State of Utah
Department of Commerce
Division of Public Utilities

FRANCINE GIANI
Executive Director

THAD LEVAR
Deputy Director

PHILIP J. POWLICK
Director, Division of Public Utilities

JON HUNTSMAN Jr.
Governor

GARY HERBERT
Lieutenant Governor

Exhibit DPU 1.1

-=-=-= M E M O R A N D U M =-=-=-

TO: **PUBLIC SERVICE COMMISSION OF UTAH**

FROM: **DIVISION OF PUBLIC UTILITIES**
Philip J. Powlick, Division Director
Bill Duncan, Manager, Telecom & Water Section
Shauna Benvegnu-Springer, Utility Analyst
Kasi Boede, Intern

DATE: May 11, 2009

SUBJECT: In the Matter of the Request of Highland Water Co. for Approval of a Rate Increase

RE: Docket No. 08-010-01, 08-010-T01

RECOMMENDATION: APPROVE DIVISION RECOMMENDATION

The Division of Public Utilities (DPU or the "Division") completed a compliance audit and site visit on December 1, 2008. The Division completed a thorough analysis of the proposed rate increase for Highland Water Co. (Highland or the "Company") following the compliance audit. Highland has experienced financial losses for the past five (5) years, consecutively from 2003 through 2007. Hence, the Division recommends that the Commission approve a rate increase to be effective May 1, 2009. However, the Company's proposed rate increase is excessive as determined by the DPU. The Division recommends that the Commission approve the Division recommended rates, corresponding tariff language changes and implementation process.

INTRODUCTION:

On October 17, 2008, the Company filed an application for a rate increase due to the financial losses experienced during 2006 and 2007 in excess of $40,000 each year. The Company is located in Mountain Green, Morgan County, Utah with 319 metered customers, of which the majority of customers are residential. The current tariff became effective on November 7, 1983, more than twenty-five (25) years ago.

BACKGROUND:

The Company received a Certificate of Public Convenience and Necessity (CPCN) Number 1520 on May 28, 1965. The proposed service area included the cities of Morgan and Highland, Utah. The service area is supported by two (2) active springs and approved for approximately six hundred (600) connections. Currently Highland consists of 313 residential and 6 commercial connections. Initially, the Company charged $6.00 per month minimum charge, which included 6,000 gallons. Water usage over the 6,000 gallons was charged $0.90 per thousand gallons.

The Company requested a rate increase in 1983 to cover rising expenses. The Commission issued an order No. 84-010-T01 to increase the minimal charge to $12.00 per month, which included 6,000 gallons. Water usage over 6,000 gallons was charged $1.00 per thousand gallons. The tariff change was approved by the Commission and became effective November 7, 1983, and has remained in effect to date.

The Company requested a tariff increase on October 17, 2008 (shown in the following table) under Docket No. 08-010-T01:

Current Rates		Proposed Rates	
Water Usage Rates			
Residential Rate		**Effective 3/1/2009**	
Min. Rate: up to 6,000 gallons	12.00 per month	Min. Rate: up to 6,000 gallons	48.00 per month
Tier 1: usage per 1,000 gal over 6,000 gallons	1.00 per 1,000 gal	Tier 1: usage per 1,000 gal over 6,001 to 25,000 gallons	1.75 per 1,000 gal
Tier 2: usage per 1,000 gal	Not applicable	Tier 2: usage per 1,000 gal over 25,001 to 50,000 gallons	2.25 per 1,000 gal
Tier 3: usage per 1,000	Not applicable	Tier 3: usage per 1,000 gal over 50,001 gallons	2.50 per 1,000 gal
Connection Fees			
Turn on service fee	20.00	Turn on service fee	100.00
Non-Payment Disconnect Charge	Not applicable	Non-Payment Disconnect Charge	$50.00
Non-Payment Reconnect Charge	Not Applicable	Non-Payment Reconnect Charge	$50.00
3/4" service line	2,500.00	3/4" service line	2,500.00
1" service line	2,500.00 + the difference in cost	1" service line	2,500.00 + the difference in cost
Stand-By Fees			
Any connection	Not applicable	Any connection	Not applicable
Additional Charges			

ANALYSIS:

The Division reviewed annual reports submitted by the Company for the years ending December 31, 2000 through December 31, 2008. The Company willingly provided information to the Division for analysis, such as water utilization records, plant and equipment records, revenue, purchase and expense records, and full disclosure and explanation for various transactions. The Division met with the Company's representative, Roger Smith, and spoke on several occasions to discuss profitability, future costs and water rate design. The Division has found the Company to be cooperative, however slow to access and provide information. The Company is current on all its reporting requirements to the Division. The Division used the calendar year 2008 as the test year for the basis of expenses and rate base. Adjustments, by the Division, were made to revenue, expenses, depreciation of certain assets over a period and disallowed certain expenses the Division believes should not be borne by the ratepayers.

ADJUSTMENTS TO THE TEST YEAR:

The estimated revenue growth of 2.28% was calculated from the average growth for the years 2005 through 2007as shown in Exhibit 1.2. Even though the eight (8) year average is slightly higher at 3.08%, the Division has taken a conservative approach and used 2.28%. Growth in the region has decreased over the same period, and is not expected to continue because of the recent instability of the real-estate market. Keeping the same three (3) year timeframe, operating expenses are expected to increase by 10.69% annually.

REVENUE:

The Division has included a few adjustments to the revenues as shown in the analysis of DPU Exhibit 1.3:

a) METERED RESIDENTIAL CUSTOMERS- An adjustment of $25,424 increased revenue for the anticipated connections’ minimum use and overage amount based on 2.28% growth.

b) CONNECTION FEES - An adjustment of $7,300 increased revenues for the anticipated growth of connection fees.

OPERATING EXPENSES:

The Division has included several adjustments for the test year for operating expenses as shown in DPU Exhibit 1.3:

a) RENTAL OF BUILDING- An adjustment of $700 decrease to eliminate rent expense for the prior calendar year of 2007,

b) INSURANCE- After discussions with the Company, the amount of $3,500 was added as an expense to the test year since liability insurance was not paid in 2008,

c) MISCELLANEOUS EXPENSE- An adjustment of $267 decrease to disallow Christmas party expenses to not be borne by the ratepayers,

d) DEPRECIATION EXPENSE - The amount of $5,520 decreased the test year expenses to correct depreciation life and rates to those allowed by the Public Service Commission. See Exhibit 1.4.

After the operating expense adjustments were made to the 2008 test year, operating expenses decreased from $177,306 to $174,319. Based on a 10.69% growth factor, the forecasted operating expense is $190,249.

RATE BASE ADJUSTMENTS:

The Division adjusted the rate base as shown in DPU Exhibit 1.5:

a) ACCUMULATED DEPRECIATION – This adjustment increased the rate base by $6,427 to correct the amount of accumulated depreciation, using the PSC allowed depreciation rates.

b) WORKING CAPITAL – The adjustment of $22,365 increased the rate base because of the Division adjustment to Operation and Maintenance Expenses and expected growth rate.

DIVISION RECOMMENDATIONS:

RATES:

The Division's analysis shows the proposed rates by the Company are not just or reasonable. The adjusted rate base is $232,304. The rate of return on rate base was calculated by allowing a 12% return on equity and 5.25% rate on debt, and computing a weighted rate of return of 6.31% (see DPU Exhibit 1.6). Federal and state taxes were calculated to be $3,667 based on a return of $14,658. Operating expenses were adjusted to be $190,249 bringing the revenue requirement for the Company to have the opportunity to be profitable to $208,586. Yet the amount it would collect by implementing the Company's proposed $48.00 rate and tier rate overage fees would be $261,250, hence the Company would be over-earning by $52,664 (see DPU Exhibit 1.7). Therefore, the Division recommends a minimum rate of $32.00 and implementation of a conservation tariff structure for overages of $1.00, $1.50, and $2.75. The amount the Company would then collect would be $208,647; over-earning by about $61 (See calculation from DPU Exhibit 1.8). However, projected revenues are based on current usage amounts. Should the conservation tariff be adopted, usage may decline. Therefore, the Company's forecasted revenues may not reach the amount projected.

Since the rates proposed are a large increase to the customer, the Division supports the modified rate increase to be implemented over a 6-month period. The first increase would be effective

May 1, 2009, of $22.00 for the minimum rate. The second increase would be effective November 1, 2009, to the full $32.00 for the minimum rate. The conservation tier structure would be effective May 1, 2009. This would allow the impact to the customers to be absorbed over a longer period rather than a 166% increase all at once.

UTILIZATION:

The Company's high levels of fixed expenses are expected to be covered by revenue from the minimum billing rate. The Division does not want to rely solely on utilization overages, since a conservation tariff, structure is being recommended and usage and revenue may decrease. If the current 319 customers are billed at the minimum $32.00 recommended rate, then the $122,496 revenue will cover the $120,423 in fixed expenses. See Exhibit 1.8.

Below, the Division has shown the impact to customers due to the rate increase. A percentage of change from current to recommended rates on Customer 1 is 166.6%, Customer 2 is 81.6%, and Customer 3 is 67.6%, respectively.

CURRENT 2 MONTH BILL

Customer	Usage in gallons	Min Rate (24.00)	Tier 1 (1.00) 12,000+	**Total Bill**
Customer 1	10,000	24.00		**24.00**
Customer 2	37,000	24.00	25.00	**49.00**
Customer 3	110,000	24.00	98.00	**122.00**

RECOMMENDED 2 MONTH BILL

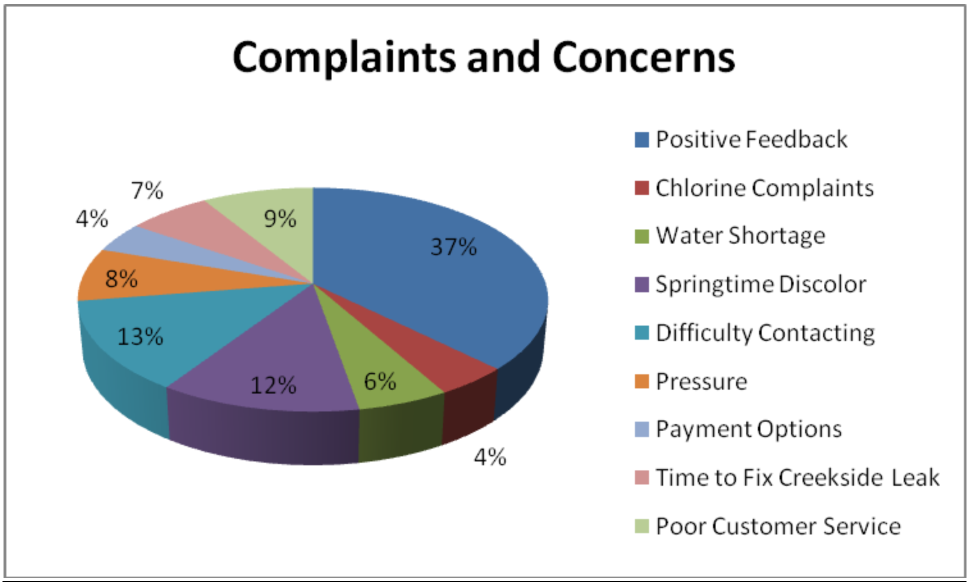
Customer	Usage in gallons	Min Rate (64.00)	Tier 1 (1.00) 12,000-	Tier 2 (1.50) 50,000-	Tier 3 (2.75) 100,000+	**Total Bill**
Customer 1	10,000	64.00				**64.00**
Customer 2	37,000	64.00	25.00			**89.00**
Customer 3	110,000	64.00	38.00	75.00	27.50	**204.50**

RESERVES:

The Division is concerned about the Company's lack of financial reserves. The Company does not anticipate infrastructure replacements in the very near future, however the Company currently does not have any reserves set aside for such. It is imperative that the Company prepare and foresee for the normal use and replacement of the infrastructure for an effective water system. Therefore, the Division recommends that the Company place the annual total depreciation amount into a reserve account; i.e. for 2008, the amount would be $18,862. This is equal to the amount claimed on the Company's depreciation schedule based off the Commission approved service lives in Rule R746-322-1. (See Exhibit 1.4)

CUSTOMER FEEDBACK:

The Division conducted a customer survey to inquire about the quality, billing, customer service and overall satisfaction of the Company (Exhibit 1.9). Over half of Highland customers replied. The majority were pleased with the water pressure and taste of their water. Fifty-eight (58%) percent of the customers that responded reported discolored water, primarily in the spring due to snowmelt and runoff. The billing process was deemed satisfactory or better than average, other than the lack of online payment options. In general, the Company received positive feedback. However, there were a few concerns that were raised. The most common was the difficulty contacting Highland personnel; resulting in poor customer service. The Division advises the Company to place a 24-hour contact number on customer billing statements to resolve this issue, with a message for emergency contact for after business hours. Other customer concerns are noted in the chart below:



<u>ADDITIONAL TARIFF LANGUAGE:</u>

The Company has requested additional language to its tariff. The following are the requested changes which have been summarized from the full view in Exhibit 1.10:

WATER RATE AND SERVICE SCHEDULE:

a) The Company would like to add additional language to the **Applicability** section to read:

"A customer unit is defined as a single family dwelling, condo, apartment, storage unit, business, single or office with multi unit's each paying a monthly base, service station, food service business, factory, shop, processing plant, or other establishment or concern that might apply for water service domestic or any other purpose."

The Division agrees the additional language clarifies the definition of a customer unit.

b) *The following rate/rates will apply for a one-month billing period for each month of the year. We reserve the option of billing in a two-month period. Each unit will pay a monthly service charge for a 12-month period. This charge may/will be subject to change as the cost of living increases each year.*

The Division recommends that the Company should standardize on a two-month billing period. The monthly service charge is the same as a the minimum rate charge which includes 6,000 gallons water for each month. The Division disagrees that the charge will be subject to change based on the cost of living, since the Commission must approve all rates changes to the Company's tariff.

c) *Premises temporarily without a meter will be charged the base rate. If a connection or meter is found to be tampered with, a fine can/will be charged.*

The Division agrees premises temporarily without a meter be charged the minimum rate of $35.00 per month. The Division disagrees with a fine for tampering with the meter at this time, since no further information has been submitted, such as the amount of the fee or the cost to repair a "tampered" meter.

d) *Under Connection Charges of the tariff the Company is requesting the Turn On Service Fee to increase to $100.00.*

The Division recommends the Company add definitions to the tariff to explain that the Turn On Service Fee is a one time charge when a connection is added to the system OR when a property owner sells, transfers or changes the name on the file of the water company.

e) The Company is requesting to add a *"Non-Payment Disconnect Charge and a Non-Payment Reconnect Charge of $50.00 each to pay for the cost to disconnect a connection and reconnect a connection due to lack of payment."*

The Division agrees that the Non-Payment Disconnect Charge and the Non-Payment Reconnect Charge are just and reasonable.

RULES AND REGULATIONS:

a) In the **Connection** section the proposed changes do not change the meaning or purpose.

The Division agrees with the proposed changes.

b) The additions to the **Application for Permit** section that read: *Applicants will furnish and install all material to be used in said connection that is not furnished by the company at their own expense. This installation will require an on sight inspection to insure quality of work and material, by a representative of the company qualified to do so with a 24-hour notice, will be required for application and inspection.*

The Company has withdrawn these changes to the tariff.

c) *The **Metering of Service** section will remove the option for customers to request a meter test and add language describing fines for tampered meters for the purpose of obtaining water.*

The Company has withdrawn these changes to the tariff.

d) *The **Meter Adjustment** section will add the option of billing the previous months and years average if a meter fails to register the water delivered.*

The Company has withdrawn these changes to the tariff.

e) *In the **Service Connections** section the changes do not change the meaning or purpose.*

The Division agrees with the proposed changes.

f) *Additional language will be added in the **Service Line** section so that the applicant provides a corporation stops valve on each service line prior to the meter valve.*

The Company has withdrawn these changes to the tariff.

g) *A section titled **Multi Unit Service Line** will be added: Dwellings with multi-unit occupants may or may not have a separate meter for each unit. However, each unit will* *pay a separate impact or development fee. In addition, a separate monthly billing to each unit will be charged.*

The Company has withdrawn these changes to the tariff.

h). *In the **Service Turn-on/Turn-off** section do not change the meaning or purpose.*

The Division agrees with the proposed changes.

i) *In the **Disruption Liability** section the statement "and shall make a reasonable effort to furnish them with a clean, pure supply of water, but" will be replaced with "that meets the State and Federal guidelines."*

The Division agrees with the proposed changes.

*j) Language was added to the **Damage to Facilities** section to clarify the meaning.*

The Division agrees with the proposed changes.

k) The **Reading of Meters** section was altered to: *The Company shall read all meters in the spring as early as possible, and in the fall as late as practicable. The bi-monthly charges between fall and spring will be charged at the monthly minimum and all overage* *charges for this period will be billed on the first reading bill in the spring at the first tier rates.*

The Division agrees with the proposed changes.

l) *In the **Billing and Payments** section the additional language allows for disconnect and reconnect fees.*

The Division agrees with the proposed changes

m) *In the **Regulated Usage** section the proposed changes do not change the meaning or purpose.*

The Division agrees with the proposed changes.

n) *New language is added in the Changes and Amendments section that states, "the Company reserves the right to have rule and regulation amendments approved by the Board of Directors and the Public Service Commission."*

The Division agrees with the proposed changes.

o) In the **Credit Deposit** section the language was altered to have deposits equal to one billing period, i.e., the equivalent of two months minimum charge of $64.00, and after six (6) months the amount will be refunded or credited to the customer's account if an current customer.

The Division agrees with the proposed changes.

FACILITY AND LINE EXTENSION POLICY:

a) In the **Facility and Line Extension** section the proposed language clarifies but does not change the meaning or purpose.

The Division agrees with the proposed changes.

b) Minimum standards were eliminated from the **Construction Standards** section the following is proposed:

> *The extension shall meet all the company requirements as well of the State Division of Drinking Water and county health codes. Capacity sizes shall be in accordance with state codes and a minimum of 8" in diameter as per company standards also the company may require a certain type of material and will be installed in dedicated streets roads or recorded easements.*

CONCLUSION:

The Division concludes that the proposed rates as recommended by the Company are not just and reasonable. The Company has incurred financial losses for the past five (5) years. In addition, expenses have increased over the last 7 years through 2007 by 47%, yet the water rates have remained the same since November 7, 1983. Generated revenue cannot sustain the rising expenses. The Division recommends:

a) the residential minimum rate be increased to $32.00 per month from $12.00 per month minimum charge,

b) the conservation tariff structure be implemented such that;

   i. Tier 1 gallons range from 12,001-50,000 for $1.00 per 1,000 gallons

   ii. Tier 2 gallon range from 50,001-100,000 for $1.50 per 1, 000 gallons

   iii. Tier 3 gallon range above 100,001 for $2.75 per 1, 000 gallons

   iv. Overages shall be measured and billed every two months

c) the billing periods to remain in 2 month increments where winter billings may be estimated at a 6,000 gallon monthly minimum and in the first reading of the calendar year only, where overages occur, customers will be charged at the first tier rate for all overages,

d) the tariff language be modified as the Division has noted agreement, and

e) modify the schedule of implementation to increase over the next six months as discussed.