/3 of the $50,000 that RRB on brief estimated would be paid to Howard.

Interestingly, by its Closing Brief, RRB abandoned its detailed billing and accountability hearing stance, and adopted Park's Regulatory Expense projection of $140,000, but it recommends a deduction of $14,000 relative to the $50,000 legal expense it ascribes to Ebershoff, and a deduction of $25,000 relative to the in excess of $50,000 consulting and expert witness expense it ascribes to Howard. RRB asserts that Park's failure to meet its burden of proof relative to the need for or the hourly rate charged mandates this disallowance.

Park's reasons for not settling the Regulatory Expense issue rest in its past experience in settling. In the past 15 years, in Park subsidiary rate cases that were settled, the Commission as accepted projections of Regulatory Expenses that were the obtained in settlements by taking the "capped" amount of the immediately preceding Park case and escalating it up to the time of the current case. However, Park feels that this settlement approach is too costly to Park. In its 1991 Santa Paula GRC (D.92-04-031), Park stated that its costs on Regulatory Expenses in every one of its four prior cases had cost Park significantly in excess of the amounts adopted by the settlements. In Santa Paula (supra), Park used the actual cost of the prior 1987-88 proceeding ($93,814), and escalated it to $100,000 for the 1991 Santa Paula proceeding. Staff, using the earlier 1987-88 settlement base of $60,000, had escalated it to $64,200 for the 1991 Santa Paula purpose. Staff's main issue then was the proper legal hourly charge to be applied – other elements were not at issue. In D.92-04-031, the Commission adopted Park's $100,000 estimate,[4] noting that "the number of professional hours actually expended seem to be a rational response to the numbers of staff-raised issues and the tenacity of its tactics."

In the present proceeding, after hearing and in its closing briefs, RRB accepts Park's methodology to determine Regulatory Expense of taking the amount allowed by the Commission for Regulatory Expense ($100,000) in Park's last case where this issue was litigated (the 1991 Santa Paula Case), and was escalating it to 1998's $140,000. But staff would reduce this $140,000 to $101,000 total, by deducting $14,000 it ascribes to unreasonable legal rates, and a further $25,000 it ascribes to undetailed Howard expenses or other evidence demonstrating their reasonableness. RRB estimates that Ebershoff and Howard would receive about $50,000 each of the $140,000 total Regulatory Expense.

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[4] But the Commission also noted that the $100,000 Regulatory Expense appeared to be an excessive amount for a 6,800 customer system's ratepayers to pay. Here we note that the $133,790 we adopt eight years later is for a 13,500 customer system.

As to the proposed legal expense reduction by RRB, under current Commission practice there is some merit to some reduction. While no definitive pay scale has been established by the Commission to apply to utility lawyers presenting a utility's case, we do apply informed judgment. We have looked to the Of Counsel attorney fee survey as a source of information. The 1997 Survey, published in June of 1997, shows partner level rates averaging $291. We have allowed a $290 rate recently in D.98-12-058 for a top intervenor attorney's compensation. Ebershoff's demonstrated competence and grasp of the issues involved here support his evaluation in the partner range. Indeed, all of the available evidence supports the reasonableness of a $290 per hour base fee level for Ebershoff, and even that base may be conservative when measured against a market standard. However, this is as far as the Commission is prepared to go at this point.

Independently, using RRB's Exhibit 18, Table 5.1 forecast of attorney involvement anticipated for Park in this proceeding, (granting its wholly unsupported stature), but also applying the $290 per hour fee level for Ebershoff that we have accepted, for the estimated 144 hours, we obtain a total attorney fee of $42,725. To this, we add a Lodging and Per Diem allowance of $600 and Transportation allowance of $465, for an overall $43,790 against the $50,000 estimate of RRB.

As to the proposed split in half of the RRB estimated $50,000 for Howard's services, we disagree with RRB. Howard's $125 per hour rate is well within a range accepted for expert witnesses and consultants.[5] As of June 2, 1998,

[5] In D.96-08-040 which addressed compensation requests for expert witnesses in the electric restructuring proceeding, the Commission noted that the range of approved hourly rates for expert witness work was $100 to $175 in 1995.

approximately 1/3 of the RRB $50,000 estimate for Howard's charges was already spent in analysis and preparation of the AVR application items on Water Sales and Present Revenues, Operating Expenses derived from Unaccounted for Water and Purchased Power, Rates, Revenues and Rate Design. Remaining were the hours used in making runs and analyzing them, preparation for hearing, representation and consultation at the hearing, and assistance for briefing. We estimate these as being approximately twice the initial preparation expenditure of time. In total then the Howard cost approximates the $50,000 RRB estimate, and we adopt it.

As Park pointed out, RRB had seven Commission Staff personnel present through most of the hearing to advise the two Commission attorneys who conducted RRB's case. Actively participating and present for Park were Park's vice-president, Howard, and Dr. Zepp, with Ebershoff as attorney.

In summation, we will adopt a total disallowance of $6,210 from Park's requested $140,000. Thus, the Regulatory Expense for this proceeding authorized is $133,790. This will be amortized over three years at the rate of $44,597 a year.

E. The Cost of Capital and Rate of Return Issue

AVR is a wholly owned subsidiary of Park. Park provides financial, administrative, accounting, engineering and data processing support for its subsidiaries. While Park has external debt, its subsidiaries do not. Park serves as a common source of any necessary debt capital for its subsidiaries because with its size it can more easily acquire debt and at more favorable rates than could any of its subsidiaries. Since Park serves as the de facto borrower for these subsidiaries, providing a source of capital through inter-company transactions, in effect there is one common capitalization for Park and the subsidiaries. Thus

Park uses a consolidated capital structure applicable to all its subsidiaries. The capital structure applicable here is estimated on that basis.

The issue here is the appropriate rate of return (ROR) for the three Test Years. A fair ROR is measured by such factors as ability to raise capital, economic risk, quality of service provided, and the cost of capital. Broad guidelines were set in two United States Supreme Court cases, Bluefield Water Works v. Public Service Commission (1923) 262 U.S. 679, and Federal Power Commission v. Hope Natural Gas (1944) 320 U.S. 591. These cases established that a utility is entitled to a return "commensurate with returns on investments in other enterprises having corresponding risk," and "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital" (Fed. Power Comm., supra at 603).

Essentially ROR is a utility's cost of capital, with capital defined as the cost of debt plus a return on equity investment. In this proceeding, no difference exists as to the Park capital structure. The parties agree that it consists of 42.27% debt and 57.73% common equity, and that it will apply each year here at issue. There is no significant difference between the parties over the cost of embedded debt as the parties were only one basis point apart for two of the years and in agreement on the third. Accordingly, for this proceeding, RRB has agreed to adopt Park's 8.89%, 8.87%, and 8.84%, respectively, for years 1999, 2000, and 2001.

The parties do not agree on the appropriate ROE to apply with Park seeking a ROE of 11.50%, and RRB recommending 8.20%. As Park and RRB arrived at their respective ROE positions by different methodology, a direct companion item by item is not possible for this highly subjective cost of capital issue.

Park's Position

First of all, Park concedes that its capital structure reflects a 57.73% equity ratio, and that this is somewhat larger than the average equity ratio of Class A water companies. Traditionally, the Commission has granted a lower ROE to utilities with high equity ratios, the perception being that they are at less financial risk because of a lower level of fixed obligations.

But it is Park's position that even though its financial risk may be somewhat lower because of its slightly higher equity ratio, its business risk is higher than that faced by the 11 Class A group RRB selected for comparison, with the result that its overall risk is considerable larger than the group's.

Park did not perform a quantitative analysis because of this lack of comparability. It asserts that the risks Park faces, including its small size, its lack of financing flexibility, the risk of tort action, and California regulatory risks, are all risks significantly greater than those faced by the nationwide assertedly comparable group selected by RRB for its quantitative analysis.

Instead of a non-comparable quantitative analysis, Park focused on its company specific risks to support its claim to being more risky than the RRB comparables, and thus entitled to a higher ROE. However, Park does agree that a quantitative analysis applied to the 11 RRB group could serve to provide a floor, if that analysis were reasonably and properly done, which Park asserts was not the case, and that a properly done analysis could provide a base above which Park's greater business risk can be applied to determine the appropriate ROE for Park.

With perhaps one exception, Park is considerably smaller than the 11 Class A companies in RRB's national group. RRB's witness asserts that size is not an element in determination of risk. Park introduced evidence to show that to investors size is of considerable importance.

In re Financial and Operational Risks of Commission - regulated Water Companies (1994) 55 CPUC2d 158, 188, the Commission declined to adopt a policy statement to the effect that small Class A water companies inherently face greater financial risk. However, the Commission left it open for small Class A water companies to present specific evidence to that point in future general rate cases. In the present case, Park in essence incorporates by reference the arguments and facts it offered in Re Financial, and adds specific new evidence to support its contention that size is a significant factor.

Amongst the evidence Park introduced was a table from the 1996 Ibbotson Associates Yearbook (Exh. 5) which shows that Ibbotson would apply a 360 basis point premium as a "size premium" to "micro-capitalization" companies - those with less than $171 million capitalization (Park's capitalization is approximately $70 million, and with but one exception, RRB's 11 comparable group all exceed $171 million capitalization). The RRB expert witness dismisses this evidence, stating that while Ibbotson variables are indeed used by investors in estimating cost of capital, and that Ibbotson looks at various sized companies in different industries including utilities, he "did not believe" that size variable are carried over to "water" utilities. But as Park noted, with far larger plant and operating revenues than Park enjoys, seven of RRB's 11 have S&P bond ratings of "A+" or better,[6] while substantially smaller Park, receives a equivalent S&P lower rating between "A" and "BBB" (Park is not rated by S&P, the equivalent rating is obtained by application of S&P criteria which RRB did - see Table 2.5, Exh. 3). It would thus appear that Park's lower rating objectively illustrates that the investment market views park as more risky overall than the comparables.

[6] Of the seven, four are rated "A+" under S&P's rating criteria, two are rated "AA-", and one is rated "A." The other four are not rated.

Park also presented ratings by the National Association of Insurance Commissioners (NAIC), and used NAIC criteria to show Park's lower rating, and therefore higher risk than the companies used by RRB as "comparable" Class A water companies as a proxy to determine Park's risk. NAIC rates Park's first mortgate bonds as "2" (the equivalent to a "BBB/Baa" investment grade rating). Using the NAIC criteria, of the 11 RRB "comparables," seven would have the higher "1" rating, and only two would get the same "2" rating as Park (one would not be rated). While NAIC ratings are done to determine reserve requirements for insurance companies holding bonds, there is as Park asserts, an obvious correlation between risk and reserve requirements.

Park pointed out that it has <u>less financing flexibility</u> than the publicly traded 11 RRB Class A "comparables." Its stock <u>not</u> being publicly traded, its only source of external financing is the debt market, and because its mortgage indenture requires that it must maintain an equity ratio of not less than 50% to maintain any borrowing capacity, the Class A publicly traded water companies in RRB's group are less risky because they have more financing flexibility. Park must depend upon insurance companies to place its debt, and as is quite evident, this comes at a price in the cost of its debt.

For Park's 1995 private placement of $10 million of 30-year bonds, Park had to pay a premium of 95 basis points over the then prevailing 7.59% interest rate for U.S. Treasury bond yields, and 24 basis points over "A2" utility bond yields. While this placement was at a time when investors were aware of on-going condemnation proceedings for a Park subsidiary, the investors were also aware of the probability of an equity infusion that exceeded the additional debt being acquired. Although the 1995 lender knew that the <u>financial risk</u> was low (Park's debt/capital ratio of 35% was well below the 50% S&P benchmark for "AA" rating on this particular ratio), the lender still concluded that Park's <u>overall</u>

risk was higher than that of an S&P, rated "A" company by 24 basis points (not rated by S&P, Park had an "A2" Bloomberg system rating equal to an S&P "A" rating).

Today, using 1993-1997 period data applied against the S&P financial benchmarks, and with a debt/capital ratio of 40%, and assuming Park's overall risk is to be considered as "below average business position" as Park contends, Park would be accorded an equivalent S&P rating of between "A" and BBB."

Another Park assertion is that it, and other Southern California water utilities face a risk of class action tort litigation related to water quality dispute compliance with Environmental Protection Agency regulations. Park's witness testified that this risk was very real and that investors were aware of it in pricing down the stock of involved utilities. While this problem brings uncertainties, the present litigation posses no immediate effect on Park which has no plans to seek outside financing during the Test or Attrition Years here in issue. But Park must maintain a borrowing capability against the threat of major catastrophies, and for the future. Thus, this litigation cloud presents an additional but difficult to quantify risk.

Park also returned to RRB's assertion that no relationship exists between ROEs authorized water utilities' and energy companies. While in San Jose Water, D.96-07-036, mimeo., at 18-19, the Commission stated that there was no "constant spread" between them, and that electric restructuring may produce distinctions in risk, water utilities had mechanisms to reduce risk, Park rejects RRB's assertion that the two returns cannot be compared. In its Capital Asset Pricing Model RRB used measures of risk (betas). Park's witness referred to Value Line information available to investors to quantify the "spread" using the .06 difference in the betas times RRB's adopted 7.8% risk premium to determine that water utilities have an equity cost approximately 50 basis points less than energy companies. Using the ROE of 11.20% granted PG&E in D.97-12-087, and updating to 11.0% to reflect the interest rate drop since D.97-12-087, Park concluded that an appropriate average for the eleven "comparables" of RRB would be an ROE of 10.50% - not the 8.20% proposed by RRB.

Park also observed that before the recent trend of "settlement decisions" in the water industry in California, back when ROE was usually a litigation issue, the difference or spread in ROE basis points between water and energy ranged between 50 and 100 basis points. Were this "spread" under litigation in effect today, the ROEs of the Class A's of RRB's group, as compared to D.97-12-087, would be in the 10.00% to 10.50% range - again, not 8.20% as proposed by RRB.

In support of this and reflecting investor expectations, Park cited various investor guide forecasts. Value Line's May 8, 1998 issue (Exh. 21) forecasted ROEs of 11.00% for American Water works; 11.50% for California Water Service; 11.50% for Consumers Water; 12.50% for Philadelphia Suburban, and 10.00% for United Water Resources. All five are in RRB's selected Class A water companies for which RRB has determined 8.20% as appropriate ROE (Value Line's 2001-2003 forecasts are higher). The July 1998 C. R. Turner Utility Report, for the four companies listed with relatively current data, show <u>allowed</u> ROEs averaging 10.30% within the last three years for Class A water utilities. These are 10.40% as of December 1995 for Southern California Water Company, 10.30% as of June 1996 for California Water Service, 11.25% for Elizabethtown Corporation, and 10.20% as of July 1996 for San Jose Water Corporation. RRB on brief calls Value Line's forecasts meaningless since it is not known how other states determine ROE. But these out-of California utilities were included in

RRB's list of 11 "comparable." Also RRB calls the Turner Utility Reports "misleading" and out of date. But three of the four are current ROEs for California Class As. And it appears that the only significant change is the drop in interest rates.

Park also contended that a fair ROE would be one high enough to provide pretax coverage above its debt cost so that it could maintain an "A" rating. In Park's case, the average 8.20% Roe that RRB attributes to the 11 Class A "comparables," and thence to Park, is less than the 8.8% cost of Park's embedded debt. Park does not have access to the financial market that large Class A do, it's debt is placed with insurance companies which generally do not allow call provisions. Thus, when interest rates fall, small non-publicly traded utilities such as Park are stuck with the higher costs on the books for debt. Park termed this a 'coverage squeeze" which contributes to making it a more risky investment in the eyes of investors.

With regard to the California regulatory climate, Park disputed RRB's assertion, based upon a 1992 report, that there is less regulatory risk in California than in other States because of mechanisms California adopted, and that this justifies lower ROE. Park introduced a substantially more current 1996 report compiled by the National Association of Regulatory Commissioners (NARC) (Exh. 4) which show that since 1992 there has been a significant increase in the number of States adopting the same mechanisms as California, and some States have mechanisms California does not offer, such as end of year rate base, fair value rate base, recovery of acquisition adjustments, statutory limits on regulatory lag, depreciation on contributions in rate base, etc. Given the current comparability of regulatory protections, there no longer is reason to assume that the California regulatory climate provides less risk and therefore warrants authorization of a lessor ROE, as RRB contended.

From the foregoing, we must conclude that Park presents an overall higher degree of business risk to investors than is reflected in its slightly higher equity ratio financial risk. To the degree that the Class A 11 water utility group RRB has made the base for data for its quantitative analysis is relevant for comparison, the group average ROE can serve as a floor above which Park must be compensated for its higher risk.

The RRB Position

RRB followed the methodology that has been applied in past Commission proceedings to obtain an average ROE applicable to a group of comparable companies. The RRB quantitative analysis used financial models applied to the recorded data of the companies selected for inclusion in the group deemed to be comparable to the applicant utility. Here the group numbered eleven, four from California. All are publicly traded and most have substantially more plant and higher revenues than Park.

In considering RRB's methodology, testimony, and product, it must be kept in mind that unlike earlier days when Commission staff was neutral, and appeared to "develop the record" to guide the ALJ and the Commission, today RRB is an advocacy unit for the ratepayers, and its product is subject to the same group interest and advocacy bias as is that of the applicant utility.

The financial models used by RRB were the Discounted Cash Flow Model (DCF), the Risk Premium model (RP), and the Capital Asset Pricing model (CAPM). The respective results obtained indicated to RRB that investors would expect to earn returns of 8.12%, 8.20%, and 8.24%. The average for the three was 8.19%, rounded by RRB to 8.20%. RRB states that these results were lower than RRB has obtained in prior cases recently because of factors such as the addition of 1997 dividend and growth figures, more months of stock prices, three stock splits, and the continued dramatic reduction in interest rates.

RRB's Discounted Cash Flow

The DCF model was used to calculate the value of future dividends. For the ingredients to be used in its DCF model, RRB looked at 1) both historical earnings growth rates and historical dividend growth rates, 2) sustainable growth rates, and 3) Zack's forecast of growth rates applicable to the eleven, in order to determine a reasonable growth rate.

The average dividend for the comparable group for the 12 months ending May, 1998 was 4.76%.

To determine the historical growth rate overall, RRB decided not to include historical earnings growth in its calculations, because of the wide fluctuations during the 10-year period. RRB assumed that these fluctuations made the averages unreliable to project future growth. Therefore, RRB decided to include only the 3.34% 10-year dividend growth rate average in its historical growth rate calculation for the DCF.

To obtain the sustainable growth rate, RRB multiplied the five and the 10-year average returns on equity for the group by the respective retention ratios, and thus obtained and adopted a range of 2.66% to 2.78% for the percentage of sustainable growth for the DCF.

For its forecast of earnings growth rates RRB decided to use Zack's forecast of earnings growth (it included nine of the 11 RRB group).

Based upon its historical, sustainable, and forecasted growth rates of 3.34%, 2.78%, and 3.57, RRB adopted a dividend growth rate range of 3.10% to 3.60% to use in its DCF model. RRB then applied this 3.10% to 3.60% range of dividend growth rates to the 11 group's 3, 6, and 12 months current dividend yields' averages to get 3, 6, and 12 month expected dividend yields. Combining the growth rates and expected yields produced the range of expected ROEs for each period. When the expected ROEs for the 3, 6, and 12 months are averaged, RRB's DCF average ROE of 8.12% is obtained.

Park was critical of RRB's selection and application of data to apply in RRB's DCF model. Park asserts bias in RRB's election to give no weight to historical data on earnings per share growth. RRB relied solely on dividends per share growth. Park contends that merely because there have been fluctuations is the historical earnings per share growth rates, either on a five or a ten year basis, does not mean the factor can be excluded. Park states that to investors it is the most important measure of growth as without earnings growth there could be no dividends growth. Therefore to obtain a more valid historical growth rate, Park would combine the earnings growth five and ten year averages with the five and ten year averages of the dividends growth, obtaining an overall average historical growth rate of 4.64%, compared to RRB's 3.34%.

Park also is critical of RRB's exclusion of growth from external sources in the development of a sustainable growth rate. RRB's position is that sustainable growth can be achieved only if part of the earnings of a utility are reinvested in the plant. But Park contends that there is an important second source of growth that comes from the external financing of common stock above book value, and that <u>both</u> must be taken into account to determine what an investor realistically expects growth to be. Unlike the energy situation, water utilities are now, and for the future will be forced to grow, adding or replacing plant, particularly to comply with the broadening requirements under clean water legislations.[7]. Stock will be sold. Again, investors will not ignore this

[7] Exh. 18, July 1994 commentary entitled "Water Utility Benchmark Approach Revisited" on S&P's revision to its financial benchmark approach for U.S. investor-owned water utilities states "The key challenges facing the industry are: the need to comply with more stringent water quality standards because of the 1986

Footnote continued on next page

factor. By including it, Park concludes the sustainable growth average should be 4.49%, rather than RRB's 2.78%.

With regard to the forecasted element of the DCF model, Park criticizes RRB for its selective choice of Zack's alone. Zack's May 30, 1998 forecast of earnings growth rates is the lowest of available forecasts. Park asserts that any knowledgeable investor would also have looked at S&P's Earnings Guide (June 1998) and Value Line's Investment Survey (May 8, 1998). Park would average the three to obtain a forecast of earnings growth rate of 5.24% compared to RRB's 3.57%.

Taking the historical 4.64%, sustainable 4.49%, and forecasted (5.24) elements, Park determines that a growth rate of 4.25% to 5.0% was more appropriate than RRB's 3.10% to 3.60%.

Applying its 4.25% to 5.0% range of growth to the average three and 12 month dividend yields of 4.69% and 4.88%, provided Park with an expected dividend yield range of 4.89% to 5.12%. Combining the expected 12-month dividend yield-range of 4.89% to 5.12% with the 4.25% to 5.0% range of expected dividend growth Park obtained a DCF calculation of an expected ROE range of 9.14% to 10.12% as applicable to RRB's selected group of 11 Class A companies.

RRB's Risk Premium Model

The purpose of an RP model is to measure the premium over the cost of long term debt, the premium that it is presumed investors expect because their risk in holding common stock is greater than would be an investment in

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amendments to the Drinking Water Act, the need to improve aging distribution infrastructure, and developing future water supply. The commentary goes on later to state: "Greater reliance on external financial markets and state regulators will be necessary to fund future outlays and maintain financial stability." (Emphasis Added.)

long term debt. This premium is added to the estimated cost of long term debt to develop an estimate of the expected ROE.

In its RP model analysis, using data of ten of the eleven companies in RRB's group, a backcast of the DCF model was applied to each of the ten to obtain the stockholders' average expected ROE each year. The average annual yields for 30-year treasuries and "AA" rated utility bonds were subtracted from these expected ROEs to obtain the risk premiums to apply for Treasuries and bonds. RRB obtained ten and five year average risk premiums for Treasuries of 3.11% and 2.15%, and for bonds of 2.15% and 2.17%, respectively. Adding the forecasted interest rates from DRI's May 1998 forecast of 5.50% and 6.55% to the respective ten and five year premium averages produced expected ROEs of 8.61% and 8.70% for the ten-year averages applicable to Treasuries and bonds, and 7.655 and 7.82% for the five-year averages applicable respectively to Treasuries and bonds.

In RRB's calculation, and application of the DCF model backcast, RRB again excluded historic growth per share earnings, relying primarily on the five-year historic dividend per share growth data. Again, Park is critical of the exclusion although RRB again submits that because of the volatility in earnings, it is a poor substitute for historical dividends growth. Park again observes that the critical question to investors is how strong is earnings growth to be, as without earnings growth, there cannot be dividends growth.

It is noteworthy that when the longer period ten year term is used, the RP numbers go up if data for <u>both</u> earnings per share growth and dividends per share growth is used. A comparison of RRB's Table 3-8 (Exh. 3) and Park's Table 8 (Exh. 9) shows ten-year period based RPs of 3.11% and 2.15% (applicable to Treasuries and bonds respectively) for RRB's analysis based on dividend growth, as contrasted to ten year period based RPs of 4.55% and 3.58% for Park's analysis based on both earnings and dividends growth. After adding the DRI forecasted interest rate average, the RRB range of equity cost estimates for the ten year basis is 8.61% to 8.70% compared to Park's 10.05% to 10.13%.

Park asserts that RRB's decision to give weight only to dividend per share growth in its estimated growth factor results in a strong downward bias in the RRB quantitative analysis.

While Park asserts that RP is expected to increase as interest rates fall for both theoretical reasons and to compensate for the higher risk associated with coverage squeeze, RRB responded by citing an extract (p. 120) from a March 1998, Federal Reserve Bulletin which stated in part:

> "[T]he current level of equity valuation suggests that investors are also requiring a lower risk premium on equities than has generally been the case in the past, a hypothesis supported by the low risk premiums evident in corporate bond yields last year."

Interestingly, that same page of the Federal Bulletin also stated:

> "Despite the strong performance of earnings and the slower rise of stock prices since last summer, valuations seem to reflect a combination of expectations of quite rapid future earnings growth and a historically small risk premium on equities."

RRB's Capital Asset Pricing Model

Betas are a measures of a specific company's security market risk. A beta with a risk equal to the market is 1.0. If the risk is greater than the market risk, the beta is over 1.0. U.S. Treasuries are a proxy for a risk-free security. RRB used DRI's May 1998 forecast of 5.50% for the Test and Attrition Years for 30-year treasuries. RRB also used Ibbotson's calculated Market Risk Premium of 7.8% as the historic RP. Betas for the RRB group of 11 Class A water utilities were obtained from Dow Jones Interactive - Tradeline (6/25/98), S&P's Stock Reports (5/2/98), and Value Line Investment Survey (6/12/98). These betas for the

11 companies averaged 0.19, 0.33, and 0.54 respectively from the three financial reporting resources. The product of the beta times the 7.80% Market Risk Premium, when added to the Risk Free Rate of 5.50% produces the CAPM ROE. Here the average betas from the three financial sources produced CAPM ROE's of 7.00% (Dow Jones); 8.05% (S&P), and 9.67% (Value Line).

Again, critical of RRB's selection and use of data, Park's expert witness pointed out that the betas used in a CAPM are very difficult to calculate, and that unless "adjusted" from the reported material, they are of limited validity, being merely" raw information." For example, one of the companies included in RRB's 11 companies has a minus beta listed from Dow Jones. This would indicate a lower rate of return from its stock then obtainable from a Treasury. Common stock is inherently more risky than Treasury bonds, so obviously no one would invest in such a company. The beta furnished for this company was not "adjusted." Park points out that only "adjusted" betas should be given weight in a CAPM analysis.

In the RRB Summary of Betas (Table 3-9, Exh. 3) which was the vehicle producing RRB's indicated ROE for the CAPM, neither the Dow Jones nor the S&P furnished betas are "adjusted." Only the betas from Value Line are "adjusted." Park would therefore use only the "adjusted" betas obtained from Value Line with their .54 average in RRB's Summary. But Park would also add "adjusted" betas from Merrill Lynch with its average .58 beta from the group of 11. Then, the average betas from Value Line and Merrill Lynch financial resources would produce CAPM ROEs of 9.67% (Value Line)and 10.02% (Merrill Lynch).

But Park also questions inclusion of the smaller of the 11 Class A companies in an CAPM analysis, noting that smaller utilities generally tend to require higher RORs than are indicated by betas, so that not all the risk and required return is captured by the analysis. In part, Park ascribed this defect to the reporting techniques used, noting that thinly traded public utilities may not always be included in the weekly returns used to estimate and adjust betas. Consequently, Park skeptical about their inclusion, would limit the CAPM to the larger companies in RRB's group. The five largest have an average beta of 0.57. Using the CAPM methodology merely would produce a CAPM ROE of 9.94%. (Park would use the Blue Chip forecasted interest rates rather than the DRI forecasted rates used by RRB, to produce range of 9.88% to 10.82%. We will adhere to the DRI forecast).

Table D

Comparison Results Of Quantitative Analysis For The Eleven Class A Water Companies - RRB And Park

Comparison Summary Of Model Results

Discounted Cash Flow Model	**RRB**		**PARK**
Growth Rates	**3.10%**	**3.60%**	**5.00%**
3-month ROE	7.82%	8.34%	9.14%
6-month ROE	7.75%	8.27%	
12-month ROE	8.01%	8.53%	10.12%
DCF Average		8.12%	9.63%
Risk Premium Model			
Period	**5-Year**	**10-Year**	**10-Year**
30-Year Treasury Bond	7.65%	8.61%	10.05%
"AA" Rated Utility Bond	7.82%	8.70%	10.13%
		8.20%	10.09%
Capital Asset Pricing Model			
Dow Jones Interactive		7.00%	
Standard & Poor's		8.05%	
Value Line		9.67%	9.67%
Merrill Lynch			10.02%
		8.24%	9.84%
Return on Equity Average Expected		8.19%	9.85%

Having concluded that an overall ROE of 8.20% was appropriate for what investors would expect to earn on average as applied to RRB's group of 11 Class A water companies, RRB then examined the specific risks facing Park; risks that are business, regulatory, and financial, to determine whether Park could be considered as being more, the same, or less risky than the 11 Class A's in RRB's asserted proxy.

RRB compared Park's pre-tax historical earned compared to pre-tax authorized for the most recent five-year period (1993-1997), noting that Park had earned 242 basis points less than authorized. Usually this would indicate that Park was a higher than average risk to investors. However, RRB concluded that Park had been "bleeding" in the early portion of the period as the result of loss of operating divisions from condemnations and the early costs of replacements. Noting that for 1996 and 1997 Park had recovered, earning slightly over (0.37%) and slightly under (-0.34%) than authorized these years, accordingly, RRB concluded that Park had an "average business risk."

Park disagreed with this conclusion on its business risk, and presented its own comparison (Exh. 11) showing a stronger variance than that presented in RRB's Table 2-1 of Exh. 3. Park pointed out that the Financial Accounting Standards Board in 1993 passed FAS 106 changing Park's accounting relating to past retirement benefits other than pension, and mandating accrual rather than pay-as-you-go accounting. This had nothing to do with sale or acquisitions of Divisions, and when adjusted for these changes, their increase in A&G costs was even less than their overall expense increase. In addition, Park cited its repeated experience of regulatory lag in the effective dates for increases in 1990, 1991, 1992, and 1993. Lastly, Park pointed out that the last two years, 1996 and 1997, were "high weather" years when water sales produced higher than normal revenues. But the significant point is that over the past ten years Park has earned its authorized ROE in only one of the ten years. From this Park argues that it is a higher than average risk to investors.

As to the fact of Park's limited financial flexibility in that not being publicity traded its must rely upon insurance companies, not the market, to place its debt, in essence RRB blames Park for its closely held, non-traded, position. However, Park told of its past unsuccessful effort to go public. The situation remains, that just as in 1995, today Park would have to pay a premium, regardless of any equivalent S&P rating, should it have to go to external financing. While Park states it has no plans to do so over the present Test Years, and has internal funds to reinvest from past condemnations, there is always the chance for a catastrophic event. From this Park contends that it presents a below average business position to investors.

RRB also compared California's regulatory climate to that of other States to conclude that California was the more supportive, offering numerous mechanisms to water utilities to protect earnings from inflation, regulatory lag, estimating errors, etc. But it used a 1992 National Regulatory Institute Survey, now very outdated, as set forth earlier herein, by the NARC 1996 report. As a consequence RRB's conclusion that the level of risk from regulatory climate is lower than the average is not valid.

RRB correctly observed that Park's 42.3% debt ratio compared to the average 53.4% debt ratio of the 11 Class A's provides less financial risk than the average of the Class As.

RRB further noted the significant drop in interest rates in recent times. Since Park's last general rate case in 1997, rates have dropped; U.S. Treasuries 30-year bonds from 6.94% in May 1997 to 5.95% in May 1998. With economic conditions relatively stable for the Test and Attrition years, RRB concluded that Park has "average" business risk, and "lower than average" financial risk. Overall, RRB concluded that Park's total risk, business plus financial, when evaluated using S&P's five water utility benchmarks and the five year average (1993-1997). Park recorded data, would result in a S&P rating of "A-" for a below average business position, to an "A+" rating for an average business position.[8]

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[8] RRB's states that with an ROE of 8.20% Park would have a pre-tax interest coverage of 3.2%, and that S&P would regard this as either an "average" or above average business

Footnote continued on next page

RRB position is that this "A-" to "A+" range for Park is roughly equal to the average S&P "A+" rating of the 11 Class A water utilities of its proxy group (Table 3-1 of Exh.3), and that the RRB 8.20% ROE obtained from its quantitative analysis of the 11 Class A water utilities (Table 3-10, Exh. 3) is therefore an appropriate ROE as well for Park.

Conclusions on Cost of Capital Issues

As stated earlier, review of the positions and arguments of the parties has led to the conclusion that Park presents a higher degree of risk to an informed investor than is presented by the average risk of the 11 Class A water utilities in RRB's "proxy" group. Park is not comparable to the average of the 11 for reasons discussed previously herein.

However, although not comparable, the average ROE of the 11 can serve as a floor above which an appropriate Park ROE can be set. In this highly subjective determination, an additional 30 basis points to recognize Park's additional risk will be adopted.

We are not in agreement with RRB that 8.20% is the appropriate average ROE for the 11 Class A water utilities' in RRB's proxy group. With reference to RRB's quantitative analysis which produced the 8.20% ROE that RRB would ascribe to the "proxy" group, Park has pointed up exclusions, flaws, selective choices of data periods and lowest forecasts. Of the two results set forth

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position for rating purposes, and would give Park a rating of just below "AA" for this S&P financial benchmark. Park disputes this, contending that the net to gross multiplier RRB used (1.7495) is too large, having failed to consider that state income taxes are deductible from federal income taxes, with the result that the appropriate net to gross multiplier should be 1.66, which produces a pre-tax interest coverage of 3.1%; an "A" S&P rating for an "average" business position, and a "BBB+" rating for a "below average" business position.

in the Summary of Model Results set forth herein, we find the Park results the more credible as reflecting what an appropriate ROE should be for the average of the "proxy" group. Accordingly, the average "proxy" group ROE of 9.85% will be adopted as our floor.

Adding the 30-basis points representative of Park's greater risk to the 9.85% produces an ROE of 10.15% for Park which is adopted for this proceeding. Accordingly the adopted RORs for years 1999 through 2001 are set forth in this table.

Table E

Apple Valley Ranchos Water Company

Adopted Rate Of Return

	Capital Structure	Cost of Factor	Weighted Cost
Test Year 1999			
Debt	42.27%	8.88%	3.75%
Common Equity	57.73%	10.15%	5.86%
Total	100.00%		9.61%
Test Year 2000			
Debt	42.27%	8.07%	3.75%
Common Equity	57.73%	10.15%	5.86%
Total	100.00%		9.61%
Test Year 2001			
Debt	42.27%	8.84%	3.74%
Common Equity	57.73%	10.15%	5.86%
Total	100.00%		9.60%

F. Summary of Earnings

Table F, our adopted Summary of Earnings, follows. It reflects the operating revenues which would be provided at present rates and those which will be required to produce the 10.15% return on common equity we are authorizing for the test years.

Table F

Apple Valley Ranchos Water Company

Summary Of Earnings

(Dollars in Thousands)

Table F

APPLE VALLEY RANCHOS WATER COMPANY

SUMMARY OF EARNINGS
(Dollars in thousands)

	1999 Present Rates	1999 Adopted Rates
REVENUES		
Operating Revenues	8,803.4	9,232.4
Deferred Revenues	(3.1)	(3.1)
TOTAL REVENUES	8,806.5	9,235.5
O&M EXPENSE		
Payroll - Operations	386.3	386.3
Operations - Other	93.1	93.1
Purchased Water	0.0	0.0
Purchased Power	750.7	750.7
Replenishment Charges	247.8	247.8
Chemicals	24.9	24.9
Payroll - Customer	167.5	167.5
Customer - Other	59.3	59.3
Uncollectibles	47.0	48.9
Payroll - Maintenance	155.0	155.0
Maintenance - Other	956.7	956.7
SUBTOTAL O & M	2,888.2	2,890.2
A&G EXPENSE		
Payroll	512.4	512.4
Payroll - Benefits	323.2	323.2
Insurance	235.6	235.6
Reg. Comm. Expense	44.6	44.6
Franchise Requirements	88.0	92.4
Outside Services	122.6	122.6
Office Supplies	136.5	136.5
A & G Transferred	(96.2)	(96.2)
Miscellaneous	20.1	20.1
Rents	0.0	0.0
Main Office Allocation (1)		
A & G Expenses	665.9	665.9
Data Processing	92.1	92.1
SUBTOTAL A & G	2,144.9	2,149.3
OTHER EXPENSE		
Ad Valorem Taxes (1)	245.9	245.9
Payroll Taxes (1)	139.4	139.4
Recover Undercollection	0.0	0.0
Depreciation (1)	888.6	888.6
CA Income Tax	151.0	188.0
Federal Income Taxes	529.1	672.8
TOTAL EXPENSES	6,987.1	7,174.1
NET REVENUES	1,819.3	2,061.0
RATE BASE	21,446.6	21,446.6
RATE OF RETURN	8.48%	9.61%

(1) DEPRECIATION, AD VALOREM AND PAYROLL TAXES FROM PARK'S MAIN OFFICE HAVE BEEN INCLUDED IN THE APPROPRIATE LINE ITEM OF EXPENSE.

Table F

APPLE VALLEY RANCHOS WATER COMPANY

SUMMARY OF EARNINGS
(Dollars in thousands)

	2000 at 1999 Adopted Rates	2000 Adopted Rates
REVENUES		
Operating Revenues	9,291.5	9,684.0
Deferred Revenues	(2.5)	(2.5)
TOTAL REVENUES	9,294.0	9,686.5
O&M EXPENSE		
Payroll - Operations	405.8	405.8
Operations - Other	78.3	78.3
Purchased Water	0.0	0.0
Purchased Power	753.0	753.0
Replenishment Charges	250.5	250.5
Chemicals	25.5	25.5
Payroll - Customer	179.1	179.1
Customer - Other	60.7	60.7
Uncollectibles	49.3	51.3
Payroll - Maintenance	164.3	164.3
Maintenance - Other	955.0	955.0
SUBTOTAL O & M	2,921.5	2,923.6
A&G EXPENSE		
Payroll	533.9	533.9
Payroll - Benefits	359.8	359.8
Insurance	243.1	243.1
Reg. Comm. Expense	44.6	44.6
Franchise Requirements	92.9	96.9
Outside Services	125.6	125.6
Office Supplies	139.7	139.7
A & G Transferred	(98.3)	(98.3)
Miscellaneous	20.6	20.6
Rents	0.0	0.0
Main Office Allocation (1)		
A & G Expenses	698.3	698.3
Data Processing	96.5	96.5
SUBTOTAL A & G	2,256.8	2,260.7
OTHER EXPENSE		
Ad Valorem Taxes (1)	264.0	264.0
Payroll Taxes (1)	145.8	145.8
Recover Undercollection	0.0	0.0
Depreciation (1)	992.5	992.5
CA Income Tax	167.4	201.6
Federal Income Taxes	599.1	730.5
TOTAL EXPENSES	7,347.1	7,518.7
NET REVENUES	1,947.0	2,167.8
RATE BASE	22,579.8	22,579.8
RATE OF RETURN	8.62%	9.60%

(1) DEPRECIATION, AD VALOREM AND PAYROLL TAXES FROM PARK'S MAIN OFFICE HAVE BEEN INCLUDED IN THE APPROPRIATE LINE ITEM OF EXPENSE.

Contrasting the Operating Revenues set forth in Table F, it is apparent that the rate of return which we are authorizing AVR will produce additional revenues of $429,033 in 1999, an increase of 4.87% over the revenues produced by existing rates. In 2000, an additional $392,455 will be produced, an increase of 4.25%. In conformity with our requirement that Class A water utilities not file general rate application's more frequently than once each three year, a third set of rates in the form of a step increase for year 2001 will be authorized to allow for attrition after 2000.[9] This attritional step increase will be $397,164, or 4.0%.

On or after November 5 in the years 1999 and 2000, AVR will be authorized to file advice letters (with appropriate work papers) to justify implementation of the step increase herein postulated for each of years 2000 and 2001. The supplemental filings will permit review of achieved rates of return before each step rate is authorized.

G. Rate Design

Finally, turning to rate design, it was agreed that metered rates would continue to provide recovery of 50% of AVR's fixed costs through the service charge component, with a single commodity rate. The resulting rates are set forth in the Tariff Schedules for the various classes of service in Appendix B.

A comparison of rates is set forth in Appendix C and Adopted Quantities including Tax Calculations are shown in Appendix D.

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[9] An attrition allowance is needed when increases in revenues and productivity to offset increases in expenses (including the effect of cost of capital) are insufficient, thereby causing a decline in the rate of return for the following year. Attrition consists of two factors - financial and operational. Financial attrition occurs when there is a change in the company's cost of capital. Operational attrition is the result of changes in operating categories, e.g. revenues, expenses, and rate base.

The rates of return found reasonable in this proceeding were determined and based upon the effect of the rate increase for the full year 1999. Unfortunately, the litigious nature and complexity of this proceeding, when taken with caseloads, made it impossible to resolve the proceeding in timely fashion. Accordingly, in that the only active participants to the proceeding are AVR and RRB, the resulting order should be effective date of signature.

H. Comments on the Proposed Decision of the ALJ

In accordance with the provisions of Pub. Util. Code § 311 and Rule 77.1 of the Commission's Rules of Practice and Procedure, the proposed decision (PD) of ALJ Weiss was issued on February 5, 1999, and the parties were afforded opportunity to comment on the PD. Rule 77.3 of the Rules sets forth the scope of permissible comment, stating that comments shall focus on factual, legal or technical error, and notes that comments which merely reargue positions taken in briefs will be accorded no weight and are not to be filed.

Both AVR and RRB filed comments. AVR also filed a reply brief as provided for in Rule 77.5.

<u>AVR's comment</u> was limited to the identification of several typographic errors. These have been corrected.

<u>RRB's comment relative to Cost of Capital</u> in Sections A and B disregarded the stricture contained in Rule 77.3, and reargued, repeating paragraph after paragraph in virtually the same words and content from its September 1998 closing brief. These paragraphs will be accorded no weight or consideration. Of the remaining short paragraphs, one, conclusionary in content, differs on the equivalent S&P rating obtained, given a "below average business position." Another assumes an "average to above average business position" for Park to equate it with RRB's group to conclude Park faces no difficulty when next it seeks to attract capital. Another concludes Park is "less risky" than the average

of RRB's group. The final paragraph essentially concludes that as AVR did not do a quantitative analysis it has not provided clear and convincing evidence and thereby fails its burden of proof. The assertions and argument of these paragraphs were all adequately addressed in the PD.

Section C in 6 lines also argues that AVR did not carry its burden of proof. While conceding that AVR did use various financial models to show cost of equity, it again concludes that it has not been demonstrated that Park faces any extraordinary risk.

<u>RRB's comment on Regulatory Expense</u> states that in RRB's September 1998 Closing Brief, RRB never adopted $140,000 as the estimate to be used, and that its use with RRB recommended disallowances was only a proposal. It's view is that AVR failed its burden of proof on these expenses. But RRB's July 2, 1998 Report postulated <u>total</u> Regulatory Expense of $35,100, all related to legal costs. This despite the fact that RRB had been working all along with Park's <u>outside</u> technical consultant, and the Closing Brief recommended disallowances respectively of $14,000 and $25,000 for legal and Howard technical costs, stating nothing about financial expert witness expense although RRB knew of the latter's extensive participation <u>before</u> hearing.

The Howard billings (Exhibit 30) through June 2, 1998 of $16,400 represent about 1/3 of the RRB September Closing Brief Estimate of $50,000 that AVR would pay Howard. As pre-hearing preparation, hearing participation, and briefing preparation in this hard litigated matter remained, the Finding of Fact estimate of another 2/3 is not unreasonable and the Finding will be retained.

Any estimate of projected Regulatory Expense for a rate proceeding cannot be more than an informed estimate based on past experience and anticipated litigation. And if outside experts are employed only a portion of their billings can be available before hearing. Park stated that in its past decade, its actually incurred costs (determined after a decision) significantly have exceeded the adopted estimate. As a consequence of difficulty in accurate forecasting, in some past Park litigated rate cases the Commission has accepted the practice of taking the adopted allowance from the immediate past litigated case and escalating it to the present. Park did this here. While RRB is dissatisfied with lack of detail in the small number of bills available before the present hearing, there was no evidence presented that RRB had attempted to audit the final recorded billings in the prior case (Santa Paula, D.92-04-031), so as to verify the base, or made any assertion that the escalation was inaccurate.

Finding of Fact 18 reflects the record as to Park's size, limited in-house resources and reliance upon outside consulting and legal services for rate proceedings and will be retained.

The parenthetical inference that RRB implied that AVR should have used an Apple Valley attorney has been deleted as RRB requested, as the source in Section A is ambiguous.

AVR's Reply Comment points up asserted RRB violations of Rule 77.3 re: Cost of Capital and denies that revisions are necessary as regards Regulatory Cost.

Findings of Fact

1. AVR, a water public utility within the context of Pub. Util. Code § 216, is subject to the jurisdiction, control, and regulation of this Commission.

2. AVR is a wholly owned subsidiary of Park, and provides public utility water service in and adjacent to the Town of Apple Valley.

3. As Park uses a consolidated capital structure applicable to all its subsidiaries, AVR's capital structure for ROR purposes is imputed to be Park's.

4. By the present application, AVR sought increases over present rates of $1,295.455 (15.1%) for 1999; an increase over proposed 1999 rates of $279,216

(2.8%) for 2000, and a further increase over 2000 rates of $280,577 (2.7%) for 2001. These increases would produce an ROE of 11.50% for each year.

5. Pursuant to Rule 6.1, by Resolution ALJ 176-2989, the Commission preliminarily designated the application as a "ratesetting" proceeding.

6. The application was timely protested by RRB, and following a PHC on May 8, 1998, the Assigned Commissioner issued a Scoping Memo and Ruling on May 18, 1998, which inter alia designated ALJ Weiss as the principal hearing officer.

7. Following notice to the customers, a PPH was conducted the afternoon and evening of June 1, 1998 in Apple Valley. Within excess of 200 customers in attendance, and 57 customers presenting their views, almost all opposed any increase. Another approximate 90 customers wrote in opposition to an increase.

8. Complaints largely pertained to the assertedly high cost of water service compared to neighboring district or municipal services, and the poor condition of water service mains in Apple Valley.

9. RRB's reports on the application included a recommended 8.20% ROE each year for the period at issue, and differed principally from AVR as to residential per customer consumption, lower unaccounted for water, lower expense estimates in most categories, and a lower rate base estimate for each year at issue.

10. Prior to the start of evidentiary hearings, AVR and RRB settled their differences on the Rate Base issues. In addition, they produced a stipulation on other issues including O&M Payroll, O&M Other, A&G Payroll, A&G Office Expense, Outside Services, Miscellaneous General Expense, Injuries & Damages, and Benefits.

11. Left for litigation in hearing were the Residential Consumption Forecasts, the Regulatory Expense issues, and the appropriate ROR issues.

12. Being reasonable in light of the whole record, consistent with law, and in the public interest, the provisions of the offered stipulation meet the standards set down in San Diego Gas and Electric Company General Rate Case. They also conform to the requirements of our Rules of Practice and Procedure.

13. Apart from the continuing necessity for replacement of vast lengths of aged, deteriorated, and substandard mains installed by predecessor owners of the system, which task is being accomplished and accelerated as expeditiously as financing can accommodate, service within the AVR service territory appears generally satisfactory with water quality meeting State drinking water standards.

14. The Table A Comparison of Rate Base with the indicated settlement of Total Rate Base for Test Years 1999 and 2000 is a reasonable resolution of the parties' rate base issues, excluding the working cash component.

15. The Table B Comparison of O&M and A&G expenses with the indicated settlement for the various components for the Test years is a reasonable resolution of those issues.

16. Neither parties' initial estimate of Residential Consumption per Customer is satisfactory. The estimate produced by AVR's hearing Exhibit 28 which dropped Time as a variable but used the Price variable to provide some accounting for both time and price over the 10-year data span, when adjusted for Jess Ranch, appears a more reliable estimate and has been adopted in our computations.

17. In the past decade and a half, Park's experience in general rate case proceeding has been that its actual Regulatory Expense costs incurred have always substantially exceeded the amounts adopted by settlements.

18. As one of the smallest Class A water utilities, Park lacks the resources to staff up with in-house expert personnel needed to compete adequately with advocacy Commission staff personnel in general rate proceedings. Accordingly,

over the years Park has relied upon external consulting and legal services as needed for its general rate proceedings.

19. Park's $140,000 Regulatory Expense estimate for the present proceeding was based upon a projection from its actual incurred costs in its last contested rate proceeding.

20. RRB recommended that Regulatory Expense be limited to $101,000, achieving this limitation by a $14,000 reduction in RRB's estimate of Park's legal costs (through use of a lower billing rate), and an $25,000 reduction in RRB's estimate of the costs of Park's use of an outside operations consultant.

21. One third of the time of Park's Operations Consultant was incurred in preparation of technical portions of AVR's application, and the remaining two-thirds were reasonably incurred in prehearing responses to RRB data requests, hearing preparation, and participation as trial consultant and expert witness whose views largely prevailed in the week long hearing. As the consultant's hourly rate was well within the range accepted 3 years ago by the Commission in D.96-08-040, the RRB disallowance recommendation will not be adopted.

22. Based on the 1997 of Counsel attorney fee survey, the Commission's top allowance for intervenor counsel in a recent proceeding was $290 per hour. The competence and grasp of technical and financial issues demonstrated herein by Park's counsel, not limited to intervenor issues, but spanning the full range of the litigated proceeding, led to adoption of the same rate, albeit it is still less than counsel's billing rate. Our adoption of an allowance of $42,725 is reasonable.

23. The Regulatory Expense authorized Park for this proceeding of $133,790, to be amortized over 3 years at the rate of $44,597 a year, is reasonable considering the complexity and litigious nature of the proceeding.

24. AVR requires additional revenues, but the rates it proposes would produce an unjustified 11.50% ROE.

25. RRB, today an advocacy organ for the ratepayers, obtains its recommended 8.20% ROE based upon a quantitative analysis which postulates a group of eleven primarily larger and non-California Class A water companies as being "comparable" to Park, and uses flawed Discounted Cash Flow, Risk Premium, and Capital Asset Pricing models.

26. While our adjustments to the flaws in the RRB quantitative analysis are themselves subject to criticism as being subjective, the quantitative analysis process itself is based upon a mechanistic application of financial models and its results must be tempered with judgments derived from the overall record and business realities, including the substantial drop in interest rates.

27. While Park's slightly higher equity ratio than the average of RRB's "comparable" group serves to somewhat lessen its financial risk, this is more than offset by Park's small size, limited financial flexibility, demonstrated higher costs to borrow, and greater vulnerability to the risks of catastrophic events which produce significantly higher business risks, leading to our finding that Park presents an overall higher risk as perceived by investors, so that the ROE expected in an adjusted quantitative analysis for the RRB "comparable" group should serve as a floor above which park should be compensated.

28. Our adjustments to the financial model results in the quantitative analysis for RRB's "comparable" group leads us to the conclusion that the appropriate average ROE for that group should be 9.85%, and that Park's greater overall risk to investors represents an additional 30 basis points.

29. We find that an ROE of 10.15% at this time will provide revenues sufficient for operating expenses and a reasonable coverage for the costs of capital, while

assuring confidence in the financial integrity of the enterprises, and providing a balance in the interests of the ratepayers and the investors.

30. Rates of return of 9.61%, 9.61%, and 9.60% respectively, on RVR's rate base for 1999, 2000, and 2001 are reasonable.

31. The adopted rates of return will require an increase of $429,033 or 4.87%, in annual revenue for 1999, an increase of $392,455 or 4.25%, in 2000, and a further attrition increase of $397,164, or 4.0% in 2001.

32. The rate design is unchanged.

33. The increased rates and charges authorized herein are justified and reasonable; and the present rates and charges, insofar as they differ from those prescribed herein, are for the future unjust and unreasonable.

34. The further increases authorized for 2000 and 2001 should be appropriately modified in the event the rate of return on rate base, adjusted to reflect the rates then in effect together with normal ratemaking adjustments authorized for the 12 months ended September 30, 1999 and/or September 30, 2000, exceeds 9.61%.

35. The calculations of adopted quantities and the adopted tax calculation are contained in Appendix D of this decision.

Conclusions of Law

1. Conforming to the requirements of Rule 51 of our Rules of Practice and Procedure, meeting the standards established in re San Diego Gas & Electric Company General Rate Case, and being reasonable in light of the whole record, consistent with law, and in the public interest, the stipulations resolving the specific issues included therein, as set forth in the August 27, 1998 motion for Adoption, should be approved and adopted.

2. A return on equity of 10.15% for 1999, 2000, and 2001 is reasonable and should be adopted.

3. The rates of AVR should be increased to enable AVR to earn the rates of return found reasonable of 9.61% for 1999 and 2000, and 9.60% for 2001.

4. The effective date of the order that follows should be the date of signature as there is an immediate need for the rate increase.

5. AVR should be authorized to file the rates set forth in Appendix B.

ORDER

IT IS ORDERED that:

1. Apple Valley Ranchos Water Company (AVR) is authorized to file the revised schedules attached to this order as Appendix B and to concurrently cancel its present schedules for such service. This filing shall comply with General Order (GO) Series 96-A. The effective date of the revised schedule shall be at least 5 days after the date of filing. The revised schedule shall apply only to the service rendered on or after the effective date.

2. On or after November 5, 1999, AVR is authorized to file an advice letter, with appropriate workpapers, requesting the step increase for 2000 included in Appendix B or to file a proportionate lesser increase for those rates in Appendix B in the event that its rate of return on rate base, adjusted to reflect rates then in effect and normal ratemaking adjustments for the 12 months ended September 20, 1999, exceeds the lesser of (3) the rate of return found reasonable for Park Water Company (Park) during the corresponding period in the then most recent rate decision, or (b) 9.61%. This advice letter filing shall conform to GO 96-A. The requested step rates shall be reviewed by the Water Division's Advisory Branch (Branch) to determine their conformity with this order and shall go into effect upon Branch's determination of conformity. Branch shall inform the Commission if it finds that the proposed step rates are not in accord with this decision or other Commission decisions. The effective date of the revised

schedules shall be no earlier than January 1, 2000, or 30 days after filing, whichever is later. The revised schedules shall apply only to service rendered on or after their effective date.

3. On or after November 5, 2000, AVR is authorized to file an advice letter, with appropriate workpapers, requesting the step increase for 2001 included in Appendix B or to file a proportionate lesser increase for those rates in Appendix B in the event that its rate or return on rate base, adjusted to reflect rates then in effect and normal ratemaking adjustments for the 12 months ended September 30, 2000, exceeds the lesser of (3) the rate of return found reasonable for Park during the corresponding period in the then most recent rate decision, or (b) 9.60%. This advice letter filing shall conform to GO 96-A. The requested step rates shall be reviewed by Branch to determine their conformity with this order and shall go into effect upon Branch's determination of conformity. Branch shall inform the Commission if it finds that the proposed step rates are not in accord with this decision or other Commission decisions. The effective date of the revised schedules shall be no earlier than January 1, 2001, or 30 days after filing, whichever is later. The revised schedules shall apply only to service rendered on or after their effective date.

4. This proceeding is closed.

This order is effective today

Dated March 18, 1999, at San Francisco, California.

RICHARD A. BILAS
President
HENRY M. DUQUE
JOSIAH L. NEEPER
Commissioners

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Apple Valley Ranchos Water Company, for authority to increase rates by $1,295,453 or 15.1% in 1999; $279,216 or 2.8% in 2000; by $280,577 or 2.7% in 2001

MOTION FOR ADOPTION OF STIPULATIONS

The parties to the accompanying Stipulations ("Parties") are the Ratepayer Representation Branch of the Water Division ("RRB") and Apple Valley Ranchos Water Company ("AVR"). The Parties have agreed on a resolution of each of the issues pending in this proceeding except residential consumption, regulatory expenses, and return on equity. The Parties now submit for adoption the attached list of Stipulations pursuant to Rules 51 et seq. of the Rules of Practice and Procedure of the California Public Utilities Commission ("Commission").

In particular, the Parties represent to the Commission as follows:

(a) That the Stipulations command the sponsorship of the Parties to this proceeding as listed above;

(b) That the Parties are fairly representative of all affected interests;

(c) That no term of the Stipulations contravenes any statutory provision or any decision of the Commission; and

(d) That the Stipulations, together with the record in this proceeding, convey to the Commission sufficient information to permit the Commission to discharge its regulatory obligations with respect to the Parties and their interests.

The Parties believe that the Stipulations are reasonable in light of the whole record, consistent with applicable law, and in the public interest.

In addition, the Parties have entered into the Stipulations on the basis that the Commission's adoption not be construed as an admission or concession by any party regarding any fact or matter of law in dispute in this proceeding.

Furthermore, the Parties intend that the Commission's adoption of the Stipulations not be construed as any statement of precedent or policy of any kind for or against them in any current or future proceeding.

Finally, the Stipulations represent an integrated agreement, so that if any portion of them are rejected by the Commission, each Party has the right to withdraw.

WHEREFORE the Parties request that the Commission adopt the accompanying Stipulations in their entirety as a complete resolution of all issues in the present proceeding except for residential consumption, regulatory expenses, and return on equity.

By: David A. Ebershoff
David A. Ebershoff
Attorney for Apple Valley
Ranchos Water Company
Fulbright & Jaworski L.L.P.
865 South Figueroa
Los Angeles, CA 90017

By: Andrew Ulmer
Andrew Ulmer
Attorney for Water Division
California Public Utilities Commission
505 Van Ness Street,
San Francisco, CA 94102

Dated: August 27, 1998

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA

Apple Valley Ranchos Water Company, for authority to increase rates by $1,295,453 or 15.1% in 1999; $279,216 or 2.8% in 2000; by $280,577 or 2.7% in 2001	Application 98-03-024

STIPULATIONS

1.00 Introduction

1.01 The parties to the Stipulations ("Parties") are the Ratepayer Representation Branch ("RRB") of the Water Division and Apple Valley Ranchos Water Company ("AVR").

1.02 The Parties agree that no signatory hereto nor any member of the staff of the Public Utilities Commission assumes any personal liability as a result of the Stipulations. The Parties agree that no legal action may be brought in any state or federal court, or in any other forum, against any individual signatory representing the interests of RRB, its attorneys, or the RRB itself regarding the Stipulations. All rights and remedies are limited to those available before the California Public Utilities Commission.

1.03 The Parties acknowledge that RRB is charged with representing the interests of customers of public utilities in the State of California, as required by Public Utilities Code Section 309.5, and nothing in the Stipulations is intended to limit the ability of RRB to carry on that responsibility.

1.04 The Parties' negotiations have resulted in the resolution of the following issues raised in Application 98-03-024 and in RRB's reports dated July 2, 1998:

2.00 Payroll: To derive estimates for the Test Years, the Parties agree to AVR's total payroll adjusted to incorporate RRB's escalation factors dated May, 1998, and to eliminate the expense of 1/2 of a position to reflect vacancies. The Parties also agree to use an average of the most recent five years of recorded allocations to determine the portion of payroll allocated to expenses:

	Test Year 1999	Test Year 2000
Operation and Maintenance	$708,700	$749,200
Administrative and General	512,400	533,900

2.01 Expenses of Operation and Maintenance

2.02 Production: The Parties agree that the expense of power purchased should be based on the rates of Southern California Edison Company and the average amount energy used for each unit of water consumed. The Parties agree that no reduction is warranted at this time because of the uncertainties of restructuring of the electric industry and the fact that the differences between adopted and actual expenses will be tracked in AVR's balancing account. The Parties further agree that the adopted expenses for the Test Years will be determined by the amount of consumption adopted by the Commission in this proceeding.

2.03 The Parties agree, based on their review of the market, that a rate of $65 per acre-foot is reasonable for pumping water, in addition to administrative and other assessments, and for leasing any additional water rights. The Parties further agree that the adopted expenses for the Test Years will be determined by the amount of consumption adopted by the Commission in this proceeding.

2.04 Other Expenses: Upon review of the most recent three years of recorded data, the Parties agree to base estimates of other expenses of operation and maintenance on RRB's escalation factors dated May, 1998, applied to amounts AVR has budgeted:

Test Year 1999	Test Year 2000
$1,109,030	$1,094,005

2.05 Unaccounted Water: The Parties agree to base the estimate of Unaccounted Water on 9% of total demand. To achieve this level, the Parties further agree that AVR should spend an additional $500,000 for replacing mains in its distributional system in 1998 and in each Test Year. The Parties agree that the expense of Unaccounted Water for the Test Years will be determined by the amount of consumption adopted by the Commission in this proceeding.

3.00 Administrative and General Expenses

3.01 Injuries and Damages: The Parties agree to calculate Injuries and Damages based on AVR's actual insurance for 1998 and increase Workers Compensation by 1.1% for each Test Year as estimated by AVR's provider:

Test Year 1999	Test Year 2000
$235,643	$243,142

3.02 Pensions and Benefits: The Parties agree to calculate Pensions on more recent information and apply an increase for each Test Year of 13.22% to account for the underfunding of AVR's pension plan. The Parties further agree to estimate Medical Insurance using the actual premiums in effect in 1998 and to incorporate increases for each Test Year by applying the Medical Cost Trend used by AVR's actuary. In addition the Parties agree to revise Pensions and Benefits consistent with the total payroll stipulated herein:

Test Year 1999	Test Year 2000
$323,216	$359,778

3.03 Other Expenses: Upon review of the most recent three years of recorded data, the Parties agree to base estimates of Other Administrative and General Expenses on RRB's escalation factors dated May, 1998, applied to amounts AVR has budgeted:

	Test Year 1999	Test Year 2000
Office	$136,472	$139,747
Outside Services	122,625	125,568
Miscellaneous General	20,125	20,608

4.00 Plant

4.01 Replacement of Mains: As discussed under Unaccounted Water, the Parties agree to an accelerated program to replace mains at an additional cost of $500,000 for 1998 and each Test Year.

4.02 The Parties agree that AVR will expend on capital the amounts proposed in A.98-03-024. The Parties further agree that

90% of the estimated cost for projects in the Test Years will be spent in the year estimated and that the cost of projects which are incomplete will be reflected in each year's average balance of Construction Work in Progress (CWIP):

	Test Year 1999	Test Year 2000
Plant	$34,394,594	$36,659,715
CWIP	364,361	320,985
Depreciation Expense	734,655	819,880
Accumulated Depre'n.	8,702,335	9,525,871

RATEPAYER REPRESENTATION BRANCH

By
Daniel R. Paige
Program and Project Supervisor

APPLE VALLEY RANCHOS WATER COMPANY

By
Leigh K. Jordan
Representative

Dated: August 27, 1998

(END OF APPENDIX A)

APPLE VALLEY RANCHOS WATER COMPANY

Schedule No. 1

GENERAL METERED SERVICE

APPLICABILITY

Applicable to all metered water services.

TERRITORY

Town of Apple Valley and vicinity, San Bernardino County.

RATES

Quantity Rate:

For all water delivered per 100 cu. ft	$ 1.041	(I)

	Per Meter Per Month	
For 5/8 x 3/4-inch meter	$ 15.20	(I)
For 3/4-inch meter	22.80	|
For 1-inch meter	38.00	|
For 1 1/2-inch meter	76.00	|
For 2-inch meter	121.60	|
For 3-inch meter	228.00	|
For 4-inch meter	380.00	|
For 6-inch meter	760.00	|
For 8-inch meter	1,216.00	|
For 10-inch meter	2,204.00	(I)

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.

SPECIAL CONDITIONS

1. A late charge will be imposed per Schedule LC.

2. In accordance with Section 2714 of the Public Utilities Code, if a tenant in a rental unit leaves owing the Company, service to subsequent tenants in that unit will, at the Company's option, be furnished on the account of the landlord or property owner.

3. All bills are subject to the reimbursement fee set forth on Schedule No. UF.

APPLE VALLEY RANCHOS WATER COMPANY

Schedule No. 1

GENERAL METERED SERVICE

AUTHORIZED STEP INCREASES

Each of the following increases in rates may be put into effect by filing a rate schedule which adds the appropriate increase to the rates at that time.

	Rates to be Effective 1-1-2000	1-1-2001
Quantity Rate:		
For all water delivered per 100 cu. ft.	$0.046	$0.040
Service Charge:		
For 5/8 x 3/4-inch meter	$0.60	$0.75
For 3/4-inch meter	0.90	1.15
For 1-inch meter	1.50	1.90
For 1 1/2-inch meter	3.00	3.75
For 2-inch meter	4.80	6.00
For 3-inch meter	9.00	11.30
For 4-inch meter	15.00	18.80
For 6-inch meter	30.00	37.50
For 8-inch meter	48.00	60.00
For 10-inch meter	87.00	108.80

APPLE VALLEY RANCHOS WATER COMPANY

Schedule No. 2

GRAVITY IRRIGATION SERVICE

APPLICABILITY

Applicability to all water service from the Company's gravity irrigation system.

TERRITORY

Within the entire service area of the Company.

RATES

Quantity Rates:

All water delivered per 100 cu. ft.	$ 0.400	(I)

Service Charge:	Per Meter Per Month	
For 5/8 x 3/4-inch meter	$ 15.20	(I)
For 3/4-inch meter	22.80	|
For 1-inch meter	38.00	|
For 1 1/2-inch meter	76.00	|
For 2-inch meter	121.60	|
For 3-inch meter	228.00	|
For 4-inch meter	380.00	|
For 6-inch meter	760.00	|
For 8-inch meter	1,216.00	|
For 10-inch meter	2,204.00	(I)

SPECIAL CONDITIONS

1. Service under this schedule is limited to lands not developed for residential use.

2. All outlets for this water shall be protected by signs stating :NON-POTABLE WATER - NOT FOR HUMAN CONSUMPTION.

3. A late charge will be imposed per schedule LC.

4. All bills are subject to the Public Utilities Commission Reimbursement Fee set for on Schedule No. UF.

APPLE VALLEY RANCHOS WATER COMPANY

Schedule No. 2

GRAVITY IRRIGATION SERVICE

AUTHORIZED STEP INCREASES

Each of the following increases in rates may be put into effect by filing a rate schedule which adds the appropriate increase to the rates at that time.

	Rates to be Effective	
	1-1-2000	1-1-2001
Quantity Rate:		
For all water delivered per 100 cu. ft.	$0.019	$0.020
Service Charge:		
For 5/8 x 3/4-inch meter	$0.60	$0.75
For 3/4-inch meter	0.90	1.15
For 1-inch meter	1.50	1.90
For 1 1/2-inch meter	3.00	3.75
For 2-inch meter	4.80	6.00
For 3-inch meter	9.00	11.30
For 4-inch meter	15.00	18.80
For 6-inch meter	30.00	37.50
For 8-inch meter	48.00	60.00
For 10-inch meter	87.00	108.80

APPLE VALLEY RANCHOS WATER COMPANY

Schedule No. 4

NON-METERED FIRE SERVICE

APPLICABILITY

Applicable for water service to privately-owned fire-hydrant and fire-sprinkler systems where water is to be used only for the purpose of fire suppression or for periodic system testing.

TERRITORY

Town of Apple Valley and vicinity, San Bernardino County.

RATES

Size of Service	Per Service Per Month	
2 - inch	$17.50	(I)
3 - inch	26.25	|
4 - inch	35.00	|
6 - inch	52.50	|
8 - inch	70.00	(I)

SPECIAL CONDITIONS

1. The fire protection service connection shall be installed by the utility with the cost thereof paid by the applicant. Such payment shall not be subject to refund.

2. The minimum diameter for fire protection service shall be two (2) inches, and the maximum diameter shall be not more than the diameter of the main to which the service is connected.

3. If a distribution main of adequate size to serve a private fire protection system in addition to all other normal service does not exist in the street or alley adjacent to the premises to be served, then a a service main from the nearest main of adequate capacity shall be installed by the utility and the cost paid by the applicant. Such payment shall not be subject to refund.

4. Service hereunder is for private fire protection systems to which no connections for other than fire protection purposes are allowed and which are regularly inspected by the underwriters having jurisdiction, are installed according to specifications of the utility, and are maintained to the satisfaction of the utility. The utility may install the standard detector type meter approved by the Board of Fire Underwriters for protection against theft, leakage or waste of water, and the cost paid by the applicant.

5. The utility undertakes to supply only such water at such pressure as may be available at any time through the normal operation of its system.

6. Any unauthorized use of water, other than for fire extinguishing purposes, shall be charged for at the regular established rate as set forth under Schedule No. 1, and/or may be the grounds for the immediate disconnection of the service without liability to the company.

7. A late charge will be imposed per Schedule LC.

8. All bills are subject to the reimbursement fee set forth on Schedule No. UF.

APPLE VALLEY RANCHOS WATER COMPANY

Schedule No. 3

NON-METERED FIRE SERVICE

AUTHORIZED STEP INCREASES

Each of the following increases in rates may be put into effect by filing a rate schedule which adds the appropriate increase to the rates at that time.

	Rates to be Effective	
	1-1-2000	1-1-2001
Service Charge:		
For 2-inch meter	$0.90	$0.85
For 3-inch meter	1.35	1.30
For 4-inch meter	1.80	1.70
For 6-inch meter	2.70	2.55
For 8-inch meter	3.60	3.40

(END OF APPENDIX B)

APPENDIX C

APPLE VALLEY RANCHOS WATER COMPANY

COMPARISON OF RATES

1999				
USAGE	PRESENT	ADOPTED	INCREASE	PERCENT
0	13.90	15.20	1.30	9.35%
10	24.09	25.61	1.52	6.31%
20	34.28	36.02	1.74	5.08%
30	44.47	46.43	1.96	4.41%
40	54.66	56.84	2.18	3.99%
50	64.85	67.25	2.40	3.70%

2000				
USAGE	PRESENT	ADOPTED	INCREASE	PERCENT
0	15.20	15.80	0.60	3.95%
10	25.61	26.67	1.06	4.14%
20	36.02	37.54	1.52	4.22%
30	46.43	48.41	1.98	4.26%
40	56.84	59.28	2.44	4.29%
50	67.25	70.15	2.90	4.31%

20001				
USAGE	PRESENT	ADOPTED	INCREASE	PERCENT
0	15.80	16.55	0.75	4.75%
10	26.67	27.82	1.15	4.31%
20	37.54	39.09	1.55	4.13%
30	48.41	50.36	1.95	4.03%
40	59.28	61.63	2.35	3.96%
50	70.15	72.90	2.75	3.92%

(END OF APPENDIX C)

APPLE VALLEY RANCHOS WATER COMPANY - DOMESTIC

ADOPTED QUANTITIES

Net-to-Gross Multiplier	1.7767	
Uncollectibles Rate	0.53%	
Franchise Rate	1.00%	
Federal Tax Rate	34.00%	
State Tax Rate	8.84%	
1. WATER CONSUMPTION (KCcf)	1999	2000
Domestic Water Sales	5,249.8	5,266.1
Unaccounted Water (9%)	519.2	520.8
Total Water Production	5,769.0	5,786.9
Replenishment Cost	$99,804	$99,908
Water Rights Lease (AF)	2,235.0	2,276.0
Lease Water Cost ($65.00/AF)	$145,269	$147,940
2. POWER PURCHASED		
Pumping Cost		
Electric	$718,487	$720,711
Gas	$ 5,980	$ 5,980
Total	$724,467	$726,691
Cost per A.F.		
Electric	$54.25	$54.25
Gas	$26.23	$26.23
3. WATER CONSUMPTION (Ccf/Cust)		
METERED SERVICE		
Residential	320.91	316.77
Commercial	723.6	726.9
Industrial	300.0	300.0
Public Authority	6,891.9	7,035.5
Landscape	3,417.0	3,417.0

APPLE VALLEY RANCHOS WATER COMPANY - IRRIGATION

ADOPTED QUANTITIES

Net-to-Gross Multiplier	1.7767	
Uncollectibles Rate	.53%	
Franchise Rate	1.00%	
Federal Tax Rate	34.00%	
State Tax Rate	8.84%	
1. WATER CONSUMPTION (KCcf)	1999	2000
Water Sales	**367.6**	**367.6**
Unaccounted Water (57%)	477.7	477.7
Total Production	845.3	845.3
REPLENISHMENT COST	$2,697	$2,697
2. POWER PURCHASED		
Pumping Cost	**$26,281**	**$26,281**
Cost per A.F.	$13.54	$13.54
3. WATER CONSUMPTION (Ccf/Cust)		
METERED SERVICE	183,816.0	183,816.0

APPENDIX D

APPLE VALLEY RANCHOS WATER COMPANY

ADOPTED QUANTITIES

4. ADOPTED AVERAGE SERVICE BY METER SIZE

	1999	2000
Domestic Metered		
5/8 x 3/4"	10,920	11,050
3/4"	681	690
1"	1,677	1,696
1 - 1/2"	196	198
2"	128	128
3"	28	29
4"	8	8
6"	10	10
8"	1	1
Total Domestic Metered	13,649	13,810
Fire Service		
2"	7	7
3"	1	1
4"	14	15
6"	39	40
8"	18	18
Total Fire Service	79	81
Irrigation		
2"	1	1
10"	1	1
Total Irrigation	2	2
TOTAL CUSTOMERS	13,730	13,893

APPLE VALLEY RANCHOS WATER COMPANY

ADOPTED
RATE BASE SUMMARY
(Dollars in Thousands)

AVERAGE BALANCES	1999	2000
PLANT IN SERVICE	34,395.0	36,659.7
WORK IN PROGRESS	364.4	321.0
MATERIALS & SUPPLIES	118.0	119.4
WORKING CASH	682.0	618.1
SUBTOTAL	35,558.9	37,718.2
LESS:		
DEPRECIATION RESERVE	8,702.3	9,525.9
ADVANCES	5,058.6	5,080.8
CONTRIBUTIONS	1,573.4	1,498.1
UNAMORTIZED ITC	124.3	119.5
DEFERRED INCOME TAX	2,256.7	2,443.3
SUBTOTAL	17,715.3	18,667.6
PLUS:		
METHOD 5 ADJUSTMENT	46.4	43.1
NET DISTRICT RATE BASE	17,890.0	19,093.7
MAIN OFFICE ALLOCATION	936.8	936.8
APPLE VALLEY-IRRIGATION	409.8	397.5
TOWN OF APPLE VALLEY	2,210.0	2,151.8
TOTAL RATE BASE	21,446.6	22,579.8

APPLE VALLEY RANCHOS WATER COMPANY

ADOPTED
INCOME TAX CALCULATIONS

	1999	2000
	(Dollars in Thousands)	
OPERATING REVENUES	**9,235.5**	**9,686.5**
EXPENSES		
Operating & Maintenance	2,841.2	2,872.2
Uncollectibles .53%	48.9	51.3
Administrative & General	2,056.9	2,163.8
Franchise Fees 1.00%	92.4	96.9
Ad Valorem Taxes	245.9	264.0
Payroll Taxes	139.4	145.8
Meals Adjustments	(8.9)	(9.2)
Subtotal	5,415.9	5,584.9
DEDUCTIONS		
California Tax Depreciation	889.0	974.2
Interest	804.2	846.7
California Taxable Income	2,126.4	2,280.6
CCFT @ 8.84%	188.0	201.6
DEDUCTIONS		
Federal Tax Depreciation	883.8	916.7
Interest	804.2	846.7
CA Tax	150.6	188.0
FIT TAXABLE INCOME	1,981.0	2,150.2
FIT (Before Adjustment) 34.00%	673.5	731.1
Prorated Adjustment	0	0
Investment Tax Credit	(.6)	(.6)
Net Federal Income Tax	672.9	730.5

(END OF APPENDIX D)