



GARY HERBERT.  
Governor  
GREG S. BELL  
Lieutenant Governor

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

--- MEMORANDUM ---

**TO:** PUBLIC SERVICE COMMISSION OF UTAH

**FROM:** DIVISION OF PUBLIC UTILITIES  
Philip J. Powlick, Division Director  
Bill Duncan, Manager, Telecom & Water Section  
Mark Long, Utility Analyst *ML*

**DATE:** June 14, 2010

**SUBJECT:** Amended Recommendation In the Matter of the Request of Hidden Creek Water Company for Approval of a Rate Increase

**RE:** Docket No. 09-2440-01

**RECOMMENDATION:** APPROVE AMENDED DIVISION RECOMMENDATION

The Division of Public Utilities (DPU or the "Division") has completed the review of the new information received subsequent to the Public Service Commission's (Commission) order dated February 9, 2010 regarding Hidden Creek Water Company ("Hidden Creek" or the "Water Company") request for a rate increase dated July 2, 2009.

**RATES AMENDED BASED ON NEW INFORMATION**

New information received by the Division has resulted in the Division amending their initial recommendation of January 20, 2010. This information consists of the following three items:

1. Two new connections were added, bringing the total number of water users from 18 to 20 and the total number of connections increased from 48 to 49. Also, updated usage amounts were used in the projections as found in Amended Exhibit 1.2.
2. The state and federal projected income tax annual expense is revised based on additional information. The annual income tax expense estimate is reduced by \$3,000.00.

3. Labor expense of \$1,020.00 is added to the qualifying expenses to cover the back-up operator's wages. In the past, the back-up operator, who is also a customer, performed the duties in lieu of paying for his water. Going forward, to show this as an arm's length transaction and to add transparency, the books of Hidden Creek will show the back-up operator labor as an expense equal to the annual amount of the 'system fee' and 'minimum monthly usage' for an annual total amount of \$1,020.00. See ***Recommendation No. 1, (Page 5).***

The net effect of items 2 and 3, above, reduces the original total revenue requirement from \$49,858.11 to \$47,878.11. See Amended Exhibit 1.1, lines 1 through 4, for further details regarding the total revenue requirement.

Based on the above items, the amounts from original Exhibit 1.7 are adjusted on Amended Exhibit 1.1, lines 5 through 12, and the corresponding rates presented below in ***Recommendation No. 2, (Page 6).***

The recommended rates generate projected revenues of \$48,453.77 through tier 2. Based on previous levels of water usage, the Division projects there will be some usage in tier 3. The Division believes that usage in tier 3 is too speculative to be included in the Revenue Generation calculation in Amended Exhibit 1.1, lines 16 through 21. However, if revenues from tier 3 should exceed the associated additional variable expenses, these revenues should be earmarked to cover variable expenses in years with revenue shortages. From time to time, these excess revenue amounts should be reviewed and any unused amounts should be applied to the Capital Reserve account to be used for the extra wear and tear put on the infrastructure in the production and distribution of the overage gallons.

### **DIVISION RESPONSES TO CUSTOMER ISSUES AND CONCERNS**

In addition to revising the rates, the Division has summarized the issues and concerns of several of the water company's customers/intervenors.

#### **A. Capital Reserve Account:**

##### **Customer Concern(s):**

- A.1. Ensure that there are clear rules for withdrawing funds from the escrow account containing the Capital Reserve funds.
- A.2. Set a maximum target amount for the Capital Reserve Account balance.
- A.3. Create a line item surcharge for the Capital Reserves fund on the bill.
- A.4. What happens to the funds set aside in the Capital Reserve amount in the event another company purchases Hidden Creek Water Company?

**Division Response:**

A.1. The Division has already recommended clear and identifiable rules for the use of the Capital Reserve Account funds and has not changed from their original recommendation. See *Recommendation No. 3, (Page 7)*.

A.2. Setting a target amount for the Capital Reserve Account initially sounds reasonable, but imposing a cap of any amount less than the current total replacement cost defeats the purpose of having a reserve account to be used for repairs and replacement of the infrastructure. The Division reviews Hidden Creek's Annual Reports, including the Capital Reserve Account and if the Capital Reserve Account should ever reach the point that the reserve account exceeds the replacement cost of the total infrastructure, the Division will recommend to the Public Service Commission that the amount being set aside be reduced or eliminated until it becomes in balance.

A.3. In order to promote trust and more transparency the Division is recommending that a separate line item show the amount of the bill that is being set aside for the Capital Reserve Account. See *Recommendation No. 4, (Page 8)* for additional details. Additionally, the Division recommends that an accounting of the Capital Reserve Account be provided annually. See *Recommendation No. 5, (Page 8)*.

A.4. The funds in the Capital Reserve Account are an asset of Hidden Creek Water Company. Upon the event that Hidden Creek is purchased by another company, the Commission will issue an order detailing how the sale is to take place, including how the assets will be distributed.

**B. Financial Disclosure:**

**Customer Concern(s):**

B.1. Require the water company to have an independent CPA audit their financial reports.

B.2. Require the water company to prepare their financial reports in accordance with generally accepted accounting principles.

B.3. Require the company to issue to each customer a copy of the audited financial statements.

**Division Response:**

B.1. In general, the Division recognizes the value of audited financial statements. Hidden Creek has a simple and straight-forward business structure and accounting system and the Division found no indication of misuse or inappropriate accounting practices and the Division does not believe that Hidden Creek Water Company or their customers would benefit from an independent financial audit and the corresponding increase in rates to pay for the additional services.

B.2. The Division's audit of the books and records of Hidden Creek verified that Hidden Creek's records were very well maintained and the accounting performed in accordance with generally accepted accounting principles.

B.3. This is a privately held company and the level of financial disclosure sought by some of the customers is excessive and too far-reaching. Hidden Creek has fully disclosed all financial information to the auditors of the Division of Public Utilities, who are charged with protecting the interests of the customers of the water company. As a note, all regulated water companies submit annual reports that can be reviewed by the public unless the utility specifically requests they be held confidential.

**C. Compensation (Wages):**

**Customer Concern(s):**

C.1. Reduce or limit the amount of compensation paid to the company operator.

C.2. Require that any increase in Tracy Tanner's salary be approved by the Commission.

**Division Response:**

C.1. In order to verify that Ms. Tanner's salary is appropriate, the Division required Ms. Tanner to obtain bids from two other certified operators to operate Hidden Creek's water system. These bids came in 50% and 90% higher than Ms. Tanner is being compensated. The Division believes that the wages paid to Ms. Tanner are fair and the level of care of the water system is excellent. See *Recommendation No. 6, (Page 8)*.

C.2. The labor amounts are set in the original recommendation, Exhibit 1.2 as follows:

Billing	\$ 2,400
Water Master Duties	8,400
Testing	1,200
Total Wages	\$12,000

Any material labor costs in excess of the above set amounts would result in an annual revenue shortfall which would be noted during the Division's annual review of Hidden Creek's Annual Report.

**D. Rate Structure Should be a Flat Rate:**

**Customer Concern(s):**

D.1. The expenses should be borne equally by all customers, regardless of their levels of water usage.

**Division Response:**

D.1. Several of the customers have requested a flat rate where each customer would pay the same amount regardless of their usage. Curiously, many of the customers requesting the use of a flat rate are using less than average water and, therefore, would be subsidizing those using more than the average.

For example, the Division learned that during the four-day Memorial Day weekend a single customer used in excess of 100,000 gallons of water. To put this into perspective, the average Utah household of four uses less than 4,000 gallons over a 4-day period during the summertime, which includes watering landscape. If a customer chooses to use exorbitant amounts of water they should pay for the privilege, never mind the environmental impact caused by the excessive water use.

The Division has also added additional water usage tiers to their original recommendation. The new tiered rates are designed to promote water conservation by increasing the cost per unit volume of water at each successive usage level or tier. This rate structure will encourage water conservation by giving those customers who choose to conserve greater control over their bills.

This appears to already be having a positive effect on conservation as one of Hidden Creek’s customers has already fixed a long-time leak to avoid having their water usage reach the more expensive upper tiers.

**DIVISION RECOMMENDATIONS:**

***Recommendation No. 1:***

The Division determined that the labor amounts paid to the back-up operator, Mr. White, are reasonable and recommends that the \$1,020 annual labor costs be funded in the rates.

***Recommendation No. 2:***

2. Rates and Charges

<b>Rate Changes:</b> <span style="float: right;"><i>(Amended Table 1)</i></span>			
<b>Description</b>	<b>Current Tariff</b>	<b>Original DPU Recommendation</b>	<b>Amended Recommended by Division</b>
System Expense	\$33.00 per month	\$61.00 per month	\$53.00 per month
<i>Note: The System Expense of \$53.00 is made up from the following items:</i>		<i>Capital Reserves:</i>	\$28.50
		<i>Fixed Expenses:</i>	\$24.50

<b>Rate Changes:</b>			
			<i>(Amended Table 1)</i>
<b>Description</b>	<b>Current Tariff</b>	<b>Original DPU Recommendation</b>	<b>Amended Recommended by Division</b>
First 12,000 gallons	\$5.00 per month	\$49.50 per month	\$32.00 per month
Monthly usage in excess of: 12,000 gallons.	78.3¢ per 1,000 gallons	\$5.00 per 1,000 gallons	<i>See below for tier rates</i>
Monthly usage from: 12,001 to 50,000 gallons.			\$2.75 per 1,000 gallons
Monthly usage from: 50,001 to 94,000 gallons.			\$3.75 per 1,000 gallons
Monthly usage in excess of: 94,001 gallons.			\$7.00 per 1,000 gallons
Water Service Turn-on & Turn-off charges	\$25.00	\$100.00	\$100.00
Late Fees: (To be assessed each billing period if there is a prior balance owing on a customer's account.)	\$5.00	\$5.00	\$15.00
First time service connection fee, up to a 2" service connection. (One time charge for hot tap and install meter and setter in can with lid.)	<i>See below for original service connection fees</i>	\$3,350.00	\$3,350.00
First time service connection fee, up to a 2" service connection. (One time charge to set yoke and meter in can.)		\$2,850.00	\$2,850.00
¾"-Line meter connection fee	\$1,550.00	<i>These fees replaced by the above service connection fees.</i>	
1"-Line meter connection fee	\$2,000.00		
2"-Line meter connection fee	\$2,500.00		
Inspection Fee	\$25.00	\$25.00	\$100.00

***Recommendation No. 3:***

Regarding the Capital Reserve Account, the following was taken directly from the original Commission Order issued February 9, 2010, which still applies.

- a. Capital reserve amounts generated from rates shall be deposited into a restricted account, such as a separate escrow account, within 30 days from the receipt of rate payments;
- b. Withdrawals shall be made from the Capital Reserve Account for capital replacements and improvements only;
- c. In accordance with Utah Administrative Rule R746-401-3A, expenditures in excess of five percent of total Utility Plant in Service, shall require the water company to file a report with the Commission, at least 30 days before the purchase or acquisition of the asset or project, and to obtain written Commission approval before transacting such acquisitions.
- d. Hidden Creek shall provide an ‘annual accounting’ of the Capital Reserve Account with its Annual Report and at any such other time as the Commission requests. The ‘annual accounting’ shall be in the form of bank statement encompassing the entire calendar year showing a series of deposits made within 30 days from the receipt of rate payments for each billing cycle and withdrawals that meet requirements a, b and c above.
- e. The balance in the reserve account shall be clearly identifiable in the audited financial statements as a restricted account.

In identifying a qualifying expenditure for replacement or improvements that may be made from the Capital Reserve Account, the Company shall consider the following guidelines:

- a. Capital improvements are typically high cost items with long service lives including: the distribution pipe mainlines, storage reservoirs, wells and surface water intakes, etc. Expenditures that qualify as capital expenditures are those which extend the life of an asset and/or enhance its original value with better quality materials or system upgrades.
- b. Capital improvements do not include such minor expenses as repair clamps, inventory parts and fittings, spare pieces of pipe kept to facilitate repairs, small tools, maintenance supplies such as paint or grease, service contracts and other such day to day supplies. Expenses for these items are properly classified as “operating and maintenance” expenses.

c. Additionally, it is not appropriate to use capital replacement funds received from existing customers for system expansion, that is, to extend main lines to serve new areas or customers or to install new services. Funds for the expansion of the system should come from new development, connection fees, assessments or other sources so that those benefiting from the improvement contribute the funds for its construction.

***Recommendation No. 4:***

The division is adding to their recommendation that the water company shows the Capital Reserve Account as a separate line item in their billing statements. For example, a typical bill would have the following line itemizations:

System Fees:	
Fixed Costs	\$24.50
Capital Reserve	28.50
Minimum Usage fee	32.00
Tier 1 Usage	(Varies)
Tier 2 Usage	(Varies)
Tier 3 Usage	(Varies)

***Recommendation No. 5:***

The Division recommends that an accounting of the Capital Reserve Account be provided to the water customers on an annual basis by the water company showing, at a minimum, the beginning balance, annual deposits, annual withdrawals and the ending balance.

***Recommendation No. 6:***

The Division determined that the labor amounts paid to Ms. Tanner are reasonable and recommends that the \$1,000 monthly labor costs be funded in the rates.

Recommendations 7 and 8 are based on discussions with water company customers and Hidden Creek.

***Recommendation No. 7:***

The Division recommends reading the meters monthly from April 1<sup>st</sup> through October 1<sup>st</sup> annually, weather permitting.

Winter months shall be billed at the minimum usage amount. The winter usage and billings shall be adjusted based on the first meter reading in the spring. As an assurance to the water customers that they will not be billed at tier 3 rates as a result of a leak, during the time period that the meters are not read monthly, the maximum monthly billing adjusted after the first spring reading cannot exceed that of the maximum usage



allowed through tier 2, unless it can be established that the customer actually used an excessive amount of water.

***Recommendation No. 8:***

The Division recommends that the new rates be effective as of June 1, 2010. Billings for service charges and usage prior to June 1, 2010 shall be based on the current approved tariff prices (old rates).

**CUSTOMER IMPACT**

The Division is aware that this amended recommendation is still a large increase and will have a big impact on ratepayer's bills, but without a developer subsidizing the Water Company as in the past, and keeping prices artificially low, the Water Company must now fund its expenses and establish a minimum financial reserve through its revenues. Using the updated usage amounts, the annual billings based on the amended recommended rates are, on average, 25% lower than those of the original recommendation. The amended recommended rates generate annual billings that are from 174% to 375% higher than the tariff rates.

**CONCLUSION**

The Division asserts that the rates and charges set forth in Amended Table 1 are just and reasonable and consistent with the public interest and, therefore, the Division recommends that the Commission approve these new rates and other recommendations contained herein.