Decision **PROPOSED DECISION OF ALJ BUSHEY (Mailed 2/7/2012)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Patricia Heimer, doing business as Redwood Lodge Water Company for a Certificate of Public Convenience and Necessity to operate as a Water Public Utility within the meaning of Public Utilities Code Section 2701 et seq., in Santa Cruz County near Los Gatos; and to establish Water Rates.	Application 09-09-005 (Filed September 11, 2009)

DECISION ISSUING CERTIFICATE OF PUBLIC CONVENIENCE AND NECESSITY AND ADOPTING FINAL RATES

1. Summary

This decision issues a Certificate of Public Convenience and Necessity to Patricia Heimer, doing business as Redwood Lodge Water Company, to operate as a public utility. This decision authorizes final rates for the applicant and orders refunds of over-collections in interim rates. This proceeding is closed.

2. Background

The Redwood Lodge Water Company (Redwood Lodge or Company)[1] provides domestic water service to 12 customers located in the Santa Cruz County hills near Los Gatos. The water system is supplied by two naturally

[1] No evidence has been presented that the entity calling itself the Redwood Lodge Water Company is, in fact, incorporated in any state. Although we refer to it as the "Company," the applicants must correct their legal status as described below.

occurring springs and has existed since 1969. The current owner, Patricia Heimer, and her late husband purchased the system in 1976 and she has been the sole owner since Mr. Heimer's death in 2003.

On November 10, 2008, the then-assigned Commissioner and assigned Administrative Law Judge (ALJ) issued a ruling directing Redwood Lodge to file an interim rate case to established rates, subject to refund, pending the filing of an application for a certificate of public convenience and necessity (CPCN) and a general rate case.

Staff from the Commission's Division of Water and Audits assisted the Company in preparing an interim rate filing as well as an application for a CPCN and a general rate case. The Company placed interim rates calculated with the assistance of Commission staff into effect in early 2009, subject to refund.

On September 11, 2009, the Company filed its CPCN application. The application stated that 14 residential parcels existed within the Company's 26-acre service area, which is described as having steep slopes, dense vegetation, and few buildings. The elevation of the water service connections varies from about 1,000 feet above sea level to 1,400 feet above sea level. The source of water is two springs located on one of the parcels within the service area, which are permitted to divert 5.99 acre-feet per year. The application sought permanent rates based on the same revenue requirement and rate base as had been used to establish interim rates. The application requested a Commission order issuing a CPCN to Patricia Heimer to operate the Company in Santa Cruz County.

On April 28, 2011, the Company filed its amendment to its original CPCN application. The amendment requested rates identical to the interim rates.

On November 23, 2011, the Commission's Water and Sewer Advisory Branch, Division of Water and Audits, served its Staff Report on the CPCN rate

case for the Company. The amended report is Attachment A to today's decision. The report included a detailed analysis of each element of revenue requirement for the Company. In summary, the report found that the reasonable revenue requirement for the Company was 20.8% below the interim rate revenue requirement. Consequently, revenue requirement should be reduced by 20.8% on a prospective basis. The report recommended that this revenue requirement reduction be accomplished by retaining the existing $100 a month service fee, but reducing each of the three tier volumetric rates by approximately 33%. To conform the interim rates to the final rates, the Staff Report recommended that the applicant file a Tier 2 Advice Letter that calculates the difference between the interim and final rates for the quantity charge collected during the period interim rates were in effect.

On December 2, 2011, the assigned Commissioner issued her scoping memo in this proceeding. The scoping set the matter for evidentiary hearing and directed Redwood Lodge to appear at the hearing and be prepared to address the following issues.

1. Generally, bringing Redwood Lodge's public utility operations into compliance with the Commission's regulations and the Public Utilities Code;
2. Developing an understanding of the role of the Commission in public utility operations, including the steps necessary to encumber public utility property;
3. Correcting corporate structure and following corporate formalities for the entity owning the public utility water system;
4. Preparing a specification of each major component of the water system, including ownership of real property and facilities necessary for the system, and assuring that the public utility holds clear title;

5. Separating personal assets and expenses from water system assets and expenses, and maintaining separate and auditable accounting and banking records;
6. Implementing the Uniform System of Accounts and proper public utility accounting and record retention;
7. Demonstrating technical competency and licensing status of system operator;
8. Improving customer billing accuracy;
9. Adopting standard tariff rules, including rules for customer collections;
10. Understanding the requirements for authorization to make off-system water sales; and
11. Any other issue that may arise during the hearing.

At the evidentiary hearing, staff of the Commission's Water and Audits Division presented the staff report and answered questions. Redwood Lodge's representative stated in response to questions on the first 10 issues listed above that Redwood Lodge is or soon will be in compliance on each item.

On December 13, 2011, the assigned ALJ authorized the applicant to file and serve, no later than December 19, 2011, comments on the refund obligation discussed at the December 8 hearing, with replies from the parties on January 5, 2012. The assigned ALJ ruled that with the filing of the reply comments, the record would be closed and the proceeding submitted for Commission decision.

3. Application for CPCN and New General Rates

This proceeding addressed Redwood Lodge's request for a public utility water system CPCN. We also considered the applicability of the California Environmental Quality Act (CEQA), and Commission General Order (GO) 103-A.

4. CPCN Requirements

For a small water provider like Redwood Lodge, the provisions of the Public Utilities Code, the Commission's Rules of Practice and Procedure (Rules), and Resolution M-4708 (August 28, 1979) set forth requirements and criteria that must be satisfied before a CPCN is granted.

4.1. Public Utilities Code

The Public Utilities Code contains both substantive and procedural requirements for an entity to be considered a public utility and issued a CPCN. Section 2701 defines a Commission-regulated water utility as a person or entity that "sells, leases, rents, or delivers water to any person, firm, corporation, municipality, or any other political subdivisions of the State, whether under contract or otherwise, ..." Judicial decisions have also required that the entity dedicate or hold out its property to public use. (*Thayer* v. *California Development*, 164 Cal. 117 (1912).)

In this proceeding, Redwood Lodge indicated that it will continue to provide water service to its customers. Under the substantive law, Redwood Lodge will operate as a public utility.

The Public Utilities Code also includes several procedural requirements. A corporate applicant for public utility status must file a certified copy of its articles of incorporation or charter and evidence that the applicant has received any necessary consent of public agencies.[2] The code also requires that the Commission, in evaluating the application, consider the potential impact of

[2] Pub. Util. Code § 1004.

utility operations on community values, recreation and park areas, historical and aesthetic values, and the environment.[3]

Today's decision grants a CPCN to Patricia Heimer doing business as Redwood Lodge Water Company. When and if Heimer forms a corporation to own the water system, Heimer must submit a Tier 2 Advice Letter to obtain approval for the transfer of control. The Advice Letter must also comply with Standard Practice U-24-W.

In its application, Redwood Lodge provided copies of its Domestic Water Permit No. 16204 issued November 3, 1969. The Redwood Lodge Water Supply is registered at the Santa Cruz County Environmental Health Services with a state system identification number of 4400584. The State Water Resources Control Board, Division of Water Rights, has issued license number 10545, permit number 16204 for the Redwood Lodge water system.

As we are issuing a CPCN to the operator of an existing water system, there are no identified impacts to recreation and park areas or historical and aesthetic values. In addition, as we are imposing rate and quality-of-service regulation on a water provider, community values will be enhanced.

4.2. Rules of Practice and Procedure

Rule 3 sets forth content requirements that must be satisfied as part of an application for a CPCN and to authorize rates. The relevant requirements of Rule 3 include a full description and map of the system,[4] identification of potential competitors, financial information, ratesetting information, and facts

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[3] *Id.*, § 1002(a).

[4] *See* Ex. 5.

supporting the issuance of a CPCN. Perhaps the most important provision of Rule 3 is the requirement that the application demonstrate "[f]acts showing that public convenience and necessity require . . . the proposed construction or extension, and its operation." The application demonstrates that public utility regulation is necessary to safeguard existing Redwood Lodge customers who have no water supply alternatives, ensure reasonable and fair rates for both ratepayers and the Company, and monitor water services in a rural area remote from these services.

Rule 3 also requires more specific financial information including estimates of operating revenues and expenses. Redwood Lodge provided these estimates.

4.3. Resolution M-4708

Commission Resolution M-4708 sets forth six basic criteria that are used to evaluate the application of small water companies (Class D companies, i.e., those serving less than 500 customers). As pertinent to this application, the resolution specifies that the Commission will issue CPCNs only when the water company is able to remain financially viable and render adequate service, and no other existing viable water or sewer providers are available to serve the proposed area. Therefore we consider each of these criteria:

1. **Financial Viability -** Redwood Lodge's financial statements, and the staff report, show that Redwood Lodge will be able to meet its water system expenses with revenue from the water system customers. On the basis of these financial indicators, Redwood Lodge's water operations appear to be self sufficient and viable.
2. **Adequate Service -** Redwood Lodge has recently improved its water system to increase system reliability and has enhanced its customer service efforts. No new customers are forecasted for

the system. Redwood Lodge appears able to provide current adequate water service.

3. **Other Viable Water and Sewer Providers -** No other potentially viable water providers exist to serve the area.

In summary, Redwood Lodge meets the conditions contained in Resolution W-4708.

5. General Order (GO) 103-A

GO 103-A sets forth the Commission's rules governing water service and the minimum standards for design, construction, and operation. We address three issues that implicate GO 103-A requirements

5.1. Water Quality

GO 103-A requires that a public utility supplying water for human consumption (a) hold a permit as provided by the state's Health and Safety Code, and (b) comply with the laws and regulations of the state or local Department of Health Services.[5] The evidence indicates that Redwood Lodge has a valid domestic water supply permit issued by the Santa Cruz County Environmental Health Services. The evidence also indicates Redwood Lodge's water supply system provides adequate service to its 12 customers.

6. California Environmental Quality Act (CEQA)

CEQA (Pub. Resources Code Sections 21000 *et seq*.) applies to discretionary projects to be carried out or approved by public agencies. The Commission has previously held that the mere granting of a CPCN involving existing facilities is exempt from CEQA.[6]

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[5] GO 103 at Para. II(1)(a).

[6] Decision 05-11-030 at 18.

7. Rates

In its initial application, Redwood Lodge requested to establish new water rates. The Staff Report includes a detailed analysis of Redwood Lodge's revenue requirement and recommends final rates. The report recommends a revenue requirement of $24,130 which results in a rate of return of 12.57%. The recommended rates are reasonable and are adopted.

As described above, Redwood Lodge was authorized to implement interim rates on November 10, 2008, subject to refund. The staff report recommends final quantity rates that are 33.8%, 33.6%, and 33.7%, respectively, in each of the three tiers, less than the interim rates. Accordingly, Redwood Lodge must refund to its customers the difference between the amount collected and the final rates.

Redwood Lodge opposes this refund obligation. Redwood Lodge argues that it did not collect all authorized amounts and that all funds collected during the interim period were necessary for water system operation.

The interim rates were set subject to refund based on the final approved rates. As the representative of the Commission's Water and Audits Division explained at the hearing, interim rates are compared to final rates and any over-collections must be refunded.

Therefore, we will adopt the Staff Report recommendation and order Redwood Lodge to file a Tier 2 Advice Letter within 30 days from the effective date of the decision calculating rate refunds from the date the interim rates went into effect until the effective date of final rates. As of the close of record in this proceeding, Redwood Lodge had not completed its corporate structure and other documents. We note as well that the assigned Commissioner in her scoping memo listed 10 items that required further attention from Redwood Lodge. We

will require the Division of Water and Audits to review Redwood Lodge's compliance with these items and direct such further efforts by Redwood Lodge that may be necessary. We will require that Redwood Lodge consult with the Division of Water and Audits staff prior to filing its Advice Letter, and to include in its Advice Letter such additional documents as may be necessary.

8. Comments on Proposed Decision

The proposed decision of ALJ Bushey in this matter was mailed to the parties in accordance with Section 311 of the Public Utilities Code and comments were allowed under Rule 14.3 of the Commission's Rules of Practice and Procedure. Comments were filed by the applicant, and reply comments were filed on March 5, 2012 by customers Roeth, Harris, Call, Bates and Mlyniec. The applicant argued that the refund recommended in the Staff Report was not accurately described in the proposed decision. The customers supported the original text in the proposed decision. The proposed decision has been clarified to show that the refund will be accomplished by retaining the service charge of $100 per month, and reducing each of the three tiers of the quantity charge by approximately 33%.

9. Assignment of Proceeding

Catherine J.K. Sandoval is the assigned Commissioner and Maribeth A. Bushey is the assigned ALJ in this proceeding.

Findings of Fact

1. Redwood Lodge has provided water service since 1976.
2. Redwood Lodge's water system is supplied by two springs, with a 20,000 gallon storage tank that allows stored water to be gravity fed to 12 service connections to attain pressures of between 40 and 125 pounds per square inch gauge.

3. Redwood Lodge's water supply is adequate for its customers.

4. As we are imposing rate and quality-of-service regulation on a water provider, community values will be enhanced.

5. Redwood Lodge submitted sufficient formal documentation required by statute for the issuance of water CPCNs.

6. Redwood Lodge appears to be financially self-sufficient and viable, and estimated operating revenues exceed expenses and will provide a positive return on investment.

7. Redwood Lodge appears able to provide current adequate water service, and no other potentially viable water providers exist to serve the Redwood Lodge area.

8. Redwood Lodge has been issued domestic water supply permit number 16204.

Conclusions of Law

1. Redwood Lodge has satisfied all of the applicable requirements to be issued a CPCN.

2. Once granted a CPCN, Redwood Lodge will be classified as a Class D water utility.

3. Redwood Lodge has satisfied the applicable requirements of Commission Resolution M-4708.

4. Public utility regulation of Redwood Lodge is necessary and convenient to safeguard existing and future water customers who have no water service alternatives.

5. Redwood Lodge should be awarded a CPCN authorizing it to operate as a public water utility within the state of California with all the rights and obligations thereof.

6. In being awarded a water CPCN, Redwood Lodge assumes the obligation to serve as set forth in the Public Utilities Code (including, but not limited to, Sections 451 and 453).

7. The final rates and requirement for a partial refund of interim rates, as well as the quantity amounts, set forth in the Staff Report are reasonable and should be adopted.

8. The Division of Water and Audits should continue to monitor and review Redwood Lodge's compliance with all applicable public utility laws and regulations.

9. Redwood Lodge should be required to file a Tier 2 Advice Letter within 30 days from the effective date of this decision calculating rate refunds from the date the interim rates went into effect until the effective date of final rates. The Advice Letter should also include completed ownership documents, and any other requirements deemed necessary by the Commission's Division of Water and Audits.

O R D E R

IT IS ORDERED that:

1. Patricia Heimer doing business as the Redwood Lodge Water Company is granted a Certificate of Public Convenience and Necessity for operation of a water utility within the service area in Santa Cruz County near the City of Los Gatos, as described in the application, and shall fulfill its obligation to serve, as set forth in the Public Utilities Code and prior decisions and orders of the Commission.

2. Patricia Heimer doing business as the Redwood Lodge Water Company is authorized to file a Tier 1 Advice Letter, and to make effective on five days'

notice, the tariff schedule shown in the Staff Report, Attachment A to today's decision.

3. Patricia Heimer doing business as the Redwood Lodge Water Company must file a Tier 2 Advice Letter within 30 days from the date of this decision calculating rate refunds from the date the interim rates went into effect until the effective date of final rates.

4. Patricia Heimer doing business as the Redwood Lodge Water Company shall confer as necessary with the Commission's Division of Water and Audits, and comply with all applicable requirements for a Class D Water Company.

5. Application 09-09-005 is closed.

This order is effective today.

Dated _____, at San Francisco, California.

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 Engineer, 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

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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 12.57% 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 to arrive at $2,393. 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, $2,500 in 2009, $2,740 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 $3,000 for this account; the rate payers estimate $1,680, 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)[7], 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 Massettti who is currently helping her with the CPCN process will be leaving once that proceeding is closed.

[7] Please refer to our Standard Practice U-27-W

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, $1,385 in 2009, $1,486 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 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 $1,196.

The Branch recommends a total of $1,196 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	$ 0
Total Rate Base for Test Year 2011:	**$ 52,373**

Cost of Capital

RLWC is a Class D water utility (less then 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 12.57%.

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.

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			
	Utility Estimated		Ratepayers	Branch Estimated			
	Current Interim	Requested	Requested	Current Interim	Requested	Recommended	Recommended
Item	Rates	Rates	Rates	Rates	Rates	Rates (ROR)	Rates (ROM)
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	$2,393	$2,393	$2,393	$2,393
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	$1,196	$1,196	$1,196	$1,196
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	$15,435	$15,435	$15,435	$15,435
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	$17,548	$17,548	$17,549	$17,549
Net Revenue	$5,466	$4,740	$7,995	$12,902	$8,852	$6,581	$4,174
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%	24.63%	16.90%	12.57%	7.97%
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 Per Month	
For 5/8 x ¾-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 Rates	Recommended Rates	Percent Increase
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 100 cu. ft.	Present Rates	Recommended Rates	Amount Increase	Percent Increase
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	
Public fire service	0	
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