

CALIFORNIA PUBLIC UTILITIES COMMISSION
Water Division

RATE DESIGN FOR
CLASS B, C, AND D WATER AND SEWER SYSTEM UTILITIES
INCLUDING MASTER METERED FACILITES

Standard Practice U-7-W

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RATE DESIGN FOR
CLASS B, C, AND D WATER AND SEWER SYSTEM UTILITIES

A. PURPOSE AND SCOPE

1. The purpose of this standard practice is to provide guidelines and procedures for designing rates for Class B, C, and D water and sewer system utilities that are regulated by the California Public Utilities Commission (Commission). This guidance should be incorporated when designing rates as part of the General Rate Case (GRC) request process for small water and sewer utilities. The scope of this document covers various aspects of rate design including, but not limited to, topics of information needed, rate calculations, revenue recovery, utility taxes, and limits on rate increases.
2. This document will be revised and updated as necessary, and those updates will be available on the Commission's website.¹

B. INFORMATION NEEDED

1. After the revenue requirement has been determined (see Standard Practice U-3-SM), rates need to be designed to allow the utility the opportunity to collect the authorized revenues. In order to design water and sewer rates, Water Division (WD) staff needs the following information:
 - (a) Revenue requirement
 - (b) For metered rates, the amount of revenue requirement due to fixed costs (fixed costs are those that do not change with the amount of water delivered; fixed costs include net income)
 - (c) Number of customers for each connection size
 - (d) Expected annual water sales (water produced and purchased, less unaccounted for water)
 - (e) If rates are to be phased in, the amount of revenues proposed, and the percent increase, shall be listed for the first year of the

¹ Standard Practices are provided at <https://www.cpuc.ca.gov/about-cpuc/divisions/water-division/wd-standard-practices>.

requested GRC, and each subsequent year of the GRC for approval.²

C. CALCULATING FLAT RATES

1. The Commission has long supported metering of water service³ and state law requires that new water service have suitable water meters.⁴ Consequently, there should be no new flat rate customers.⁵ Normally, the flat rate charge will be equal to the average bill for a metered customer of the same connection size unless the utility knows approximately how much water its flat rate customers use⁶, in which case, the flat rates should reflect the expected use. Additionally, in 2004, the Legislature passed Assembly Bill (AB) 2572, requiring all water suppliers to install water meters on all customer connections by January 1, 2025. The law requires all metered services to be billed at a metered rate, so that water bills reflect water consumption.
2. Where more than one dwelling exists on the same property, the rate for the additional buildings should be the same as the rate for the first building unless the property has landscaping that requires watering with utility water. In that case the flat rate for any additional buildings should be set at the average bill minus one-half of the average amount paid by metered customers for the water itself (one half of the average use times the commodity charge). If there are no metered customers, staff should use one half of the flat rate bill as a proxy for outside use.

² Phased-in rates were established by Decision D.60648, August 30, 1960, Crestmore Village Water Company. Due to depressed economic conditions balanced with the utility's entitlement to earn a fair rate of return, this decision established, and allowed for, rates to be phased in over a period of more than one year. Res. W-5208, Owens Valley Water Company, dated December 19, 2019, provides a recent example of a 3-year phase-in of rates; One Test Year followed by two escalation years.

³ D.16-12-026, December 9, 2016, in R.11-11-008, on the Commission's Own Motion into Addressing the Commission's Water Action Plan Objective of Setting Rates that Balance Investment, Conservation, and Affordability for Class A and Class B Water Utilities.

⁴ Water Code, Section 525.

⁵ If the utility can show that all residences are vacation homes and used only a few days per year, the staff may continue to allow flat rate service.

⁶ This requires at least some metered customers, so metered usage can be compared to flat rate usage.

D. CALCULATING METERED RATES

1. An Order Instituting Investigation (OII)⁷ was opened on November 21, 1984, to determine whether the existing rate design policy for water utilities resulted in a realistic and appropriate distribution of revenues between the service charge and consumption charge.⁸ There was no standard definition of fixed costs within the water industry at that time. The rate design policy was based on a service charge (to recover the costs associated with providing customers access to water) and the commodity charges (to recover the costs of the water delivered to a customer). Staff recommended a flatter rate design policy with the elimination of lifeline water service.

2. The OII resulted in Decision (D.)86-05-064 of May 28, 1986, which modified water rate design as follows:
 - (a) A flatter rate design policy shall be adopted as statewide rate design policy for water utilities.
 - (b) The flatter rate design policy shall incorporate the following guidelines:
 - i. Service charges shall be set to allow utilities to recover up to 50% of their fixed costs.
 - ii. There may be multiple commodity blocks, with the number of commodity blocks normally limited to no more than three blocks.
 - iii. Seasonal rates may be applied in resort areas.
 - (c) This rate design was implemented by a memorandum⁹ that summarized the provisions of the new rate design. It noted that:
 - i. No customer should receive an increase more than twice the overall increase.

⁷ Order Instituting Investigation I.84-11-041.

⁸ In a later decision, D.16-12-026, December 9, 2016, in R.11-11-008, the Commission ordered Class A and B water IOUs to propose forecast methodologies in their General Rate Case (GRC) applications to more accurately determine how GRC-authorized revenue will be collected through water rates.

⁹ Memorandum to all Water Branch Technical Personnel dated December 9, 1986 from Wes Franklin, Chief, Water Utilities Branch, Subj: Rate Design Policy Established by D.86-05-064.

- ii. Service charges should be set to cover at least 50% of fixed costs.
 - iii. For companies that presently have over 50% of fixed costs in the service charge, staff can discuss in the GRC resolution why that percentage is justified (the decision did not order a reduction if fixed costs exceeded 50%).
 - iv. Calculate fixed costs by subtracting all variable costs from the revenue requirements. Variable costs include purchased power, purchased water, chemicals, income taxes, uncollectibles, and any other cost which is expected to vary with usage.
 - v. The maximum number of commodity blocks is three. One block shall be used whenever possible.
 - vi. Lifeline rates shall be phased out.
 - vii. Seasonable rates can be used in resort areas but only when no other equitable rate design is available.
 - viii. Staff must review conservation plans in each GRC.
3. This rate design was reviewed in the Risk OII proceeding (I.90-11- 033) and further rate design considerations were made in the Rate Structure Rulemaking (R.11-11-008). The rate design was modified to allow recovery of 50% of the fixed costs in the service charge for Class A and B water companies¹⁰, 65% for Class C and 100% for Class D.¹¹ When any regulated water utility acquires an inadequately operated and maintained small water utility, it may also design rates to recover up to 100% of the fixed costs in the service charge.¹²
4. The Commission opened the Conservation OII (I.07-01-022) to address policies toward achieving its conservation objectives for Class A water companies. In this proceeding, rate structures and conservation were investigated, resulting in guidance specifically toward Class A utilities

¹⁰ D.16-12-024, December 12, 2016, O.P. 13.

¹¹ D. 92-03-093, March 31, 1992, O.P. 6. Class A companies serve over 10,000 service connections, class B 2,001 through 10,000, class C 501 through 2,000. and class D 500 service connections or less.

¹² D.99-10-064, October 21, 1999, Appendix D, para. 3.03 B.

that distinguished them from smaller utilities in terms of these objectives.¹³

5. D.86-05-064 also determined that the meter service charge ratios were out of date and directed the Water Branch, now known as the Water Division, to send a letter to all Class A water utilities proposing new ratios. The Water Branch sent the letter on December 6, 1990, proposing to spread the service charge over the meter sizes in proportion to the maximum capabilities of the meters themselves to handle flows.
6. Where a larger size meter is required because the dwelling has a sprinkler system, the customer shall be billed at the rate calculated in Appendix B.
7. Calculating Meter Ratios: Calculate the service charge by first determining the amount of the revenue requirement that is a result of fixed costs, then multiply by the proper percentage to get the amount that needs to be recovered by the service charge. For Class A and B water companies the percentage is 50%, for Class C it is 65% and for Class D it is 100%.¹⁴ These dollars are then spread to different meter sizes as follows¹⁵:

SERVICE CHARGE ALLOCATION BY METER SIZE

Meter Size [inches]	Ratio [unitless]
5/8 x 3/4	1.0
3/4	1.5 ¹⁶
1	2.5 ¹⁷
1.5	5.0
2	8.0
3	15.0
4	25.0

¹³ Water Division’s Standard Practice 40 provides further water conservation related information.

¹⁴ D.16-12-026, December 9, 2016, in R.11-11-008.

¹⁵ Memorandum to Water Branch Staff from Fred L. Curry dated January 18, 1991, Subject: Rate Design Policy – Service charge allocation by meter size.

¹⁶ If the utility is installing 3/4 inch meters on normal residential service either because it cannot purchase 5/8 by 3/4 inch meters or because it has chosen to do so, the ratio for 3/4 inch meters should be 1.0.

¹⁷ If the local fire protection agency or County is requiring sprinkler systems in new homes and if the only reason for the larger meter is to provide adequate flow to the sprinkler system, then calculate a surcharge on the 5/8 x 3/4 rate using Appendix B.

6	50.0
8	80.0
10	115.0
12	165.0
14	225.0

- (a) First multiply the number of services of each size by the ratios shown above to determine “meter-equivalents”. Sum the products and divide the sum into the dollars to be spread. The result is the service charge for a 5/8x3/4 inch meter.
- (b) The other service charges are calculated by multiplying the charge for the 5/8x3/4 inch meter by the meter ratios.

E. QUANTITY RATES¹⁸

1. The quantity rates must recover those revenues not recovered by the service charge as described below:

(a) Single quantity rate

i. Divide the allocated revenue requirement for quantity rates by the forecasted annual water usage to arrive at the single quantity rate.

(b) Tiered quantity rates

i. Tiered quantity rates are structured to encourage customers to use water more efficiently and limit excessive water usage. By charging higher rates for higher levels of consumption, customers are incentivized to reduce their water usage and become more conscientious about their water consumption. Tiered quantity rates should encourage conservation as well. Each rate tier states the amount of water usage allocated to it. When a customer exceeds the water usage allowed in a specific tier, they will be charged at a higher rate in the next tier.

¹⁸ Also referenced as commodity charges

- ii. Tiered quantity rates are generally applied exclusively to residential customers. Non-residential customers maintain a single quantity rate structure.
- iii. It is common for the upper water usage limits of the first tier to be set at the average residential usage. For example, if the average residential usage is 10 CCF (one-hundred cubic feet), Tier 1 rates for a sample utility would be set between 0-10 CCF. Tier 2 would account for any usage above 10 CCF.
- iv. Calculation of tiered rates
 - a. First separate the allocated revenue requirement for quantity rates between residential and non-residential based on their forecasted water usage.
 - b. Divide the residential quantity rate revenue for each tier by their forecasted tier usage.

F. CONSERVATION RATES

1. WD's Standard Practice U-40-W contains guidance to the public and regulated water utilities of procedural steps for adding and activating conservation measures when utilities suffer a water shortage. During times of drought or other shortage in water supply the Commission may adopt "increasing block" rates.¹⁹ This rate design sets a "reasonable" amount of water use and charges customers who use more than this amount a higher commodity charge (see D.00-03-053 for an example). These types of rate designs are much more volatile than the Commission's standard rate design and may also involve a revenue adjustment mechanism which tracks revenues and allows the utility to make up or give back revenues that were less or more than the adopted revenue requirement.

G. TEMPORARY OR CONSTRUCTION WATER SERVICE

1. Temporary or Construction Water can be either flat rate or metered; preferably metered. It should be priced at a greater rate than non-residential water service as existing water customers may be

¹⁹ Water Division's Standard Practice U-40-W, page 4.

disadvantaged by the rate difference. As temporary water use is unpredictable, it is not part of the revenue requirement.

H. RATE SCHEDULE NUMBERING

1. New rate schedules should be numbered and consistent with the format of the utility's existing tariffs. Appendix A is an example of how rate schedules can be numbered.

I. INTERNET PUBLICATION

1. Each Class A utility is required to publish its latest tariffs on its internet web site. The utility shall update its tariffs within five (5) business days of Commission approval.²⁰

J. ESCALATION YEAR INCREASES

1. At the request of the utility, or the discretion of staff, a significant rate increase may be phased-in over multiple years based on factors, including but not limited to socioeconomic conditions, rate shock mitigation, and the contentious nature of a GRC due to the magnitude of protests. The utility may propose, or staff may recommend, to phase in a general rate increase over a period of two or three years via escalation year rate increases, which may be adopted via Commission resolution.
2. Each Test Year and/or Escalation Year increase must remain in effect for a minimum of 12 months.
3. Escalation Year Phase-in Example: Commission Resolution W-5208, adopting Owens Valley Water Company's GRC, dated December 19, 2019²¹, phased in an 86.2% increase in rates over a period of three years; an excerpt is provided as an example below.

²⁰ D.01-07-026, July 12, 2001, Appendix A, para. 2.1

²¹ <https://docs.cpuc.ca.gov/PublishedDocs/Published/G000/M323/K675/323675246.pdf>

Owens Valley proposes to phase this increase over a three-year period as follows:

<u>Monthly Present Rates:</u>	<u>TY-2019</u>	<u>Year One Increase</u>
\$51.81	\$63.75	\$11.94, or 23.04%
<u>2019 Effective Rates:</u>	<u>EY-2020</u>	<u>Year Two Increase</u>
\$63.75	\$78.43	\$14.69, or 23.04%
<u>2020 Effective Rates:</u>	<u>EY-2021</u>	<u>Year Three Increase</u>
\$78.43	\$96.51	\$18.07, or 23.04%

Test Year 2019 (TY-2019) rates should be effective upon adoption of this Resolution and shall remain in effect for minimum of 12 months.

K. INTERIM RATE RECOVERY

1. When the Commission allows water companies the opportunity to recover revenue from the time of the effective date of a decision or from the first day of the test year, calculate the lost revenue and the resulting surcharge as follows:

(1st test year revenue at authorized rates minus 1st test year revenue at present rates) times the number of days between the effective date of the rates and the effective date of the GRC decision plus 5 days and divide this product by the adopted annual sales times the number of years of recovery.

$$\text{Rev. at authorized rates} = \text{Revenue calculated on actual sales during the time period at authorized rates}$$

$$\text{Rev. at present rates} = \text{Revenue collected during the time period in question}$$

$$\text{Lost Revenue} = \text{Rev. at authorized rates} - \text{Rev. at present rates}$$

$$\text{Surcharge} = \frac{\text{Lost revenue}}{\text{Water consumption} \times \text{Number of years for recovery}} = \$/\text{CCF}$$

2. The lost revenue is collected through a surcharge applied to the quantity rates over either a 12-month or a 24-month period depending on the amount of surcharge and its impact on the overall rate increase.

L. RATE DESIGN – SEWER

1. Sewer rate design is similar to flat rate water rate design; all similar customers should pay the same rate, and customers who pay different rates should do so based on differing costs to the utility to provide service. Sewer load may be estimated or calculated based on water use in the building, if such information is available.

M. UTILITY TAXES

1. Since the passage of Proposition 13, many municipalities have levied a “utility tax”. This tax is usually collected as a percentage of the utility bill. These taxes should be a separate line item on the bill and shall only apply to the customers within the municipality imposing them.

N. RATE DESIGN FOR MASTER METERED FACILITIES

1. D.01-05-058, May 14, 2001, sets out the rate design for master metered mobile home parks and apartment houses.
 - (a) Arguably, if the mobile home park or apartment house doesn’t follow the following rate design rules, it is no longer exempt by Code §2705.5 from Commission regulation.
 - i. Mobile home parks that are provided water by Commission-regulated water corporations are exempt from Commission regulation if they charge “the rate which would be applicable if the user were receiving the water directly from the water corporation.” This consists of both set charges (service charge and commodity charge) and apportioned charges (utility taxes and surcharges).

- ii. If the mobile home park has removed all capital carrying costs from its rental rates, it can charge individual service charges; if it has not, it must apportion to the submetered customers the actual service charge it pays.
- 2. Assembly Bill 1830, effective January 1, 2013, amended Code §2705.6 of the Commission's Public Utilities Code and provides the Commission limited jurisdiction over mobile home parks that provide water service only to their tenants from their own water supplies and facilities. Jurisdiction is provided to the Commission if a complaint is filed with the Commission by tenants and the complaint is signed by tenants representing at least 10% of the mobile home park's water service connections during any 12-month period.²² The Commission would then have the authority to determine whether rates are just and reasonable and whether the service provided to tenants is adequate.

²² Tenants may include former and/or current tenants; however, a former tenant shall not file if they have not resided in that mobile home park within the last five years.

Appendix A

O. APPENDIX A: GUIDE TO NUMBERING RATE SCHEDULES

1. The rate schedule number will indicate the class of service as shown in the following tabulation. (These numbers have been selected to correspond generally to the revenue classes in the present uniform system of accounts for water utilities.)

Schedule No	<u>Class of Service</u>
1.	Metered service.
2.	Flat rate service.
3.	Irrigation service.
4.	Private fire protection service.
5.	Public fire hydrant service.
6.	Resale service.
7.	Service to governmental agencies.
8.	Interdepartmental service.
9.	Other water service (such as construction service).
10.	Service to company employees.

2. Where appropriate, the number indicating the class of service will be followed by one or more of the suffixes shown below to further define the type of service covered by the schedule in those situations when the service rendered may be somewhat different than might be expected for the particular type of service.

Suffix	<u>Type of Service</u>
A	Annual service.
C	Construction service under Schedule 9.
E	Special Charges.
F	Flat rate service for other than service under Schedule 9.
I	Industrial service, under Schedule 9.
L	Limited service, as to area or customers.
M	Measured service for other than service under Schedule 1.
O	Optional service.
R	Residential service.
S	Seasonal service.
T	Treated water (other than service under Schedule 1 or 2) utilized for human consumption.
U	Untreated water for other than irrigation service.
W	Off season or winter irrigation service.
V	Temporary service.
Z	Surplus water sales.

Appendix A (cont.)

3. When a tariff area has more than one rate zone (such as a lower and an upper elevation zone) each rate zone will be designated by a single identifying capital letter prefix followed by a hyphen placed ahead of the rate schedule number indicating the class of service. For example, the zone prefixes for the Valley Rate Zone and the Hill Rate Zone could be V- and H-, respectively, followed by the class of service number and, where appropriate, the type of service suffix. If the utility has more than one system, the zone prefix will follow the system prefix.
4. Tariffs imposing fees that apply to all customers of the utility shall be labeled by a letter or letters that relate to the fee being imposed. For example, Schedule No. LC (Late Charge), or Schedule No. F (Facilities Fees).
5. For a water utility which has different rates established for its separately operated systems (such as districts or divisions of a multi-system utility) the rate schedule numbers applicable to each system will be further codified by use of a system prefix comprising the first two letters of the system's name (tariff area), both capitalized. This prefix will be separated from the remainder of the schedule number designation by a hyphen. If the names of two systems have the same first two letters, the second letters should be changed to other distinguishing letters that will maintain the alphabetical sequence of the full names. For example, the designations for Normandy and Norwalk could be NM and NW.
6. Where a rate schedule is universally applicable throughout all the systems of a multi-system or district utility, the schedule number should have the prefix AA (applicable all areas), and the schedule heading should show that it is of general application, as follows:

Appendix A (cont.)

(i) Schedule No. AA-9FC

(a) All Tariff Areas

(i) **CONSTRUCTION AND OTHER
TEMPORARY FLAT RATE
SERVICE**

7. In rate schedules for individual systems of a multi-system utility, the schedule number will be followed on separate lines by the tariff area name (and rate zone, where required) and by the class of service title, as indicated below:

(ii) Schedule No. BAC – 3ML

(iii) Bakersfield Tariff Area

(a) Crest Zone

(i) **LIMITED MEASURED IRRIGATION SERVICE**

8. Some examples of rate schedule numbers are:

Schedule No. 1	(metered service, single-system utility)
Schedule No. 2S	(seasonal, flat rate service, single-system utility)
Schedule No. U-3F	(flat rate irrigation service, upper zone, single-system utility)
Schedule No. BA-3M	(Bakersfield tariff area, measured irrigation service)
Schedule No. VA-9MI	(Vacaville District, metered industrial service)
Schedule No. SUH-1X	(Suburban tariff area, Hill Zone, temporary metered service)

9. The following material lists typical wording for the “applicability” portion of the rate schedule.

Appendix A (cont.)

Schedule No	<u>APPLICABILITY</u>
1	Applicable to all metered water service or sewer that uses metered water as the basis.
1A	Applicable to all metered water or sewer service furnished on an annual basis.
1S	Applicable to all metered water or sewer service furnished on a seasonal basis.
2	Applicable to all flat rate water or sewer service
2A	Applicable to all flat rate water or sewer service furnished on an annual basis.
2LX	Applicable to all flat rate water service furnished on a limited temporary basis.
2R	Applicable to all flat rate residential water or sewer service.
2RA	Applicable to all flat rate residential water or sewer service furnished on an annual basis.
2RS	Applicable to all flat rate residential water service or sewer furnished on a seasonal basis.
2X	Applicable to all flat rate residential water service furnished on a temporary basis.
3FL	Applicable to all flat rate irrigation service furnished on a limited basis.
3M	Applicable to all measured irrigation service.
3ML	Applicable to all measured irrigation service furnished to the lands owned by John A. Doe as of January 1, 1942.
4	Applicable to all water service furnished to privately owned fire protection systems.
5	Applicable to all fire hydrant service furnished to municipalities, organized fire districts and other political subdivisions of the State.
6	Applicable to all water service furnished for resale purposes.
7F	Applicable to all flat rate water service furnished to public parks.
9E	Applicable to all service furnished under schedules for metered and flat rate water service. (For service establishment or other special charges.)
9FC	Applicable to all flat rate water service furnished for general construction.
9M	Applicable to all tank truck water sales.
10R	Applicable to all residential water service furnished to regular and pensioned employees of the company.
Note:	Other specialized schedules shall follow the same order of designation outlined above, i.e., first, flat rate or metered; second, purpose or use of water; third, limitations.

Appendix A (cont.)

10. Some examples of territorial descriptions are given below. The phrase “and vicinity” will usually be included in the territory description. If the Preliminary Statement contains more than one service territory, the name on the map and the name on the associated tariff must be identical or the tariff must reference the appropriate service area map.

TERRITORY

Los Altos and vicinity, Santa Clara County.

Keeler and vicinity, Inyo County.

Graeagle and vicinity, located approximately 12 miles southwest of Portola, Plumas County.

Tracts Nos. 1187 and 1188, and vicinity, located three miles north of Simi, Ventura County.

Tahoe Valley Center, Gardner Mountain Subdivision, Tamarack Subdivision and Tucker Subdivision, and vicinity, located in Tahoe Valley, El Dorado County.

Portions of Bellflower, Lakewood and Paramount, and vicinity, Los Angeles County.

Tracts Nos. 9389, 9775, 9856 and 1138, located in portions of Downey and Pico Rivera, and vicinity, Los Angeles County.

Appendix B

P. APPENDIX B: EXAMPLE OF METHOD FOR CALCULATING THE SURCHARGE OVER THE 5/8 X 3/4 INCH METERED SERVICE WHEN THE LARGER METER IS NEEDED FOR FIRE PROTECTION

Workpaper for Advice Letter

		5/8-inch		2-inch	
Price of Materials		\$	26.50	\$	209.00
Sales Tax		\$	2.25	\$	17.77
Cost of Installation					
Labor	\$	35.6	per person hour	35.6	per person hour
		0.5	hours	4	hours
Labor Cost	\$	\$	17.80	\$	142.40
Benefits	\$	\$	7.12	\$	56.96
Subtotal		\$	53.67	\$	426.13
Overhead		\$	4.29	\$	34.09
Total Cost		\$	57.96	\$	460.22
Product Life			25 years		10 years
Depreciation Expense		\$	2.32	\$	46.02
Average Return on Investment					
		0.0864	Adopted ROR		
		1.4	Net-to-gross		
		0.12096	Revenue Requirement		
		\$	3.51	\$	27.83
Annual Cost		\$	5.82	\$	73.86
Difference in Cost				\$	68.03
Per Month				\$	5.67
5/8 inch rate				\$	10.30
Percent Surcharge					0.55
Rounded					50%