J-21

State of California

Memorandum

ate : February 22, 1983

To : Professional Staff

From : **Public Utilities Commission — San Francisco** -- W. R. Ahern, Director, Utilities Division WRA
B. A. Davis, Director, Revenue Requirements Div. BD

File No.:

Subject: CAPS Standard Procedure

Purpose

The purpose of this memorandum is to provide the Commission staff and interested parties with a standardized procedure to implement the Commission's adopted policy on CAPS (deferral of a portion of a general rate increase) for water utilities.

Background

At the Commission Conference on February 4, 1982, the Commission approved a staff recommended policy limiting rate increases for water utilities (Attachment No. 1). This policy provided for deferral of that portion of general rate increases in excess of 50% for large water utilities and 100% for the smaller water utilities. This policy was adopted to mitigate the impact of a large rate increase on the utility's customers.

At the Commission Conference on August 18, 1982, the Commission approved a staff recommended policy on CAPS that the rates be reduced to the adopted level as soon as the deferred revenues are provided to the utilities (Attachment No. 2). This modification of the CAPS policy insures that the rates to recover the deferred revenues plus interest would be above the adopted level for the minimum period of time.

Citizens Utilities Company petitioned for a rehearing on the method of computation of interest on the deferred revenues contending that the monthly compounding method should be used instead of the simple annual method. The Commission in Decision 82-11-054, dated November 17, 1982, affirmed the simple annual method of compensation shown on Appendix E of the following decisions: 82-03-023, 82-04-009, 82-04-017, 82-05-038, and 82-05-076.

The recommended standard procedures to implement CAPS were distributed for analysis, review, and comments. The following standard procedure is a consensus of the reviewing Commission staff.

Criteria/Ground Rules

The following basic criteria (or ground rules) shall be used for rate increases in excess of 50% for large (Class A) water utilities or 100% for small water utilities. The procedures in this Memorandum are equally applicable to smaller (Class B, C, and D) water utilities by substituting 100% where the text reads 50%.

1. The initial increase shall not exceed 50% except: (1) in the case where the total deferred revenue including interest cannot be recovered in three years with the 50% limitation, and (2) in the case where the 50% limit would be insufficient to meet operating expenses. In the first case, approximately equal percentage increases should be used for the initial increase and the succeeding annual step increases. In the second case, the increase should be sufficient to eliminate a negative return. In all cases, the recovery should occur in three years to permit filing for further relief as prescribed in the Water Regulatory Lag Plan.

2. Step rates for both deferred revenues and attrition shall be authorized at 12-month intervals effective on the first of the month following the anniversary date of the decision authorizing the rate increase. This deviation from the present policy of attrition step rates being effective on January 1 shall only be applicable where there is a CAP on the amount of the annual rate increase.

3. Interest on the deferred rate increase (deferred revenues) shall be computed as simple interest on an annual basis. The annual interest rate shall be the authorized rate of return on rate base or such other rate as the Commission finds as reasonable in the decision authorizing the rate increase.

4. In cases with multiple test years, any attrition allowance (step rate increases) shall be included in the CAP of 50% in any one year. However, any increase in gross annual revenues associated with adopted levels of customer growth shall be excluded in the CAP of 50% in any one year.

5. The deferred rate increase revenues including interest shall be recovered in the first step rate increase, provided that the gross increase does not exceed 50%; otherwise, the balance of the deferred revenue plus interest will extend into a second step (year).

6. The decision shall provide for a final step to reduce the rates to the level of the adopted gross revenues for the latest test year.

7. The incremental rates (deferred revenue including interest) that are greater than the adopted revenues shall not be used in the summary of earnings filed with advice letter filings for attrition step rate increases.

Sample Computations

Sample computations for some typical rate case situations are shown on Attachments Nos. 3, 4, and 5. These examples are not meant to be all inclusive. Each rate case, where the 50% CAP is implemented, will ultimately be handled on a case-by-case basis using the criteria and ground rules contained herein.

Attachment No. 3 shows an example of the Appendix to Commission decisions for the following conditions:

1. Single test year
2. No attrition
3. No adopted customer growth
4. Two-year deferred revenue recovery period.

Attachment No. 4 shows an example of the Appendix to Commission decisions for the following conditions:

1. Three test years
2. Attrition step rates
3. Adopted customer growth in second and third test years
4. Two-year deferred revenue recovery period

Attachment No. 5 shows an example of the Appendix to Commission decisions for the following conditions:

1. Very large (123.5%) increase for Class A utility
2. Single test year
3. No attrition
4. No adopted customer growth
5. Three-year deferred revenue recovery period

RHB:KL

Attachments

State of California

Memorandum

Date: January 28, 1982
(For February 4 Conference)

To: COMMISSIONERS
J. E. Bryson, President
R. D. Gravelle
L. M. Grimes
V. Calvo
P. C. Grew

From: Public Utilities Commission — San Francisco -- J. E. Kerr, General Counsel
I. R. Alderson, Chief ALJ
W. R. Ahern, Director, Util. Div.
B. A. Davis, Director, Rev. Req. Div.
B. Barkovich, Director, Policy Div.

File No.: 076

Subject: "Caps" for Water Utility Rate Increases (for Commission consideration at the February 4, 1982 Conference)

RECOMMENDATIONS: The following policy be established as a guideline to staff in water utility rate proceedings:

1. For the large utilities that regularly file for rate relief, the staff will recommend that relief be granted with step increases for recommended increases in excess of 50%.

2. For the smaller utilities that file infrequently for rate relief, a cap of 100% should be used, with deviations granted in accordance with criteria specified below.

DISCUSSION: In response to a discussion at the conference of January 5, 1982, staff indicated that it would provide the Commission with a recommendation on "caps" for water company increases.

The primary advantage of a cap is that the burden placed on consumers in any year would be limited and rate increases would occur in a more orderly manner. Consumers would thereby be better able to budget for utility increases during this period of rapid inflation. The main disadvantage of an imposed cap is the question of fairness and proper notice, especially since such a cap would inflict the greatest hardship on the smaller water companies. Another disadvantage is the possibility that the smaller companies would react by seeking rate increases at shorter time intervals and more frequent rate cases would increase the staff workload to levels that may be difficult to manage and impose higher average rates to consumers.

To determine the extent of the problem, rate increase requests over the last two years were reviewed. The larger water utilities filed 26 applications for rate increases, of which 7 were authorized increases in excess of 50%. Six of these were applications by PG&E for a 1980 test year, and rate relief was authorized as step increases in view of the lengthy period since the prior filings. The other was the increase authorized for Park Water Company for one of its small districts in November 1981.

The smaller water companies filed 63 advice letters for general rate increases, of which only 1 in excess of 100% was granted. Spring Crest Water and Power Company, which serves 15 customers near Palm Desert, Riverside County, was authorized a rate increase of 233% on October 8, 1980. However, this increase produced only $2,520 in additional revenue and still resulted in a negative rate of return. It should also be noted that 9 companies were authorized increases of 100% and that some of these were influenced by the staff to temper their requests.

In view of the potential problems if the Commission issued a notice prescribing a cap for water increases, we recommend that the Commission establish the following policy.

Except for unusual circumstances which will be completely documented, staff will recommend step increases for the larger utilities for any rate requests in excess of 50% Any attrition allowance will be subject to this cap of 50% in any one year.

For the smaller utilities filing advice letters or formal applications for general rate increases, staff will not recommend increases in excess of 100% unless:

1. A larger increase would be required to eliminate a negative rate of return or out of pocket loss.

2. A large increase is based on large investment for new facilities primarily to improve service.

EJT/WRA.st

cc: J. E. Bodovitz
Division Directors

State of California

ATTACHMENT NO. 2
Sheet 1 of 2

Memorandum

Date : Conference of August 18, 1982

To : President Bryson
Commissioner Gravelle
Commissioner Grimes
Commissioner Calvo
Commissioner Grew

From : Public Utilities Commission — San Francisco -- J. E. Kerr, General Counsel
W. R. Ahern, Director, Utilities Div.
B. A. Davis, Director, Rev. Req. Div.
B. Barkovich, Director, Policy Div.

File No.:

Subject: Implementation of "Caps" for Water Utility Rate Increases (for Commission Consideration at the August 18, 1982 Conference)

RECOMMENDATION: The staff recommends that rates for water utilities subject to a cap be reduced to the adopted level as soon as the revenues deferred due to the cap are provided to the utilities.

DISCUSSION: At the February 4, 1982 Conference, the Commission approved a general policy limiting annual rate increases to 50% for large water utilities and 100% for small water utilities. The Commission further indicated that any deferred revenues would be provided to the utilities with interest. In attempting to implement this policy, a pivotal issue emerged. After the deferred revenues are returned to a utility, should the rates be reduced back to the adopted level or be allowed to remain at the level set to provide the deferred revenues and interest (authorized level). The attachment presents a graphical representation of the two methods.

The advantage of the staff method is that the rates would be above the proper adopted level for the shortest time. The disadvantage would be the possibility of rate instability if the deferred revenues are repaid in year 2, rates are reduced to the adopted level in year 3 and the utility files for and receives another rate increase beginning in year 4. If the utility does not file for a rate increase in year 3, however, and the higher rates are not reduced after the revenues are returned, the customers would be paying an unauthorized rate increase beginning in year 4. Utilities do not automatically file for rate increases every three years, and they might have an incentive not to file if the authorized revenues were larger than the proposed increases. This would be another advantage of the staff method.

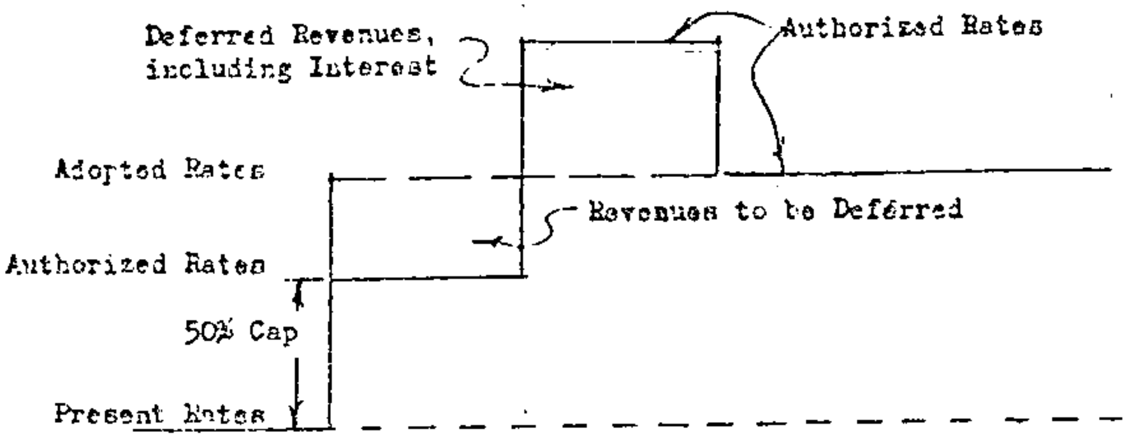
ALTERNATIVE: The initial decision draft in Application No. 60253 used the staff recommended method in ordering the recovery of deferred revenues in one year and then reducing the rates to the adopted level in year 3. However, at the conference of May 18, 1982, the Commission, in issuing Decision No. 82-05-076 in that proceeding, selected the alternative method of spreading the deferred revenues equally over years 2 and 3 and keeping the rates at this higher level for year 4. This results in more stable rates for those years, assuming that the utility receives a rate increase in the fourth year.

EJT:KN
Attachment

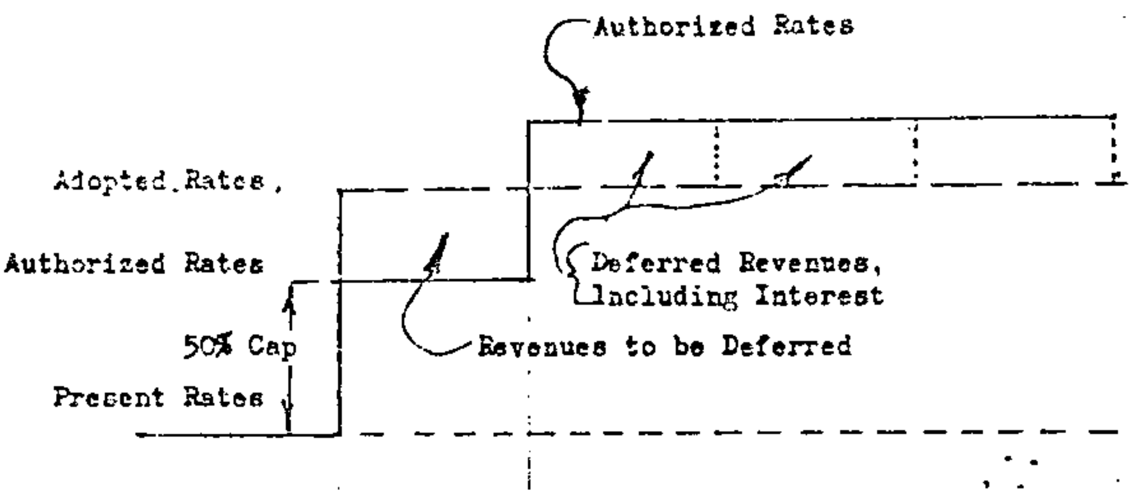
cc: J. D. Reader
M. J. Purcell
W. E. Franklin

Test Year   Year 2   Year 3   Year 4

Recommended Method



Alternate Method



Authorized level represents the adopted revenues plus the deferred revenues, including interest in Year 2 and Year 3.

NO ATTRITION - SINGLE TEST YEAR

DECISION DATE - MARCH 20, 1983; EFFECTIVE DATE - APRIL 1, 1983

(Dollars in Thousands)

	Adopted	Adjustment	CAPS
1983	Effective Date - April 1, 1983		
Present	$438.5		$ 438.5
Adopted	787.9		657.8
Increase	349.4 79.7%		219.3 50%
1984	Effective Date - April 1, 1984		
Present	787.9		657.8
Adopted	787.9	[$130.1 + $15.6]	933.6
Increase	-		275.8 41.9%
1985	Effective Date - April 1, 1985		
Present	787.9		933.6
Adopted	787.9		787.9
Increase (Decrease)	-		(145.7)(15.6%)

COMPUTATIONS

Deferred Amount

$349.4 - $219.3 = $130.1

Interest

$130.1 x (12.0%) = $15.6

Accumulated Revenues

	Adopted	CAPS	Difference
1983-85	$2,363.7	$2,379.3	$15.6

ATTRITION - THREE TEST YEARS

DECISION DATE - MARCH 20, 1983; EFFECTIVE DATE - APRIL 1, 1983
(Dollars in Thousands)

		Adopted		Adjustment	CAPS	
1983	Effective Date - April 1, 1983					
	Present	$438.5			$438.5	
	Adopted	787.9			657.8	
	Increase	349.4	79.7%		219.3	50%
1984	Effective Date - April 1, 1984					
	Present	791.2 *			660.2 *	
	Adopted	842.8 **		130.1 + 15.6	988.5	
	Increase	51.6	6.5%		328.3	49.7%
1985	Effective Date - April 1, 1985					
	Present	847.8 *			992.1	
	Adopted	902.8 **			902.8	
Increase/(Decrease)		55.0	6.5%		(89.3)	(9.0%)

* The following increases results from customer growth:

Year	Adopted	Distribution
1984	$3.3	$2.4
1985	$5.0	$3.6

** The following increases results from attrition:

Year	Attrition	
1984	$51.6	($842.8 - $791.2)
1985	$55.0	($902.8 - $847.8)

COMPUTATIONS

Deferred Amount

$349.4 - $219.3 = $130.1

Interest

$130.1 x (12.0%) = $15.6

Accumulated Revenues

	Adopted	CAPS	Difference
1983-1985	$2,533.5	$2,549.1	$15.6

Note: Note that the total dollar amount of deferred revenue and payback (interest) are not affected by customer growth and attrition. However, the percentage amount of the annual increases are changed. (See Attachment No. 3).

NO ATTRITION - SINGLE TEST YEAR

DECISION DATE - MARCH 20, 1983; EFFECTIVE DATE - APRIL 1, 1983
(Dollars in Thousands)

		Adopted		Adjustment	CAPS
1983	Effective Date - April 1, 1983				
	Present	$170.0			$170.0
	Adopted	380.0			255.0
	Increase	210.0	123.5%		85.0--50%
1984	Effective Date - April 1, 1984				
	Present	380.0			255.0
	Adopted	380.0		/2.2 + 0.3/	382.5
	Increase	-			127.5--50% 1/
1985	Effective Date - April 1, 1985				
	Present	380.0			382.5
	Adopted	380.0		/122.8 + 29.5/	532.3
	Increase	-			149.8--39.2%
1986	Effective Date - April 1, 1986				
	Present	380.0			532.3
	Adopted	380.0			380.0
Increase/(Decrease)		-			(152.3)--(28.6%)

COMPUTATIONS

Deferred Amount

$210 - $85.0 = $125.0

Distribution

1984 - $ (255.0 x 1.5 - 380.0) ÷ 1.12 2/ = $2.2

1985 - $ 125.0 - 2.2 = $122.8

Interest

1984 - 2.2 x 12% = $0.3

1985 - 122.8 x 12% x 2 yrs. = $29.5

Accumulated Revenues

	Adopted	CAPS	Difference
1983-1986	$1,520.0	$1,549.8	$29.8

1/ Note that the 50% CAP for Test Year 1984 requires that the deferred revenue is recovered in Test Year 1985.

2/ The factor 1.12 is a combination of principal (1.0) plus interest (12.0%).