

WATER/SNR/TAC/LTR:jrb

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

WATER DIVISION

RESOLUTION No. W-4363

November 21, 2002

R E S O L U T I O N

(RES. W-4363), WATERTEK, INC., INDIAN SPRINGS DISTRICT (ISD). ORDER AUTHORIZING A GENERAL RATE INCREASE PRODUCING ADDITIONAL ANNUAL REVENUE OF \$34,930 OR 50.1% IN 2002.

SUMMARY

This resolution grants a general rate increase in gross annual revenues of \$34,930 or 50.1% for Test Year 2002. This increase will provide a 20% margin over expenses in the test year.

BACKGROUND

ISD requested authority under Section VI of General Order 96-A and Section 454 of the Public Utilities Code to increase rates for sewer service to produce additional revenues of \$58,113 or 83.38% in 2001. ISD's request shows 2002 gross revenue of \$69,695 at present rates increasing to \$129,854 at proposed rates to yield a 20% rate of margin.

ISD currently serves 176 sewer customers located near Salinas, Monterey County. The current rates were established on November 19, 2001, pursuant to Resolution W-4298, which authorized an interim rate increase (subject to refund). Ownership of ISD was transferred to Watertek by Decision (D.) 97-10-013 (effective 10/09/97), which also established rates and approved the purchase price of \$1,000.

DISCUSSION

Watertek was founded in 1969 and is currently classified as a sewer utility regulated by the CPUC. Watertek has been owned and operated since 1986

(authorized by Decision 86-12-051) by Raymond L. Smith (CEO) and Esther F. Smith (CFO). Watertek's principal place of business is in Salinas, Monterey County. Mr. Smith is a State certified Grade III Wastewater Operator, Grade II Water Operator, Grade II Distribution Operator, and a general contractor.

Watertek provides water and sewer services to six CPUC-regulated entities (districts) and contracts for services to one additional water and sewer entity. The six CPUC-regulated districts are: East Plano (Porterville area water system), Grandview Gardens (Porterville area water system), Indian Springs (Salinas area sewer system), Metropolitan (Fresno area water system), Oak Hills (Salinas area sewer system), and Spreckles (Salinas area sewer system). The non-regulated sewer entity is San Lucas (Salinas area water and sewer system).

The six CPUC-regulated entities, while distinct, do have the benefit of some shared expenses (e.g. transportation, salaries, insurance, etc.). This allows the customers of each company to pay a smaller percentage of some of the expenses than had each one of the companies been separate. Shared expenses are allocated to each district based upon the number of customers. This resolution deals specifically with ISD's rate increase request. Grandview Gardens' and Oak Hills' requests are dealt with in separate resolutions.

On June 27, 2001 Watertek, Inc. (Watertek) filed a general rate increase request for its Indian Springs District. The staff (Staff) of the Water Branch (Branch) reviewed and accepted the filing in late July. The Branch made an independent analysis of ISD's summary of earnings and issued its report on August 5, 2002. Audit Branch also performed an audit of company's numbers and determined that aside from some minor adjustments, Watertek's books are kept according to generally accepted accounting standards. Appendix A shows ISD's and the Branch's estimates of the summary of earnings at present, requested, and recommended rates. Appendix A also shows differences between ISD's and the Branch's estimates in operating revenues, expenses and rate base.

The ISD filing erroneously estimated many of the expense categories basing expenses on actual year 2000 instead of the more current 2001 expenses. This resulted in many of the differences between ISD's and Branch's estimates. For example, ISD based its power cost estimate for 2002 on its year 2000 power expense. Staff based its estimate on actual energy usage for a 12-month period (2001 calendar year) and Pacific Gas & Electric Company's (PG&E's) current tariff surcharges.

The other large differences are in labor, contract work, transportation, other plant maintenance, office services and rentals and general expenses. Staff studied Watertek's operation to determine reasonable and necessary amounts of employee labor, office salaries and management salaries in order to efficiently and safely run the company. Staff reduced the amount of transportation expense because of reduced travel need due to the hiring of a plant operator in the Porterville/Fresno Area. Staff also found that Watertek does not maintain a vehicle log that clearly identifies charges relating to each of its districts.

Staff reviewed expenses booked to contract work account and determined that ISD inadvertently booked an employee salary to contract work. Staff redirected the salary to employee labor. Staff reviewed expenses booked to other plant maintenance account over the last three years, adjusted non-recurring/unusual expenses, and redirected charges to other accounts. Staff chose to average the last two years rather than three years because the recorded 1999 account balance was significantly different than 2000 and 2001.

Staff reviewed expenses booked to office services and rentals account over the last three years and has found that this account includes charges for a warehouse rental (Quality Corner) as well as an additional smaller storage unit (U Stor Self Storage). Staff redirected charges of warehouse rent to general expenses. Staff also believes that there is sufficient room in the warehouse to house any additional material that is being housed in the smaller storage unit and therefore has disallowed the charges for the smaller storage unit.

ISD was informed of the Branch's differing views of revenues, expenses and rate base and it agrees with the Branch's findings.

The filing also included an additional request for recovery in the amount of \$4,081. The recovery was requested in the form of a one-time surcharge of \$23.19 per customer. This recovery was for a personal loan provided by Mr. Smith to ISD for incurred expenses. Such action would result in retroactive ratemaking.

In D.92-03-093, effective April 30, 1992, the CPUC adopted the operating ratio method of ratemaking as an alternative to the rate of return method for Class C and Class D utilities. Thus, two methods are available for Staff to utilize in the ratemaking process: Return on Rate Base (net investment) and Operating Ratio. Staff first calculates the revenue requirement utilizing the rate of return method

and then calculates the revenue requirement utilizing the operating ratio method. Policy dictates that Staff will recommend the method that produces the higher revenues.

In the operating ratio method, the utility's revenue requirement is defined as the sum of its operating and maintenance expenses, depreciation expenses, income and other taxes, and an operating margin. Staff determined that a 20% rate of margin is reasonable for ISD.

Comparison of the revenue requirement indicates that the operating ratio method produces a higher revenue requirement than the return on rate base method. In keeping with policy, Staff recommends the operating ratio method for determining the revenue requirement.

ISD did not estimate average plant-in-service because it chose to determine revenue requirement based on the operating ratio method to yield a 20% margin over expenses. In a later filing ISD stated that prior to acquisition, the amount booked to plant in service was \$862,470 and the amount booked to accumulated depreciation was \$583,145. Decision (D.) 97-10-013, which granted authority for Watertek, Inc. to buy ISD, stated that "the original cost of the property being transferred is not known, but the replacement cost has been estimated at \$662,165." In the application, the purchase price of ISD was \$1,000. Staff did not make an evaluation of the plant at acquisition because it was not necessary for ratemaking purposes. Staff's estimate for average plant-in-service is \$11,805 for Test Year 2002 and depreciation expense is calculated based on the average plant-in-service amount.

There are no outstanding Commission orders requiring system improvements. Watertek has been filing annual reports as required. However, Staff notes that annual reports for Watertek's individual districts are not being filed with complete information. Information on several schedules is missing, with the reader being referred to Watertek's consolidated annual report. This has posed a significant problem for Staff in determining plant-in-service and accumulated depreciation reserve for ratemaking purposes. Staff notes that Watertek should file complete annual reports for each district if each district is to be treated as a separate entity for ratemaking purposes.

Staff has reviewed Watertek's tariff sheets and has determined that the entire tariffs need to be corrected to reflect all governing rules, forms, and schedules.

Staff notes that Watertek should have separate tariffs for its water and sewer systems. Included in the water systems tariffs should be East Plano, Grandview Garden, and Metropolitan; included in the sewer tariff book should be Indian Springs, Oak Hills, and Spreckles.

Staff has also reviewed copies of ISD's bills and has determined that they do not conform with the format requirements of Tariff Section B Rule No. 5. In addition, the bills do not separately identify the monthly service charge and the PUC reimbursement fee.

ISD's current rate structure consists of one schedule: Schedule No. 2, Flat-Rate Service. Schedule No. 2 consists of a single-block rate structure, with billings occurring monthly.

Schedule No. 2 rates were designed by simply dividing the 2002 Test Year revenue by the number of customers. The new rate schedule can be found in Appendix B. A bill comparison can be found in Appendix C.

At the Branch's recommended rates shown in Appendix B, the bill for a typical residential customer would increase from \$33.00 to \$49.54 per month. A comparison of customer bills at present and recommended rates is shown in Appendix C. The adopted quantities and tax calculations are shown in Appendix D.

NOTICE AND PUBLIC MEETING

Customer notices of the proposed rate increase were mailed to each customer on August 16, October 5, and December 15, 2001. One protest was received by the Staff and is discussed below. From February 4, 2001 to February 4, 2002, the Consumer Affairs Branch of the Public Affairs Division received no complaints regarding ISD.

On January 17, 2002, Staff held an informal public meeting near ISD's service area with six customers attending. Mrs. Tatiana Cherkas, Senior Utilities Engineer, explained the Commission rate setting procedures. The balance of the meeting consisted of comments, questions, and discussion among the participants.

At the public meeting, Staff was presented a rather lengthy protest document by Mr. Dave Korpi. The document was created on behalf of the Indian Springs Ranch Property Owners Association (ISRPOA) and concluded that a rate increase of 40% (\$33.00 to \$46.00 per month) was a reasonable increase. Included in the document was a brief examination of increase scenarios, selected correspondence from Watertek to Indian Springs Mutual Water Company (ISMWC, as known prior to Watertek's ownership), correspondence between ISMWC Board and members regarding ownership transfer recommendations, copy of ISD's rate case request, and copies of the customer notices for ISD's rate increase.

Of particular note is the projection by ISMWC of rates from 1997 to 2021 and the assumptions that were utilized for the projections. Correspondence from ISMWC's Board to its members indicate that yearly inflationary increases (from 2 to 4%) and a general rate increase in 2002 were to be expected under Watertek ownership. As a result, ISMWC projected sewer rates to be \$38.26 in 2002. In reality, Watertek has not filed for the inflationary increases but has filed for the general rate increase.

Staff had numerous conversations with Mr. Korpi explaining the process of a general rate case and the audit procedures used by staff to determine the proposed numbers. (Mr. Korpi's proposed rate was \$46 while staff proposed \$49.54.) At the completion of the investigation, Staff sent Mr. Korpi the "Staff Report." In addition, Staff spoke with Mr. Korpi on November 1, 2002, and it appears that he was satisfied with Staff's recommendations.

Also included in this document was Watertek's 10-year business plan. In part, it was stated as being:

to acquire ownership of a sufficient number of viable systems, and contract operation of other carefully selected systems in order to become efficiently attractive that a major financial broker will package an initial public offering that will eventually be followed by acquisition of Watertek by a much larger utility.

Watertek has continued to expand its operations to include several new systems since 1996. Mr. Smith is responsible for seven systems in various areas of California, which could possibly place existing customers in danger due to Mr.

Smith's inability to operate that many systems efficiently. Staff recommends that Mr. Smith be directed to address the impact on existing systems in any filing to add additional systems to Watertek.

Because ISD is a small system with little ability to weather shortfalls in revenue, this resolution should be effective immediately.

FINDINGS

1. The Staff's recommended Summary of Earnings (Appendix A) is reasonable and should be adopted.
2. The rates recommended by the Staff (Appendix B) are reasonable and should be adopted.
3. The quantities (Appendix C) used to develop the Staff's recommendations are reasonable and should be adopted.
4. The rate increase proposed by the Staff is justified. The resulting rates are just and reasonable.
5. Loans to cover operating expenses are not recoverable because such action would constitute retroactive ratemaking.
6. Watertek does not maintain a vehicle log that clearly identifies charges for all utility-related transportation expenses for each of its districts.
7. Watertek does not file complete annual reports for each of its districts that would allow Staff to easily identify district-specific accounts.
8. Watertek's tariff book is not up-to-date and is incomplete.
9. Watertek's bills are not in compliance with Rule No. 5.
10. Watertek expanded its operations to include several new systems since 1996. Mr. Smith should address the impact on existing systems in any filing to add additional systems to Watertek.

THEREFORE IT IS ORDERED THAT:

1. Authority is granted under Public Utilities Code Section 454 to Watertek, Inc., Indian Springs District, to file an advice letter incorporating the summary of earnings and the revised rate schedule attached to this resolution as Appendices A and B respectively, and concurrently cancel its presently

effective rate Schedule No. 2, Flat-Rate Service. The filing shall comply with General Order 96-A. The effective date of the revised schedule shall be five days after the date of filing.

2. Watertek is ordered within 90 days of the effective date of this resolution to maintain a detailed transportation log that will clearly identify utility-related expenses for each of its districts.
3. Watertek is ordered to file complete 2002 annual reports for each of its districts.
4. Watertek is ordered to update its tariffs within 90 days of the effective date of this resolution and file two separate sets of tariffs: one for the water systems and one for the sewer systems. The water systems tariffs shall include the East Plano, Grandview Garden, and Metropolitan districts. The sewer tariffs shall include the Indian Springs, Oak Hills, and Spreckles districts.
5. Watertek is ordered within 90 days of the effective date of this resolution to bring all bills into compliance with Rule No. 5.
6. Watertek is ordered to address the impact on existing systems in any filing to add additional systems.
7. This resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on November 21, 2002; the following Commissioners voting favorably thereon:

WESLEY M. FRANKLIN
Executive Director

LORETTA M. LYNCH
President

HENRY M. DUQUE

CARL W. WOOD

MICHAEL R. PEEVEY

Commissioners

Commissioner Geoffrey F. Brown, being necessarily

absent did not participate.

Appendix A
Watertek, Inc. – Indian Springs District
SOE - Test Year 2002

Description	ISD	ISD	Branch	Branch	Branch
	Present Rates	Requested Rates	Present Rates	Requested Rates	Recommended Rates
OPERATING REVENUES					
Flat Rate Sewer Revenues	69,696	129,854	69,695	129,865	104,625
TOTAL REVENUES					
OPERATING EXPENSES					
Purchased Power	5,807	5,807	7,630	7,630	7,630
Other Volume Related Exp.	6,908	6,908	6,510	6,510	6,510
Employee Labor	16,526	16,526	27,625	27,625	27,625
Materials	1,812	1,812	1,410	1,410	1,410
Contract Work – General Exp.	1,667	1,667	0	0	0
Contract Work – Water Testing	5,533	5,533	5,700	5,700	5,700
Transportation Expenses	4,492	4,492	1,910	1,910	1,910
Other Plant Maintenance Exp.	11,431	11,431	1,735	1,735	1,735
Office Salaries	13,153	13,153	6,425	6,425	6,425
Management Salaries	13,281	13,281	2,400	2,400	2,400
Employee Pensions and Benefits	1,992	1,992	1,020	1,020	1,020
Uncollectible Accounts Exp.	0	0	0	0	0
Office Services and Rentals	5,464	5,464	2,730	2,730	2,730
Office Supplies and Expenses	3,047	3,047	4,505	4,505	4,505
Professional Services	1,233	1,233	230	230	230
Insurance	2,176	2,176	3,410	3,410	3,410
Regulatory Commission Exp.	338	338	595	595	595
General Expenses	267	267	4,175	4,175	4,175
SUBTOTAL	95,129	95,129	78,010	78,010	78,010
Depreciation Expense	990	990	355	355	355
Taxes Other Than Income Taxes	5,654	5,654	3,330	3,330	3,330
Income Taxes	2,194	8,610	2,195	13,350	7,255
TOTAL DEDUCTIONS	103,967	110,383	83,890	95,045	88,950
NET REVENUE	<34,271>	19,471	<14,195>	34,820	15,675
RATE BASE					
Plant in Service prior to Acquisition	862,470	862,470			
Accumulated Depr. prior to Acquisit.	583,145	583,145			
Less: Plant Acquisition Adjustment	278,325	278,325			
Purchase Price	1,000	1,000	1,000	1,000	1,000
Plant-in-Service			10,805	10,805	10,805
Average Plant			11,805	11,805	11,805
Avg. Accumulated Depreciation.			1,275	1,275	1,275
NET PLANT			10,530	10,530	10,530
RATE BASE			10,530	10,530	10,530
RETURN OF MARGIN		20%			20%

Appendix B
Watertek, Inc. – Indian Springs District

Schedule No. 2
FLAT-RATE SERVICE

APPLICABILITY

Applicable to all flat-rate service.

TERRITORY

Subdivision of Indian Springs, in the vicinity of Salinas, Monterey County.

RATES

Per Service Connection
Per Month

For each residential customers and
small commercial service connection..... \$49.54 (I)

SPECIAL CONDITIONS

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

Appendix C

Watertek Inc. – Indian Springs District Comparison of Rates - Test Year 2002

	Per Service Connection Per Month		
	<u>Present</u> <u>Rates</u>	<u>Recommended</u> <u>Rates</u>	<u>Percent</u> <u>Increase</u>
For each residential and small commercial service connection	\$33.00	\$49.54	50.1%

Appendix D
(Page 1 of 2)
Watertek Inc. – Indian Springs District
Recommended Quantities - Test Year 2002

1. Federal Tax Rate: 15% for 1st \$50,000 of taxable income
25% for next \$25,000 of taxable income
34% for next \$25,000 of taxable income
39% for next \$235,000 of taxable income

2. State Tax Rate: 8.84%

3. Service Connections:

176 flat rate

4. Property Taxes: \$0

5. Payroll Taxes: \$3,330

6. Contract Work – Water Testing: \$5,700

7. Purchased Power

Pacific Gas & Electric, Schedule No. A-1
Small General Service
Effective March 4, 2002

Energy Charge:

kWh used - total: 42,795

kWh used - summer: 18,577

\$/kWh – summer: \$0.14870

kWh used - winter: 24,218

\$/kWh – winter: \$0.10193

Customer Charge:

\$/pump/mo.: \$12.00

Pacific Gas and Electric Company, Schedule No. E-EPS,
Energy Procurement Surcharges, Effective June 1, 2001

Quantity Charge:

All electric service customers: \$0.01000/kWh

Resolution W-4363
ISD/SNR/TAC/LTR:jrb

November 21, 2002

Schedule A-1 customers:
\$0.06140/kWh – summer
\$0.02838/kWh – winter

Appendix D
(Page 2 of 2)
Watertek Inc. – Indian Springs District
Recommended Quantities - Test Year 2002
(Continued)

8. Adopted Tax Calculations

Line No.	Item	State Tax	Federal Tax
1.	Operating Revenues	\$104,625	\$104,625
2.	Expenses	\$ 78,010	\$ 78,010
3.	Taxes Other Than Income Taxes	\$ 3,330	\$ 3,330
4.	Depreciation	\$ 355	\$ 355
5.	State Taxable Income	\$ 22,930	
6.	State Income Tax (@8.84% or \$800 minimum)	\$ 2,027	
7.	Federal Taxable Income		\$ 20,903
8.	Federal Income Tax (@15%)		\$ 3,135
9.	Monterey County Franchise Tax (@2% of revenues)	\$2,093	
10.	TOTAL INCOME TAX		\$7,255