Agenda Date: October 30, 2008
Item Number: A9

Docket: **UW-081226**
Company Name: Suncadia Water Company, LLC

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

Recommendation

1. Dismiss the Complaint and Order Suspending the Tariff Revisions filed by Suncadia Water Company, LLC;
2. Allow the revised rates filed September 30, 2008, to become effective November 1, 2008;
3. Apply deferred accounting treatment to the variable portion of the purchased water component of the usage rate and require the company to reconcile and "true up" customer usage charges after a period of twelve months, subject to the conditions set forth in staff's memorandum;
4. Grant an exemption from the provisions of WAC 480-110-375(3) to allow the company to not read meters when they are covered with snow and ice, subject to the conditions set forth in staff's memorandum; and
5. Require the company to file a new rate case no later than May 1, 2010, using actual customer water usage data.

Background

On July 3, 2008, Suncadia Water Company, LLC (Suncadia Water or company) filed with the commission tariff revisions that would generate $603,141 (499 percent) in additional annual revenue. All customers receive un-metered service. This is the company's first general rate increase since becoming regulated on May 15, 2008. Suncadia serves 125 mixed-use customers in a planned community consisting of single family homes, multi-family condominiums, a restaurant, a lodge and two golf courses. The water system is located near Cle Elum in Kittitas County.

Suncadia Water charges customers a flat rate for water service, but will change to metered rates with this proposed tariff. The company stated that it filed the proposed metered rates because of increased demands on the water system and the company's need to file "full cost recovery" rates to allow the company to become self-supporting. Along with this general rate case filing, the company has requested an exemption from WAC 480-110-375(3) to allow the company to not read meters for more than two consecutive months when the meters are covered with snow and ice.

Staff's review of the company's operations and financial records indicated that the company's proposed rates and rate design filed on July 3, 2008, were not justified. On July 31, 2008, the commission entered a Complaint and Order Suspending Tariff Revisions. Staff and the company reviewed the company's original filing and agreed to a revised revenue requirement of $670,092 (554 percent) in additional revenue per year, and to a revised rate design.

On September 30, 2008, the company filed revised rates and rate design at the staff recommended level. The original proposed ready to serve rate was increased from $10.00 to $20.79, and the original proposed usage rates ranging from $1.59 to $6.36, were changed to one usage rate at $2.65, both of which are higher than the rates in the company's original customer notice of July 2, 2008. The revised rates also increase and decrease base charges and fire flow rates.

Current, proposed and revised rates are shown in Attachment A.

Average Monthly Residential Bill Comparison

Average Monthly Residential Usage 6,725 Gallons	**Current Rate**	**Proposed Rate**	**Revised Rate**
Flat Rate	$35.00	NA	NA
Base Meter Charge	N/A	$43.86	$42.73
8,871 Gallons (July 31, 2008, Staff Memorandum)	N/A	$17.08	N/A
6,725 Gallons	N/A	N/A	$17.82
Average Monthly Bill	$35.00	$60.94	$60.55
Increase from current rates		(74%)	(73%)

Customer Notice and Comments

The company sent customers a notice on July 2, 2008, advising customers of the proposed rates and that customers could comment on the general rate filing at the commission's July 10, 2008, open meeting. No customers commented at that time. The commission received seven customer comments as of the July 10, 2008, open meeting and one follow-up customer comment. Staff's memorandum, dated July 10, 2008, summarized, and responded to, those comments.

On August 1, 2008, commission staff sent every customer who commented on the filing a letter advising them that the commission had suspended the filing. The commission received 33 additional comments regarding the rate increase. Staff's summary of those customer comments and its response are set forth in Attachment B.

The company sent a new notice to all customers on September 30, 2008, advising customers of the revised rates and that customers could comment on the revised rates at the commission's October 8, 2008, open meeting. One customer commented at that time. The commission received six additional comments since the September 30, 2008, notice, which are also addressed in Attachment B.

Water Company Background.

The Suncadia Resort area has been under development by different parties since the 1990s. Suncadia, LLC (Developer) is the current developer. The developers needed to acquire water sources and build water infrastructure facilities. The Developer began providing water service in November 2005. Staff met with the company in December 2007, March 2008, and April 2008 to discuss the transition to regulation.

Water Source. The Developer spent $9,563,607 to purchase water rights from various parties and transfer those water rights to allow domestic use at the Suncadia Resort location. The Developer contributed those water rights to Suncadia Water at the end of 2007.

Water Treatment and Delivery. The Developer contracted with the City of Cle Elum to provide potable water for domestic use and non-potable water for irrigation. The Developer contributed land and paid approximately $16.6 million in construction costs for facilities that are now owned and operated by the City of Cle Elum.

For potable water, the facilities pump water from the Yakima River, treat, store, and deliver the water to Suncadia Water's potable distribution system. For non-potable water, the facilities pump water from the Yakima River and deliver the water to Suncadia Water's irrigation distribution system.

To recover its costs, the Developer charges, by separate contract, the purchaser of each lot / unit a "Capital Recovery Fee" defined in the Developer's document titled "Addendum To Mountainstar Resort Homesites Lot Reservation And Purchase And Sale Agreement." As stated in that document, "…Capital Recovery Fees are for the purpose of reimbursing Seller for capital costs related to the construction of the off-site infrastructure for these utilities and area not in lieu of charges levied by the applicable utilities in connection with the provisions of water and sewer service to the Homesite." The fee was set at $3,777 in the document that staff reviewed. The Developer has collected approximately $3.8 million to date and expects to increase the fee over time and to eventually recover approximately $11.6 million of its investment.

Staff believes this is an appropriate way to recover costs incurred to build facilities that neither the Developer nor Suncadia Water now own. If Suncadia Water owned these facilities, staff would recommend that each customer pay a "facilities charge," in the same manner in which the Developer charges a "Capital Recovery Fee," except that staff would set the fee to recover the full original cost and provide a return on the investment at Suncadia Water's weighted average cost of capital over the usable life of the assets or projected build-out, whichever is shorter.

Water System - Distribution. Suncadia Water operates two separate water distribution systems: one system delivers potable water for domestic use and the second system delivers non-potable water for irrigation use.

The potable water system consists of two water storage tanks, several booster stations and the distribution system throughout the Suncadia development. The potable water system serves three categories of customers: (1) residential customers (single-family homes and condominium units) within the Suncadia development, (2) non-residential customers located primarily in the core development area (lodge, restaurant, inn, recreational facilities, etc.), and (3) potable irrigation customers within the Suncadia development.

The non-potable water system consists of a distribution system and one booster station that serves two golf courses and will serve a third golf course that is now under construction.

The Developer transferred these assets, with some designated as contributions in aid of construction (CIAC), to Suncadia Water at the end of 2007.

Affiliated Interest.

On September 8, 2008, Suncadia Water filed a letter advising the commission of several affiliated interest transactions. In support, the letter included attachments of a promissory note and a separate letter, dated September 8, 2008, describing payments to the affiliate for accounting services, management services and office space. The statute requires the company to file a "verified copy, or a verified summary if unwritten…." RCW 80.16.020. The promissory note is not verified. The letter summarizing the business services is verified.

The statute states the filing must be made prior to the effective date of the contract or arrangement. However, failure to file prior to the effective date does not void the transaction. The "cure" is to file the affiliated contract or arrangement, which Suncadia Water has done. The promissory note is dated December 31, 2007, prior to Suncadia Water filing its initial tariff with the commission on May 15, 2008, but perhaps not prior to Suncadia Water serving the 100th customer.

Staff placed the filing on the September 25, 2008, open meeting as a No Action item. The commission took no action. By taking no action, the commission accepted the filing as meeting the requirements of the statute as was the intent of the filing. Because the filing requested no rate treatment, the commission neither approved, nor disapproved, any rate making implication of the affiliated transaction.

Staff finds it useful to view the affiliated interest filing in two parts: (1) the contracts and arrangements for services, and (2) the payments for services. Filing the affiliate contracts and arrangements with the commission provides notice to the commission, nothing more. The commission is not required to take any action.

The commission may institute an investigation at any time after receiving the filing. The commission may disapprove the contracts and arrangements if the company fails to prove they are reasonable and consistent with the public interest. If the commission finds that the contracts and arrangements are reasonable and consistent with the public interest, the commission may approve them, but only if expressly conditioned upon the commission's continuing authority to revise the transactions and costs as required to meet the public interest. That is, although the commission can approve the contracts and arrangements to provide services as consistent with the public interest, the commission may not "pre-approve" the reasonableness of the payments associated with those contracts and arrangements for the purposes of setting rates.

During any rate case, such as the one you have before you today, the commission may exclude any payments for services provided by an affiliate unless the regulated company demonstrates that the payments are reasonable. Staff closely reviews affiliated payments in every rate case.

On October 6, 2008, Mr. Tom Miller, on behalf of the Suncadia Residents Owners Advisory Committee, asked the commission to reconsider its "…decision to allow certain affiliated interest transactions to become effective through their inclusion on the 'no action' agenda on September 25, 2008 in Docket No. 081636." As stated above, the commission neither approved, nor disapproved, the affiliated interest contracts or arrangements on September 25, 2008.

In support of his request, Mr. Miller states that the customers did not receive notice of the affiliated interest filing, that the "no action" approval of the affiliated interest issues in advance of the substantive discussions of the rate case "predetermines" or "prejudges" the cost of capital issues in the rate case, that Suncadia Water misrepresented that the 2007 loan was not governed by the affiliated interest statute on the theory that it predated commission regulation, and that the affiliated interest transactions are not supported by satisfactory proof. Mr. Miller asks the commission to reverse its decision to allow the affiliated interest filing to go into effect and decide the request for approval of the affiliated interest transactions in the context of the pending rate case.

> Staff's Response: Again, the commission neither approved nor disapproved the affiliated interest filing; it has not become "effective." The filing provides notice to the commission, nothing more. Moreover, there is no requirement that customers receive notice. As staff said at the October 8, 2008, open meeting, the cost of capital issue is properly before the commission in the rate case docket today. The 2007 loan is an affiliate transaction governed by the statute cited above, regardless of when Suncadia Water became jurisdictional or when the 2007 loan was executed. Staff's review of Suncadia Water's financial books and records included the information related to the affiliate payments, which staff believes provided satisfactory evidence of the nature and amount of those affiliated payments, as discussed below.
>
> Staff concludes that the affiliated transactions provide essential services and are typical of how other regulated water companies operate. Although in its cover letter accompanying its filing, the company sought approval of the affiliate transactions, no approval is necessary.

Staff recommends that the commission consider the above discussion responsive to the Suncadia Residents Owners Advisory Committee's letter dated October 6, 2008, in which the Committee requested the commission to "reconsider" the placement of Suncadia Water's affiliated interest filing on the September 25, 2008, open meeting "No Action" agenda.

Rate Case Issues

Affiliated Loan. Staff allows the actual cost of third party debt. For affiliated debt, staff relies on a prior commission decision in Docket UW-980072, American Water Resources, Inc., in which the commission authorized the use of the actual cost of debt or prime plus 200 basis points, whichever is less. The 6.06 percent interest rate on the affiliated debt is lower than the test period average prime rate of 8.08 percent plus 200 basis point for a total of 10.08 percent.

Affiliated Management and Billing Payments. Suncadia Water pays the affiliate:

- $37,500 annually for accounting, monthly billing, invoicing and responding to customer inquiries, and
- $2,880 for management services related to forecasting capital requirements and obtaining funding, review of operating results, reviewing and determining tariff issues, oversight of operations, and providing company financial directions and decisions.

Staff has reviewed both the services provided and the payments. Staff found the services necessary for Suncadia to conduct business and the payments for company management, accounting services, monthly billing, invoicing and responding to customer inquiries, including payroll, payroll taxes, office overhead, supplies and postage costs to be less than those of other regulated water companies of similar size, based upon customer count. Staff believes the payments are reasonable.

Affiliated Office Expense. Suncadia Water pays the affiliate $12,000 annually to lease 1,350 square feet of office and shop space, including utilities, property taxes, insurance and office cleaning services. Staff has reviewed office space rental in the area and found the monthly rents are approximately $1.00 per square foot, or $1,350 per month for the facility. The $1,000 per month rent payment to the affiliate, including utilities, property taxes, insurance and cleaning services, is less than market cost. Staff believes the payment is reasonable.

Return / Capital Structure. Staff calculated Suncadia Water's overall rate of return to be 9.73 percent using the company's actual capital structure of 39 percent debt and 61 percent equity. Staff believes the capital structure provides a reasonable balance between safety and economy. For affiliated debt, staff relies on a prior commission decision in Docket UW-980072, American Water Resources, Inc., in which the commission authorized the use of the actual cost of debt (6.06 percent) or prime plus 200 basis points (10.08 percent), whichever is less. For equity, staff relies on a prior commission decision in Docket UW-010877, Rainier View Water Company, Inc., setting equity return at 12 percent. Although staff reviewed the Developer's capital structure, we did not use that information to calculate return, which is consistent with the commission's decision in Docket UE-051090, Pacific Power and Light Company.

Assets on Each Water System. Asset costs are assigned directly and allocated. Staff reviewed the company's asset assignment, costs (both direct and allocated), and depreciation schedules, and concludes Suncadia Water's accounting is accurate and correct.

Utilities for potable water, irrigation water, sewer and the "dry utilities" (e.g. telecommunications, electrical and cable) are often constructed at the same time. Suncadia Water advised staff that the potable water system and the irrigation water system share a common trench of less than one mile. Some costs (e.g. materials, etc.) are easily assigned directly to each utility. Other costs (e.g. trenching, surveying, paving, erosion control, etc.) are shared, or common, costs that must be allocated. The company used the direct costs of each utility to assign the common costs. Each utility service was assigned the percentage of common costs equal the percentage of its direct costs to the total direct costs of all utilities. This allocation method is relatively standard among engineering companies and staff believes it results in a reasonable allocation of the indirect costs.

Water rights are allocated to each water system based upon usage, together with the same amount of contribution-in-aid-of-construction (CIAC).

Water Rights. The Developer contributed $9,563,607 in water rights to Suncadia Water. This provides a significant benefit to customers because water rights do not depreciate. As investment, customers would pay $930,539 (using 9.73 percent return that staff recommends in this rate case) every year, or, assuming that potable water uses 50 percent of the water rights, approximately $11.35 per month per ERU. As contributed plant, customers will pay nothing for the water rights.

Staff has allocated the cost of the water rights, offset by the same amount of contribution-in-aid-of-construction (CIAC), to the two separate water systems based on 2007 usage. As a practical matter, it makes no difference how the water rights are allocated, because the allocation is offset by the same amount of CIAC, resulting in "zero" cost to customers.

Operating Expenses. Staff has reviewed the company's allocation of staff operating costs between the two water systems and believes they are reasonable for this case. The company allocated staff expenses, net of ancillary charge revenues, based upon experience. The company does not have time records or other written documentation. Although the company has committed to maintaining timesheets in the future, it has not yet started. The company reviewed its maintenance staff work load and assigned amounts to potable water service, fire protection service, irrigation water service, and ready-to-serve class customers. Within the potable water class and irrigation class, the company allocated 50 percent to the base charge and 50 percent to the usage charge. The overall maintenance staff cost is about 71 percent to potable water and 29 percent to irrigation.

Customer Water Usage. Suncadia Water is a new system that has not previously had metered rates or consistent meter readings. Several customers stated concerns that the figures for average water usage are based on sample meter readings, engineering estimates, and growth projections, not actual historical usage. Indeed, the company has proposed various usage numbers based on different methodologies.

Rates are properly set using water sold, as measured at the customer's meter. Suncadia Water does not have sufficient data to do that at this time. Instead, Suncadia Water proposes to use average water purchased to set metered rates. The result will under collect revenue because all water systems have some leakage, the difference between water purchased and water delivered to the customer's meter. Department of Health rules will require all water systems to achieve less than ten percent leakage no later than 2020.

Staff believes that setting rates based on purchased water is a reasonable first step to transition to metered rates and eventually, multiple usage blocks with inverted rates to encourage conservation. To ensure that the customers pay for the water they use, and that the company receives adequate revenue for the water it purchases, staff recommends that if the commission approves the revised rates, that the commission apply deferred accounting treatment to the variable portion of purchased water component of the usage rate and require the company to reconcile and "true up" customer usage charges to reflect the actual amount of water purchased during the first twelve months, as set forth in greater detail in Attachment C. The actual purchased water cost as compared to projected purchased water cost will be distributed among all customers using each customer's actual usage, and billed or credited over the following twelve months.

To set more accurate rates, including moving to multiple usage blocks with inverted rates, staff recommends the commission require Suncadia Water to file a new rate case no later than May 1, 2010, using actual customer usage data.

Meter Reading Exemption Suncadia Water requested an exemption from WAC 480-110-375(3) to allow the company to not read meters for more than two consecutive months when the meters are covered with snow and ice. Staff has reviewed and supports the proposed billing process of charging only the base meter charge each month during periods when snow or ice cover meter boxes. The company will bill the usage charge over the same number of months that the company did not read the meters. These "catch up" usage payments will be in addition to payments for the regular monthly bills. Staff believes the requested exemption from WAC 480-110-375(3) is appropriate.

Conclusion

Commission staff has completed its review of the company's supporting financial documents, books and records. Staff believes that Suncadia Water's proposed methodologies, as adjusted by staff and agreed to by the company, taken as a whole, provide reasonable results, both in terms of revenue requirement and rates. Staff's review shows that the expenses are reasonable and required as part of the company's operations. Additional customer comments do not change staff's opinion that the company's financial information supports the revised revenue requirement and the revised rates and charges are fair, just, reasonable, and sufficient.

Staff recommends that the commission:

1. Dismiss the Complaint and Order Suspending the Tariff Revisions filed by Suncadia Water Company, LLC;
2. Allow the revised rates filed September 30, 2008, to become effective November 1, 2008;
3. Apply deferred accounting treatment to the variable potion of the purchased water component of the usage rate and require the company to reconcile and "true up" customer usage charges after a period of twelve months, subject to the conditions set forth in staff's memorandum;
4. Grant an exemption from the provisions of WAC 480-110-375(3) to allow the company to not read meters when they are covered with snow and ice, subject to the conditions set forth in staff's memorandum; and
5. Require the company to file a new rate case no later than May 1, 2010, using actual customer water usage data.

ATTACHMENT A
Rate Comparison

Ancillary Charge	Current Rate	Proposed Rate
Reconnection	N/A	$40.00 Per Hour
Service Visit	N/A	$30.00
Late Payment	N/A	2 % or $5.00
Account Set-up	N/A	$30.00
NSF Charge	N/A	$10.00
Hydrant Meter Deposit	N/A	$500.00
Repair / Damage	N/A	$40.00 Per Hour

Monthly Rate	Current Rate	Proposed Rate	Revised Rate
Residential			
Ready To Serve	$10.00	$10.00	$20.79
Un-metered Service	$35.00	N/A	N/A
Base Charge 1 Inch Meter	N/A	$43.86	$42.73
Residential Usage All usage above zero	N/A	N/A	$2.65 Per 1,000 Gallons
Residential Usage 0 – 7,000 Gallons	N/A	$1.59 Per 1,000 Gallons	N/A
7,001 – 14,000 Gallons	N/A	$3.18 Per 1,000 Gallons	N/A
>14,000 Gallons	N/A	$6.36 Per 1,000 Gallons	N/A

Non- Residential			
Base Charge 2 Inch Meter	N/A	$140.35	$136.74
Base Charge 3 Inch Meter	N/A	$280.70	$256.38
Base Charge 4 Inch Meter	N/A	$438.60	$427.30
Non-residential – All Usage	N/A	$2.54 Per 1,000 Gallons	$2.65 Per 1,000 Gallons

Suncadia Lodge			
The Lodge at Suncadia (mixed use)	N/A	$9,746.58	$9,494.61
Lodge Fire Protection	N/A	$137.97	$171.20
Non-residential – all usage	N/A	$2.54 Per 1,000 Gallons	$2.65 Per 1,000 Gallons

ATTACHMENT A
Rate Comparison
(Continued)

Monthly Rate	Current Rate	Proposed Rate	Revised Rate
Fire Protection			
Fire Protection Fee 1 Inch	N/A	$5.43	$5.35
Fire Protection Fee 2 Inch	N/A	$17.38	$17.12
Fire Protection Fee 4 Inch	N/A	$54.30	$53.50
Fire Protection Fee 6 Inch	N/A	$108.60	$107.00
Potable Irrigation			
Base Charge 1.5 Inch Meter	N/A	$80.28	$78.12
Base Charge 2 Inch Meter	N/A	$128.45	$124.99
Base Charge 3 Inch Meter	N/A	$256.90	$234.36
Potable Irrigation – All Usage	N/A	$2.54 Per 1,000 Gallons	$2.65 Per 1,000 Gallons
Golf Course Irrigation			
Base Charge 6 Inch Meter Non-Potable Irrigation	N/A	$3,220.77	$3,220.77
Non-Potable Irrigation – All Usage	N/A	$.36 Per 1,000 Gallons	$.36 Per 1,000 Gallons