

Agenda Date: March 12, 2009
Item Number: A1

Docket: UW-082113
Company Name: Deer Meadows Water Company, Incorporated

Staff: Jim Ward, Regulatory Analyst
Dennis Shutler, Consumer Protection Staff

Recommendation

Dismiss the Complaint and Order Suspending the Tariff Revisions filed by Deer Meadows Water Company, Incorporated and allow the revised rates filed February 18, 2009, to become effective March 20, 2009.

Background

On November 21, 2008, Deer Meadows Water Company, Incorporated (Deer Meadows or company) filed with the Utilities and Transportation Commission (commission) tariff revisions that would generate \$215,307 (172 percent) in annual revenue. The company serves 351 customers: 199 residential customers, 150 ready-to-use residential customers, one golf course, and one restaurant/motel. The proposed rates were prompted by increases in supplies, power, laboratory fees and maintenance expenses. The proposed effective date for the original filing was January 20, 2009.

Deer Meadows' initial tariff filing with the commission became effective November 1, 2007. The company states that its last general rate increase was approximately five years ago. The company proposed to change residential rates from a one-block rate design with a 5,000 gallon usage allowance to a zero allowance, three-block rate design to encourage conservation. Currently, the company charges \$500 per month to serve both the restaurant/motel and the golf course. The company proposed to change the rates for the restaurant/motel and the golf course from flat rates to metered rates using a zero allowance, three-block rate design.

On November 22, 2008, the company notified its customers of the rate increase by mail. The commission received numerous customer comments on this filing as of March 5, 2009. The commission also heard comments on the filing at its December 23, 2008, open meeting. All customers are opposed to the proposed increase. A summary of the written comments were attached to the December 23, 2008, memorandum.

On January 8, 2009, staff participated in a customer meeting by conference call. About 12 customers participated along with the company's consultant, Belsby Engineering, and commission staff. The meeting agenda included an explanation of the commission's regulatory process, regulatory principles and rate-setting methodology. Since staff had not yet completed its audit, staff was not able to respond to some of the customers' specific questions on specific issues.

On January 15, 2009, the commission entered a Complaint and Order Suspending Tariff Revisions pending an investigation to determine whether the proposed rates are fair, just, reasonable and sufficient.

Staff and the company reviewed the company's original filing and agreed to a revised revenue requirement of \$34,499 (27.4 percent) in additional annual revenue and revised rates. On February 18, 2009, the company filed revised rates at the staff recommended level as follows:

- Base Charge: The base meter charge, which does not include any water usage, increases in proportion to the meter size to reflect the potential capacity demand on the water system, consistent with standard rate design
 - For residential customers and ready-to-serve customers, the original proposed base charge and ready-to-serve rates of \$54.50 per month are decreased to \$26.25 per month.
 - For the golf course customer, the original proposed base rate of \$500.00 per month is increased to \$874.38 per month.
 - For the restaurant/motel customer, the original proposed base rate of \$115.00 per month is increased to \$438.38 per month.
- Usage Rate: All water usage on the water system is charged at the same rate.
 - For all customers, the original proposed usage rates, ranging from \$1.05 to \$3.20 per 1,000 gallons, are decreased to \$.46 per 1,000 gallons.

Customers expressed concerns regarding water bills and usage. For 2007, the 199 residential customers consumed 41,760,639 gallons. The estimated golf course and restaurant/motel usage for 2007 was about 76 million gallons for the year.

The golf course provided daily usage data for the month of August 2008. Staff projects this data to represent about one-half the usage for 2007. The golf course is under new management and irrigation procedures have been changed starting in August 2008. Based on the golf course meter readings and improved water use practices, staff believes the estimated total water usage for future periods should be about 34,120,000 gallons. Based on the same period of meter readings the restaurant/motel is estimated to use 495,000 gallons for the projected future periods.

The customers of the water company and golf course management have expressed concerns about continued operation of the golf course with the end of the \$500 per month flat, unlimited use rate. Staff explained that its goal is to recommend rates that fairly allocate the costs of operating the water system to the rates paid by the various customers. Staff recognizes that many customers consider the golf course and the restaurant/motel as assets to their community, and staff encourages those customers to explore different ways for the community to support those customers. However, staff strongly believes the commission should not set rates that require all residential customers to pay higher rates that would subsidize the golf course and the restaurant/motel customers. Options that staff suggested to customers, golf course management, and the water company included:

- The golf course drill its own well;
- The golf course decrease water use;
- The golf course consider becoming a 9-hole course instead of an 18-hole course;
- Interested residents form an association to purchase and operate the golf course;

- Interested customers form a “Friends of the Golf Course” organization to help the golf course pay its water bills;
- The golf course consider creating a “Friend of the Golf Course” membership to help pay the water bills, and
- The golf course and restaurant/hotel customers review their water use requirements and, if appropriate, request the company to install smaller water meters to save on base rate charges.

Staff identified a \$46,000 loan between the company and a shareholder, an affiliate transaction. The loan was not subject to the terms of the commission’s securities filings because it was made before the company became regulated by the commission. The company entered into the agreement on October 5, 2007 and the water company dated the agreement October 11, 2008. The loan has an interest rate of 11 percent. Because this loan is an affiliated interest transaction, commission staff imputed an interest rate of 10.08 percent (prime plus two percent) for the test period of 2007, which is consistent with a previous commission decision. Staff determined that the company used the proceeds of the loan to cover operating expenses and removed costs related to the loan from our calculation of rates.

The company’s actual capital structure is \$46,000 (39 percent) debt and \$71,335 (61 percent equity), which staff believes is reasonable. This capital structure results in an 11.25 percent weighted average rate of return. However, staff disallowed the \$46,000 loan and used a hypothetical capital structure (40 percent debt and 60 percent equity), resulting in an 11.23 percent weighted average return. Using the hypothetical capital structure decreases the revenue requirement by \$69.

Residential customers using 3/4-inch meters have a revised base rate of \$26.25. Staff uses the capacity factor, as calculated by the American Water Works Association (AWWA), to calculate the base rate for larger meters. For a 4-inch meter (restaurant/motel), the capacity factor is 16.7 times a 3/4-inch meter, which calculates to a \$438.38 base rate. For a 6-inch meter (golf course), the capacity factor is 33.3 times a 3/4-inch meter, which calculates to an \$874.13 base rate. This form of rate design is common practice for the water industry on larger meter sizes and normally would include a similar adjustment to the usage blocks. The usage block adjustment is not possible for this rate case because of insufficient water usage data. For this case, staff believes the proposed single usage block and single usage rate for all customers are reasonable.

Customer Comments

A total of 52 customer comments have been received to date, all opposed the rate increase as originally proposed. Please note: Customers often address several issues of concern within one comment. Therefore, subtotals may not equal the total number of comments submitted.

Consumer Protection staff advised customers that they may access company documents pertinent to this rate case at utc.wa.gov, and utc.wa.gov/water and that they may contact Dennis Shutler toll-free at 1-888-333-9882 with questions.

Filing Documents and Methodology Comments

- Nine customers expressed concerns over the company’s proposed rate increase and the effect on the golf course.

Staff Response

Rates are designed to recover costs from water users. Under the revised rate design, the golf course will pay a base charge plus a usage charge. Residential water rates will not subsidize golf course water rates.

- Eleven customers mentioned their distrust of the information and documentation provided by the company to substantiate its rate increase, requesting staff review the company's financial records from more than only a single test-year period.

Staff Response

Staff only reviews one year of operating expenses and revenues called a "test period" to determine rates. Adjustments to this test period may be made to reflect a typical year of operations. The company filed 2007 as a test period and staff used the 2007 test period for the rate case.

- One customer inquired about the 2007 Profit/Loss statement showing a \$46,000 loan from a shareholder, wondering if this should be listed as income rather than an expense.

Staff Response

Loans to a company are neither income nor expenses. They are a source of funds reflected on a company's balance sheet. Normally, loans are used to purchase new assets. Because this loan was used to cover operating expenses, there was no recovery of costs related to the loan in rates.

- Eleven customers expressed concerns over the differences in the water system valuation surveys submitted by Munson Engineering at \$2,347,591 and what they believed to be an inflated valuation submitted by Thomas Dean & Hoskins (TD&H) at \$8,622,484.

Staff Response

Staff uses historical cost of plant less depreciation and contributions in aid of construction (CIAC) to determine the appropriate assets recovery amount known as rate base. Staff used neither study to determine rates. The surveys were not used to determine the rates for the company.

General Comments

- Twenty-seven customers believe the amount of the increase is unacceptable and unaffordable, mentioning the drastic increase in rates, increased costs of living and current economic conditions as the basis for their opposition. Customers stressed their fear of losing their landscaping and the green-belts surrounding their homes if they cannot afford to water, believing an increase based on inflation would be more reasonable.

Staff Response

Customers were advised that state law requires rates to be fair and reasonable for customers, but sufficient to allow the company the opportunity to recover operating

expenses and earn a return on investment. The commission cannot deny rates that are needed to cover company costs.

- Nine customers expressed their concern with the company submitting this filing during a time of year when a large number of residents were traveling outside the area and unable to respond with their concerns.

Staff Response

A company may submit a filing at any time the company believes it is able to support its request. The company initially submitted its filing on July 30, 2008, and later withdrew it on September 5, 2008. The company obtained additional documentation supporting its filing and again refiled its request on November 21, 2008.

- Nineteen comments mentioned poor company management, mentioning the company's poor record keeping practices and its mismanagement of company revenues as an additional basis for their opposition.

Staff Response

Staff reviews financial records and determines what costs are appropriate to pass to customers through rates. Staff found no evidence of mismanagement of company revenues. Staff found some historical plant cost records were not available (initial water system construction records). These historical costs were not allowed in rates, though the company may substantiate these costs at a later time. Previously, company revenues were supplemented by the \$2,000 connection charges, resulting from rapid growth in the company. As construction slowed these revenues diminished.

Rate Comparison

Monthly Rate	Current Rate	Proposed Rate	Revised Rate
Residential			
Ready To Serve	N/A	\$54.50	\$26.25
Base Rate (3/4 Inch Meter, 5,000 Gallon Allowance)	\$28.00	N/A	N/A
Base Rate (3/4 Inch Meter, Zero Allowance)	N/A	\$54.50	\$26.25
0 - 5,000 Gallons, Per 1,000 Gallons	N/A	\$1.05	\$0.46
5,001 - 10,000 Gallons, Per 1,000 Gallons	\$0.35	\$1.90	\$0.46
Over 10,000 Gallons, Per 1,000 Gallons	\$0.35	\$3.20	\$0.46

Monthly Rate	Current Rate	Proposed Rate	Revised Rate
Restaurant/Motel			
Base Rate (4 Inch Meter, Included With Golf Course)	N/A	N/A	N/A
Base Rate (4 Inch Meter, Zero Allowance)	N/A	\$115.00	\$438.38
0 - 10,000 Gallons Per 1,000 Gallons	N/A	\$0.30	\$0.46
10,001 - 50,000 Gallons Per 1,000 Gallons	N/A	\$0.75	\$0.46
Over 50,000 Gallons Per 1,000 Gallons	N/A	\$1.50	\$0.46
Golf Course			
Base Rate (6 Inch Meter, Flat Rate)	\$500.00	N/A	N/A
Base Rate (6 Inch Meter, Zero Allowance)	N/A	\$500.00	\$874.13
0 – 1,000,000 Gallons Per 1,000 Gallons	N/A	\$0.100	\$0.46
1,000,001 – 5,000,000 Gallons Per 1,000 Gallons	NA	\$0.325	\$0.46
Over 5,000,000 Gallons Per 1,000 Gallons	NA	\$0.410	\$0.46

Average Monthly Bill Comparison, Residential Customers

During staff's review of the filing and customer usage data, staff has determined that the average residential customer uses 5,645 gallons per month. Staff previously noted 9,907 gallons as the estimated average usage.

	Current Rate	Proposed Rate	Revised Rate
Base Meter Charge (3/4 inch meter)	\$28.00	\$54.50	\$26.25
5,000 Gallons usage	\$0.00	\$5.25	\$2.30
645Gallons usage	\$.23	\$1.23	\$0.30
Average Monthly Bill	\$28.23	\$60.98	\$28.85
Increase From Current Rates		(116%)	(2%)

Staff has completed its review of the company's supporting documents, books, and financial records. Staff's review shows that the expenses are required and reasonable for the company's operations. The company's financial information supports the revised revenue requirement of \$34,499 (27.4 percent) and the revised rates which are fair, just, reasonable, and sufficient. The company has agreed to upgrade its office technology and intends to refile after one year of operations. During that time the company will collect meter readings for all customers, improve accounting records and develop support for additional historical plant cost.

Conclusion

Therefore, staff recommends the commission dismiss the Complaint and Order Suspending the Tariff Revisions filed by Deer Meadows Water Company, Incorporated and allow the revised rates filed February 18, 2009, to become effective March 20, 2009.