WATER/SNR/TAC/LTR:jrb

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

WATER DIVISION **RESOLUTION W-4354**
October 24, 2002

R E S O L U T I O N

(RES. W-4354), WATERTEK, INC., OAK HILLS DISTRICT (OH). ORDER AUTHORIZING A GENERAL RATE INCREASE PRODUCING ADDITIONAL ANNUAL REVENUE OF $98,815 OR 84.9% IN 2002.

SUMMARY

This resolution grants a general rate increase in gross annual revenues of $98,815 or 84.9% for Test Year 2002. This increase will provide a 20% margin over expenses in the test year.

BACKGROUND

OH requested authority under Section VI of General Order 96-A and Section 454 of the Public Utilities Code to increase rates for water service to produce additional revenues of $134,453 or 116.04% in 2001. OH's request shows 2002 gross revenue of $115,871 at present rates increasing to $254,329 at proposed rates to yield a 20% rate of margin.

OH currently serves 450 flat-rate residential sewer customers located approximately 3 miles east of Castroville, Monterey County. The current rates were established on December 16, 2001, pursuant to Resolution W-4313, which authorized an interim rate increase.

Prior to the interim increase, OH received a Consumer Price Index (CPI) rate increase in 1997. OH's last general rate increase was granted on March 13, 1991 by Commission resolution W-3547 which authorized a $39,214 or 59.6% increase in rates at a rate of return of 11.0%.

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 OH's rate increase request. Indian Springs' and Grandview Gardens' requests are dealt with in separate resolutions.

On June 18, 2001 Watertek, Inc. (Watertek) filed a general rate increase request for its OH District. The staff (Staff) of the Water Branch (Branch) reviewed and accepted the filing in late July. The Branch made an independent analysis of OH's summary of earnings and issued its report on August 5, 2002. Appendix A shows OH's and the Branch's estimates of the summary of earnings at present, requested, and recommended rates. Appendix A also shows differences between OH's and the Branch's estimates in operating revenues, expenses and rate base.

The OH 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 OH's and Branch's estimates. For example, OH 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 PG&E's current tariff surcharges.

The other large differences are in labor, materials, 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.

In order to determine reasonable amount for expenses dealing with materials, staff reviewed expenses booked to this account over the last three years and adjusted non-recurring/unusual expenses. Staff reviewed expenses booked to contract work account and determined that OH 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, has adjusted non-recurring/unusual expenses, and has 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.

OH 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 $10,391. Recovery was requested in the form of a one-time surcharge of $23.19 per customer. This recovery was for personal funds provided by Mr. Smith to OH for expenses incurred. OH did not have CPUC authority for such a loan and therefore this surcharge should be denied.

In D.92-03-093, effective April 30, 1992, the CPUC adopted the operating ratio method of ratemaking as an alternative to return on rate base method for Class C and Class D utilities. Thus, two methods are available to Staff to utilize in calculating a reasonable profit: Return on Rate Base (not 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. A 20% rate of margin has historically been used to determine the margin over and above operating, maintenance and depreciation expenses.

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.

OH 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.

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. In addition, Staff notes that depreciation for OH is not being recorded in accordance with Ordering Paragraph No. 3 of W-3547, which orders a depreciation rate of 2.4% be used. 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 tariff book needs to be corrected to reflect all governing rules, forms, and

schedules. Staff notes that Watertek should have separate tariff books for its water and sewer systems. Included in the water systems tariff book 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 OH'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.

OH's current rate structure consists of Schedule No. 2, Flat-Rate Service, with billings occurring quarterly.

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 $64.66 to $119.56 per quarter. 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 16, 2001. Six letters objecting to the proposed rate increase were received by Staff. From February 4, 2001 to February 4, 2002, the Consumer Affairs Branch of the Public Affairs Division received no complaints regarding the OH district.

On January 16, 2002, Staff held an informal public meeting near OH's service area with twenty-two 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. Of particular note was the objection by a customer to the location of the meeting. Evidently the selected location was approximately a 10 to 15 minute drive from OH's service area. The customer indicated that a school auditorium, within the service area, could have been selected for the meeting and

may have encouraged the elderly customers to attend. The customer requested that future meetings be held within the service area.

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 the Commission instruct Mr. Smith that no additional systems can be added until all districts have been evaluated.

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. OH did not have Commission authority for a personal loan made by Mr. Ray Smith.
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 permit district-specific accounts to be easily identified.
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 continues to expand its operations to include several new systems since 1996. Commission should instruct Mr. Smith that no additional systems can be added until all districts have been evaluated.

THEREFORE IT IS ORDERED THAT:

1. Authority is granted under Public utilities Code Section 454 to WATERTEK, INC., OAK HILLS 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 should be ordered to maintain a detailed transportation log that will clearly identify utility-related expenses for each of its districts.
3. Watertek should be ordered to file complete annual reports for each of its districts.
4. Watertek should be ordered to update its tariff book and file two separate books: one for the water systems and one for the sewer systems. The water systems tariff book should include the East Plano, Grandview Garden, and Metropolitan districts. The sewer tariff book should include Indian Springs, Oak Hills, and Spreckles districts.
5. Watertek should be ordered to bring all bills into compliance with Rule No. 5.
6. Watertek should be ordered to cease adding additional systems until its other districts have been evaluated for rate increases.
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 October 24, 2002; the following Commissioners voting favorably thereon:

_____
WESLEY M. FRANKLIN
Executive Director

Appendix A
Watertek, Inc. – Oak Hills District
SOE - Test Year 2002

Description	OH Present Rates	OH Requested Rates	Branch Present Rates	Branch Requested Rates	Branch Recommended Rates
OPERATING REVENUES					
Flat Rate Sewer Revenues	115,871	254,329	116,390	249,425	215,205
TOTAL REVENUES					
OPERATING EXPENSES					
Purchased Power	4,080	4,080	3,005	3,005	3,005
Other Volume Related Exp.	2,591	2,591	2,720	2,720	2,720
Employee Labor	35,298	35,298	70,550	70,550	70,550
Materials	3,061	3,061	660	660	660
Contract Work – General Exp.	6,956	6,956	0	0	0
Contract Work – Water Testing	3,950	3,950	4,895	4,895	4,895
Transportation Expenses	8,462	8,462	4,075	4,075	4,075
Other Plant Maintenance Exp.	11,294	11,294	1,975	1,975	1,975
Office Salaries	34,598	34,598	16,415	16,415	16,415
Management Salaries	33,813	33,813	6,130	6,130	6,130
Employee Pensions and Benefits	5,072	5,072	2,610	2,610	2,610
Uncollectible Accounts Exp.	0	0	0	0	0
Office Services and Rentals	13,753	13,753	5,655	5,655	5,655
Office Supplies and Expenses	6,314	6,314	11,180	11,180	11,180
Professional Services	3,046	3,046	580	580	580
Insurance	5,338	5,338	8,710	8,710	8,710
Regulatory Commission Exp.	3,726	3,726	1,520	1,520	1,520
General Expenses	660	660	9,090	9,090	9,090
SUBTOTAL	182,012	182,012	149,770	149,770	149,770
Depreciation Expense	6,897	6,897	8,905	8,905	8,905
Taxes Other Than Income Taxes	10,287	10,287	10,010	10,010	10,010
Income Taxes	3,117	16,785	3,130	25,190	14,780
TOTAL DEDUCTIONS	202,313	215,981	171,815	193,875	183,465
NET REVENUE	<86,442>	38,348	<55,425>	55,550	31,740
RATE BASE					
Average Plant			822,270	822,270	822,270
Avg. Accumulated Depreciation.			260,815	260,815	260,815
NET PLANT			561,455	561,455	561,455
Contributions			357,970	357,970	357,970
RATE BASE			203,485	203,485	203,485
MARGIN RATE		20%			20%

(END OF APPENDIX A)

Appendix B

Schedule No. 2
FLAT RATE SERVICE

APPLICABILITY

Applicable to all flat-rate service.

TERRITORY

Subdivision of Oak Hills, in the vicinity of Salinas, Monterey County.

RATES

	Per Service Connection Per Quarter	
For each residential customers and Small commercial service connection	$ 119.56	(I)

SPECIAL CONDITIONS

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

(END OF APPENDIX B)

Appendix C

Watertek Inc. – Oak Hills District
Comparison of Rates - Test Year 2002

	Per Service Connection Per Quarter		
	Present Rates	Recommended Rates	Percent Increase
For each residential and small commercial service connection	$ 64.66	$ 119.56	84.9%

(END OF APPENDIX C)

Appendix D
(Page 1 of 2)
Watertek Inc. – Oak Hills 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:

   450 flat rate

4. Property Taxes: $1,505
   1.0% tax rate

5. Payroll Taxes: $8,505

6. Contract Work - Water Testing: $4,895

7. Purchased Power

   Pacific Gas & Electric, Schedule No. AG4A
   Time-Of-Use Agricultural Power
   Effective August 8, 2000
   - Energy Charge:
     - kWh used - total: 18,545
     - kWh used - summer: 8,656
       - kWh used – summer peak: 1,457
       - $/kWh – summer peak: $0.32436
       - kWh used – summer off-peak: 7,199
       - $/kWh – summer off-peak: $0.06524
     - kWh used - winter: 9,889
       - kWh used – winter off-peak: 5,936
       - $/kWh – winter off-peak: $0.05674
       - kWh used – winter part-peak: 3,953
       - $/kWh – winter part-peak: $0.07135
   - Customer Charge:
     - $/pump/mo.: $12.00
   - Meter Charge:
     - $/pump/mo.: $6.80

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

7. Purchased Power Cont.

Demand Charge:
Summer: $2.40/Hp
Winter: $2.20/Hp

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
Schedule AG4A customers:
$0.03051/kWh – summer peak

8. Adopted Tax Calculations

Line No.	Item	State Tax	Federal Tax
1.	Operating Revenues	$215,205	$215,205
2.	Expenses	$149,770	$149,770
3.	Taxes Other Than Income Taxes	$ 10,010	$ 10,010
4.	Depreciation	$ 8,905	$ 8,905
5.	State Taxable Income	$ 46,520	
6.	State Income Tax (@8.84% or $800 minimum)	$ 4,112	
7.	Federal Taxable Income		$ 42,408
8.	Federal Income Tax (@15%)		$ 6,361
9.	Monterey County Franchise Tax (@2% of revenues)		$ 4,304
10.	TOTAL INCOME TAX	$14,777	

(END OF APPENDIX D)