

WATER/RSK/FLC/JB5/SRW/jlj

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

DIVISION OF WATER AND AUDITS  
Water and Sewer Advisory Branch

RESOLUTION NO. W-4789  
September 24, 2009

**R E S O L U T I O N**

**(RES. W-4789), IDYLWILD WATER SYSTEM (Idylwild).  
ORDER AUTHORIZING RATES FOR A GENERAL RATE  
INCREASE OF ADDITIONAL ANNUAL REVENUES OF  
\$16,497 OR 45.79% IN TEST YEAR 2009 AND TO  
ESTABLISH A PURCHASED WATER BALANCING  
ACCOUNT.**

---

**SUMMARY**

By Draft Advice Letter filed on October 11, 2006, Idylwild requested a rate increase to cover increased expenses and plant costs for a filtration system. By a letter dated November 22, 2006, from Mr. Herb Chow, Senior Public Utility Financial Examiner, to Idylwild stated that it would be more appropriate to cover all relevant plant costs and operating expenses in one examination. No further action was taken by Idylwild. Under the Commission's outreach program, the Division of Water and Audits (DWA) had a staff engineer contact Idylwild and obtain the information necessary to process a general rate increase. This resolution grants Idylwild rates for a general rate increase of additional annual revenues of \$16,497 or 45.79% for test year 2009. This would result in a rate of return of 13.07%. Idylwild's present rates became effective January 19, 1993. This resolution also authorizes Idylwild to establish a balancing account to track purchased water expense.

**BACKGROUND**

By Draft Advice Letter, filed on October 11, 2006, Idylwild, a Class D water utility, requested authority under Rule 7.6.2. and Water Industry Rule 7.3.3.(5) of General Order 96-B and Section 454 of the Public Utilities Code to increase rates for water service and plant additions to be completed. Idylwild's present rates became effective on January 19, 1993, pursuant to Commission Res. W-3739 dated January 8, 1993.

Idylwild serves 44 metered customers in an unincorporated area known as Idylwild, located three miles south of Los Gatos, along the eastern side of State Highway 17, in Santa Clara County. E. Bruce Franks is the owner of the water company. Dan Gehret, an employee of Idylwild, has the water treatment and distribution licenses required to

run the water system. Idylwild is a gravity water system that consists of three steel storage tanks with a storage capacity of 100,000 gallons and a distribution system of six and two-inch plastic pipe. Idylwild obtains its water from an intake formed by a natural rock barrier in Moody Creek at Moody Gulch. From this intake, the water is piped through a strainer to a 20,000-gallon storage tank from which, after chlorination, water flows by gravity to the two 40,000-gallon storage tanks and then to the customers.

### **NOTICE, PROTESTS, AND PUBLIC MEETINGS**

A notice of a \$21,871 or 60.7% increase, based on preliminary and undocumented plant-in-service estimates, was mailed to customers on or about June 26, 2009.

Notice of the public meeting was mailed to customers more than 20 days prior to the meeting date. The meeting was scheduled on a Tuesday evening, July 21, 2009, at 6:30 p.m. at the Loma Prieta Community Center Conference Room, 23800 Summit Road, Los Gatos, California to ensure maximum public participation.

A public meeting was attended by eight residents. Staff explained the rate increase request before the Commission and provided every attendee a copy of a draft resolution. One attendee suggested more than a one-tier commodity rate to conserve water. No attendees protested the rate increase. In response, the staff has recommended a two-tier commodity rate design. The staff has not received any protests to the rate increase. Staff and Idylwild representatives responded to various questions from the attendees.

### **DISCUSSION**

The staff made an independent analysis of Idylwild's operations. Appendix A shows the staff's estimates of the Summary of Earnings at present, proposed and DWA recommended rates for test year 2009. Idylwild is in agreement with the Division's recommended revenue requirement and the rates are shown in Appendices A and C. Income tax calculations are shown in Appendix B.

Staff reviewed operating revenues and expenses including employee labor, materials, water testing, transportation expenses, other plant maintenance, contract work, employee salaries, office services and rentals, office supplies and expenses, professional services, insurance, general expenses, depreciation and taxes other than income. The number of Idylwild's customers has remained constant from 2007 to date. Staff used the revenues recorded for 2007, 2008, and seven months of 2009 and verified the operating expenses by reviewing the recorded 2007 and nine months 2008 recorded data and included the amounts that were deemed reasonable and prudent. Idylwild's plant-in-service data is not sufficiently documented. Staff had to rely on verbal

information provided by the owner of Idylwild to calculate the plant-in-service figures. Staff used land value of \$3,061, \$85,000 for the costs of three storage tanks and distribution mains at the beginning of 1990, \$25,000 for a building and plant replacement during 2001, and \$25,000 for water intake renovations and a chlorination system during 2004. Staff then calculated the test year 2009 rate base using plant-in-service, accumulated depreciation, estimated materials and supplies, and working cash allowance based on one-twelfth of total operating expenses. The owner of Idylwild should assist DWA's auditors to document and confirm Idylwild's plant-in-service figures for use in its annual reports and future proceedings.

Two methods are available to DWA for determining a reasonable profit to utilize in the rate-making process: (1) rate of return, and (2) rate of margin. In the rate of margin method, the utility's net revenue requirement is defined as the sum of its operating expenses, depreciation, and taxes other than income taxes, multiplied by the rate of margin. In Res.W-4524 (March 17, 2005), the Commission adopted a revised set of standard practices for determining the profit for Class C and Class D water utilities using the rate of return and rate of margin methods. DWA must recommend the method that produces the higher revenues pursuant to Commission D.92-03-093, effective April 30, 1992. The Utility Audit, Finance, & Compliance Branch (UAFCB) recommends either a rate of return from 12.75% to 13.75 for a Class D, 100% equity financed utility, or a rate of margin of 24% for Class D water utilities. DWA's recommended 13.07% rate of return provides net revenues of \$13,047. The 13.07% is in the lower range of acceptable returns for a Class D utility and was chosen to mitigate Idylwild's relatively high tariff rates. A 24% rate of margin provides net revenues of \$8,565. The DWA recommends the rate of return method as providing a higher revenue requirement to Idylwild.

Idylwild's rate structure consists of one schedule: Residential Metered Service. At the recommended 13.07% rate of return, the increase in revenues will be \$16,497 or 45.79% for test year 2009.

A typical customer bill for 4,000 and 10,000 gallons of water per month would be \$61.33 and \$67.12, respectively, at present rates, and \$83.92 and \$101.92, respectively, at proposed rates for a monthly increase of \$16.80 or 25.03% and \$34.80 or 51.85%. The DWA recommended rates are set forth in Appendix C. The income tax calculations are shown in Appendix B.

Staff recommends that Idylwild be authorized to establish a balancing account to track purchased water expense. Idylwild's water supply is surface flow water from Moody Creek at Moody Gulch. During the summer months Idylwild has been required to purchase water to meet water demand. Idylwild has always had a monthly service charge and a one-tier quantity rate. Staff is recommending a monthly service charge

and a two-tier rate structure that has a first tier quantity rate of \$0.80 and a second tier rate of \$1.60. A two-tier quantity rate design is intended to reduce the amount of purchased water. Because there is no history how a two-tier quantity rate design will affect revenues, staff is recommending the establishment of a purchased water balancing account to track actual water purchase expense compared to authorized amount. Idylwild should file a Tier 1 advice letter to establish a balancing account. When the balancing account has a debit or credit balance more than two percent of authorized revenues, Idylwild shall file a Tier 1 advice letter with a surcharge or surcredit to amortize the balance subject to the amortization not causing Idylwild's recorded rate of return to exceed the authorized rate of return adopted in this resolution or in subsequent resolutions for Idylwild. The amortization should follow the requirements outlined in DWA's Standard Practice U-27-W.

### **COMPLIANCE**

Idylwild's 2008 annual report is incomplete. No data for revenues and plant-in-service are provided. Idylwild had been filing annual reports that included data for revenues, expenses, and number of customers. Idylwild needs to update the following in its tariffs: Rules 3, Application for Service; 5, Special Information Required on Forms; 7, Deposits; 8, Notices; 10, Disputed Bills; 11, Discontinuance and Restoration of Service; 15, Main Extensions; 16, Service Connections, Meters, and Customer's Facilities; 20, Water Conservation; and 21, Fire Protection. Idylwild should delete Rule 14.1, Water Conservation Plan. Idylwild needs to update Schedule UF, Surcharge to Fund Public Utilities Commission User Fee.

### **COMMENTS**

Public Utilities Code (PU Code) §311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. PU Code §311(g) (2) provides that this 30-day period may be waived or reduced upon stipulation of all parties in the proceeding. Idylwild is the only party in this proceeding. The 30-day comment period for the draft resolution was waived by Idylwild, the only party.

### **FINDINGS AND CONCLUSIONS**

1. The Division of Water and Audits based operating revenue on current customers and water usage for recorded 2007, 2008, and seven months of 2009.
2. The Division of Water and Audits estimated expenses based on a review of the recorded data for 2007 and nine months of 2008 and included those amounts deemed reasonable.

3. The Division of Water and Audits calculated the test year 2009 rate base using plant-in-service, accumulated depreciation, estimated materials and supplies, and working cash allowance based on one-twelfth of total operating expenses.
4. The Division of Water and Audits used a 13.07% rate of return for test year 2009 that is within the guidelines from the Division of Water and Audits' Utility Audit, Finance and Compliance Branch and at the same time mitigates Idylwild Water System's relatively high rates.
5. The Division of Water and Audits' recommended Summary of Earnings (Appendix A) is reasonable and should be adopted.
6. The rates recommended by the Division of Water and Audits (Appendix C) are reasonable and should be adopted.
7. The Division of Water and Audits based plant-in-service on verbal information provided by the owner of Idylwild Water System.
8. Idylwild Water system's figures for plant-in-service are not sufficiently documented.
9. The owner of Idylwild Water System should assist the Division of Water and Audits' auditors to document and confirm the plant-in-service figures.
10. The Division of Water and Audits is recommending a two-tier rate structure for water sold for the first time.
11. A two-tier rate design is intended to reduce Idylwild's purchases of water.
12. A balancing account to track actual purchased water expense compared to authorized amount should protect customers from paying too much for water and Idylwild Water System from not earning its authorized rate of return.
13. The Division of Water and Audits recommends the establishment of a purchased water balancing account.
14. The rate increase authorized herein is justified and the resulting rates are just and reasonable.
15. Idylwild Water System should be authorized to file for rates that may increase annual revenues by \$16,497 or 45.79%. This results in test year 2009 revenues of \$52,527.
16. Idylwild Water System should be required to update the following in its tariffs: Rules 3, Application for Service; 5, Special Information Required on Forms; 7, Deposits; 8, Notices; 10, Disputed Bills; 11, Discontinuance and Restoration of Service; 15, Main Extensions; 16, Service Connections, Meters, and Customer's Facilities; 20, Water Conservation; and 21, Fire Protection. Idylwild Water System should delete Rule 14.1, Water Conservation Plan.



Resolution W-4789  
Idylwild/DRAFT AL/RSK/FLC/JB5/SRW/jj

September 24, 2009

RACHELLE B. CHONG  
TIMOTHY ALAN SIMON  
Commissioners

**Appendix A  
 Idylwild Water Company  
 Summary of Earnings  
 Test Year 2009**

	<b>Staff Estimated</b>		<b>DWA</b>
	<b>Present</b>	<b>Proposed</b>	<b>Recommended</b>
	<b>Rates</b>	<b>Rates</b>	<b>Rates</b>
<b><u>Operating Revenues</u></b>			
Metered water revenue	\$ 36,030	\$ 52,527	\$ 52,527
<b>Total Revenue</b>	<b>36,030</b>	<b>52,527</b>	<b>52,527</b>
<b><u>Operating Expenses</u></b>			
Purchased Power	3,000	3,000	3,000
Other Volume Related Expenses	1,100	1,100	1,100
Materials	1,000	1,000	1,000
Contract Work	10,000	10,000	10,000
Water Testing	2,700	2,700	2,700
Contract Labor	3,000	3,000	3,000
Transportation Expense	500	500	500
Other Plant Maintenance	1,500	1,500	1,500
Office Services and Rentals	2,400	2,400	2,400
Office Supplies and Expenses	1,900	1,900	1,900
Professional Services	500	500	500
Insurance	4,200	4,200	4,200
Regulatory Expense	200	200	200
General Expense	500	500	500
Subtotal	32,500	32,500	32,500
Depreciation Expense	2,387	2,387	2,387
Taxes Other Than Inc. Taxes	800	800	800
State Income Tax	800	1,489	1,489
Federal Income Tax	(69)	2,303	2,303
Total Deductions	36,418	39,478	39,478
<b>Net Revenue</b>	<b>(388)</b>	<b>13,049</b>	<b>13,049</b>
<b><u>Rate Base</u></b>			
Plant	138,061	138,061	138,061
Depreciation Reserve	41,915	41,915	41,915
Net Plant	96,146	96,146	96,146
Plus: Working Cash Allowance	2708	2708	2708
Plus: Materials and Supplies	1000	1000	1000
Rate Base	99,854	99,854	99,854
Rate of Return	-0.4%	13.07%	13.07%
Return of Margin		\$8,565	

**Appendix B**

**Income Tax Calculations**

	Present Rates	Proposed Rates
Gross Revenues	\$ 36,030	\$52,527
Total Income Tax Deductions	35,687	35,687
State Taxable Income	343	\$16,840
State Income Tax Rate	0.0884	0.0884
State Income Tax	800	1,489
Federal Taxable Income	(457)	15,351
50,000	0.15	7,500
25000	0.25	6,250
25000	0.34	8,500
	0.39	
Federal Income Tax	(69)	2,303
Income Taxes	731	3,791
Total Deductions		
Net Income	(388)	13,049

