

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

COMMISSION ADVISORY & COMPLIANCE DIVISION  
Water Utilities Branch

RESOLUTION NO. W-3540  
February 6, 1991

RESOLUTION

(Res.W-3540) REDWOOD WATER COMPANY (RWC). ORDER  
AUTHORIZING A GENERAL RATE INCREASE PRODUCING  
\$7,641 OR 36.06% ADDITIONAL ANNUAL REVENUE.

RWC, by draft advice letter accepted by the Water Utilities Branch (Branch) on August 29, 1990, requested authority under Section VI of General Order 96-A and Section 454 of the Public Utilities Code to increase rates for water service by \$11,410 or 53.85%. RWC estimates that 1991 gross revenue of \$21,190 at present rates would increase to \$32,600 at proposed rates to produce a net loss of \$4,804. RWC presently serves 163 flat rate customers in areas known as Summer Home Park and Highcroft and vicinity, located approximately four miles northwest of Forestville, Sonoma County.

The present rates became effective on October 14, 1986 pursuant to Resolution W-3339, dated October 1, 1986, which authorized a general rate increase of \$5,115 or 34.0%.

The Branch made an independent analysis of RWC's summary of earnings. Appendix A shows RWC's and Branch's estimated summary of earnings at present, requested and adopted rates for test year 1991. Appendix A shows differences in expenses and rate base.

The differences in estimates for operating expenses are in purchased power; contract work; other plant maintenance; management salary; regulatory expense; office supply and expenses; insurance; general expenses; depreciation expense; property taxes; and income taxes.

The Branch's estimate of purchased power is lower than RWC's. The difference between the Branch and RWC estimates of purchased power is due primarily to the difference in estimates of water production. The Branch based its 1991 water production estimate on 1988 recorded data. The County of Sonoma currently has a restriction on new construction in RWC's service area due to the lack of sewer service in the area. For this reason, there has been no growth in RWC's service area in the last two years and no growth is expected in the near future. In view of this, the Branch believes that its estimate, based on 1988 recorded data, is a reasonable representation of water production expected in test year 1991. RWC based its 1991 water production estimate on 1989 recorded data which included excessive water losses due to a broken water main. RWC further increased its estimate by 5% even though it did not estimate any customer growth for either 1990 or 1991.

RWC currently has an annual contract with Russian River Utility (RRU) for \$7,800 to operate the system and provide routine maintenance. The Branch believes this amount to be reasonable for a utility of RWC's size and

operating characteristics. In addition to the \$7,800 contract work, RWC's estimate inadvertently included (1) capital expenditures which the Branch appropriately shifted to "utility plant" and (2) costs for maintenance work not included in RWC's contract with RRJ which the Branch appropriately shifted to "other plant maintenance".

Most of RWC's estimate of other plant maintenance costs included repair work which occurred in 1989 and 1990 on a one-time basis. It also included some capital improvement costs which the Branch shifted to the utility plant account. The Branch's estimate of other plant maintenance expenses consists of normally recurring maintenance expenses beyond the scope of contract work, and engineering and testing which were transferred from the contract work account as pointed out earlier in the contract work expense discussion.

The Branch estimated \$240 per year for management salary for an individual who monitors utility operations; plans system improvements; coordinates with RRJ about system maintenance; and provides billing and collection services. RWC's request included no compensation for management salary.

The Branch's estimate of regulatory expense is the three year amortization of \$366 billed RWC by RRJ for preparing this rate increase request. RWC inadvertently omitted this cost in its estimate.

The Branch computed its estimate for office supplies and expenses by taking a five year average of recorded 1985 through 1989 figures and then escalating it for inflation to test year 1991. The Branch believes that the projection of five years of recorded information is the best way to estimate costs that fluctuate from year to year. The Branch's escalation factors were provided by the Energy Rate Design and Economics Branch of the Commission's Division of Ratepayer Advocates. RWC could not explain its estimate of office supplies and expenses which was approximately twice that of the Branch's.

The difference between the Branch's and RWC's estimates of insurance expenses is due to the Branch having access to later and more up-to-date insurance premium information.

RWC's estimate of general expenses represents interest on two long term loans which the utility acquired without Commission approval; the first, a loan from its parent - Summerhome Park; and the second, a Small Business Administration (SBA) loan. Since interest is not an above the line expense item, the Branch excluded it from its estimate. The loan from its parent was an internal transaction, therefore, for the purpose of this rate proceeding, the Branch has considered it equity for the rate of return determination as explained later in the rate of return discussion. The Branch, on the other hand, believes that because the SBA loan, which was for \$17,600 at 4.0% interest, was entered into to improve RWC's service to its customers, it should be considered appropriate. In view of this, the Branch recommends that the Commission approve the SBA loan.

Both the Branch and RWC used the straight-line-remaining-life method of determining depreciation with a composite rate of 2.8%. The Branch's

estimate is higher than RWC's because the Branch estimated higher average plant.

RWC's estimate of property taxes is the actual amount it was billed in tax year 1990-91. The Branch's estimate is based on the 1990-91 property tax bill adjusted to take into account the additions made to utility plant in service.

The Branch's estimate of payroll taxes is based on its estimate of management salary and the current rates for social security and unemployment tax rates.

The Branch's income tax estimates reflect the current rates under the Federal Tax Reform Act of 1986 and the corresponding state rates for 1991. RWC's income tax estimates reflect the utility losing money in 1991 at requested rates. It, however, inadvertently used \$850 instead of the \$800 minimum state franchise tax.

The difference in rate base estimates is due to the differences in utility plant-in-service and accumulated depreciation estimates.

The Branch's estimate of utility plant in service is higher than RWC's because Branch shifted to this account capital costs that the utility had improperly included in contract work and other maintenance expenses, as explained earlier in the expenses discussion.

The Branch's estimate of accumulated depreciation is higher than RWC's because of its higher estimate of utility plant in service.

To prevent future inconsistencies between figures adopted by the Commission and the figures shown in RWC's annual reports, the Branch recommends that RWC be directed to record on its books of account the water plant in service and accumulated depreciation balances upon which the average amounts adopted in this resolution are based, and to reflect those balances in its 1991 annual report to the Commission. Those balances are \$77,223 for total utility plant in service and \$45,352 for accumulated depreciation as of December 31, 1989.

RWC's draft advice letter requested rates which it estimated would still produce a loss in net revenue. The Branch's recommended summary of earnings would produce a rate of return of 11.00% at the Branch's recommended rates. This 11.00% rate of return is the high point of the 10.50% to 11.00% standard rate of return range recommended by the Finance Branch of the Commission Advisory and Compliance Division for small, 100% equity financed utilities. With an 11.00% rate of return on rate base, RWC's capital structure would be:

	<u>Percentage</u>	<u>Cost</u>	<u>Wt'd. Cost</u>
SBA Loan	17.1	4.00%	0.68%
Equity	82.9	12.45%	10.32%
Total Investment	100.0		11.00%

The 12.45% rate of return on equity resulting from this capital structure reasonably represents shareholder risk based on RWC's size and operational characteristics.

RWC was informed of the Branch's differing views of expenses and rate base and has stated that it accepts the Branch's estimates.

A notice of the proposed rate increase and public meeting was mailed to each customer on September 10, 1990. The Commission received four letters of response. In addition to protesting the magnitude of the increase, all four respondents complained that RWC's current water rate, which is the same for all customers, is unfair to part-time residents who should not be charged the same rate as the year-round residents. The Consumer Affairs Branch has not received a single complaint against the utility in the last three years.

On October 4, 1990, a public meeting, attended by five members of the public, was held in RWC's service area. A Branch representative conducted the meeting and the manager of RWC and a representative of RRJ explained RWC's request and answered questions. Several customers indicated that water pressure seems to drop significantly on the Fourth of July and Labor Day weekends. RWC's manager explained that resident occupancy is probably at its highest on those two holiday weekends and the water system has experienced difficulty in supplying enough water at adequate pressure consistently throughout these weekends. To alleviate this problem, RWC plans to augment its water supply by purchasing water from the Russian River County Water District (RRCWD) on the rare occasion when system supply cannot keep up with system demand. RWC already has an emergency connection with RRCWD. Another customer at the meeting complained that RWC's current water rate, which is one flat rate for all customers, is unfair to part-time residents who should not have to pay the same rates as the full-time residents because they use less water. The Branch representative explained that a water utility has a fundamental obligation to stand ready to serve its customers at all times and in doing so incurs certain fixed costs. These fixed costs, which make up most of a water utility's operational expenses, are independent of the costs to deliver water and its recovery should be shared equally by each customer. Fixed costs include system maintenance expenses, customer accounting expenses, insurance premiums, property taxes and depreciation expenses. Most of the flat rate charged by RWC is to recover these fixed costs. A very small portion of the flat rate compensates the utility for water delivery costs. This amount is so small that it would not be reasonable to differentiate in rates between the full time and part-time residents. Ideally, the fairest way to charge for water service is to meter each customer. The installation of meters in the RWC system, however, would cost each customer at least \$40 more per year, which would not be cost effective.

According to the Sonoma County Environmental Health Department, RWC meets all drinking water standards currently in effect. There are no outstanding Commission orders requiring system improvements.

Branch engineers conducted a field investigation of RWC's facilities and service area on October 4, 1990. Visible portions of the water system were inspected, utility books reviewed, customers and company employees interviewed and methods of operation checked. The investigation indicated

that service is satisfactory and that RWC's system was in compliance with the requirements of the Commission's General Order 103 "Rules Governing Water Service Including Minimum Standards for Design and Construction."

RWC obtains its water supply from a relatively shallow well sunk in the bed of the Russian River. Because the turbidity and other physical characteristics of this water change quickly in response to similar changes in the surface flows of the river, RWC believes that this water source will be considered "groundwater under the direct influence of surface water" under the new Surface Water Treatment Rule (SWTR) which will take effect in 1991. If RWC chooses to rely on its current source of water, it will have to install a water treatment facility to comply with the requirements of the SWTR. This would not only necessitate a significant capital investment, it would also lead to sharply elevated operating expenses. In view of this, RWC plans to abandon its present well and drill a new well further away from the river at a site where there is no surface water influence. Because the cost of this new well project will have a significant impact on the utility's rate base and thus customer water bills, the Branch recommends that once plans are formulated and costs determined, RWC inform its customers of the project. Project information should include description; purpose; alternatives; and cost and its impact on customer bills. A public meeting would be the most effective way to pass on the information. The Branch will assist RWC in this effort in any way it can. Once RWC has disseminated the project information as recommended above, the Branch recommends that RWC be allowed to file an advice letter rate increase request to offset the cost of the new well once it is placed into service.

RWC has an emergency connection to the Russian River County Water District (RRCWD) and has had to purchase water through the connection on several occasions in the past when portions of its transmission and distribution system failed. System failures are less likely to happen in the future now that RRW is operating and maintaining the RWC system. As stated earlier, RWC also plans to take water from this connection on rare occasions (Fourth of July and Labor Day weekends for example) when the demand exceeds the system's capability to deliver. Since the amount of water needed for emergency purposes cannot be determined at this time, the Branch recommends that RWC be authorized to maintain a balancing account for the cost of purchasing water through this emergency connection. RWC should be required to justify every emergency purchase entry made in the balancing account and demonstrate that the purchase was kept to an absolute minimum.

RWC's conservation program consists of providing customers with conservation literature, posting reminders of water conservation throughout the service area and constantly patrolling the system looking for water wasters. RWC also informed the Branch that it has an adequate water supply that has not been adversely impacted by the current drought situation. In view of this, the Branch believes that no further conservation measures are necessary.

RWC currently has one rate schedule: Schedule No. 2AR, Annual Residential Flat Rate Service. The present schedule consists of an annual flat rate charge, paid in advance, for a single-family residential unit including premises.

The rates proposed by the Branch, included here in Appendix B, were determined by increasing the single-family residential flat rate charge by the system average increase adopted in this resolution.

The Branch recommends that the Commission authorize an increase in gross revenue of \$7,641 or 36.1% in 1991. This increase provides an 11.00% rate of return on rate base in test year 1991.

At the Branch's recommended rates shown in Appendix B, a residential customer's annual water bill will increase from \$130 to \$176.90 or 36.1% in 1991.

**Findings:**

1. The Branch's recommended summary of earnings (Appendix A) is reasonable and should be adopted.
2. The rates recommended by the Branch (Appendix B) are reasonable and should be adopted.
3. The quantities (Appendix C) used to develop the Branch's recommendations are reasonable and should be adopted.
4. The SBA loan RWC acquired in 1986 should be approved.
5. RWC should be required to record on its books of account the water plant in service and accumulated depreciation balances upon which the average amounts adopted in this resolution are based, and to reflect those balances in its 1991 annual report to the Commission. Those balances are \$77,223 for total utility plant in service and \$45,352 for accumulated depreciation as of December 31, 1989.
6. RWC should be authorized to file an advice letter increase request to recover the costs associated with drilling a new well for the system after it has fully informed its customers of the project.
7. RWC should be authorized to maintain a balancing account for the cost of purchasing water on an emergency basis through the emergency connection with RRCWD. RWC should be required to justify every emergency purchase entry made in the balancing account and demonstrate that the purchase was kept to an absolute minimum.
8. The rate increase authorized herein is justified and the resulting rates are just and reasonable.

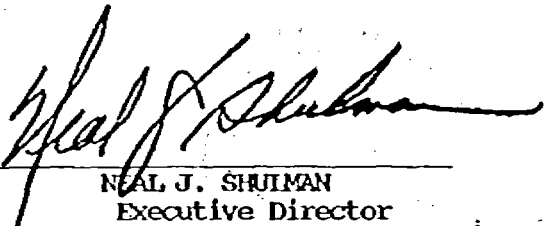
**IT IS ORDERED THAT:**

1. Authority is granted under the Public Utilities Code Section 454 for Redwood Water Company to file an advice letter incorporating the summary of earnings and revised rate schedule attached to this resolution as Appendices A and B respectively and concurrently to cancel its presently effective rate Schedule No. 2AR. Such filing shall comply with General Order 96-A. The effective date of the revised rate schedule shall be the date of filing.

2. Redwood Water Company is authorized to file an advice letter increase request to recover costs associated with drilling a new well for the system after having met the requirements of the Commission's service improvement policy.
3. Redwood Water Company is authorized to maintain a balancing account for the emergency purchase of water from the Russian River County Water District. Redwood Water Company shall be able to justify every emergency purchase entry made in the balancing account and demonstrate that the purchase was kept to an absolute minimum.
4. Redwood Water Company shall record in its books of account the water plant in service and the accumulated depreciation balances upon which the average amounts adopted in this resolution are based, and shall reflect those balances in its 1990 annual report to the Commission.
5. Redwood Water Company's long term loan obtained from the Small Business Administration in October, 1986 is approved.
6. This resolution is effective today.

I certify that this resolution was adopted by the Public Utilities Commission at its regular meeting on February 6, 1991. The following Commissioners approved it:

PATRICIA M. ECKERT  
President  
G. MITCHELL WILK  
JOHN B. CHANIAN  
Commissioners

  
NEAL J. SHUMAN  
Executive Director

## APPENDIX A

## REDWOOD WATER COMPANY

SUMMARY OF EARNING  
(Estimated Year 1991)

Item	:Utility Estimated :		: Branch Estimated :		
	:Present :	: Requested:	Present :	: Requested:	:Adopted :
	:Rates :	: Rates :	Rates :	: Rates :	
Operating Revenue					
Flat Rate	\$21,190	\$32,600	\$21,190	\$32,600	\$28,831
Metered	0	0	0	0	0
Total Revenue	\$21,190	\$32,600	\$21,190	\$32,600	\$28,831
Operating Expenses					
Purchased Power	4,500	4,500	3,414	3,414	3,414
Materials (Chlorine)	100	100	100	100	100
Contract Work	11,750	11,750	7,800	7,800	7,800
Other Plant Maintenance	7,350	7,350	1,650	1,650	1,650
Management Salary	0	0	240	240	240
Regulatory Expenses	0	0	122	122	122
Office Supplies & Exp.	600	600	340	340	340
Professional Service	900	900	900	900	900
Insurance	6,400	6,400	6,000	6,000	6,000
General Expenses	2,600	2,600	0	0	0
Subtotal	34,200	34,200	20,566	20,566	20,566
Depreciation Expense	2,004	2,004	2,346	2,346	2,346
Property Tax	350	350	393	393	393
Payroll Tax	0	0	29	29	29
Income Tax	850	850	800	1,986	1,415
Total Expenses	37,404	37,404	24,134	25,320	24,749
Net Revenue	(16,214)	(4,804)	(2,944)	7,280	4,082
Average Plant	73,503	73,503	85,731	85,731	85,731
Average Depr. Reserve	45,300	45,300	48,634	48,634	48,634
Net Plant	28,203	28,203	37,097	37,097	37,097
Less: Advances	0	0	0	0	0
Contribution	0	0	0	0	0
Plus: Working cash	0	0	0	0	0
M&S	0	0	0	0	0
Rate Base	28,203	28,203	37,097	37,097	37,097
Rate of Return	loss	loss	loss	19.62%	11.00%

End of Appendix A



APPENDIX B  
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Schedule No. 2AR

ANNUAL RESIDENTIAL FLAT RATE SERVICE

7

APPLICABILITY

Applicable to all flat rate residential water service furnished on an annual basis.

TERRITORY

The area known as Summer Home Park and Highcroft and vicinity, located approximately 4 miles northwest of Forestville, Sonoma County.

RATES

	Per Service Connection <u>Per Year</u>	
For a single-family residential unit including premises.....	\$176.90	(I)

SPECIAL CONDITIONS

1. The above flat rate applies to service connections not larger than one inch in diameter.
2. The annual flat rate charge applies to service during the 12-month period commencing January 1 and is due in advance. A permanent resident of the area who has been a customer of the utility for at least 12-months may elect, at the beginning of the calendar year, to pay prorated flat rate charges in advance at intervals of less than one year (monthly, bimonthly or quarterly) in accordance with the utility's established billing periods.

(continued)

APPENDIX B  
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Schedule No. 2AR  
(continued)

ANNUAL RESIDENTIAL FLAT RATE SERVICE

7

3. The opening bill for flat rate service shall be the established annual flat rate charge for the service. Where the initial service is established after the first day of any year, the portion of such annual charge applicable to the current year shall be determined by multiplying the annual charge by one three-hundred sixty-fifth ( $1/365$ ) of the numbers of days remaining in the calendar year. The balance of the payment of the initial annual charge shall be credited against charges for the succeeding annual period. Upon request, any unused portion of the annual flat rate charge (prorated on a monthly basis) which has been prepaid by a customer is refundable, when and provided a new customer is subsequently served at the same location. Request for such refunds must be within 60 days after the new customer establishes service. (N)
4. All bills are subject to the reimbursement fee set forth in Schedule No. UF. (L)  
(L)

End of Appendix B

APPENDIX C  
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Redwood Water Company

ADOPTED TAX CALCULATIONS  
Test Year 1991

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Federal Tax Rate:	15%
State Tax rate :	9.3%
Local Franchise tax:	0.0%

Expenses:

1. Purchased Power  
Pacific Gas and Electricity Company

Rate Schedule	A-1
Effective Date	January 1, 1990
Kwh used:	
Summer	18,596
Winter	9,404
Rate per Kwh:	
Summer	\$0.12150
Winter	\$0.09986
Monthly Customer Charges	\$8.75
Number of pump Station	2
Energy Commission Surcharge	\$0.0002 per kwh

2. Purchased Water  
None
3. Insurance Expenses  
\$6,000
4. Ad Valorem Taxes:  
    Tax Rate  
    Assessed Value  
\$393  
1.0607%  
\$37,097
5. Testing  
\$750

Service Connections

Flat Rate Service	163
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APPENDIX C  
Page 2

ADOPTED TAX CALCULATIONS  
Test Year 1991

Line No.	Item	<u>1991 Adopted Rates</u>	
<u>OCFT</u>	<u>FIT</u>		
1.	Operating Revenue	\$28,831	\$28,831
2.	Expenses	20,566	20,566
3.	Taxes Other than Income	422	422
4.	Depreciation	2,346	2,346
5.	Interest	596	596
6.	Taxable Income for State Tax	4,901	
7.	State Tax	800 minimum	
8.	Taxable Income for FIT		4,101
9.	Federal Income Tax		615
10.	Total Income Tax		\$1,415

End of Appendix