

Agenda Date: June 26, 2002  
Item Number: Utilities 2

Docket: UW-020307  
Company Name: Rosario Utilities, L.L.C.

Staff: Jim Ward, Regulatory Analyst  
Tani Thurston, Regulatory Analyst  
John Cupp, Consumer Program Specialist  
Penny Hansen, Public Involvement Coordinator

**Recommendation:**

Dismiss the Complaint and Order Suspending the Tariff Revisions in Docket UW-020307 and allow Rosario Utilities' revised Tariff WN U-1, to become effective on July 1, 2002.

**Discussion:**

On March 12, 2002, Rosario Utilities, L.L.C. (Rosario Utilities or Company), filed for general rates in the amount of approximately \$164,000 (157 percent) of additional revenue per year. The company serves approximately 270 residential and vacation units, the Rosario Resort and Cascade Harbor Inn near East Sound on Orcas Island in the San Juan Islands. Part of the customer base is served through master meters to two homeowner's associations. On April 10, 2002, the Commission entered a Complaint and Order Suspending Tariff Revisions pending an investigation by Staff to determine whether the tariff revisions were fair, just and reasonable.

Staff has completed its investigation of the Company's books and records and finds that the Company has justified \$95,437 of its requested \$164,000 proposed rate increase. The revised rates produce an 87% increase in annual revenues; this is in contrast to the 157% increase proposed by the Company in its original filing. In addition, as a result of a review of the Company's proposed rate structure, the Company has, in consultation with Staff, proposed to raise its Ready-to-Serve charge to 110 of its customers.

Of the \$95,437 increase a large percentage is due to increased expenses as related to the new water treatment plant. The revised rates also include \$4,166 annual expense related to preparing its required Water System Plans. Water System Plans are comprehensive planning documents required by the Washington Department of Health, which address water conservation, water quality monitoring and emergency response, among other things. A licensed engineer must prepare Water System Plans every six years.

In review of the current rate structure, Staff found that the reduced billing to bulk users was unsupported and has determined a new rate structure. Many of the customers felt that large bulk users should have their rates determined separately. Staff continues to support a uniform rate structure because it provides for risk distribution among all the Company's customers and also effectively deals with small-system viability issues. Difficulties associated with multi-user rates include cost allocation problems and a more complicated billing system. Also, similar company wide costs would have a disproportionate impact on individual customers depending on their Equivalent Residential Units (ERU) or meter size. The Company has completed installation of meters on all customers. However, due to a lack of usage history to determine rates, Staff recommends the use of ERUs/usage for rate design and requests monthly meter readings along with billed revenues for a period of one year. After a year of data, Staff requests the company file rates based on actual meter size and usage.

Rosario Utilities serves four basic categories of water customers: Residential, Bulk metered, Commercial, plus a Ready to Serve category. The Ready to Serve is used on an interim basis from the time a person becomes a customer until such time as the customer uses water. This normally occurs during the planning and construction of a new residence. The table below shows the customer categories, identifies the customer, shows the number of customers, and shows the number of Equivalent Residential Units (ERU)<sup>1</sup> for active and Ready to Serve customer categories.

CATEGORY	CUSTOMER	Number of CUSTOMERS	EQUIVALENT RESIDENTIAL UNITS	
			Active	Ready to Serve
Residential	Homeowners	156	156	39
Bulk Metered	Highlands HOA*	1	93	15
	Vusario HOA*	1	10	6
Commercial	Rosario Resort	1	74	50
	Cascade Harbor Inn	1	13	0
Ready to Serve	Connections	110		
<b>TOTAL</b>		<b>270</b>	<b>346</b>	<b>110</b>

\* **Note:** HOA means Homeowner's Association. Rosario Utilities provides water in bulk-metered service to the Homeowner's Association. The Homeowner's Association is Rosario Utilities' customer. Rosario Utilities' responsibilities end at the bulk master meter. Beyond the bulk master meter, the Homeowner's Association owns and maintains the water system. Members of the Homeowner's Association are water customers of the Homeowner's Association, not Rosario Utilities.

### **Water Treatment Plant Cost:**

Rosario Utilities receives its water from Cascade Lake. This water source is considered surface water by the state Department of Health (DOH) and falls under the surface water treatment rules for potable water. Currently, Rosario Utilities has water rights for 220 gallons per minute (gpm) from the lake.

Staff's investigation did review the Company's capital cost for the new water treatment plant. However this capital cost is not part of this filing and is considered to be Contributions in Aid of Construction and not investment in water plant serving its customers. The water treatment plant is being recovered by the company's Facilities Charge (\$3,100) and the monthly Surcharge (\$22).

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<sup>1</sup> An ERU is a unit of measure used to equate non-residential or multi-family residential water usage to a specific number of single family residences. Note: The quantity of water associated with an ERU is system-specific. The ERU level for one system may not apply to another system with differing demographics or water use patterns. Moreover, an ERU "level of service" for any specific system may in itself change with time (may not be the same from year to year) as water use patterns in a particular water system changes for various reasons (demographics, conservation activities, etc.). As meter records are kept and evaluated over time for any given system, it may be expected that changes in the specific level of demand associated with changing water-use patterns will result in adjustments to the system's basic ERU level. Department of Health, Water System Design Manual, June 1999

Rosario Utilities made a filing in late 1999, effective January 15, 2000, to recover the \$1,000,000 of initial capital cost involved with placing that treatment plant in service. The \$1,000,000 loan was used for the water treatment plant \$546,100, pilot testing \$27,050, electrical \$127,250, emergency generators \$51,810, land clearing and building \$110,600, pumping upgrades \$24,500, survey & permitting \$8,150, engineering \$70,300 and legal & miscellaneous \$35,250. That filing resulted in a facilities charge of \$3,100 to new customers and a surcharge of \$22 per month for all residential customers and all ERUs for bulk and commercial customers. The facilities charge and surcharge were calculated to fully recover the cost of the water treatment plant and upgrades over a seven-year period. All funds collected from the facilities charge and surcharge are considered Contribution in Aid of Construction (CIAC) and are excluded from any future recovery through depreciation or earning a return.

The Company has determined that operating the water treatment plant has increased the overall expenses of the Company. The Company is seeking this rate change to recover the increased cost of operating the new water treatment plant including water testing, electrical power, property tax, labor, and chemicals. Additionally, the company contends that other operating expenses such as materials and maintenance, office rent and supplies, and transportation have also increased since the company's last rate case in 1999.

The new water treatment plant allowed an additional 127 ERU by DOH. Of these 127 ERUs, 19 ERUs/connections went to prospective customers as part of the earlier settlement. This left 108 ERUs/connections to be sold. In accordance with the earlier settlement 89 ERUs/service connections were provided to specific prospective customers resulting in 38 unassigned ERUs/service connections. These unassigned ERUs/service connections were made available to the general public on June 15, 2001. By use of the facilities charge, the water company collected approximately \$334,800 for the new connections. By using these funds for a loan pay down, the water company was able to receive a lower monthly payment on the loan starting July 2001.

As to the assets, depreciation and rate base, Staff has worked with the company to establish these items. The capital cost of \$1,000,000 for the water treatment plant (WTP) has been removed from any consideration during this rate case. The reasoning is that the WTP cost recovery is being funded by the facilities charge and monthly surcharge.

The Company has and is spending funds to update the comprehensive water system plan. Additionally, the company has finished installing meters to all customers. These additional plant assets and a small amount of older plant assets have resulted in approximately \$128,000 of rate base. This rate base yields about \$8,854 per year in depreciation and with rate case adjustments equates to \$10,652 of annual depreciation expense.

### **Customer Comments:**

Since April 11, 2002, the Commission has received an additional 11 comments to this filing. Commission staff attended a public meeting held by the Company on March 19, 2002 on Orcas Island near the water system. Approximately 150 customers attended this meeting. In this meeting, the customers had many questions and issues regarding this filing. The Commission received 120 letters opposed to the proposed increase in the original filing. Customer's concerns from the meeting and letters are highlighted below.

Treatment Plant: Customers believe the purchase of the Hydroxyl water treatment system was not a prudent decision. The customers had significant concerns regarding the Company's decision to purchase the Hydroxyl water treatment system instead of another type, such as a slow sand filter system. The customers wanted to know who made the decision and if it was the correct decision. The customers do not understand why the company did not allow their input in the decision of which treatment system to purchase. The customers stated that they have engineering and contract expertise, which they offered to the Company, but were refused.

Staff's Response: Staff disagrees with this interpretation and, based on our review, believe that Hammond, Collier and Wade – Livingstone Associates, Inc. and Gray & Osborne, Inc., recommended the Hydroxyl system. DOH approved the Hydroxyl multi-stage treatment system on November 20, 1997. The decision to not use customer input was the utility's.

Customers stated that the Hydroxyl system has been defective since the beginning and they do not believe they are getting the benefits of paying \$22 per month surcharge due to the delays to get the system online and working correctly.

Staff's Response: There were substantial delays in the treatment system going online. The surcharge that customers have been paying has gone to the capital cost of the treatment plant. Cost overruns were incurred when the cartridge filters were replaced with Zeolite filters at a negotiated additional cost of approximately \$85,000, which is not part of this rate case. Other costs for engineers, consultants, etc. for work required during construction and startup of the plant, were absorbed by Hydroxyl Company as part of the purchase contract.

Treatment Capacity: Customers stated concerns that the current treatment design of the filtration system is not big enough to meet the current capacity and they fear that the company will have to upgrade the system at a greater cost to customers in the near future. Customers wanted to know if this treatment plant could be expanded to allow for additional capacity.

Staff's Response: Staff has found that Rosario Utilities did purchase a hybrid water treatment plant in which some components have additional capacity. Rosario Utilities is collecting data and has engineering reviews in process to determine if additional capacity can be achieved and what water system components are currently limiting capacity. The company has sent a letter to DOH requesting a reevaluation of the ERU capacity, based on current data. Rosario Utilities is also pursuing additional water rights from Cascade Lake.

Staff believes the current DOH capacity of approved connections is being served. If additional customer growth occurs, the Company will need to provide additional capacity. This additional capacity may result in additional cost.

Customers questioned the Company's reasons to purchase the Hydroxyl treatment system. They think the operational expenses for this plant are much higher than what the slow sand filter plant would have been. The customers think the Company could have purchased another system at half the cost that would have worked just as well.

Staff's Response: Rosario Utilities has entered into a water treatment plant maintenance agreement, at a cost of \$9,250 annually. This cost is \$13,200 less than the Gray & Osborne study projected and meets the majority of concerns. Water treatment operating costs have increased the company's cost of doing business. Some of these increased costs were addressed in the Gray & Osborn study, however actual costs were unknown during the study. Other cost increases such as personal property tax were not addressed in the study

and are part of Staff's review in this filing. In accordance with the Gray & Osborne study the next alternative (slow sand) was not half the cost. On page 33 of the study the summary table for water treatment plant shows Hydroxyl treatment at a present worth of \$1,111,900 and slow sand with pre-ozonation treatment at a present worth of \$1,350,800. Based upon our review of the two engineering studies, which included costs analyses of various options considered, Staff concludes that Rosario Utilities' decision to purchase the Hydroxyl water treatment system was not unreasonable.

Company Management: Many customers stated concerns with the current management of Rosario Utilities and request the Commission conduct a management audit of the Company. Customers believe the Company has not made prudent decisions and believe that customers are now being requested to pay for those mistakes.

Staff's Response: Staff believes that customers did not fully understand the capital cost incurred for the water treatment plant. Additionally, this rate case includes several other operating cost and increased expenses for providing water services including new water treatment plant expenses. This lack of understanding may have led to inappropriate conclusions involving the water treatment plant.

Employee Salaries: Customers questioned the increase of the employee's salaries. Also, they are concerned they have to pay this high rate when they still have mortgages and other expenses. They state the increase the Company is requesting is a considerable burden on their incomes.

Staff's Response: Staff reviewed the total number of employees, wages and salaries, and allocations for both water and sewer portion of the utility. Staff has found the company uses a simple allocation for wages of 35 % to sewer expenses and 65 % to water expenses. To more accurately reflect the salary allocation, Staff requests the company immediately start maintaining daily time sheets on all employees to allow future allocations to truly reflect the work performed.

Sewer Costs: Customers questioned the Company's sewage expenses. They were concerned about the allocation of the expenses between the utility's water and sewage businesses. They wanted to know what proportions of the employees' salaries are allocated to the water versus the sewage business. Also, they were very concerned that both the water and the sewage business are the same owner and, therefore, may have inflated the sewage expenses to the water utility.

Staff's Response: Staff has reviewed the total cost of Rosario Utilities including the sewer treatment portion of the Company. This review looked at affiliated allocations and the expenses behind the allocations. Water treatment by-products must be disposed of in some manner. The Company is currently using the sewer disposal system and may review other options at a future point. Staff has found that the water treatment plant is being charged the same rate as Moran State Park. Expenses and revenue have not changed dramatically due to the addition of the water treatment plant. Staff has recommended gathering data and review of the allocation of some expenses to coincide with the company's 35/65% method of allocating wages.

Company Expenses: Customers believe the Company could make some changes to reduce the operating costs, such as:

- Bill customers' quarterly instead of monthly.

Staff's Response: with less frequent billings, the actual amount due would become large and may cause more bad debt and delayed payments. Delayed billings for water service, would not allow the customers to be responsive to usage and price signaling.

- Reduce the number of full time employees.

Staff's Response: The number of field employees is determined by treatment expertise as required by DOH. Staff is proposing future review of the total water utility compensation cost.

- Refinance the plant loan to reduce the interest rates.

Staff's Response: Staff recommends that the Commission review the allowed interest rate on the loan for ratemaking purposes when the Company requests any change to the Facilities Charge or monthly Surcharge.

- Meter water usage by Rosario Resort and Cascade Harbor Inn. Customers believe the failure to meter these two commercial establishments leaves a big gap in the raw data needed to establish equitable water rates for both residential and commercial customers. Residential customers state concerns about subsidizing the Rosario Resort's use of water.

Staff's Response: See answers below on meters.

Ownership: Customers wanted to know if the company owner reviewed the filing. They also questioned if owners of a Washington Company could live outside the State of Washington and still make decisions about service in Washington.

Staff's Response: It is certainly appropriate for the owner to review the filing, and the owner's responsibility and ability to make decisions may be affected by where the owner lives. Rosario Utilities does maintain an office at the water system and all books and records have been made available to Staff.

Rate of Return: Customers were concerned about the company's request for a rate of return of 10-12%. They felt a more reasonable rate of return should be between 6-7%.

Staff's Response: Staff recommended a 10.8% return on equity in the Commission's last litigated water case. The overall rate of return on investment is a function of the total capital structure and the weighted cost of capital. In this case Staff continues to recommend the company be allowed an opportunity to earn 10.8% equity return on its unrecovered capital investment. The weighted cost of capital that Staff used for this rate case is 8.46 %.

Owner Debt: Customers had many questions about the operation and the expenses of the water treatment system. They wanted to know why the Company does not refinance the current loan of 9.25% to a lower rate that would exist today.

**Staff's Response:** Staff has asked the same question of the Company and has determined the appropriate return on affiliated loans should be 6.75 %. Using the prime interest rate and adding 2 points for affiliated transactions in a small water utility to determine this amount. Noting that this reduces the interest cost to customers, Staff believes that the surcharge loan and repayment will remain unaffected. With an equity return of 10.8% for recovering capital plant and an affiliated loan return of 6.75%, the overall return on water plant investment for this utility would be 8.46%. Staff again notes that the recovery for capital cost of the water treatment plant is not part of this filing.

**Meters:** Customers wanted to know when meters will be installed for the Cascade Harbor Inn and Rosario Resort. Both are currently unmetered. They felt the Company was neglecting to do this.

**Staff's Response:** All customers have now been metered and will be billed accordingly. Additionally, Staff is recommending that the company gather meter and revenue data for a one-year period and report to the Commission on the possibility of a new rate design.

**Rate Design:** Customers wanted to know why the base rate was so high before any water was used. They stated the rates were not increasing consistently between the commercial and the residential accounts. The commercial rates were increasing by 220% while the residential rate, was increasing by 280%.

**Staff's Response:** Staff has reviewed the usage data available and DOH's ERU allocations. To more closely tie the rates and revenues to the usage patterns, Staff has revised the rates as shown under the revised portion of the proposed rates on the last page of this memo.

**Customer Service:** The Commission has received several comments stating that when customers contact the Company for information or complain about a problem with their water service that the Company is unresponsive. Many of these letters are from homeowner association members who are not customers of Rosario Utilities. This is a unique situation. The Company provides bulk master meter water service to two homeowner associations, the Vusario Homeowners Association and the Highland Homeowner's Association, that provide water service to their member customers, who are not customers of Rosario Utilities. When information or a situation with water service occurs with a member of an association, the member typically contacts the Company to resolve situations as they occur.

**Staff's Response:** Rosario Utilities' obligation is to the homeowners association as a bulk master metered customer, and not to each individual member within the homeowners association. Vusario and Highland homeowner's association members are confused about whom to contact when they have problems or questions about their water service. Members of those two homeowners associations are water customers of the homeowners associations and members must address all questions and concerns to the appropriate homeowners association, not Rosario Utilities. The association representative may need to contact Rosario Utilities. If the Company is not responsive to the association representative, the association representative should contact the Commission for assistance.

Staff's Response: Staff discussed WAC 480-110-315, Availability of Information, with the company. This administrative code details the company's requirements for responding to customers' calls and letters as well as providing other information. The company is maintaining a log of customers' contacts to the company and the company's responses to the customers.

### Recovery and Rates

The company's last general rate increase was effective August 1, 1999, and was based on information from 1998. The average monthly residential customer impact of the proposed rate change would have been approximately \$40.11. Revised rates should produce approximately \$22.74 increase per month based on average usage. The current, proposed, and revised rates are provided below:

<u>Monthly Base Rate*</u>	<u>Current</u>	<u>Proposed</u>	<u>Revised</u>
Residential flat Per Customer	\$ 27.05	\$ 69.75	Removed
Commercial flat Per ERU**	\$ 27.05	\$ 69.75	Removed
Residential metered Per Customer	\$ 18.55	\$ 52.00	\$ 29.75
Commercial metered Per ERU**	\$ 18.55	\$ 52.00	\$ 29.75
Bulk metered (HOAs) Per ERU**	\$ 12.70	\$ 39.00	\$ 25.00

\* Zero Allowance of water in monthly base charge

\*\* ERU Equivalent Residential Unit

### Monthly Usage Rate

0 - 1,500 cu. ft. (per 100 cu. ft.)	\$ .75	Removed	Removed
0 - 1,200 cu. ft. (per 100 cu. ft.)	N/A	\$ 1.50	N/A
<b>0 - 400 cu. ft. (per 100 cu. ft.)</b>	<b>N/A</b>	<b>N/A</b>	<b>\$ 1.50</b>
> 1,500 cu. ft. (per 100 cu. ft.)	\$ 1.50	Removed	Removed
1,200 - 2,000 cu. ft. (per 100 cu. ft.)	N/A	\$ 2.25	N/A
<b>400 - 1,000 cu. ft. (per 100 cu. ft.)</b>	<b>N/A</b>	<b>N/A</b>	<b>\$ 2.50</b>
> 2,000 cu. ft. (per 100 cu. ft.)	N/A	\$ 3.00	N/A
<b>&gt; 1,000 cu. ft. (per 100 cu. ft.)</b>	<b>N/A</b>	<b>N/A</b>	<b>\$ 3.50</b>

### Ancillary Charges

<u>Ancillary Charges</u>	<u>Current</u>	<u>Proposed</u>	<u>Revised</u>
Ready to Serve	\$ 6.40	\$ 8.40	\$ 12.00
Current Capital Surcharge	\$ 22.00	\$ 22.00	\$ 22.00.

### Monthly Average Customer/ERU billing (including Surcharge)

Retail - Based on 888 cuft per month of usage.	<b>\$ 47.21</b>	<b>\$ 87.32</b>	<b>\$ 69.95</b>
Bulk - Based on 888 cuft per month of usage.	<b>\$ 41.36</b>	<b>\$ 74.32</b>	<b>\$ 65.20</b>

The water system is currently at the maximum capacity established by DOH and water rights from Cascade Lake and cannot issue any new ERUs'/connections.

Rosario Utilities has provided information that the revised rates are fair, just, and reasonable. Therefore, Staff recommends that the Commission Dismiss the Complaint and Order Suspending the Tariff Revisions in Docket UW-020307 and allow Rosario Utilities' revised Tariff WN U-1, to become effective on July 1, 2002.