

Revised December 28, 2005

Agenda Date: December 28, 2005
Item Number: A1

Docket: UW-051336
Company Name: Southgate Water Systems, Inc.

Staff: Jim Ward, Regulatory Analyst

Recommendation:

Issue an order in Docket UW-051336 authorizing the accounting treatment recommended by staff and agreed to by Southgate Water Systems, Inc.

Take no action on the tariff revisions filed in Docket UW-051336, thereby allowing them to become effective January 1, 2006, by operation of law.

Discussion:

On September 6, 2005, Southgate Water Systems, Inc., (Southgate Water or Company) filed for a general rate increase of \$14,060 (58 percent) of annual revenue. Southgate Water became regulated in 1997 and has not had a rate increase since becoming regulated. Southgate Water serves approximately 44 customers south of Kennewick located in Benton County.

Southgate Water stated it is requesting this increase in rates to recover operating costs to provide water and maintain the water system, and recover a portion of the capital improvements.

The current and proposed rates are provided below:

<u>Monthly Rates</u>	<u>Current</u>	<u>Proposed</u>
Metered Base		
Allowance of 45,000 gallons	\$ 48.00	NA
Allowance of 15,000 gallons	NA	\$ 37.50
Usage Rate		
> 45,000 gallons (per 1,000 gallons)	\$.30	NA
15,000 – 50,000 gallons (per 1,000 gallons)	NA	\$ 1.00 (\$0.75 per 100 ft3)
> 50,000 gallons (per 1,000 gallons)	NA	\$ 3.00 (\$2.25 per 100 ft3)

The average monthly usage per customer for the twelve-month test period is 43,558 gallons (5,823 cubic feet). The charge for 43,558 gallons (5,823 cubic feet) is \$48.00 using current rates and \$66.06 using proposed rates.

The Company notified its customers of this proposed rate change the first part of December. The Commission received comments from two customers who represented themselves as well as twenty other households who receive service from Southgate Water. These customers did not express opposition to the rate increase, however they have many concerns and issues. The comments questioned the rate design and consider the reduced allowance excessive and unwarranted. Customers feel it is unfair that they should receive less allowance than they agreed to and have historically used.

Customer Issues

Below is a summary of issues (and comments) from the customer comments and questions.

Agreement / contract with developer or water company – Customers questioned why the Commission could set rates different than those stated in written contracts. Customers referred to written documents stating customers would receive 60 days notice before a rate increase and that the water company can only raise rates to match other water systems. The rates established were \$48.00 base charge to include 45,000 gallons of water and \$0.30 per 1,000 gallons thereafter. Staff requested, but has not yet received, copies of the written contracts.

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According to the Commission’s legal advisers, contracts signed by a water company prior to regulation no longer apply once the company becomes regulated, because allowing prior contracts to be enforced would interfere with the state’s right to maintain uniform rates.¹ RCW 80.28.080 requires that only rates published in tariffs be charged.

¹ Raymond Lumber Co. v. Raymond Light & Water Co., 92 Wash. 330, 159 P. 133, L. R. A. 1917C, 574 (1916). “The power to regulate and control the rates of public service corporations is within the legitimate exercise of the police power of the state. [...] The rule is that contracts upon subjects which are within the police power, even though valid when made, must be taken to have been entered into in view of the continuing power of the state to control the rates to be charged to public service corporations. [...] There is nothing in the public service commission law which prevents the commission from directing that a rate contract be terminated, even though such contract when made was valid, when the performance of the contract results in discriminatory rates.”

When new lots are developed, are current customers subsidizing the builder?

- No. The Commission sets rates using historical costs. In this case, the Company used a twelve-month test period of calendar year 2004. Current customers pay for current plant. Future plant is normally recovered after it is constructed and placed in service (used and useful). Regulated companies do not recover costs associated with contributions in aid of construction, such as service connection charges, received from developers or customers. Service connection charges assessed to new customers are designed to recover the cost of the main tap, the piping out to the meter setter, and the meter box with a stub out to connect the customer's distribution pipe.

Average customer billing does not correspond to the individual customers.

- Staff and the Company used the average customer usage during the winter months (September – April) and actual customer usage for each month during the summer (May – August) to compare water bills using current and proposed rates. The amount of increase each customer will pay depends upon that customer's actual water usage.

Rates should be designed to reflect changes in the cost of living or other water company rates in the same location.

- The average monthly usage per customer for the twelve-month test period is 43,558 gallons. The monthly charge for 43,558 gallons usage has been \$48.00 since the Company became regulated December 11, 1997. That charge would increase to \$58.46 (21.8 percent) if the 1997 rates are adjusted using the Consumer Price Index, and would increase to \$66.06 (37.6 percent) using the proposed rates.
- Setting rates based upon cost of living indexes or what customers pay on other water systems is inconsistent with the requirement that the company recovers reasonable operating costs and has an opportunity to earn a reasonable return.
- The Commission is required to set rates that are fair, just, reasonable, and sufficient. The Commission uses a rate base / rate of return methodology to do that. A company that proposes a rate change bears the burden to demonstrate that it requires additional revenue and that the proposed rates are fair, just,

reasonable, and sufficient. To determine a company's revenue requirement, staff audits the company's books and records and applies regulatory principles to identify reasonable operating costs, company investment, customer contributions, appropriate rate base, and appropriate return.

- Staff has reviewed the supporting information filed by Southgate Water and audited the Company's books and records. Staff concludes that Southgate Water has demonstrated it needs the proposed annual revenue requirement of \$38,305.

Won't these rates produce a big profit for the water company?

- Staff has considered the effect of the proposed rate design and customer usage. If the customers reduce usage, little if any profit will be made. If the customers continue their usage patterns, there is a potential the Company could earn excess profit.
- Due to the extensive changes to the rate design (both rate price and usage blocks), staff recommended and Southgate Water has agreed to several conditions in this filing. Monthly revenues received above an adjusted base period will be considered excess revenues and deposited in a separate account. The Company will be required to provide quarterly reports to the Commission providing details on the account balance. Excess revenues will be considered Contributions In Aid of Construction and will only be used for conservation efforts to include educational materials provided to customers, conservation equipment provided to customers and additional source and capacity to serve customers. The Company will get approval from the Executive Secretary prior to spending the excess revenue, and all excess revenue that has not been spent by July 1, 2007 will be refunded to customers. The Company also proposes to evaluate the effect of the proposed rates at the end of 12 months and refile rates to become effective no later than April 1, 2007. Also, the usage rates are set to expire April 1, 2007, if no new rates are filed.

The following table, *Usage and Billing Comparison*, shows various usage amounts and what the water bills would be using current rates and proposed rates. The usage amounts are zero gallons (assume empty house); the lowest individual customer's average monthly usage for May through August of 7,563 gallons; 25,946 gallons average monthly use during eight winter months (September – April); 43,558 gallons average monthly usage for the twelve-month test period, and 60,508 gallons average monthly

usage for May through August. Staff also included the highest individual customer’s average monthly usage for May through August, **199,209** gallons. The table shows that a customer using a low amount of water, averaging 7,563 gallons per month over four months would pay \$150 (4 x \$37.50) and a customer using a high amount of water, averaging 199,201 gallons per month over four months would pay \$2,140.52 (4 x \$535.13).

Usage and Billing Comparison

Cubic Feet	Gallons Used	Company Current			Company Proposed					Bill	
		Base	Usage \$0.30	Current Total	Base	Usage 1 \$0.00	Usage 2 \$1.00	Usage 3 \$3.00	Proposed Total	Difference to Current	% Change
0	0	\$48.00	\$0.00	\$48.00	\$37.50	\$0.00	\$0.00	\$0.00	\$37.50	(\$10.50)	-22%
1,011	7,563	\$48.00	\$0.00	\$48.00	\$37.50	\$0.00	\$0.00	\$0.00	\$37.50	(\$10.50)	-22%
3,469	25,946	\$48.00	\$0.00	\$48.00	\$37.50	\$0.00	\$10.95	\$0.00	\$48.45	\$0.45	1%
5,823	43,558	\$48.00	\$0.00	\$48.00	\$37.50	\$0.00	\$28.56	\$0.00	\$66.06	\$18.06	38%
8,089	60,508	\$48.00	\$4.65	\$52.65	\$37.50	\$0.00	\$35.00	\$46.52	\$119.02	\$66.37	126%
26,632	199,209	\$48.00	\$46.26	\$94.26	\$37.50	\$0.00	\$35.00	\$462.63	\$535.13	\$440.87	468%

Why is the company changing its rate design?

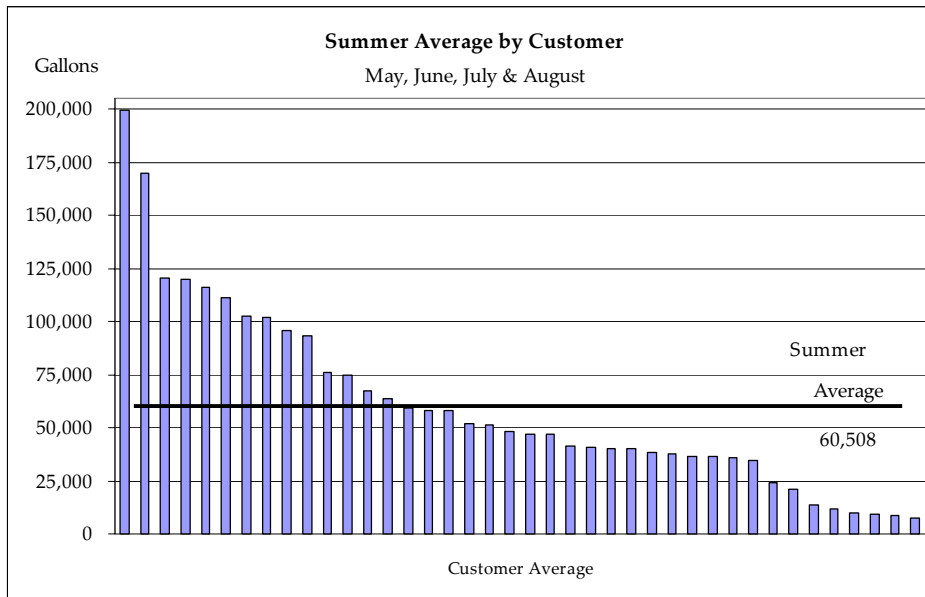
- With the increased growth of customers and more stringent drinking water regulations, conservation of natural resources helps to ensure adequate drinking water now and in the future.
- The 2003 Municipal Water Law, directs water utilities to encourage water use efficiency. Under the proposed rule ‘water use efficiency means minimizing supply and demand inefficiencies, and reducing water withdrawals and water use.’
- One of the tools available to water companies to reduce water usage is to adopt and implement a rate structure that encourages water conservation.
- Department of Health guidelines for types of efficiency rate structures identifies inverted rate structures similar to the Company’s proposal and seasonal rates to

include an additional charge for use above a specific threshold during months of high system demand.

The Company proposes rates of \$1.00 per 1,000 gallons from 15,000 to 50,000 and \$3.00 per 1,000 gallons for all usage over 50,000 gallons. This increasing usage and increasing cost is commonly called an inverted rate structure. The \$3.00 amount was selected by the Company based, in part, on its review of other rates in the Tri-Cities area by the company engineer. The 50,000 gallon break point is higher than the 43,100 gallons per month that the company's engineer determined to be the monthly average use for a household of five people and 4,000 square feet of lawn.

The Seattle Public Utility Annual Purveyor Survey, 2003 of rates charged by cities (10) and water districts (17) served by Seattle Public Utility showed all but five had inverted block rates. Of the cities with inverted block rates, five had rates in excess of \$6.68 per 1,000 gallons for high usage residential. Duvall charges \$6.89 per 1,000 gallons starting at 59,800 gallons, increasing to \$7.95 per 1,000 gallons above 74,800 gallons. Bothell charges \$6.89 per 1,000 gallons after 18,700 gallons. Staff believes that \$3.00 per 1,000 gallons over 50,000 gallons is reasonable as a starting point for rate design changes.

The chart below, **Summer Average by Customer**, shows the average monthly usage for May through September, by customer. The average monthly usage for May through September for all customers is 60,508 gallons (8,090 cubic feet) per month. As shown on the chart, two customers greatly exceeded the summer average at 199,209 gallons (26,630 cubic feet) and 169,905 gallons (22,715 cubic feet) per month.



By changing the usage blocks and using an inverted rate structure, Staff believes that high summer peaking usage will be reduced. This should allow operations and maintenance cost savings.

Recommendations

Reduced Allowance and Inverted Rate Design: Staff recommends the Commission accept the reduced base charge allowance and use an inverted rate design as the appropriate rate design that will promote conservation for this Company. Staff believes there is sufficient data to support this rate design and that discontinuing the current high allowance will result in conservation efforts and wise use of our natural resource.

Staff has audited the Company's books and records, concludes that the Company has demonstrated need for the additional revenue requested, and, with the conditions included in the accounting treatment, believes the Company has demonstrated that the proposed rates are fair, just, and reasonable. Therefore, Staff recommends that the Commission issue an order in Docket UW-051336 authorizing the accounting treatment recommended by staff and agreed to by Southgate Water Systems, Inc., and take no action on the tariff revisions filed in Docket UW-051336, thereby allowing them to become effective January 1, 2006, by operation of law.

Attachment