



FILED

12-02-11
08:00 AM

ATTACHMENT A

ATTACHMENT A

**California Public Utilities Commission
Water and Sewer Advisory Branch
Division of Water and Audits**

REPORT
ON THE
CPCN RATE CASE
FOR
REDWOOD LODGE WATER COMPANY

This report was prepared by Oge Enyinwa, Utilities Engineers, under the supervision of Senior Utilities Engineer, Supervisor Peter Liu. It represents the results of a review and analysis of the rates for the CPCN of Redwood Lodge Water Company.

November 2011

Table of Contents

<u>Item</u>	<u>Page No.</u>
I. INTRODUCTION	2
II. SYSTEM DESCRIPTION	2
III. SUMMARY OF EARNINGS	2
IV. RATE DESIGN	7
V. FINDINGS & RECOMMENDATIONS	9

I. INTRODUCTION

This report represents the results of a review and analysis of the rates for the CPCN of Redwood Lodge Water Company.

The present interim rates became effective on September 9, 2009, pursuant to A-09-09-005 which authorized revenue \$30,450 resulting in a Rate of Margin of 24%. Redwood Lodge Water Company has requested a revenue of \$26,400.

This report recommends a revenue of \$24,130 which results in a Rate of Return (ROR) of 12.50% for the 2011 test year. This represents a decrease of \$6,320 or -20.80% over the interim revenue of \$30,450. The recommended ROR for class D water utilities is 12%-13%.

II. SYSTEM DESCRIPTION AND BACKGROUND

RLWC serves 12 residential customers by means of a 2-inch distribution line with 3/4 -inch laterals, in Santa Cruz County near Los Gatos. There is a 20,000 gallon storage tank and two 3,000 & 2,500 gallon service tanks. The original plant has been in place since the 1969, and belonged to Melvin & Melissa Fitzgerald who then transferred to Dennis & Patricia Heimer in 1976. Patricia Heimer started running the water company solely in July 2003, when her husband Dennis Heimer passed away.

III. SUMMARY OF EARNINGS

Branch performed an independent analysis of RLWC's rate application. Appendix A provides a summary of RLWC's and the Branch's estimates of operating revenues, expenses and rate base at both present, proposed and recommended rates for TY 2011.

Operating Revenues

RLWC's operating revenues consist of metered rate sales.

RLWC currently has a total of 12 customers classified as follows:

Metered Rate Customers	Number of Customers
Residences 5/8	12
Churches	
Fire Protection Public	
Commercial	
Total	12

Branch reviewed RLWC's billing records and confirmed that RLWC's estimated customer base for the test year is accurate.

RLWC estimates that water usage will be 43,200 cf for the test year in their proposed work sheets (based on an average consumption of 300 cf a month per customer).

Appendix A shows a complete breakdown of revenues by category.

Operating Expenses

RLWC and the Branch differ in estimates for expenses at the proposed rates. The Branch's estimate for the majority of the expenses, with the exception of purchased power, professional services and insurance, are based on an average of the recorded values for the last three years, 2008 through 2010, and adding an additional escalation factor of (4.8)% for non-labor and 0.3% for labor related expenses in each account. Meanwhile, RLWC used a weighted average of the expenses with a distribution for the years September to December 2008, 2009, 2010 up to June 2011 correspondingly.

Account 615 - Purchased Power

In TY 2011, RLWC estimates \$720 for this account, and the Branch and rate payers concur. This account is the cost of power, delivered by Pacific Gas and Electric Company, which is used to operate the well pumps. RLWC provided the actual power usage for 2010 in the form of electric bills, which the Branch further analyzed, applied the correct power rate schedules and recommends the value of \$720 for the TY.

Account 640 - Materials

In TY 2011, RLWC estimates \$1,200 for this account and has labeled it as Accrue for Materials, the Branch estimates \$524. The materials account includes all materials and supplies used in the operation and maintenance of the water system. RLWC had applied payment made to contractors and laborers for repairs done to the system to this account, which should be placed under account 650: Contract Work. As such Branch has removed this portion and awarded an amount of \$500 for the accumulation of materials and supplies needed for the regular maintenance and repair of the system. By applying the escalation factor of (4.8) %, the Branch arrived at the TY estimate of \$524. The rate payers also differ on the classification of account by RLWC and the amount requested.

The Branch recommends a total of \$524 for this account for TY 2011.

Account 650 - Contract Work

In TY 2011, RLWC estimates \$2,400 for this account, the rate payers and Branch concur, but the Branch applies the escalation factor of 0.3% for labor. Contract work includes the cost of maintenance and repairs performed by non-employees. RLWC currently contracts Messrs. Troy Burchby and Tyler Boswell, who is a certified system operator, to perform routine service work and maintenance in addition to repairs on an as-needed basis. Messrs. Burchby and Boswell take care of customer complaints. They have also been instrumental in helping to bring the water system up to standard. RLWC booked this account \$400 in the last quarter of 2008, \$2500 in 2009, \$2740 in 2010 and \$820 in the first half of 2011.

Water Testing

For the test year, RLWC estimates \$360 for this account, the rate payers concur with RLWC, while the Branch estimates \$853. Branch's estimate includes the annual permit paid to the Environmental Health Service (EHS) of \$474. RLWC and the rate payers put this under Permits which is not a system of account used by the Commission. RLWC booked to this account \$100 in the last quarter of 2008, \$199 in 2009, \$594 in 2010 and \$25 in the first half of 2011. By averaging these amounts, including the EHS permit of \$474 and applying an escalation factor of 4.8 %, the Branch arrived at the test year estimate of \$853.

Account 660 – Transportation Expenses

In TY 2011, RLWC estimates \$480 for this account and the rate payers concur, while Branch estimates \$415. The branch averaged the past three years recorded expenses to arrive at its test year estimate of \$396 and applied the escalation factor of 4.8% to arrive at \$415.

As such, the Branch recommends a total of \$415 for this account for TY 2011.

Account 664 - Other Plant Maintenance

In TY 2011, RLWC estimates \$3000 for this account; the rate payers estimate \$1680, while Branch estimates \$500. This account includes all regular plant operation and maintenance expenses not related to the volume of water. RLWC booked expenses related to general repairs and unanticipated repairs to this account. RLWC can file an Advice Letter to establish a memorandum account for Unanticipated Expense Memorandum Account (UEMA)¹, which is the means through which water utilities regulated by the Commission seek recovery for legitimate unanticipated expenses incurred by the water utility. It is recommended that RLWC file an advice letter to establish this memorandum account in line with our Standard Practice U-27. Given that RLWC the nature of repairs done are not routine, the Division will only allow \$500 for this account which is a reasonable amount for a water company of RLWC's size.

As such, the Branch recommends a total of \$500 for this account for TY 2011.

Account 671 - Management Salaries

Ms. Patricia Heimer, owner of RLWC, performs the management duties of the company. Ms. Heimer's duties include correspondence, handling customer's complaints 24/7, answering questions, purchasing supplies and materials and serves as interface with the regulatory agencies, among other managerial responsibilities. In TY 2011, RLWC requests a management salary of \$4,800 per year for this account. While the rate payers requested a salary of \$2,400, with the justification that a lot of the work involved in running the water system is out sourced. Since RLWC has become a Commission regulated water utility, Ms Heimer is going to have more matters to attend to as well as managing the affairs of RLWC, especially with complying with the Commission's rules, procedures and all other routine filings required by the Commission and other government agencies. Furthermore, Mr Nick Massetti who is currently helping her with the CPCN process will be leaving once that proceeding is closed.

Using ACWA 2009 Salary Survey's average value for the minimum and maximum monthly salaries for a management class equivalent to Ms. Heimer's position in plants comparable to RLWC's location and size, the Branch calculated an average hourly rate of \$35.00. Staff recommends an hourly rate of \$33.35. The Branch estimates 3 hours per week. Using the Branch's total managerial time estimate of 3 hours per week, the Branch recommends a salary of \$4,800 per year.

Account 678 - Office Services and Rentals

In TY 2011, RLWC estimates \$120 for this account, the rate payers estimate \$0, while the Branch estimates \$63. This account includes items such as payments to office bureaus, bank fees, and other office related services. Since Ms. Heimer uses these facilities as well for personal use, staff has allocated a 50% portion of the costs to the RLWC. RLWC booked to this account \$0 in the last quarter of 2008, \$96 in 2009, \$80 in 2010 and \$0 in the first half of 2011. By averaging these amounts, dividing it by 2 and applying an escalation factor of 4.8 %, the Branch arrived at the test year estimate of \$63.

The Branch recommends a total of \$63 for this account for TY 2011.

Account 681 - Office Supplies and Expenses

In TY 2011, RLWC estimates \$1,680 for this account, the rate payers estimate \$600 and Branch estimates \$834. This account includes the cost of office supplies and expenses including printing, phone service, stationary, general accounting supplies, post office expenses, and other office expenses. RLWC booked to this account \$780 in the last quarter of 2008, \$1385 in 2009, \$1486 in 2010 and \$996 in the first half of 2011. Since Ms. Heimer uses the phone facility for personal use as well, staff has allocated a 30% portion

¹ Please refer to our Standard Practice U-27-W

of the costs to the RLWC. By averaging these amounts, and applying an escalation factor of 4.8 %, the Branch arrived at the test year estimate of \$834.

Account 682 - Professional Services

In TY 2011, RLWC estimates \$2,400 for this account; while the rate payers estimate \$1,200. The Branch assessed the reasonableness of the rate payers estimate and concurs. Professional Services consists of fees charged by professional consultants including accountants. RLWC has booked to this account legal expenses for which the Commission has a proper mechanism in place to recover expenses of this nature called the Engineering and Legal Cost Memorandum. It is recommended that RLWC file an advice letter to establish this memorandum account in line with our Standard Practice U-27. RLWC based its estimate on a weighted average of recorded expenses for the last three years. RLWC booked to this account \$5,658 in the last quarter of 2008, \$4,236 in 2009, \$5,205 in 2010 and \$1,787 in the first half of 2011. Since 2008, RLWC has used the services of a bookkeeper to maintain its books and aid with the billing.

After careful review of the expenses under this account, the Branch deemed the expense just and reasonable. By using the bookkeeper fees of \$100 per month for 12 months in the TY and applying an escalation factor of 0.3%, the Branch arrived at the TY estimate of \$1,219.

The Branch recommends a total of \$1,219 for this account for TY 2011.

Account 684 - Insurance

In TY 2011, RLWC estimates \$2,400 for this account, the rate payers concur (this estimation did not include vehicle insurance). This account includes all insurance costs including property, liability, fire and theft. RLWC provided documentation of invoices, copies of the policy agreements, and a description of coverage limits in various risk categories. The Branch's estimate is based on invoices submitted by RLWC for the August 2010 period, coming to a total of \$2,441.

The Branch recommends a total of \$2,441 for this account for TY 2011.

Account 688 - Regulatory Commission Expense

For this account RLWC requests \$0 and the rate payers concur. This account is for all expenses incurred by the utility in connection with formal cases before the Commission. Based on the small size of the water system and how new it is under the CPUC regulation, staff allotted a total of 10 hours a year at the rate of \$50 an hour for this account.

The Branch recommends a total of \$500 for this account for TY 2011.

Account 403 - Depreciation Expense

Branch concurs with RLWC's proposed depreciation rate. RLWC has proposed to use the rate of 3.00% in the current rate case due to the estimation of actual plant equipment, and the Branch agrees with this notion. For the test year, Branch found depreciation expenses to be \$1,044 based on its plant in service. Branch recommends \$1,044 for depreciation expense for TY 2011.

Account 408 - Taxes Other Than Income

In TY 2011, RLWC estimates \$1500 for taxes other than income, while the rate payers and Branch estimate \$336. This account is intended to include property taxes, payroll taxes, and other taxes except income taxes. RLWC has included the annual permits paid to the Environmental Health Service (EHS) and the State Water Resources Control Board. The Division has reclassified the permit paid to EHS under Water Testing and the amount paid to the Control Board for water rights under other volume Related Expenses

This account includes property taxes, payroll taxes, other taxes and licenses. The only tax paid by RLWC under this account is property taxes. RLWC pays \$236 for property taxes, which was verified through documents and records submitted to the Branch.

The Branch recommends a total of \$236 for this account for TY 2011.

Account 427 – Interest Expense

In TY 2011, RLWC estimates \$400 for Interest Expense, while Branch recommends \$33. This account is for all interest expenses of the utility and does not include payment of loan principals. This interest expense is for a \$30,000 loan; Mrs. Heimer has incurred from Mr. Nick Masseti, in order to get the water system in compliance with plant improvements ordered by the Drinking Water Program of County of Santa Cruz, Environmental Health Service (EHS). After a through review by staff it was determined that \$2,442 of this sum was used towards Account 684 – Insurance, which has already been provided for in rates, as well as \$361 which was used for expenses belonging to Account 681 - Office Supplies and Expenses, amounting to a total of \$2803, (\$30,000-\$2,803=\$27,197). As such, only \$27,197 of the \$30,000 is recoverable for interest expense under this account. RLWC had included the principle and interest payment amounting to \$400, erroneously for this account. Staff re-calculated the interest at a rate of 3% for the loan amount of \$27,197 for the loan term of 7 years or 84 months and did an average payment calculation for the 84 months to come up with \$33.

The Branch recommends a total of \$33 for this account for TY 2011 till the expiration date of this loan of 10/1/2017.

Rate Base

To calculate Rate Base, Branch used estimates provided by RLWC for recent upgrades and improvements done to the system in compliance with plant improvements ordered by the Drinking Water Program of County of Santa Cruz, Environmental Health Service (EHS). As well as Land valued as stated on the Santa Cruz county property tax bill for \$17,568. Branch’s rate base calculation matches RLWC’s rate base computation listed below and in Appendix A.

Branch estimates total rate base as follows:

Land	\$ 17,568
Plant in Service	\$ 34,805
Average Depreciation Reserve	\$ 0
Net Plant	\$ 51,805
Plus: Working Cash	<u>\$ 0</u>
Total Rate Base for Test Year 2011:	\$ 52,373

Cost of Capital

RLWC is a Class D water utility (less than 500 customers). The Water Division’s Audit & Compliance Branch has conducted an analysis of the financial market changes with the last year and the high operational risk faced by Class D water companies and has determined that the appropriate range for Return on Return (ROR) is 12% - 13%.

Based on the interim current rates, RLWC’s annual revenue is \$30,450. For the test year 2011, RLWC’s annual revenue is \$24,130; the decrease will be (\$6,320) or -20.80%, with a resulting Rate of Return of 12.50%.

Findings and Recommendations

Based on the analysis and auditing done, staff has discovered the following:

Insurance

Although, insurance was provided for in the interim rates, RLWC did not obtain insurance until August 2010, which was paid from the \$30,000 loan incurred from Nick Masseti. Staff has reviewed this, and has removed this amount from the loan and recalculated the interest expense without this amount. Also, in doing the cash flow analysis above, staff has excluded insurance as an expense until August 2010.

Purchased Water (Water Hauling)

Purchased water was provided for in the interim rates but was only expensed in the Year 2009; this item was excluded in the cash flow analysis for the rest of the period.

Accrual for Repairs

RLWC had requested a sum of \$1,200 for accrual for repairs, but provisions under the Materials, Contract and General Expense account has been made for that. The Division has a memorandum account in place for any needed repairs that take place outside of the regular maintenance and repairs of a water system. Please refer to Water Division's Standard Practice U-27-W.

Debt Service

RLWC has incurred a \$30,000 loan for plant improvements ordered by the Drinking Water Program of the County of Santa Cruz, Environmental Health Service (EHS), as a result of these improvements, their rate base has gone up considerably from \$38,995 to \$52,373 allowing them a chance to earn a higher amount on their allowable Rate of Return. When an investment is made into plant, the returns for such investments are made through the rates, based on this accounting principle staff has disallowed this request of \$400 for debt service from RLWC. The only aspect of this loan allowable into rates is the interest expense which expires on 10/1/2017.

Office Services and Rental

Under this account category RLWC books bank fees. Since these are also being used by Ms. Heimer personally, staff has allocating only 50% of the bank fees in rates and recommends that Ms. Heimer get a separate bank account for the water company.

Facilities and Connection Fees

RLWC should refer to our Standard Practice U-28-W for a guide on how to handle fees under this category. This information is online and can gotten from this link:
http://docs.epuc.ca.gov/word_pdf/REPORT/83021.pdf

Audit

Staff recommends that the Utility Audit Finance & Compliance Branch conduct an audit of RLWC books and records within a year from the effective date of the rates on Appendix B. This is to educate the utility on proper accounting rules and procedures, and ensure compliance to the Commission's Uniform System of Accounts for Class B, C and D water utilities.

Refunds

The rates as shown in Appendix C will result in a quantity charge reduction of about -33.8%\$ in the 1st Tier rate, -33.6% in the 2nd tier rate and -33.7% in the third tier rate, while the service charge remains the same with a 0% change in rate.

Given the rate reduction, staff recommends that RLWC submits a Tier 2 Advice Letter calculating rate refunds from September 2008 till date. This advice letter should include supporting data for the water company's results and will be provided to all the rate payers during the comment period to allow for protests and comments. Staff will review the submission for accuracy and verify that these results are accurate before it is approved.

For The Branch's recommended Summary of Earnings (Appendix A) is reasonable and should be adopted.

- The rates recommended by the Branch (Appendix B) are reasonable and should be adopted.
- The quantities (Appendix D) used to develop the Branch's recommendations are reasonable and should be adopted.

Appendix A							
Redwood Lodge Water Company							
Summary of Earnings							
Test Year 2011							
Item	Utility Estimated		Ratepayers	Branch Estimated		Recommended Rates (ROR)	Recommended Rates (ROM)
	Current Interim Rates	Requested Rates	Requested Rates	Current Interim Rates	Requested Rates		
Operating Revenue							
General Metered Sales	\$30,450	\$26,400	\$21,011	\$30,450	\$26,400	\$24,130	\$21,723
Total	\$30,450	\$26,400	\$21,011	\$30,450	\$26,400	\$24,130	\$21,723
Operating Expenses							
Purchased Water	\$2,450	\$0	\$0	\$0	\$0	\$0	\$0
Purchased Power	\$1,975	\$720	\$660	\$720	\$720	\$720	\$720
Other Volume Related Expenses	\$0	\$0	\$0	\$100	\$100	\$100	\$100
Employee Labor	\$4,800	\$0	\$0	\$0	\$0	\$0	\$0
Materials	\$500	\$1,200	\$0	\$524	\$524	\$524	\$524
Contract Work	\$1,520	\$2,400	\$2,400	\$2,407	\$2,407	\$2,407	\$2,407
Water Testing	\$1,500	\$360	\$960	\$836	\$836	\$836	\$836
Transportation Expenses	\$600	\$480	\$480	\$415	\$415	\$415	\$415
Other Plant Maintenance	\$500	\$3,000	\$1,680	\$500	\$500	\$500	\$500
Management Salaries	\$4,800	\$4,800	\$2,400	\$4,800	\$4,800	\$4,800	\$4,800
Uncollectibles Expense	\$50	\$0	\$0	\$50	\$50	\$50	\$50
Office Services & Rentals	\$0	\$120	\$0	\$63	\$63	\$63	\$63
Office Supplies & Expenses	\$840	\$1,680	\$600	\$834	\$834	\$834	\$834
Professional Services	\$200	\$2,400	\$1,200	\$1,219	\$1,219	\$1,219	\$1,219
Insurance	\$3,100	\$2,400	\$2,400	\$2,441	\$2,441	\$2,441	\$2,441
Regulatory Commission Expense	\$0	\$0	\$0	\$500	\$500	\$500	\$500
General Expenses	\$60	\$600	\$0	\$63	\$63	\$63	\$63
Subtotal	\$22,895	\$20,160	\$12,780	\$15,473	\$15,473	\$15,473	\$15,473
Depreciation	\$660	\$0	\$0	\$1,044	\$1,044	\$1,044	\$1,044
Taxes other than Income	\$420	\$1,500	\$236	\$236	\$236	\$236	\$236
Income Taxes	\$1,009	\$0	\$0	\$800	\$800	\$800	\$800
Interest Expense	\$0	\$0	\$0	\$33	\$33	\$33	\$33
Total Deductions	\$24,984	\$21,660	\$13,016	\$17,586	\$17,586	\$17,586	\$17,586
Net Revenue	\$5,466	\$4,740	\$7,995	\$12,864	\$8,814	\$6,544	\$4,137
Rate Base							
Average Plant	\$38,995	\$38,995	\$0	\$52,373	\$52,373	\$52,373	\$52,373
Ave. Accumulated Depreciation	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Net Plant	\$38,995	\$38,995	\$0	\$52,373	\$52,373	\$52,373	\$52,373
Less Advances	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Contributions	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Plus Working Cash	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Materials & Supplies	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Rate Base:	\$38,995	\$38,995	\$0	\$52,373	\$52,373	\$52,373	\$52,373
Rate of Return	14.02%	12.16%	0.00%	24.56%	16.83%	12.50%	7.90%
Rate of Margin							24.89%

APPENDIX B

Redwood Lodge Water Company

Schedule No. 1

GENERAL METERED SERVICE

Test Year 2011

APPLICABILITY

Applicable to all metered water service

TERRITORY

Applicable to Redwood Lodge Water Company's Service Area as shown on its Service Area Map.

RATES

Quantity Rates:

Each of the First 2Ccf...	\$ 22.52 (R)
Each of the First 8Ccf...	\$ 24.55 (R)
Above 10 Ccf...	\$ 33.14 (R)

Service Charge:

	Per Meter
	<u>Per Month</u>
For 5/8 x 3/4-inch meter	\$ 100.00
For 3/4-inch meter	\$ 150.00 (N)
For 1-inch meter	\$ 250.00 (N)
For 1-1/2-inch meter	\$ 500.00 (N)
For 2-inch meters	\$ 800.00 (N)

The Service Charge is a readiness-to-serve charge which is applicable to all metered service and to which is added the water used computed at the Quantity Rate.

SPECIAL CONDITIONS

1. All bills are subject to the reimbursement fee set forth in Schedule No. UF.

(continued)

APPENDIX C
Redwood Lodge Water Company
Comparison of Rates

Test Year 2011

		Per Service Connection Per Month		
		Present	Recommended	Percent
		<u>Rates</u>	<u>Rates</u>	<u>Increase</u>
Service Charge:				
	For 5/8 x 3/4-inch meters	\$ 100.00	\$ 100.00	0.0%
	For 3/4-inch meters	\$ -	\$ 150.00	0.0%
	For 1-inch meters	\$ -	\$ 250.00	0.0%
	For 1-1/2-inch meters	\$ -	\$ 500.00	0.0%
	For 2-inch meters	\$ -	\$ 800.00	0.0%
Quantity Charge:				
	Each of the first 2Ccf	\$34.00	\$22.52	-33.8%
	Each of the first 8Ccf	\$37.00	\$24.55	-33.6%
	Above 10 Ccf	\$50.00	\$33.14	-33.7%

A monthly bill comparison for a customer with a 5/8 x 3/4-inch meter is shown below:

Usage	Present	Recommended	Amount	Percent
<u>100 cu. ft.</u>	<u>Rates</u>	<u>Rates</u>	<u>Increase</u>	<u>Increase</u>
0	100.00	100.00	0.00	0.0%
3 (Avg)	205.00	169.60	-35.40	-17.3%
8	387.00	292.35	-94.65	-24.5%
10	461.00	341.45	-119.55	-25.9%
15	646.00	507.16	-138.84	-21.5%
20	831.00	672.87	-158.13	-19.0%

Appendix D

Redwood Lodge Water Company
 Adopted Quantities
Test Year 2011

1. Purchased Power	
Total Cost	\$ 720
2. Water Sales in Ccf	43,200
3. Payroll	
Office Salaries	\$ 0
Management Salaries	\$ 4,800
4. Property Taxes	\$ 236

Metered Rate Service Connections

Single-family residential unit 5/8"	12
Business unit	0
Churches	0

<u>Public fire service</u>	<u>0</u>
Total Flat Rate customers	12

Adopted Tax Calculation Test Year 2011

1. Operating Revenues	\$24,130
2. Expenses	\$15,473
3. Depreciation	\$ 1,044
4. Property Taxes	\$ 236
5. Taxable Income for State Tax	\$ 7,344
6. State Tax (min 800)	\$ 800
7. Taxable Income for FIT	\$ 0
8. Federal Tax	\$ 0

(END OF ATTACHMENT A)