STATE OF CALIFORNIA
PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

March 10, 2008

RE: Rates of Return and Rates of Margin for Class C and D Water Utilities

TO: COMMISSION

By this memorandum, the Division of Water and Audits (DWA) updates its recommended Rates of Return and Rates of Margin for Class C and D water utilities.[1] These updates have been calculated in accordance with Resolution W-4524, which revised the Standard Practice that addresses how the rate of return and rate of margin are calculated for Class C and D water utilities.

DWA considered a number of factors in determining the rates of return. DWA assessed the movement in actual and forecasted interest rates over the last year's (lower actual rates that are forecast to recover to near recent historical). In addition, DWA took into account the high operational risks faced by Class C and Class D water utilities and the constant level of authorized rates of return for Class A water utilities in 2007 over 2006 (average of 8.94% in both years).

In determining the rates of margin, DWA considered the most recent authorized average rates of return for Class B water utilities (9.68%), the most recent Class B rates of margin for the same period (14.91%), and the recommended rates of return for Class C and D water utilities, as calculated above.

For 2008, DWA recommends that the following rates of return and rates of margin be used for Class C and Class D water utilities informal general rate cases (supporting documentation is attached):

	Rates of Return (ROR)	**Rates of Margin**
Class C	**12.00% to 13.00%**	**19%**
Class D	**12.75% to 13.75%**	**20%**

If you have any questions regarding the Rates of Return or Rates of Margin recommendations, please contact Sean Wilson of the Water Division (1-415-703-1818, smw@cpuc.ca.gov).

Sincerely,

Rami Kahlon
Director, Division of Water and Audits

Kayode Kajopaiye,
Principal, Utility Audit, Finance, & Compliance Branch

Attachment

[1] As required by D.92-03-093, in Phase I of I.90-11-033 (Water Risk OII).

CALCULATION OF CLASS C & D WATER COMPANY[2] RATES OF RETURN (ROR) & RATES OF MARGIN (ROM)[3]

- Rates are calculated using both return-on-ratebase and operating ratio methods.
- The method that produces the higher result is used.
- ROR is set at a level above or below the recommended ranges, if warranted.
- Where little or no rate base exists, the ROM is used.
- The ROM is applied to Operating Expenses to determine the estimated dollar return, which is then compared with the average dollar ROR on rate base.
- Calculations are based on the assumption that there is a comparable relationship between authorized Class B ROR and ROM and Class C and D ROR and ROM.
- Class C and D water operations, finances, and risks are more similar to those of the Class B water companies, than with Class A water utilities.

Data Used In the Determination of the Rates of Return And Rates Of Margin

Year	Recommended ROR Range		Actual Interest Rates from the Federal Reserve			
	Class C Water	Class D Water	90-day Treasuries	1-Year Treasuries	5-Year Treasuries	30-Year Treasuries
2006	12.00% - 13.00%	12.75% - 13.75%	4.85%	4.94%	4.75%	4.91%
2007	12.10% - 13.10%	12.85% - 13.85%	4.48%	4.53%	4.43%	4.84%
2008 (As of 02/08)	12.00% - 13.00%	12.75% - 13.75%	2.18%	2.23%	2.84%	4.35%
			Forecast Interest Rates from DRI			
Forecast for 2009 (As of 01/08)			3.93%	4.05%	4.28%	4.98%

Calculation of Rate of Margin	Inputs	Class C ROM	Class D ROM
Avg Class B Rate of Margin (ROM)	14.91%		
Avg Class B Rate of Return (ROR)	9.68%		
Avg Class C ROR	12.50%		
Avg Class D ROR	13.25%		
Avg Class C ROM = Avg Class B ROM * (Avg Class C ROR/Avg Class B ROR)		19%	
Avg Class D ROM = Avg Class B ROM * (Avg Class D ROR/Avg Class B ROR)			20%

[2] Class C water utilities have 501 to 2,000 customers, Class D water utilities have 500 or less customers.
[3] Pursuant to D.92-03-093, Ordering Paragraph 8 and Resolution W-4524.