

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

WATER DIVISION

RESOLUTION NO. W-4614

October 5, 2006

R E S O L U T I O N

**(RES. W-4614), RURAL WATER COMPANY, INC. (RURAL) -
CYPRESS RIDGE SEWER SYSTEM (CYPRESS RIDGE). ORDER
AUTHORIZING A GENERAL RATE INCREASE PRODUCING
ADDITIONAL ANNUAL REVENUE OF \$49,144 OR 25.8% IN 2006.**

SUMMARY

By Advice Letter (AL) No. 5, filed on August 24, 2005, seeks an increase in its annual rates for sewer service of \$89,030 to recover increased operating expenses and to provide a rate of margin (ROM) of 24.63%.¹

This resolution grants an increase in gross annual revenues of \$49,144, or 25.8%, for Test Year 2006. Cypress Ridge is not eligible for a rate of return (ROR) since it has no rate base. Cypress Ridge initially requested a 24.63% ROM and then revised its request to a 15% ROM. This resolution authorizes a 5% ROM.

This resolution also orders a general rate case (GRC) filing for Rural within 90 days of the issuance of this resolution. Cypress Ridge may file a request for a change of ROM, along with documentation supporting the request, concurrently with the Rural GRC.

BACKGROUND

Cypress Ridge has requested authority under Section VI of General Order 96-A and Section 454 of the Public Utilities Code to increase its annual sewer rates by \$89,030, or 46.7%, in Test Year 2006. The purpose of the annual rate increase was to recover increased operating expenses and to provide a ROM. Cypress Ridge's request shows

¹ Resolution (Res.) W-4524 is cited as the basis for requesting a ROM of 24.63%. However, Res. W-4524 was strictly applicable to Class C and D water utilities and not applicable to sewer utilities.

gross revenues of \$190,735 at present rates increasing to \$279,765 at proposed rates. Cypress Ridge is requesting a 24.63% ROM.

The present rates were established on September 7, 2006, pursuant to Res. W-4612, which authorized recovery of \$69,675 from Cypress Ridge's Unanticipated Expense Memorandum Account (UEMA) for the period of January 1 to June 30, 2005.

Cypress Ridge was granted a Certificate of Public Convenience and Necessity (CPCN), effective January 1, 2003, and rates were initially set by Commission Decision (D.) 02-06-005. In D. 02-06-005, the Commission recognized the uncertainty of operational expenses and allowed for re-evaluation of contract services (Finding of Fact No. 4), an allowance of a ROM (Findings of Fact No. 7), the establishment of an insurance expense memorandum account (Findings of Fact No. 12), and the adjustment of rates for additional commercial customers (Findings of Fact No. 20). Rates were set to allow Cypress Ridge a 15% ROM, thus recognizing the higher uncertainty of operational expenses and the lack of rate base.

Cypress Ridge is a Chapter S (Sole Proprietorship) California corporation with Mr. Charles Baker as CEO (and sole stockholder).

Cypress Ridge serves approximately 352 residential and 8 commercial flat rate sewer customers in its service area in San Luis Obispo County. Cypress Ridge's filing did not project any customer growth in 2006. The majority of customers are full-time residents and are either retired or working (executives and self-employed) individuals. Service territory is less than one square mile and the terrain is generally flat land.

Cypress Ridge's sewage treatment plant is a stand-alone batch reactor sewer system which requires a minimum Grade 3 Wastewater Treatment Plant Operator as its chief operator. Cypress Ridge does not have any employees or equipment, but rather contracts for all services. Mr. Baker oversees all contracts and day-to-day management.² Cypress Ridge is provided water by Rural, which Mr. Baker also owns. Because of the dual ownership, some expense items are shared.

² Mr. Baker does not possess any operator's licenses for either wastewater or water facilities.

NOTICE, PUBLIC MEETING, PROTESTS AND STAFF REPORT

A notice for the GRC was mailed to each customer on November 2, 2005. The Water Division (Division) received no letters regarding the GRC request.

From December 12, 2004, to December 12, 2005, the Consumer Affairs Branch of the Consumer Service and Information Division received no complaints regarding Cypress Ridge.

A field investigation was performed and an informal meeting, in the service area, was conducted on December 13, 2005. The meeting commenced at 2:10 p.m. and adjourned at 4:24 p.m., with approximately 28 individuals attending. The Division representative explained the Commission rate setting procedures as well as the purpose of the meeting. Cypress Ridge's representative provided justification for the request. In addition, Cypress Ridge Owners' Association (CROA) gave a slide presentation regarding their concerns over the operations and rate setting procedures. The balance of the meeting consisted of comments, questions, and discussion among the participants.

The Division issued its staff report on May 4, 2006. The report was mailed to all interested parties, including CROA. On June 2, CROA issued comments on the staff report. CROA questioned the number of customers for the Test Year and made a suggestion to the wording in minutes for the public meeting. On June 5, the Division replied to the comments and informed CROA that the draft resolution would be distributed for comments.

DISCUSSION

The Division made an independent analysis of Cypress Ridge's summary of earnings for the GRC request and issued its report on May 4, 2006. Appendix A shows Cypress Ridge's and the Division's estimates of the summary of earnings at present, requested, and recommended rates. Appendix A shows differences in Cypress Ridge's and the Division's estimates in operating revenues, expenses, rate base, and ROM.

There are minor differences in all expense categories. The Division's estimates were determined using actual billing and past recorded expenses. Cypress Ridge's estimates were oftentimes not supported. The differences are explained below.

For the Power account, the Division examined historical power consumption to determine the Test Year consumption. Current tariff rates for power were applied to the estimated consumption. Cypress Ridge did not provide supporting documentation for its estimate.

For the Contract Work account, the Division estimate included a contract with ECO Resources, Inc. and a groundwater monitoring expense. Cypress Ridge did not provide supporting documentation for its estimate.

For the Office Supplies and Expenses account, the Division allowed for office supplies and expenses that Cypress Ridge omitted to include in its request.

For the Professional Services account, the Division allowed certified public accounting services and disallowed the fees for memorandum accounting services.

For the Insurance account, the Division estimate was based upon current bills. Cypress Ridge did not provide supporting documentation for its estimate.

For the Regulatory Commission Expense account, the Division estimate was based upon current bills from the State Water Resources Control Board. Cypress Ridge did not provide supporting documentation for its estimate.

Division notes that several expense categories are split between Cypress Ridge and Rural. While the sharing of expenses is not an uncommon practice when both water and sewer services are provided, what is uncommon is for non-concurrent rate cases to be filed. Because a rate case has not been filed for Rural, no adjustments can be made to rates for Rural to reflect the current shared expenses.

Division also notes that the last GRC for Rural was conducted in 1992, nearly 14 years ago, when Rural had 237 active metered service connections. An examination of the 2005 annual report shows the number of active metered connections growing to 901, an increase of 280%. There has been no downward adjustment in rates due to customer growth. Rural has increased its recorded management salaries by 404% over that last authorized. Because a significant rate reduction may be warranted for Rural, Division is strongly recommending that Rural be ordered to file a GRC within 90 days of this resolution. We will so order.

Cypress Ridge was financed and constructed by a developer and was considered 100% contributed in D.02-06-005. As such, the original plant was excluded from rate base for ratemaking purposes. Division has examined the plant account since 2003 and found that Cypress Ridge has made no plant additions. Cypress Ridge's records show a total

of \$4,760,000 for plant accounts which should be considered contributed.³ Appendix E lists the individual plant account contributed items.

Rate base is calculated by taking the net plant, subtracting advances & contributions, and adding working cash, materials & supplies, and construction work in progress. Cypress Ridge has no rate base because all plant is contributed and there is no working cash⁴, no materials and supplies⁵, and no construction work in progress.⁶ Therefore, Cypress Ridge does not qualify to earn a return since it has no rate base on which to earn a return.

In cases where little or no rate base exists for water utilities, the Commission has authorized a ROM to be applied to determine the revenue requirement. However, this has not been authorized uniformly for sewer utilities.⁷ Rather, the ROM for sewer utilities has been determined on a case-by-case basis and has been dependent upon the risk profile of the sewer utility.⁸

³ D.02-06-005 did not note the amount for sewer plant in service. The \$4,760,000 amount is based upon Rural-CRSS' annual reports.

⁴ Sewer service is billed at a flat rate and paid in advance; therefore there is no working cash.

⁵ Cypress Ridge has no maintenance program for its sewer system and therefore does not require any materials and supplies. Any maintenance would be performed by a contractor using acquired materials.

⁶ Cypress Ridge has not added any plant nor does it project to add any plant in the near future.

⁷ Res. W-4524 allows all Class C and D water utilities to seek a ROM of 24.63%. There was no provision for the ROM to be applied to sewer utilities. The Commission also recognized this in Res. W-4510 when it stated: "There is no Commission order requiring the use of the operating ratio method for sewer utilities."

⁸ Examples include CA Hot Springs (Res. W-4008, 11/26/96) which was allowed a ROM for both water and sewer services of 20%, Big Basin (Res. W-4044, 06/11/97) which was allowed a ROM for sewer services of 10%, Rural Water Company (D.02-06-005, 06/06/02) which allowed a ROM for sewer services of 15% and Mayacama Golf Club, LLC (D.03-08-056, 08/21/03) which allowed a ROM for sewer services of 19%.

The Commission currently regulates 12 sewer utilities.⁹ At the time of a GRC investigation, the Division examines the risk profile of a utility and recommends an appropriate ROR or ROM. Normally the method (ROR or ROM) recommended for adoption is whichever method results in a higher revenue requirement. However, oftentimes a ROR is recommended rather than a ROM because of the risk profile of the utility does not warrant a ROM.¹⁰

Cypress Ridge claims that it is at risk and should be allowed a minimum of a 15% ROM, which is the same ROM allowed in D.02-06-005. Cypress Ridge has already been provided with several risk-mitigating means, thus reducing its risk from that originally deemed in D.02-06-005. In D.02-06-005, the Commission recognized that insurance premiums were likely to escalate beyond what was allowed in rates and ordered Cypress Ridge to establish a limited-time memorandum account for insurance expenses.¹¹ In addition, D.92-03-093 and Res. W-4467 allowed all water and sewer utilities to establish and seek recovery of unanticipated repair expenses.

Cypress Ridge has sought, and has been granted, recovery for its memorandum accounts. Cypress Ridge has already been authorized recovery of \$145,542 for expenses due to problems balancing flows in its treatment plant in 2004 and in the first half of 2005. Cypress Ridge continues to track these expenses and has indicated that filings will be forthcoming for additional expenses from July 1, 2005 until the approval of this resolution.

Cypress Ridge initially requested a 24.63% ROM and then revised its request to a 15% ROM, but did not provide any risk profile which would justify the application of such levels of ROM. The existence of the risk-mitigating memorandum accounts (UEMA and insurance), the lack of any need for investment, and the lack of a GRC for Rural gives support for a lower ROM.

⁹ Utility size varies from 18 to over 1,111 customers.

¹⁰ Examples include Interstate-5 Utility Company, Inc. (Res. W-4435, 10/30/03), which was allowed a ROR for sewer services of 12.5%, and Rolling Green Utilities, Inc. (Res. W-4448, 01/08/04), which was allowed a ROR for sewer services of 12.9%. Had the ROM method been authorized, the net revenues would have been substantially more than that authorized under the ROR method. Obviously, the risk profile of these utilities did not warrant the application of the ROM method.

¹¹ Ordering Paragraph No. 8 of D.02-06-005 allowed for the insurance expense memorandum account to remain in effect until December 31, 2005.

The Division is recommending a 5% ROM, which is more consistent with the risk level under the current GRC situation and takes into account the risk-mitigating mechanisms already in place.

By denying the ROM requests, the Division is not precluding Cypress Ridge from requesting a change in the ROM in future rate cases. Cypress Ridge may renew its request at the time the concurrent GRC is filed with Rural. The Division notes that any ROM determination for Cypress Ridge should be done concurrently with an evaluation of Rural and a risk profile should be clearly supported justifying the ROM level requested.

Cypress Ridge currently provides service under two rate schedules: Schedule No. 1, Residential Flat Rate Sewer Service, and Schedule No. 2, Commercial Flat Rate. The new rate schedules can be found in Appendix B.

At the Division's recommended rates shown in Appendix B, the monthly bill for a residential customer will increase from \$44.03 to \$55.37, or 25.8%. The monthly bills for the commercial customers are increasing by 26.1% and 26.4%. Bill comparisons are shown in Appendix D.

Cypress Ridge's Advice Letter No. 5 should be approved as modified.

COMPLIANCE

There are no outstanding Commission orders requiring system improvements. The utility has been filing annual reports as required. A review of Cypress Ridge's tariff sheets has determined that the entire tariff book needs to be updated to comply with the current sewer tariff book tariffs and rules.

COMMENTS

Public Utilities 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. Code §311(g)(2) provides that this 30-day period may be waived or reduced upon stipulation of all parties in the proceeding.

The 30-day comment period for the draft resolution was neither waived nor reduced. Accordingly, this draft resolution was mailed to parties for comments, and will be placed on the Commission's agenda no earlier than 30 days from the date of its mailing.

No comments were received.

FINDINGS

1. The summary of earning (Appendix A) developed by the Division is reasonable and should be adopted.
2. The rates proposed by the Division (Appendix B) are reasonable and should be adopted.
3. The quantities (Appendix C) used to develop the Division's recommendations are reasonable and should be adopted.
4. Advice Letter No. 5 should be approved as modified above.
5. Cypress Ridge needs to update all tariff sheets to reflect the current sewer tariff sheets.
6. Several expenses are allocated between Rural and Cypress Ridge. The rates recommended are for Cypress Ridge. Rates are not being adjusted for Rural at this time.
7. It has been 14 years since Rural's last general rate increase and Rural has experienced a 280% increase in active metered connections without any adjustment in rates.
8. Cypress Ridge initially requested a 24.63% rate of margin and then revised its request to a 15% rate of margin.
9. A rate of margin of 5% is reasonable and should be adopted.
10. Rural should be ordered to file a general rate case request within 90 days of the issuance of this resolution.
11. Cypress Ridge may renew its request for a rate of margin at the time the concurrent general rate case is filed with Rural. Any rate of margin determination for Cypress Ridge should be done concurrently with an evaluation of Rural and a risk profile should be clearly supported justifying the rate of margin level requested.

THEREFORE IT IS ORDERED THAT:

1. Authority is granted under Public Utilities Code Section 454 to Cypress Ridge to file a supplemental advice letter incorporating the summary of earnings and the revised rate schedules attached to this resolution as Appendices A and B, respectively, and

concurrently cancel its presently effective rate Schedule No. 1, Residential Flat Rate Sewer Service, and Schedule No. 2, Commercial Flat Rate Sewer Service. The revised rate schedules shall become effective five days from the date of filing.

2. Cypress Ridge is authorized to increase its annual revenues by \$49,144 or 25.8%, based on reasonable rates for 2006.
3. Cypress Ridge Advice Letter No. 5 is approved as modified.
4. Rural shall file a general rate case request within 90 days of the issuance of this resolution. Cypress Ridge may file a concurrent request for a rate of margin.
5. Cypress Ridge shall update all tariff sheets to reflect the current standard sewer tariff sheets.
6. 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 October 5, 2006; the following Commissioners voting favorably thereon:

/s/ STEVE LARSON

STEVE LARSON
Executive Director

MICHAEL R. PEEVEY
President

GEOFFREY F. BROWN

DIAN M. GRUENEICH

JOHN A. BOHN

RACHELLE B. CHONG

Commissioners

Appendix A
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Rural Water Company, Inc.
Cypress Ridge Sewer Service
Summary Of Earnings - Test Year 2006

Description	RWC-CRSS Present Rates	RWC-CRSS Requested Rates	Branch Present Rates	Branch Requested Rates	Branch Recommended Rates
OPERATING REVENUES					
Flat Rate Sewer Revenues	190,735	279,765	190,735	279,665	239,879
TOTAL REVENUES	190,735	279,765	190,735	279,665	239,879
OPERATING EXPENSES					
Purchased Water	0	0	0	0	0
Power	19,000	19,000	21,023	21,023	21,023
Other Volume Related Exp.	0	0	0	0	0
Employee Labor	0	0	0	0	0
Materials	0	0	0	0	0
Contract Work – General Exp.	174,700	174,700	174,013	174,013	174,013
Contract Work – Water Testing	0	0	0	0	0
Transportation Expenses	0	0	0	0	0
Other Plant Maintenance Exp.	0	0	0	0	0
Office Salaries	0	0	0	0	0
Management Salaries	0	0	0	0	0
Employee Pensions and Benefits	0	0	0	0	0
Uncollectible Accounts Exp.	0	0	0	0	0
Office Services and Rentals	0	0	1,800	1,800	1,800
Office Supplies and Exp.	3,600	3,600	3,600	3,600	3,600
Professional Services	5,495	5,495	2,400	2,400	2,400
Insurance	15,000	15,000	15,314	15,314	15,314
Regulatory Commission Exp.	6,700	6,700	6,235	6,235	6,235
General Expenses	0	0	0	0	0
SUBTOTAL	224,495	224,495	224,385	224,385	224,385
Depreciation Expense	0	0	0	0	0
Taxes Other Than Income Taxes	0	0	0	0	0
Income Taxes & Franchise Fee	0	0	800	12,485	3,488
TOTAL DEDUCTIONS	224,495	224,495	225,185	236,870	227,873
NET REVENUE	-33,760	55,270	-34,450	42,795	12,006
RATE BASE					
Average Plant In Service			4,760,000	4,760,000	4,760,000
Average Depreciation Reserve			0	0	0
NET PLANT			4,760,000	4,760,000	4,760,000
Less: Advances	0	0	0	0	0
Contributions (Undepr.)			4,760,000	4,760,000	4,760,000
Plus: Working Cash	0	0	0	0	0
Materials & Supplies	0	0	0	0	0
Const. Work In Progress	0	0	0	0	0
RATE BASE	n/a	n/a	0	0	0
RATE OF MARGIN	-15.04%	24.62%	-15.30%	18.07%	5.00%

**Appendix B
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Rural Water Company, Inc.
Cypress Ridge Sewer Service

**Schedule No. 1
RESIDENTIAL FLAT RATE SEWER SERVICE**

APPLICABILITY

Applicable to all residential sewer service.

TERRITORY

Cypress Ridge, within Tract # 1933, and including Golf Course Complex,
San Luis Obispo County.

RATES

	Per Connection	
	<u>Per Month</u>	
For all residential sewer service	\$55.37	(I)

SPECIAL CONDITIONS

1. All sewer service is subject to a monthly surcharge of \$6.47 for a period of 36 months beginning September 12, 2005.
2. All sewer service is subject to a monthly surcharge of \$5.37 for a period of 36 months beginning September 18, 2006, the effective date of Advice Letter No. 4A.
3. All bills are subject to the Reimbursement fee set forth in Schedule No. UF.

Appendix C
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Rural Water Company, Inc.
Cypress Ridge Sewer Service
Recommended Quantities - Test Year 2006

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:

Residential Flat Rate Sewer Service: 352
Commercial Flat Rate Sewer Service:
Golf Pro Shop: 3
Golf Maintenance Facility: 1
Commercial/Office Facility: 3
Pavilion: 1

4. Contract work:

ECO Resources, Inc. - \$171,500 per year
Groundwater monitoring - \$2,513 per year

5. Purchased Power:

Pacific Gas and Electric Company, Schedule No. A-1, Small General Service,
Effective January 1, 2006

Quantity Charge:

kWh used - total: 138,789
kWh used - summer: 66,849
\$/kWh - summer: \$0.17375
kWh used - winter: 71,940
\$/kWh - winter: \$0.12673

Service Charge:

Customer Charge:
\$/meter/day - single-phase: \$0.26612
\$/meter/day - polyphase: \$0.39425
No. of meters - single phase: 3 No. of meters - polyphase: 0

Appendix C
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Rural Water Company, Inc.
Cypress Ridge Sewer Service
Recommended Quantities - Test Year 2006

6. Recommended Rates – Adopted Tax Calculations

Line No.	Item	State Tax	Federal Tax
1.	Operating Revenues	\$239,879	\$239,879
2.	Expenses	\$224,385	\$224,385
3.	Taxes Other Than Income Taxes	\$ 0	\$ 0
4.	Depreciation	\$ 0	\$ 0
5.	Interest	\$ 0	\$ 0
6.	State Taxable Income	\$ 15,494	
7.	State Income Tax (@8.84% or \$800 minimum)	\$ 1,370	
8.	Federal Taxable Income		\$ 14,124
9.	Federal Income Tax (@15% & 25%)		\$ 2,119
10.	TOTAL INCOME TAX		\$ 3,488

Appendix D
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Rural Water Company, Inc.
Cypress Ridge Sewer Service
Comparison of Rates - Test Year 2006

A comparison of bills for each customer classification is shown below:

	<u>Customer Type</u>	<u>Present Rates</u>	<u>Recommended Rates</u>	<u>Percent Increase</u>
<u>Schedule No. 1:</u>	Residential	\$ 44.03	\$ 55.37	25.8%
<u>Schedule No. 2:</u>	Golf Pro Shop	\$ 29.50	\$ 37.30	26.4%
	Golf Maintenance Facility	\$ 71.55	\$ 90.19	26.1%
	Commercial/Office Facility	\$ 58.99	\$ 74.39	26.1%
	Pavilion	\$ 58.99	\$ 74.39	26.1%

Appendix E
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Rural Water Company, Inc.
Cypress Ridge Sewer Service
Contributed Sewer Plant-In-Service

<u>Account</u>	<u>Description</u>	<u>Beg. Of Year</u> <u>2006</u>
301	Intangible Plant	\$ 0
303	Land	\$ 0
304	Structures	\$ 0
307	Wells	\$ 0
317	Other Water Source Plant	\$ 0
311	Pumping Equipment	\$ 10,000
320	Treatment Plant	\$ 3,200,000
330	Reservoirs, tanks, & sandpipes	\$ 0
331	Mains	\$ 1,500,000
333	Services & Meter Installations	\$ 0
334	Meters	\$ 0
339	Other Equipment	\$ 40,000
340	Office Furniture & Equipment	\$ 10,000
341	Transportation Equipment	\$ 0
	Total	\$ 4,760,000