

Decision 03-12-040 December 18, 2003

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

In the Matter of the Application of Park Water Company (U 314 W) for Authority to Increase Rates in its Central Basin Division as authorized by NOI 03-04-004: In 2004 of \$1,775,880 or 9.83% above revenues generated by present rates, in 2005 of \$671,705 or 3.39% above the revenues generated by the rates proposed for 2004, in 2006 of \$674,319 or 3.29% above the 2005 requirements.

Application 03-04-015  
(Filed April 11, 2003)

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applicant.

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Advocates, protestant.

**OPINION RESOLVING GENERAL RATE CASE**

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## **OPINION RESOLVING GENERAL RATE CASE**

### **1. Summary**

Park Water Company (Park) is authorized an \$803,100 (4.4%) general rate increase for Test Year 2004, \$513,000 (2.7%) for Test Year 2005, and \$487,500 (2.5%) for Attrition Year 2006. We authorize rates of return on rate base of 9.51% in 2004, 9.50% in 2005, and 9.49% in 2006.

Park bills its customers every two months. As a result of the revenue increase granted by this decision, the bimonthly bill for the average residential customer (27 hundred cubic feet (Ccf) of water with a 5/8 x 3/4-inch meter) would increase by \$3.80 or 4.68% from \$81.00 to \$84.78 in the year 2004.

### **2. Background and Procedural History**

Through its Central Basin Division (which is the subject of this application), Park provides public utility water service to 27,088 customers in the southeastern section of Los Angeles County. Park also owns two subsidiary public utilities, the Apple Valley Ranchos Water Company, which provides water service in San Bernardino County, and Mountain Water Company, which provides water service in Missoula, Montana.

The Central Basin Division consists of three separate service areas. It serves customers in the cities of Norwalk, Santa Fe Springs, Lynwood, Bellflower, Artesia, and Compton, and in unincorporated areas in southern Los Angeles. Park does not expect any significant growth in number of customers.

Most of the water supply for the Central Basin Division is purchased from the Central Basin Municipal Water District, a subagency of the Metropolitan Water District of Southern California (MWD). The remainder is obtained from 15 company-owned wells. Park also serves recycled water for non-potable purposes, primarily irrigation.

Park's last general rate increase occurred in 2001, as authorized in Decision (D.) 01-03-078. Park filed this General Rate Case on April 11, 2003. On May 19, 2003, the Commission's Office of Ratepayer Advocates (ORA) protested the utility's request for increased rates. A Prehearing Conference was conducted on June 11, 2003, and Assigned Commissioner Carl Wood issued a Scoping Memo on June 18, 2003, concluding that a hearing was required.

A public participation hearing attended by about 30 persons was conducted in Bellflower on August 18, 2003. The Commission heard from nine ratepayers, including Lynwood Mayor Fernando Pedroza, who objected to what Park concedes are the highest water rates in the general areas of its service. One speaker, Anthony Kingsley, outlined a detailed study he had done of Park's annual reports. The Administrative Law Judge (ALJ) ordered Park to respond to the study during the evidentiary hearing. Another speaker, Rod White of Lynwood, asked that he be permitted to repeat his remarks during the evidentiary hearing, and that permission was granted. The Commission also received City Council Resolution 1805 of the City of Artesia declaring its opposition to Park's rate increases.

Four days of hearing were conducted in Los Angeles on August 19-22, 2003, and two days of hearing dealing primarily with a proposed settlement of cost of capital issues were conducted in San Francisco on August 28 and 29, 2003. The Commission heard from 15 witnesses and received 42 exhibits into evidence. Final briefs were filed on October 8, 2003, when the case was deemed submitted for Commission decision. A joint exhibit comparing the recommendations of Park and ORA was submitted on October 10, 2003.

### 3. Park's Application

Park's initial request for overall rate increases is shown in Table 1, along with the utility's revised request following hearings and consultation with ORA. Also shown are ORA's initial recommendations and revised recommendations. The differences between Park and ORA estimates are due in large part to ORA's recommendations to eliminate or defer major construction and maintenance projects that ORA felt had not been adequately justified prior to hearing. Table 1 shows the adopted rate increases authorized by this decision.

The Commission is also asked to decide on one of four alternatives for dealing with contaminants detected in some of Park's wells.

**Table 1**  
**Revenue Requirement Increases**

	2004		2005		2006	
	\$ (000)	%	\$ (000)	%	\$ (000)	%
<b>Park Water Company</b>						
Application Request	1,775.9	9.83	671.7	3.4	674.3	3.3
Revised Request	860.5	4.73	807.0	4.22	775.4	3.92
<b>ORA</b>						
Initial Recommendation	(763.4)	(4.16)	294.0	1.67	264.2	1.48
Revised Recommendation	195.1	1.06	441.3	2.37	356.8	1.90
<b>Adopted</b>	<b>803.1</b>	<b>4.4</b>	<b>513.0</b>	<b>2.7</b>	<b>487.5</b>	<b>2.5</b>

Park prepared its request using a 12% return on common equity, which resulted in a 10.47% rate of return in 2004, a 10.46% rate of return in 2005, and a 10.45% rate of return in 2006. ORA's recommendations used a 9.30% return on common equity. On that basis, ORA calculated a rate of return of 9.00% in 2004; 8.99% in 2005, and 8.98% in 2005. This decision approves a settlement agreement

between Park and ORA that adopts a 10.15% return on common equity, with rate of return set at 9.51% in 2004, 9.50% in 2005, and 9.49% in 2006.

In the discussion that follows, we will first address issues on which the parties have reached agreement. We then will deal with unresolved issues. Finally, we will turn to the parties' proposed settlement on rate of return issues.

#### **4. Uncontested Issues**

##### **4.1. General Rates in 2004, 2005 and 2006**

Park maintains that the increases sought in this General Rate Case are intended to recover operating expenses as well as to provide a fair return on rate base. Park and ORA agree that Park's water system facilities are in good condition, and service complaints are few. Capital expenditures planned through 2006 consist largely of replacements in kind to maintain the condition of the water system and ensure water quality. Park has submitted its current Urban Water Management Plan as part of this proceeding.

##### **4.2. Consumption**

The Commission's Standard Practice U-25 contains guidelines for estimating consumption for water utilities. Consistent with that, the parties agreed on the following consumption estimates for both of the test years:

Residential	159.6 Ccf per year
Business	802.5 Ccf per year
Industrial	8,158.0 Ccf per year
Public Authority	1,814.6 Ccf per year
Temporary	707.0 Ccf per year
Resale 71	25,291.7 Ccf per year
Resale 72	25,746.0 Ccf per year
Reclaimed	6,305.8 Ccf per year

#### **4.3. Number of Customers**

Park estimated a growth of 20 customers per year, based on the built-out nature of its service territories. ORA estimated customer growth of 70 customers per year, based on the average growth over the past six years. Park has accepted ORA's estimate, and we agree that the record supports this higher growth rate. Total number of customers is 27,242 for Test Year 2004 and 27,319 for Test Year 2005.

#### **4.4. Unaccounted-For Water**

ORA based its estimate of unaccounted water loss at 1.80% on the average water loss experienced by Park in the past five years. Park had rounded that number to 2% but has agreed, as do we, that ORA's estimate is the more reasonable one.

#### **4.5. Purchased Power (Unit Costs)**

Following testimony at hearing, Park and ORA agreed that the per unit cost of purchased power will be the current rate of Southern California Edison Company. The parties agreed that the adopted expense for the supply mix will determine the test year estimates adopted by the Commission in this proceeding.

#### **4.6. Leased Water Rights (Unit Costs)**

The parties agreed to use Park's estimate of the per unit cost of leased water rights of \$232.56 per acre foot for Test Year 2004 and \$237.21 per acre foot for Test Year 2005. The supply mix adopted by the Commission determines the adopted expense for the test years.



#### **4.7. Replenishment Charges (Unit Costs)**

The parties agreed on a per unit cost of replenishment charges of \$117.60 per acre foot, which is the current rate of the Water Replenishment District of Southern California. The adopted expense for the test years is determined by the supply mix adopted by the Commission.

#### **4.8. Utility Plant in Service - 2003 Capital Projects**

During hearing, the parties agreed to use Park's estimates of plant additions for 2003. ORA originally recommended disallowance of \$85,000 in replacement vehicles, \$85,000 in miscellaneous tools, and \$388,000 in replacement main projects, along with the deferral of \$380,000 in additional replacement main projects. Park provided additional justification for these projects and reduced its expense estimates to reflect \$16,000 in cost savings associated with replacement vehicles and miscellaneous tools. Park also provided additional information demonstrating that all of the plant items originally in dispute would be completed during 2003.

#### **4.9. Utility Plant in Service - Advances and Contributions**

ORA estimated that Park will have Advances for Construction of \$209,310 and Contributions in Aid of Construction of \$87,168 for the test years, based on a six-year average of recorded data. Park's estimates had been substantially lower, but the utility agreed to ORA's estimates. The parties also agreed to increase total plant additions in estimated year 2003 and Test Years 2004 and 2005 by \$228,487, representing the difference between the parties' original estimates. The record supports these adjustments.

#### **4.10. Rate Base - Deferred Investment Tax Credit**

ORA agreed to use Park's estimates for deferred investment tax credit of \$117,330 for Test Year 2004 and \$110,299 for Test Year 2005. The estimates are based on a methodology adopted by the Commission in prior decisions.

We now turn to the contested issues (Sections 5-12 below).

### **5. Operating Revenues**

#### **5.1. Investment Income**

ORA's financial witness recommended adding \$121,600 to operating revenues annually as ratepayers' "share" of interest earned on Park's retained earnings investments. This unusual recommendation – apparently the first ever made in a water utility rate case – was based on the payroll time and expense incurred by Park in connection with these investments and on a theory that retained earnings derive from ratepayers. Park's witness testified that staff time spent on retained earnings was minimal (about 18 hours per year), and that the retained earnings at issue are not in rate base but represent money retained by the company prior to investment in utility plant or distribution to shareholders as dividends.

Park showed that its total capitalization exceeds rate base by \$24.4 million. This difference, it argues, can only result from capital contributed by stockholders or borrowed money held by the company prior to investments in rate base. Park states that stockholders bear the risk of borrowing money in advance of it being invested in the utility's rate base.

We agree with Park that it is inappropriate to share investment income from investing shareholder funds, just as it would not be appropriate to charge ratepayers should the investments generate a loss. However, Park's payroll

numbers have been reduced by \$1,500 (the only estimate that appears in the record) to reflect executive time spent on this non-ratepayer investment task.

## **6. Operating Expenses**

### **6.1. Escalation Factors**

ORA challenged Park's methods for estimating expenses and applying escalation factors to those estimates. Generally, Park first "budgeted" a dollar amount for 2003 for each line item in an expense category, then escalated those expenses for the test years. ORA contended that it was given insufficient information to test the "budgeted" amounts for 2003. Accordingly, ORA developed an average for 2003 line items based on five years of recorded expenses, or it began with 2002 recorded expenses and then escalated from there.

Park contended that ORA's methodology resulted in significantly lower expense estimates than are justified by the record. It notes that ORA accepted "0" estimates for some line items when in fact those line item expenses had been lumped together into other categories in a 1999 accounting change made by Park. These revised entries, Park contends, were excluded from ORA's analysis.

The parties also disagreed on escalation factors. Park for the most part used a 2.5% "inflation factor" to escalate expenses to the test years. ORA exercised its judgment to apply escalation to each line item based on one of four escalation categories: non-labor, labor, composite (60% non-labor/40% compensation per hour), and compensation per hour.

There is merit in both of these approaches to estimating expenses. ORA's method has the advantage of starting with actual recorded expenses per line item, as contrasted with the more speculative "budgeted" numbers used by Park. On the other hand, some line items, like insurance, appear more accurately estimated through the budgeting process, which includes professional guidance

on expense trends. We will take these factors into account in evaluating each of the party's estimates.

## **6.2. Payroll**

Park's estimated 2003 payroll is based on its employees' hourly rates in effect at the end of 2002, a 3.2% cost-of-living increase granted for 2003, estimates of merit salary adjustments to be granted during 2003, and overtime and bonus estimates. Park has budgeted about \$30,000 for bonus awards. Similar calculations were made for Test Year 2004 and Test Year 2005, although Park revised its estimates to reflect ORA's labor escalation factors.

Contending that Park's method included employees who may or may not remain on the payroll for the periods in question, ORA based its test year estimates on Park's recorded payroll in 2002, escalated to the test years. In testimony at hearing, however, ORA's witness stated that, for consistency, ORA would accept the Commission's then-pending decision on this issue in the general rate case for Park's Apple Valley Ranchos subsidiary. In that decision (D.03-08-069), the Commission concluded that Park's payroll estimates, when adjusted, produced a more accurate preview of likely payroll costs.

In discussions subsequent to the evidentiary hearings, ORA and Park agreed that Park's methodology to estimate its payroll is the same methodology adopted in D.03-08-069. The parties agreed to use Park's original test year estimates revised to reflect ORA's labor escalation factors. While we agree with ORA that the Park methodology makes assumptions about continued employment that are speculative, we also agree with Park that its number of employees is small enough (49 employees in the Central Basin Division) to make such assumptions reasonable. Accordingly, we adopt the payroll estimates recommended by the parties, as follows:

**Payroll for Test Year 2004 (in 000s)**

Operations	588.0
Customer Accounts	653.3
Maintenance	321.1
Admin. & General	1,171.9
Clearing Accounts	<u>81.7</u>
Total	2,816.0

**Payroll for Test Year 2005 (in 000s)**

Operations	611.7
Customer Accounts	679.5
Maintenance	333.1
Admin. & General	1,177.3
Clearing Accounts	<u>84.6</u>
Total	2,886.2

As to the category of Payroll Benefits, the original positions of Park and ORA differed because of the payroll expense estimates. Since the expense estimates are resolved, there is no longer a difference in the benefits category.

**6.3. Operations Other Expenses – Laboratory Fees**

Laboratory testing for contaminants in water is required both by federal and state agencies. At hearing, ORA introduced Park's laboratory cost workpapers that show the testing schedules required by the Department of Health Services (DHS) and the Environmental Protection Agency (EPA). Park's estimates include a 10% contingency amount for laboratory costs, which the company based on its prior experience with emerging contaminants that require monitoring. The contingency amount covers expenses for future tests that may be required by DHS and EPA for either new substances or changes in testing schedules for existing substances.

ORA adopted Park's budgeted estimates of laboratory costs but excluded the 10% contingency amount on the basis that Park should be able to estimate

laboratory costs without building in a contingency amount. On brief, ORA argues that a provision for unknown “contingencies” has no place in a General Rate Case. All adopted expenses are intended to be estimates of future expenses, developed by the utility and by staff based on historical data, experience and expertise. ORA states that if a contingency adjustment is granted here, it could logically be applied to any number of other expense items, adding “catch-all” amounts to rate base. ORA notes that if Park’s laboratory fees turn out to be lower than forecast, ratepayers would not be made whole for the excess amount they had funded.

The burden is on Park to show why these fees, unlike others, are uniquely qualified for a contingency addition. That burden has not been met. We disallow the 10% contingency amount. We adopt ORA’s estimates for laboratory fees of \$131,300 for Test Year 2004 and \$171,800 for Test Year 2005.

#### **6.4. Production Expenses – Supply Mix**

The parties agree on the total amount of water production of 13,717 acre feet for Test Year 2004 and 13,753 acre feet for Test Year 2005. The parties disagree, however, on the supply mix between lower-cost water pumped from Park’s wells and higher-cost water purchased from Central Basin Municipal Water District. Park recommends 1,500 acre feet of well water production. ORA recommends 1,882.88 acre feet of well water production.

Park’s witness testified that the company has been gradually reducing its amount of pumped water to reduce its exposure to liability under the Comprehensive Environmental Response, Compensation and Liability Act, 42 U.S.C. §§ 9601 *et seq.*, commonly known as Superfund. The witness cited the 2003 case of *Castaic Lake Water Agency v. Whittaker Corp.* (C.D.Cal, 2003) 272 F.Supp.2d 1053, as standing for the proposition that a water company can be potentially

liable under Superfund legislation if it can be shown that excess pumping by the company contributed to the spread of an aquifer's contaminated plume to wells operated by the plaintiff. Park's witness stated that it is known that volatile organic chemicals have been detected in the Central Basin Aquifer, and that pumping can induce their spread.

ORA contends that Park over the past five years has pumped an average of 1,882.88 acre feet of this lower-cost water and that in only one year (1997) has it pumped as little as 1,500 acre feet. ORA states that Park does not provide a reasoned basis for its assertion that 1,500 acre feet is the proper amount to minimize the impact of its pumping on contaminant migration and reduce its exposure to Superfund liability.

We agree with ORA that the likelihood of Superfund litigation seems as likely (or unlikely) on this record at 1,500 acre feet as it does at 1,800 acre feet, especially since the latter amount represents average pumping in the recent past. For ratemaking purposes, it is appropriate to assume that the water supply mix should consist of 1,882.88 acre feet of pumped water. Management, of course, retains discretion as to the actual amount of pumping relative to its supply mix. The adopted numbers follow:

<b>Test Year 2004 (in 000s)</b>	
Purchased Water	5,795.7
Purchased Power	172.8
Leased (Pumped) Water	437.9
Replenishment	<u>221.4</u>
Total Expenses	6,627.8

**Test Year 2005 (in 000s)**

Purchased Water	5,812.5
Purchased Power	172.8
Leased (Pumped) Water	446.6
Replenishment	<u>221.4</u>
Total Expenses	6,653.3

**6.5. Purchased Water Expense**

The parties agreed to use the purchased water rate of \$467 per acre foot adopted by the Central Basin Municipal Water District for 2004 for Test Year 2004. The parties disagree on the purchased water rates for Test Year 2005 and Attrition Year 2006. Park recommends forecasting purchased water rates of \$488 per acre foot for Test Year 2005 and \$524 per acre foot for Attrition Year 2006 based on published budgets of the MWD. ORA recommends that, consistent with past Commission practice, the same \$467 rate be used for 2005 and 2006, with any subsequent increase in those amounts logged to an account for later recovery through surcharge.

That, says Park, is the rub. In the past, increased costs in purchased power, purchased water and replenishment were recoverable through a balancing account, and forecasts of increased costs were unnecessary. However, in D.03-06-072, dated June 19, 2003, the Commission changed the balancing account to a memorandum type of account in which these cost increases are fully recoverable only if the water utility can show that it did not earn more than its authorized rate of return for the period in question. By using forecasted rates, Park would give itself some protection against increased rates that it would not be able to recover, while at the same time it would still be required to refund to ratepayers under the memorandum account procedure any amounts that did not reach the forecasts.



ORA disagrees. Under D.03-06-072, it argues, Park would not have to forgo recovery of all such expense increases. If the utility has exceeded its authorized rate of return, the amount that it would forgo would be only that amount by which it is over-earning. On brief, ORA states:

More importantly, however, Park's proposal is a masked attack on the Commission's determinations in D.03-06-072. The Commission concluded in that decision that "[t]he revised procedures permit the utility to earn at least up to its authorized rate of return, and even more than the authorized rate of return through any means other than the collection of these balancing-type memorandum accounts." (D.03-06-072, Finding of Fact 11.) In establishing new balancing account procedures, the Commission did not add the qualifier that water utilities would now be able to forecast rates. (ORA Reply Brief, at 8.)

We agree with ORA that the Commission's rationale in D.03-06-072 was that balancing account procedures are intended to be "insurance to protect a utility against failure to earn its authorized earnings due to unanticipated expenses beyond the utility's control," but that those procedures "become problematic when they have the effect of enhancing utilities' earnings above Commission-authorized rates of return." (D.03-06-072, Conclusion of Law 1.) ORA contends that under Park's proposal to forecast higher purchased water rates while still maintaining a balancing-type memorandum account, Park is asking ratepayers for additional money up-front in case it is able to exceed its authorized rate of return.

We do not agree with ORA that Park's approach is a "masked attack" on D.03-06-072. Park's witness was candid in testifying that Park's approach is directly in response to D.03-06-072. He stated that, in his opinion, the decision was wrongly conceived, wrongly decided and was made without hearings and without real opportunity for the industry to raise its objections. Notwithstanding

those views, however, we agree with ORA that a utility-specific proceeding like this rate case is not the forum for the kind of generic change in purchased water estimates that Park proposes in light of D.03-06-072. Park has not demonstrated that its needs are unique and that, unlike other water companies, it requires the use of estimated purchased water rates. Park's argument to use rate case resources to reliably forecast purchased water rates would be more persuasive if it also proposed to forgo all protection of the balancing-type memorandum account for those expenses.

We adopt ORA's recommendation. The adopted expenses for purchased water for Test Year 2005 and Attrition Year 2006 are the sum of the unit cost of purchased water (\$467) and the supply mix adopted in this proceeding.

#### **6.6. Customers - Other Expense**

Park provides forecasts for 10 items in this category, and ORA concludes that the estimates are reasonable in all but two items. As for those two items, ORA excludes \$1,406 for meter reading benches that ORA states should have been classified as plant, and it escalates the expenses from 2002 recorded numbers. The parties' estimates are within \$1,000 of each other for both test years. We will adopt the ORA estimates, as follows:

2004	\$146,600
2005	\$150,251

#### **6.7. Maintenance – Other Expense**

Park agreed to revise its estimates to reflect \$8,000 in savings related to Park's 2003 vehicle replacements. Park's revised estimates are based on the 2003 operating budget and reflect maintenance requirements like water tank painting that are not performed annually. ORA's estimates are based on an escalated five-year average of recorded expenses, along with some of Park's budgeted

estimates. At hearing, Park's witness demonstrated that at least some of ORA's estimates excluded legitimate expenses because of a Park accounting change in 1999, and that the estimates thus are less than historical averages. Park has made the more persuasive showing in this category, and we adopt its estimates, as follows:

2004	\$438,922
2005	\$442,623

#### **6.8. Clearing – Other Expense**

Park agreed to revise its estimates to reflect \$8,000 in savings related to Park's 2003 addition of miscellaneous tools. ORA agreed with Park's estimates for 16 of the 18 line items in this account, but it elected estimates based on 2002 recorded expenses for estimated repairs and estimated fuel-transportation. Park's witness testified that the utility has increased its budgeted amount for vehicle repairs because of the aging of its fleet, including several vehicles that were purchased before 1993 and will reach 100,000 miles of use in the test years. Park's estimates also reflect an increase in license fees that at the time of hearing appeared likely to continue in the test years. Park has made the more persuasive showing in this category of expenses, and we adopt the utility's estimates of \$315,103 for Test Year 2004 and \$324,629 for Test Year 2005.

#### **6.9. Insurance Expense**

Park during hearing revised its estimates of insurance expense to incorporate actual premiums in effect for the 2003-2004 policy year. ORA's original estimates were based on a linear trend of recorded 2000 through 2003 data. The remaining differences reflect Park's reliance on an outside insurance agent and on company specifics likely to affect insurance rates. While the differences in estimates are not that far apart, we conclude that Park's estimates

are more likely to reflect actual expenses. We adopt the utility's estimates of \$786,291 for Test Year 2004 and \$919,626 for Test Year 2005.

#### **6.10. Regulatory Commission Expense**

Park states that its estimate for the test years of \$174,444 (amortized at \$54,481 per year) is based on costs incurred in Test Years 1992-1993 rate case for its former Santa Paula Water Works subsidiary (D.92-04-031), escalated to 2003. ORA estimated rate case costs of \$150,732 (amortized at \$50,241 per year) based on the more recent rate case of Park's Apple Valley Ranchos subsidiary, escalated to the test years. We agree with ORA that its estimates are based on a more recent and similar rate case proceeding, and we adopt those estimates. At the same time, we note the Commission's concern in 1992 about the cost of these rate cases:

We are also concerned about the cost of the process; the per customer costs of litigating this case are distressingly high....With annual costs at this level, we cannot help asking whether the process has become more expensive than can be justified by possible benefits to the public. (*Re Santa Paula Water Works, Ltd.* (1992) 43 CPUC2d 661, 667.)

We continue to believe that rate case costs are too high, and we encourage water companies and Commission staff to find ways to reduce the time and expense devoted to these cases without sacrificing the clear benefits to ratepayers of a thorough review. In this case, for example, while we believe that more of the small-dollar differences in estimates could have been resolved without continued litigation, we are encouraged that the parties' proposed resolution of cost of capital issues saved at least two days of hearing and reduced what would have been substantial expert witness fees.

#### **6.11. Outside Services**

Both Park and ORA have used five-year averages to calculate the test year estimates for outside services, including audit and income tax, legal and consulting. ORA disallowed expenses for the categories of safety consulting and water quality consulting because of a failure of supporting data by the company. At hearing, however, ORA's witness acknowledged that Park has numerous water quality monitoring and safety activities, and it is likely that some consultant fees will be incurred. Based on the record, we adopt Park's revised estimate for Outside Services of \$117,739 for Test Year 2004 and \$120,494 for Test Year 2005.

#### **6.12. Office Supplies**

We adopt Park's estimates for bank fees and expenses other than bank fees of \$353,482 for Test Year 2004 and \$360,915 for Test Year 2005. Park's witness showed at hearing that ORA's five-year averaging method for expenses other than bank fees was based on years in which Park had less office space, fewer phones, and lower-cost licensing and permit fees. The same witness sponsored an exhibit (Exhibit 20) that showed Park's methodology estimating bank fee expenses is the same methodology approved by the Commission in D.84-05-058 and used in subsequent Park rate cases. The contention by ORA's witness that a superior methodology was used in another utility's rate case is not persuasive.

#### **6.13. Miscellaneous Expense**

While the differences in estimate expenses between the parties in this category are not substantial, we find that Park has made the more persuasive case of showing that its estimates reflect current information and costs than does ORA's method of linear averaging of these costs. We adopt Park's revised estimates of \$46,019 for Test Year 2004 and \$47,096 for Test Year 2005.

## **7. Main Office**

ORA agreed to use Park's proposed Main Office allocation of 41.42% as the Central Basin Division's share of these centralized administrative expenses.

### **7.1. Payroll**

In discussions after the evidentiary hearings, ORA accepted Park's methodology for estimating Main Office Payroll, concluding that it is the same methodology adopted by the Commission in D.03-08-069 for Park's Apple Valley Ranchos subsidiary. We adopt the Main Office Payroll estimates as follows:

<b>Payroll (in 000s)</b>	
2004	2,366.1
2005	2,453.7

### **7.2. Maintenance - Other Expense**

ORA adopted Park's estimates for four of the five line items in this category. For General Plant/Other, ORA took a five-year average of recorded amounts and applied a composite escalation factor. ORA's analysis is not seriously challenged. We adopt ORA's estimates of \$216,663 for Test Year 2004 and \$221,819 for Test Year 2005.

### **7.3. Clearing – Other Expense**

We adopt Park's revised estimates of \$56,403 for Test Year 2004 and \$58,304 for Test Year 2005 for this category. We agree with Park that ORA's use of a five-year average of recorded expenses escalated to the test years is inappropriate for transportation and insurance clearing accounts, since increases in these matters are not reflected in the averaging method. Similarly, depreciation on transportation clearing and tools clearing is more reasonably based on plant account balances and depreciation rates rather than an average of prior years.

#### **7.4. Outside Services Expense**

Both parties use a five-year average of recorded expenses to estimate outside services. Differences are due to the use of different escalation factors, with Park choosing to use the composite escalation factor and ORA choosing to use the compensation per hour escalation factor. After revisions, ORA's estimates are approximately \$10,000 higher than Park's for Test Year 2004 and \$20,000 higher than Park's for Test Year 2005. In the absence of record evidence clearly supporting one escalation factor over another in this category, we elect to authorize Park's lower estimates of \$424,660 for Test Year 2004 and \$434,596 for Test Year 2005.

#### **7.5. Insurance Expense**

Both parties revised their estimates to reflect 2003-2004 insurance premiums that became available during the course of the proceeding. In addition, ORA revised its methodology to be consistent with the linear trend model used for the Central Basin Division. The results are similar for both Park and ORA. We authorize Park's revised estimates of \$114,706 for Test Year 2004 and \$127,482 for Test Year 2005.

#### **7.6. Office Supplies**

As we did for the Central Basin Division, we will authorize Park's estimates of Main Office Supplies. Those estimates, as revised, are \$154,163 for Test Year 2005 and \$156,666 for Test Year 2005. ORA's estimates using a different methodology were similar to those of Park.

#### **7.7. Miscellaneous Expense**

Park's revised estimates based on the utility's 2003 operating budget are \$77,658 for Test Year 2004 and \$79,475 for Test Year 2005. We adopt Park's estimates. ORA's estimates using an averaging method are about \$16,000 lower

for each of the test years. We agree with Park, however, that the averaging method is less accurate than the budgeted amounts in this category in view of the changes in Main Office space and facilities over the five years of averaging.

## **8. Taxes Other Than Income**

### **8.1. Payroll Taxes**

Based on their agreement on revisions made to payroll expenses, Park and ORA agree on the following estimates of Payroll Taxes in the test years:

#### **Test Year 2004 (in 000s)**

Central Basin	196.2
Main Office	<u>53.1</u>
Total	249.3

#### **Test Year 2005 (in 000s)**

Central Basin	202.2
Main Office	<u>53.4</u>
Total	255.6

### **8.2. Ad Valorem Taxes**

The difference between Park and ORA's estimates of Ad Valorem Taxes is due to the difference between the parties' estimates of utility plant. The adjustment has been made in the attached appendices.

## **9. Depreciation Expense**

The difference between Park and ORA's estimates of Depreciation Expense is based on the parties' differences in estimates of utility plant balances. The adjustment has been made in the attached appendices.

## **10. Income Taxes**

The differences between Park and ORA's estimates of Income Tax are based on differences in estimates of factors resolved elsewhere in this decision,



including Operating Expense and Taxes Other Than Income. Both parties use the same methodology to calculate interest deduction – weighted cost of long-term debt multiplied by the rate base. The differences in Interest Expense are due to differences in rate base estimates. These adjustments have been made in the attached appendices. Similarly, the differences in Park and ORA's estimates of Tax Depreciation are due solely to the remaining differences between the parties' estimate of utility plan in the test years. That adjustment has been made in the attached appendices.

## **11. Rate Base**

### **11.1. Utility Plant in Service**

We adopt Park's estimates of Utility Plant in Service of \$2,585,300 for Test Year 2004 and \$2,208,100 for Test Year 2005. This is in contrast to ORA's estimates of \$2,156,300 for Test Year 2004 and \$1,430,100 for Test Year 2005. The differences are due to additions to Utility Plant in Service of company-funded transmission and distribution main projects. Park's estimate of main projects was \$1,074,000 in Test Year 2004 and \$808,000 in Test Year 2005, while ORA disallowed numerous main repairs and extensions to arrive at estimates of \$645,000 for Test Year 2004 and \$30,000 in Test Year 2005.

ORA's witness testified that Park had failed to justify many of the main repairs and extensions, stating that a simple notation in Park's workpapers that a project would increase fire flow or would improve water quality was insufficient to support ratepayer funding of the projects. In rebuttal testimony, however, Park's witness described in detail the expected benefits of each of the main repairs or extensions, noting in some cases that replacement of deteriorating pipelines would correct serious leaks and, in other cases, the replacement of four-inch pipelines with eight-inch mains would improve fire flow capacity to

permit opening of new businesses in commercial areas. While ORA criticized the late explanations provided by Park, it did not challenge the company's assessment of the value and necessity for the pipeline work.

We agree with ORA that an earlier and more complete explanation of some of these transmission and distribution projects should have been provided. With complete information before it, ORA would have been in a better position to judge whether some projects could be deferred or altered in order to reduce ratepayer funding. Nevertheless, the task of the Commission is to evaluate the entire record in a general rate case, including the rebuttal testimony, and make a judgment on whether the company has met its burden of justifying proposed expenditures. In this case, we conclude that Park has shown the need for its planned transmission and distribution improvements in the test years, and we adopt Park's estimates for additions to Utility Plant in Service.

#### **11.2. Proposed New Well**

Park requests \$79,000 in Test Year 2004 for design of a new well and \$483,000 in Year 2005 for the start of drilling of the well. ORA disallowed these costs as premature, stating that the well will not be needed until 2006 or later.

Park's director of engineering testified that the new well would serve the Bellflower/Norwalk system and would supplement three purchased water connections and eight wells. The wells are old ones, averaging 52 years, and are used primarily as an alternate source for the purchased water. He noted that the DHS in a letter dated August 13, 2003, agreed with Park's plans to drill for a more efficient and better producing new well to replace one or more of the older wells.

ORA has made the more persuasive showing that adding these costs to rate base is not warranted at this time. There is no immediate need for a new

source of water for the Bellflower/Norwalk area, particularly in view of Park's intention to limit the amount of well water it will produce. The area has eight producing wells, and four of those are little used and are simply held in reserve. The age of these wells justifies replacement, but we are not convinced that ratepayers should bear initial costs of replacement as part of this rate case. While DHS agrees that a new well should be drilled, it has not set a required date for construction. We must balance the need for the well at this time against the burden of high water rates borne by Park's ratepayers. The estimated costs for the new well in 2004 and 2005 are disallowed.

### **11.3. Construction Work in Progress**

The differences between Park and ORA's estimates result solely from ORA's exclusion of a new well proposed by Park. Since we agree with ORA that the need for a new well at this time has not been shown, we adopt ORA's estimates as follows:

<b>Construction Work in Progress (in 000s)</b>	
2004	87.2
2005	23.0

### **11.4. Working Cash Allowance**

Under the Water Division's Standard Practice U-16-W, the purpose of the Working Cash Allowance is to compensate investors for defined funds provided by them to pay certain operating expenses in advance of receipt of offsetting revenues. The issues in Working Cash Allowance involve adjustments to Park's calculations recommended by ORA. ORA's recommendations fell into three basic categories: elimination of certain balance sheet accounts included by Park as additions in determining its Operational Cash Requirement; inclusion of certain balance sheet accounts not included by Park as reductions to the

Operational Cash Requirement; and revisions to the revenue lag and average expense lag in the lead-lag study. There is also an issue with respect to the manner in which ORA calculated its proposed reductions. A number of these issues have now been resolved based on discussions between the parties both during and after the evidentiary hearing.

In rebuttal testimony, Park agreed to eliminate any balance sheet account additions associated with Main Office Notes Receivable and Main Office Accounts Receivable, and to include balance sheet account reductions based on average monthly balances of accounts dealing with accounting fees, city water tax and work order deposits. Park also revised its positions with respect to Central Basin Accounts Receivable, Main Office Miscellaneous Deferred Debits, and Revenue Lag. ORA agreed to remove any reductions associated with its account dealing with grants from the Replenishment District. ORA and Park also reached agreement on the inclusion of a reduction based on average monthly balances of accrued pensions, along with the use of zero lag days for that expense in the lead-lag study.

The parties have no issues on the calculation of expense lag days for specific items except where adjustments based on monthly balances are used for items that have expenses included in the lead-lag study. In those cases, the parties agreed that the lag day included in the lead-lag study should be zero. The average expense lag for each party is also different due to the differences in other estimates and their effect on the dollar-weighting of lag days.

For the few remaining issues in which the parties have not reached agreement, we have carefully considered the testimony of the accounting witnesses for Park and for ORA and the extensive briefing on this subject submitted by both parties. We conclude that Park has made the more persuasive

case on the remaining disputes, including those involving accounts receivable, balance sheet accounts, pension disclosures and regulatory liability. We adopt Park's estimates of Central Basin Division Working Cash, as follows:

<b>Working Cash (in 000s)</b>		
<b>Fixed Portion</b>	<b>2004</b>	<b>2005</b>
Account Receivables Misc.	5.7	5.8
Misc. Deferred Debits	84.2	60.5
Accrued Payroll	0.0	0.0
Accrued Payroll Tax	4.3	4.4
Advances, Discontinued Operation	0.0	0.0
Group Pension Disclosure	0.0	0.0
Regulatory Liabilities	0.0	0.0
Rate Case Cost	123.4	82.3
Non-issues	<u>(264.4)</u>	<u>(277.5)</u>
Total Fixed Portion	(46.6)	(124.4)
<b>Variable Portion</b>		
Lead-Lag Study		
Accounting Fees	0.0	0.0
Other	<u>1,033.9</u>	<u>1,089.1</u>
Total	1,033.9	1,089.1
Total Working Cash	987.3	964.8

#### **11.5. Depreciation Reserve**

The parties differ slightly in estimates of Depreciation Reserve. The differences result from the differing estimates of Utility Plant in Service, and the appropriate adjustment has been made in the attached appendices.

#### **11.6. Deferred Tax Reserve**

Both parties have revised their estimates of Deferred Taxes to reflect bonus depreciation. The difference between Park and ORA's estimates result from different estimates of Utility Plant in Service, and the appropriate adjustment has been made in the attached appendices.

## **12. Miscellaneous**

### **12.1. Dioxane Contamination**

As part of this rate application, Park asks the Commission to specify one of three methods for dealing with a low level of contaminant found in four wells serving the Bellflower/Norwalk area. The contaminant, 1,4-dioxane, was found to have exceeded the state action level of three per billion (ppb) in three of the wells. By letter dated January 23, 2003, the DHS advised Park that the low levels of the contaminant (averaging 4.9, 3.7 and 3.4 ppb in three of the wells) did not represent a significant health risk to customers and that closing the wells would not be required unless the level of 1,4-dioxane exceeded 300 ppb. Based on this advice, Park has resumed pumping from the wells.

Noting that the Commission shares regulatory responsibility with DHS in water quality matters, Park presented three methods of dealing with the problem and asks the Commission to select the one it should follow: (1) Turn off the wells and increase purchased water at an additional cost of \$16,500; (2) Install treatment to the wells at an additional cost of \$432,000, or (3) Continue to pump groundwater without treatment. Park's witness stated that the reason for seeking Commission approval of one of these three scenarios is to help shield the company from liability in case a lawsuit is filed by a consumer of the water.

ORA argues that the request for Commission advice in this matter is inappropriate in an application for a general rate increase. ORA's witness stated that if Park seeks a Commission investigation and order on this subject, it should submit a separate application. The witness said that he had asked for detailed information, including expert analyses, about the contamination, but that all Park submitted was the letter from DHS and a general description of the problem.

We agree with ORA that Park's request is inappropriate in this rate case and that, in any event, the information supplied by Park is inadequate for the Commission to make any reasoned evaluation of the effects of low levels of 1,4-dioxane. With that said, however, we note that this Commission has found that DHS requirements governing drinking water quality adequately protect the public health and safety. (*See In re Standards of Drinking Water Quality* (2000) D.00-11-014, Conclusion of Law 4.) As ORA notes, the Commission generally defers to DHS on matters of contaminant levels in drinking water.

### **13. Settlement on Rate of Return**

For a regulated utility, rate of return on rate base is the ratio of earnings to total rate base. Essentially, rate of return is the compensation paid to investors for the capital they have provided for public utility service. A fair rate of return is acknowledged to be no less than the company's cost of capital (so that the utility can maintain its credit rating and attract additional investment). For Park, cost of capital is determined as a weighed average of the cost of long-term debt and the cost of common equity. (Because Park is closely held and not publicly traded, preferred stock, a third element of the cost of capital, is not included.) The cost of each capital component is weighted on the basis of the company's capital structure (that is, the relative amounts of equity and long-term debt that constitute the company's long-term financing).

On August 28, 2003, Park and ORA jointly filed a motion for adoption of a settlement on cost of capital for the Central Basin Division. Following a series of settlement meetings, the two parties agreed on a return on rate base of 9.51% in test year 2004, 9.50% in test year 2005, and 9.49% in attrition year 2006. Park in its testimony had urged a return on equity (ROE) of 11%, while ORA submitted evidence supporting an ROE of 9.3%. The parties settled on an ROE of 10.15%.

The following table shows agreed-upon capital structure, cost of debt, and return on equity, and the resulting return on rate base for the test years.

<b>Cost of Capital</b>			
	Settlement		
	Capital Structure	Cost	Rate of Return
Test Year 2004			
Long-Term Debt	40.02 %	8.55%	3.42%
Common Equity	59.98%	10.15%	6.09%
Total	100.00%		9.51%
Test Year 2005			
Long-Term Debt	40.02%	8.53%	3.41%
Common Equity	59.98%	10.15%	6.09%
Total	100.00%		9.50%
Attrition Year 2006			
Long-Term Debt	40.02%	8.51%	3.41%
Common Equity	59.98%	10.15%	6.09%
Total	100.00%		9.49

Cost of equity is typically the most contested component of rate of return in water general rate cases. It is a direct measure of the company's after-tax ROE investment, and its determination is by necessity somewhat subjective and not susceptible to direct measurement in the same way as capital structure and embedded cost of debt.



Both Park and ORA acknowledge the established legal standard for determining a fair ROE, and we have many times cited that same legal standard. In the *Bluefield Water Works* case,<sup>1</sup> the Supreme Court stated that a public utility is entitled to earn a return on the value of its property employed for the convenience of the public, and set forth parameters to assess a reasonable return. That return should be “...reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economic management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.”

As the Supreme Court also noted in that case, a utility has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. In 1944, the Court again considered the rate of return issue in the *Hope Natural Gas Company* case,<sup>2</sup> stating, “[T]he return to the equity owner should be commensurate with returns on investments in other enterprises sharing corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.” The Court went on to affirm the general principle that, in establishing a just and reasonable rate of return, consideration must be given to the interests of both consumers and investors.

With these principles in mind, we examine the parties’ proposed settlement of the rate of return issues.

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<sup>1</sup> *Bluefield Water Works & Improvement Company v. Public Service Commission of the State of Virginia* (1923) 262 US 679.

<sup>2</sup> *Federal Power Commission v. Hope Natural Gas Company* (1944) 320 US 591.

### **13.1. Support for Settlement Proposal**

Both Park and ORA submitted substantial testimony on cost of capital issues. To determine the appropriate return on equity for Park, both parties performed quantitative analyses and then assessed the level of business and financial risk Suburban faced. In its analysis, ORA used two financial models, DCF (discounted cash flow) and RP (risk premium), to estimate investors' expected return on equity.<sup>3</sup>

In addition to its DCF and RP quantitative analyses, ORA assessed the level of financial and business risk Park faces. In concluding that Park's business risk is low, ORA cited the Commission's many risk-reducing mechanisms available to water utilities, including memorandum-type balancing accounts for purchased water, purchased power and pump taxes, memorandum accounts for Safe Drinking Water Act compliance, 50% fixed cost recovery, and Construction Work in Progress in rate base. As to financial risk, ORA noted that Park's equity ratio of nearly 60% is larger than that of comparable water companies

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<sup>3</sup> The DCF model is a financial market value technique based on the premise that the current market price of a share of common stock equals the present value of the expected future stream of dividends and the future sale price of a share of stock, discounted at the investor's discount rate. By translating this premise into a mathematical equation, the investor's expected rate of return can be found as the expected dividend yield (the next expected dividend divided by the current market price) plus the future dividend growth rate.

The RP model is a risk-oriented financial market value technique which recognizes that there are differences in the risk and return requirements for investors holding common stock as compared to bonds. An RP analysis determines the extent to which the historical return received by equity investors in utilities comparable to the utility at issue exceeds the historical return earned by investors in stable, long-term bonds. This difference, or "risk premium," is then added as a premium to the estimated cost of long term debt to derive average expected return on equity for the test period.

(approximately 50%), indicating that Park has lower financial risk than the comparable group.

Based upon its analyses and risk assessment, ORA recommended a return on equity of 9.3%.

Park also performed DCF and RP analyses, although, since Park's stock is not publicly traded, it questioned the comparison of Park with large publicly traded companies. Park stressed the risks the company faces because of its small size, limited financial flexibility and its demonstrated higher costs of borrowing. Park showed that it has net plant that is only 12.5% as large as net plant of the average larger water utility and operating revenues that are only 14.6% of the average for the larger water utilities.

Park notes that in the 1999 General Rate Case for the Central Basin Division, in which cost of capital was fully litigated, the Commission found that Park was viewed as a greater overall risk to investors. The Commission adopted a 30-basis point adder to ROE to recognize that risk. Based on what it perceives as greater risks since that time, Park in this case urged a 90-basis point adder. Park argued that its analyses support a return on equity of 11.75%, although it limited its request to 11% to minimize the impact on rates.

Park in its testimony was particularly critical of Commission Resolution W-4294 that in D.03-06-072 limits recovery of water supply expenses (power costs, purchased water costs and pump taxes) when a water utility earns more than its authorized rate of return for the period of time in question. Park's consultant did simulation analyses of three large California water companies, and presented evidence purporting to show that in each case the new balancing account rules reduce expected future ROE by no less than 75 basis points. ORA disputes that conclusion, noting that the newly adopted procedures for balancing

account recovery are similar to those that already were being used by California-American Water Company and do not affect a utility's opportunity to earn its authorized return.

At hearing, rate-of-return witnesses for Park and for ORA took the stand together to respond to questions about the settlement. Leigh K. Jordan, Park's executive vice president, testified that the parties looked at the evidence that each had produced and at Commission actions in recent cases and concluded that a 10.15% ROE was "a reasonable ballpark approximation of what would have been the outcome if we had litigated the issue." (Transcript, at 408.) ORA financial analyst Cleason Willis testified that ORA regarded the settlement as a reasonable compromise between Park's recommendation of 11% and ORA's recommendation of 9.3%. He added that had the issue been litigated, his 9.3% estimate "was low enough to allow room for a risk premium adder." (Transcript, at 405.)

### **13.2. Discussion of Proposed Settlement**

The Commission's Rules of Practice and Procedure address criteria for adoption of a settlement. Under Rule 51.1, the Commission must find that the settlement is reasonable in light of the whole record, consistent with the law, and in the public interest.

Ultimately, the choice of factors used to measure an appropriate return on investors' equity is a matter of judgment. Both parties rely on DCF and RP analyses that we have consistently accepted in the past for water companies. The 10.15% ROE is at midpoint between the 9.3% ROE recommended by ORA and the 11% ROE recommended by the company. While they disagree on the extent of the risk faced by Park, both parties acknowledge that risk is increased by the small size of the utility and its inability to borrow at rates available to larger Class

A water companies. Indeed, ORA candidly acknowledges that its 9.3% recommendation could appropriately be increased by a risk adder, as was done in Park's 1999 general rate case. That would bring ORA's recommendation to within a few basis points of the ROE on which the parties settled.

Moreover, a 10.15% ROE is within a reasonable range of ROEs recently authorized other California Class A water utilities. It is approximately the same as the 10.10% ROE authorized for Park's subsidiary, Apple Valley Ranchos, in D.03-08-069 on August 21, 2003, and is only marginally greater than the 9.84% ROE granted the much larger Suburban Water Systems in D.03-05-078 on May 22, 2003. Based on the record as a whole, we conclude that the proposed settlement on rate of return is reasonable.

The settlement is consistent with the law and is in the public interest. Our assessment of whether the proposed rate of return is in the public interest must consider the future viability of the utility to provide service. At the same time, we must consider the customers' need for fair and reasonable rates. It is the Commission's obligation to balance these interests. We conclude that the settlement strikes such a balance. Accordingly, the settlement should be adopted.

#### **14. Comments on Proposed Decision**

The principal hearing officer's proposed decision was filed with the Commission and served on all parties in accordance with Section 311(d) of the Public Utilities Code and Rule 77.1 of the Rules of Practice and Procedure. Only ORA filed comments, stating that the proposed decision equitably resolves the issues in this case.

**15. Assignment of Proceeding**

Carl W. Wood is the Assigned Commissioner and Glen Walker is the assigned Administrative Law Judge in this proceeding.

### **Findings of Fact**

1. Park's Central Basin Division provides public utility water service to 27,088 customers in the cities of Norwalk, Santa Fe Springs, Lynwood, Bellflower, Artesia and Compton, and in unincorporated areas in southern Los Angeles.
2. The last general rate increase for Park's Central Basin Division occurred in 2001, as authorized in D.01-03-078.
3. Park water rates in its general areas of service are higher than the rates of other water agencies in and around those service areas.
4. Park's water system facilities are in good condition, and service complaints are few.
5. Retained earnings used for investments are not in rate base.
6. Park's methodology to estimate its payroll is the same methodology approved by the Commission in D.03-08-069.
7. Park over the past five years has pumped an average of 1,882.88 acre feet of well water per year.
8. Volatile organic chemicals have been detected in the Central Basin Aquifer from which Park draws its pumped water.
9. Under D.03-06-072, full recovery of increases in the cost of purchased water is conditioned on a water utility not earning more than its authorized rate of return.
10. The DHS agreed with Park's plan to drill a new well to serve the Bellflower/Norwalk system.
11. DHS has advised Park that low levels of 1,4-dioxane detected in four wells in the Bellflower/Norwalk area do not represent a significant health risk to customers.

12. Park and ORA jointly recommend adoption of a cost of capital that would produce a return on rate base of 9.51% in 2004, 9.5% in 2005 and 9.49% in 2006.

### **Conclusions of Law**

1. The adopted summaries of earnings presented in Appendix A, and the quantities and calculations included as Appendix D that underlie them, are reasonable for ratemaking purposes and should be adopted.

2. A settlement of cost of capital issues proposed by Park and ORA is reasonable in light of the whole record, consistent with the law, and in the public interest, and should be adopted.

3. Park should not be required to add to operating revenues a share of interest earned on investments of retained earnings.

4. Park has not met its burden of proof in showing that a 10% contingency fee should be budgeted for unanticipated laboratory testing costs.

5. For ratemaking purposes, it is appropriate to assume that water supply mix for Park should consist of 1,882.88 acre feet of pumped water.

6. The 2004 purchased water rate of \$467 per acre foot should be applied for Test Year 2005 and Attrition Year 2006 because of the protection provided by a memorandum-type balancing account.

7. The task of the Commission is to evaluate the entire record in a general rate case, including rebuttal testimony, and make a judgment on whether the company has met its burden of justifying proposed expenditures.

8. The Commission has found that DHS requirements governing drinking water quality adequately protect the public health and safety.

9. Park should be authorized to implement the rate changes set forth in this order.



10. This decision should be made effective immediately to allow Park opportunity to earn the return found reasonable for it in Test Year 2004.

**O R D E R**

**IT IS ORDERED** that:

1. Park Water Company's Central Basin Division (Park) is authorized to file in accordance with the General Order 96 series, and make effective on not less than five days' notice, the revised tariff schedules for 2003 included as Appendix B to this order. The revised tariff schedules shall apply to service rendered on and after their effective date.

2. Advice letters for authorized rate increases for 2005 and 2006 may be filed in accordance with the General Order 96 series no earlier than November 1 of the preceding year. The filing shall include appropriate work papers. The increase shall be the amount authorized herein, or a proportionate lesser increase if Park's rate of return on rate base, adjusted to reflect rates then in effect, normal ratemaking adjustments, and the adopted change to this pro forma test, for the 12 months ending September 30 of the preceding year, exceeds the lower of (a) the rate of return on rate base found reasonable by the Commission for Park for the preceding year in the then most recent rate decision, or (b) the return on rate base authorized herein for the preceding year. The advice letters shall be reviewed by the Commission's Water Division for conformity with this decision, and shall go into effect upon Water Division's determination of compliance, not earlier than January 1 of the year for which the increase is authorized, or 30 days after filing, whichever is later. The tariffs shall be applicable to service rendered on or after the effective date. The Water Division shall inform the Commission if it finds the proposed increase does not comply with this decision or other Commission requirements.

3. The joint motion of Park and the Office of Ratepayer Advocates for adoption of a settlement proposal resolving all issues relating to Park's cost of capital is granted.

4. The summaries of earnings presented in Appendix A, and the quantities and calculations included as Appendix D which underlie them, are adopted.

5. Park's requests in Application 03-04-015 are granted as set forth above, and in all other respects are denied.

6. This proceeding is closed.

This order is effective today.

Dated December 18, 2003, at San Francisco, California.

MICHAEL R. PEEVEY

President

CARL W. WOOD

LORETTA M. LYNCH

GEOFFREY F. BROWN

SUSAN P. KENNEDY

Commissioners