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Exhibit DPU 1.1

--==-- MEMORANDUM ==--

TO: PUBLIC SERVICE COMMISSION OF UTAH

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

DATE: December 9, 2008

SUBJECT: In the Matter of the Request of White Hills Water Co., Inc. for Approval of a Rate Increase

RE: Docket No. 08-2199-01, 08-2199-T01

RECOMMENDATION: APPROVE

The Division of Public Utilities (DPU or the "Division") completed a compliance audit on September 10, 2008 and an analysis of the proposed rate increase for White Hills Water Co., Inc. (WHWCI or the "Company"). The Company has experienced financial losses for the past seven (7) years, consecutively from 2001 through 2007. The Company also needs to replace equipment over the next few years. Therefore, the Division recommends that the Commission approve the proposed rate increase to be effective incrementally over the next 18 months, effective January 1, 2009.

INTRODUCTION:

On June 12, 2008, the Company filed an application for a rate increase due to the financial losses the Company has experienced during 2005, 2006 and 2007 in excess of \$10,000 each year. The Company is located on the western slope of Cedar Valley in Utah County with 124-metered customers. Of the 124 customers, 13 customers have a one-inch (1") connection for a five (5) acre lot and 111 customers have a three quarter inch (¾") connection for an one (1) acre lot, but all are classified as residential customers. The current tariff issued on July 28, 2003 became effective on September 1, 2003.

BACKGROUND:

The Company received a Certificate of Public Convenience and Necessity (CPCN) Number 2766 on August 12, 1994. The White Family owned the Company. The proposed service area consisted of over 2,000 acres and was approved for up to 404 connections. At the time of the application in September 1993, there were 12 connections with expected growth over many years. Initially, the Company was approved to charge \$10.00 per month minimum charge, which included 5,000 gallons with usage over 5,000 per month being charged at \$1.00 per thousand gallons.

The Company filed a request for a rate increase on April 3, 2003 in order to cover increased operational costs. The Commission issued an order on July 28, 2003 and the tariff change became effective on September 1, 2003, and has remained in effect to date.

In 2007, the White Hills Water Company and the White Hills Land Company were purchased by Cedar Valley Water LLC and are now managed by DAI, Inc.

The Company requested a tariff increase on June 12, 2008. The Division met with the Company and had numerous conversations discussing various rate design options. The Company filed a modified tariff increase on October 20, 2008 (shown in the following table) under Docket No. 08-2199-T01:

| ACTUAL RATES | | PROPOSED RATES | |
|---|---------------------------|---|---------------------------|
| Water usage Rates | | | |
| Residential Rate | | effective January 1, 2009 | |
| Base Rate: up to 10,000 gallons | | Base Rate: up to 10,000 gallons | |
| 3/4" service connection | <u>\$15.00 min per mo</u> | 3/4" service connection | <u>\$25.00 min per mo</u> |
| 1" service connection | \$20.00 min per mo | 1" service connection | \$25.00 min per mo |
| Tier 1: usage per 1,000 gallons over 10,000 | \$1.50 per 1,000 gallons | Tier 1: usage per 1,000 gallons next 10,000 | \$2.75 per 1,000 gallons |
| Tier 2: | Not Applicable | Tier 2: usage per 1,000 gallons next 10,000 | \$3.25 per 1,000 gallons |
| Tier 3: | Not Applicable | Tier 3: usage per 1,000 gallons over 40,000 | \$3.75 per 1,000 gallons |
| | | effective June 1, 2009 | |
| | | Base Rate: up to 10,000 gallons | |
| | | 3/4" service connection | <u>\$29.00 min per mo</u> |
| | | 1" service connection | \$29.00 min per mo |
| | | Tier 1: usage per 1,000 gallons next 10,000 | \$3.00 per 1,000 gallons |
| | | Tier 2: usage per 1,000 gallons next 10,000 | \$3.50 per 1,000 gallons |
| | | Tier 3: usage per 1,000 gallons over 40,000 | \$4.25 per 1,000 gallons |

| | | |
|--|---|--------------------------|
| | effective January 1, 2010 | |
| | Base Rate: up to 10,000 gallons | |
| | 3/4" service connection | \$33.00 min per mo |
| | 1" service connection | \$33.00 min per mo |
| | Tier 1: usage per 1,000 gallons next 10,000 | \$3.50 per 1,000 gallons |
| | Tier 2: usage per 1,000 gallons next 10,000 | \$3.75 per 1,000 gallons |
| | Tier 3: usage per 1,000 gallons over 40,000 | \$4.50 per 1,000 gallons |
| | effective June 1, 2010 | |
| | Base Rate: up to 10,000 gallons | |
| | 3/4" service connection | \$38.00 min per mo |
| | 1" service connection | \$38.00 min per mo |
| | Tier 1: usage per 1,000 gallons next 10,000 | \$4.25 per 1,000 gallons |
| | Tier 2: usage per 1,000 gallons next 10,000 | \$4.75 per 1,000 gallons |
| | Tier 3: usage per 1,000 gallons over 40,000 | \$5.25 per 1,000 gallons |
| Commercial Rate | effective January 1, 2009 | |
| | Base Rate: up to 10,000 gallons | |
| | 3/4" service connection | \$75.00 min per mo |
| | 1" service connection | \$75.00 min per mo |
| | Tier 1: usage per 1,000 gallons OVER 10,000 | \$3.80 per 1,000 gallons |
| Industrial Rate | effective January 1, 2009 | |
| | Base Rate: up to 10,000 gallons | |
| | 3/4" service connection | \$75.00 min per mo |
| | 1" service connection | \$75.00 min per mo |
| | Tier 1: usage per 1,000 gallons OVER 10,000 | \$1.50 per 1,000 gallons |
| Agricultural Rate | effective January 1, 2009 | |
| | Base Rate: up to 10,000 gallons | |
| | 3/4" service connection | \$75.00 min per mo |
| | 1" service connection | \$75.00 min per mo |
| | Tier 1: usage per 1,000 gallons OVER 10,000 | \$1.50 per 1,000 gallons |
| Premises temporarily without a meter will be charged the minimum rate. | | |

| Connections Fees | | | |
|--|---|--|---|
| 3/4" Service to Property Line | \$1,100 | 3/4" Service to Property Line | \$3,800 |
| 1" Service to Property Line | Proportionate Fee | 1" Service to Property Line | \$4,750 |
| 1 1/4" Service to Property Line | Not Applicable | 1 1/4" Service to Property Line | \$6,400 |
| Turn on service fee | \$20 | Turn on service fee | \$50 |
| Standy-By Fees | | | |
| Any connection | Not Applicable | Any connection | \$30.00 per month |
| Additional Charges | | | |
| Late Fee | \$10.00 or 10% of the delinquent amount, which ever is greater, applied to the unpaid balance at the time the next statement is prepared. | Late Fee | \$10.00 or 10% of the delinquent amount, which ever is greater, applied to the unpaid balance at the time the next statement is prepared. |
| Returned Check Fee | \$25.00 | Returned Check Fee | \$25.00 |
| Reconnect Charge after Disconnection for non-payment | \$30.00 | Reconnect Charge after Disconnection for non-payment | \$30.00 |

ANALYSIS:

The Division reviewed annual reports for the years ending December 31, 2001 through December 31, 2007 (See Exhibit 2.2). The Company readily provided information to the Division for analysis, such as water utilization tables, land 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 and spoke on several occasions to discuss profitability, future costs and water rate design. The Division has found the Company to be very organized and cooperative. The Division used the calendar year 2007 as the test year for water utilization, expenses and rate base. Adjustments were made to revenue, expenses and rate base to record changes in growth, amortize certain expenses over a period and disallowed certain expenses the Division believes should not be borne by the ratepayers.

ADJUSTMENTS TO THE TEST YEAR:

The estimated growth of 3.75% (rounded to 4%) over the next 3 years was calculated as the average growth for the past seven (7) years shown in Exhibit 2.2. Although DAI of Utah Inc. (the Land Developer) forecasts growth of 25 residential homes per year over the next five years. The Division has taken a conservative approach and used the estimated average growth of 4% per year.

REVENUE:

The Division has included several adjustments to the revenues as shown in the analysis of DPU Exhibit 1.2 a) an adjustment to the metered residential customer revenue for the anticipated minimum use and overage of new connections, and b) and adjustment to connections fees.

METERED RESIDENTIAL CUSTOMERS- An adjustment of \$11,434 increased the revenues for the anticipated connections' minimum use and overage amount of 4% growth.

CONNECTIONS FEES - An adjustment of \$2,700 increased the revenues for the anticipated growth of connection fees.

STANDBY FEES - An adjustment of \$3,600 was made for the proposed standby fees of 5 anticipated lots.

After the revenue adjustments were made to the 2007 test year, revenues increased by \$17,734 to \$86,606 from \$68,872.

OPERATING EXPENSES:

The Division has included several adjustments for the test year for operating expenses as shown in DPU Exhibit 1.2: a) an adjustment to payroll costs, b) an adjustment to benefits costs, c) an adjustment to accounting costs, d) an adjustment for donations, e) and an adjustment to depreciation expense:

SALARIES & WAGES - An adjustment of \$23,100 increased the salaries and wages of the 1099 employees i.e., the Water Manager & the Water Master increasing the operating costs.

EMPLOYEE PENSIONS & BENEFITS - The amount of \$657 decreased the test year expense for benefits related to the employees since they were reclassified as 1099 contractors rather than employees.

CONTRACTUAL ACCOUNTING - The amount of \$2,400 increased the expenses since in the past the Water Manager had performed the accounting work. Since the purchase of the Company, managing company, DAI, INC., will bear the cost of accounting and management functions.

INSURANCE GENERAL LIABILITY – After discussions with the Company, the amount of \$2,000 was added as an expense to the test year since the insurance was pre-paid in December 2006 and again in January 2008.

DONATIONS - The amount of \$764 decreased the test year amount for the cost of donations made by the Company.

REPAIR & DAMAGE EXPENSE - During 2008, the Company experienced repairs and damage loss of \$133,000 which was not covered by the insurance company. The Division has included an adjustment of \$13,300 for the next ten years to recover the cost of this loss.

DEPRECIATION EXPENSE - The amount of \$2,785 increased the test year expenses to correct depreciation life and rates to those of the Public Service Commission allowed life and rates. See Exhibit 2.1.

INTEREST EXPENSE - The debt of the loans that were transferred from the White Hills Land Company to DAI, Inc. will remain at the same terms as previously negotiated with White Hill Land Company. Therefore, no change was made to the interest expense for the test year.

After the operating expense adjustments were made to the 2007 test year, operating expenses increased by \$40,643 to \$133,346 from \$92,703.

RATE BASE ADJUSTMENTS:

The Division made several adjustments to the rate base as shown in DPU Exhibit 1.3 to include a) improvements to utility plant, b) accumulated depreciation and c) working capital.

IMPROVEMENTS TO UTILITY PLANT – The adjustment of \$105,600 increased the rate base due to:

- a) automation of the 500,000-gallon tank and 1,100 gpm pump for \$21,300
- b) 1 million gallon tank pressure regulator for \$22,500
- c) replacement of 1,100 lineal feet of 6" still pipe with a 6" bluebird culinary water pipe for \$34,800 and,
- d) 122 radio read meters and the radio reader for \$27,000.

ACCUMULATED DEPRECIATION – This adjustment decreased the rate base by \$2,785 to correct the amount of accumulated depreciation, using the PSC allowed depreciation rates.

WORKING CAPITAL – The adjustment of \$4,855 increased the rate base because of the \$39,379 expense adjustment to Operation and Maintenance Expenses.

RATES:

The Division's analysis shows the proposed rates to be just and reasonable. The adjusted rate base is \$639,922. The rate of return on rate base was calculated by allowing a 12% return on equity and 7% rate on debt, and computing a weighted rate of return of 4.4% (see DPU Exhibit 1.4). Federal and state taxes were calculated to be \$7,079 based on a return of \$28,387. Base operating expenses were adjusted to be \$157,823 (including the interest expense of \$24,447). Therefore, the revenue requirement for the Company to maintain profitability is \$193,307, yet the amount it will collect by implementing the new proposed rates and fees will be \$190,388. The Company therefore will be under-earning by \$2,919. (See calculation from DPU Exhibit 1.5)

Since the rates proposed are a large increase to the customer, the Division supports the modified rate increase to be implemented over an 18-month period. The first increase would be effective January 1, 2009, the second increase would be effective July 1, 2009 (rather than June 1, 2009), the third increase would be effective January 1, 2010 and the fourth increase effective July 1, 2009 (rather than June 1, 2010). This would allow the impact to the customer to be absorbed over a longer period rather than a 90% increase all at once.

The Company has requested three additional rate classifications of commercial, industrial and agriculture rates. Currently all customers are classified as residential customers. The proposed rates were reviewed and compared with other commercial, industrial and agriculture rates charged within the State of Utah.

Commercial Rate: The Company has requested a commercial rate of \$75.00 minimum fee for the first 10,000 gallons for each service connection that meets the commercial definition. Water usage above 10,000 gallons would be at \$3.80 per 1,000 gallons in addition to the minimum charge. Since the company does not currently have a commercial rate, the Division compared the proposed rate to commercial rates throughout Utah ranging from as low as \$12.15 to as high as \$70.11 for the first 10,000 gallons. For the additional usage, the range is as low as \$.85 for the next 1,000 gallons to as high as \$8.15 per 1,000 gallons. The Division is recommending the minimum charge be adjusted to a proposed rate of \$54.00 effective January 1, 2009 and a charge for additional usage as proposed of \$3.80 for use above 10,000 gallons. The minimum charge of \$54 would be halfway between the residential proposed rate of \$38 and the high of \$70.11. See Exhibit 2.3

Industrial Rate: The Company has requested an industrial rate of \$75.00 minimum fee for the first 10,000 gallons for each service connection that meets the industrial definition. Water usage above 10,000 gallons would be at \$1.50 per 1,000 gallons in addition to the minimum charge. Since the company does not currently have an industrial rate, the Division compared the proposed rate to industrial rates throughout Utah ranging from as low as \$12.15 to as high as \$139.00 for the first 10,000 gallons. For the additional usage, the range is as low as \$.85 for the next 1,000 gallons to as high as \$2.55 per 1,000 gallons. The Division is recommending implementing the Company's request because it is within the range of rates used within the State of Utah. See Exhibit 2.3 page 2.

Agriculture Rate: The Company has requested an agriculture rate of \$75.00 minimum fee for the first 10,000 gallons for each service connection that meets the agriculture definition. Water usage above 10,000 gallons would be at \$1.50 per 1,000 gallons in addition to the minimum charge. Since the company does not currently have an agriculture rate, the Division compared the proposed rate to agriculture rates throughout Utah ranging from as low as \$5.00 to as high as \$36.00 for the first 10,000 gallons. For the additional usage, the range is as low as \$.10 for the next 1,000 gallons to as high as \$9.63 per 1,000 gallons. The Division is recommending implementing a lower minimum charge of \$38.00 for the first 30,000 gallons, plus a tier rate of \$5.50 for 30,001 to 60,000 gallons per 1,000, an additional rate of \$3.50 for the 60,001 to 90,000 gallons per 1,000, an additional rate of \$2.00 for 90,001 to 120,000 gallons per 1,000 and an additional rate \$1.50 for 120,001 gallons and above per 1,000 gallons. The Division is recommending this type of structure because it follows similar agriculture rates used within the

State of Utah and it would provide an incentive for those who engage in agriculture activities.

See Exhibit 2.3, page 3.

Definitions: The Division suggests the Company add to the proposed tariff the following definitions as defined by the *Utah's Division of Water Resources: Planning for the Future 2008*.

Commercial Use - Water uses normally associated with small business operations, which may include drinking water, food preparation, personal sanitation, facility cleaning and maintenance, and irrigation of landscapes

Industrial Use - Use associated with the manufacturing or assembly of products, which may include the same basic uses as a commercial business. The volume of water used by industrial businesses, however, can be considerably greater than water use by commercial businesses.

Institutional Use - Uses normally associated with operation of various public agencies and institutions including drinking water; personal sanitation; facility cleaning and maintenance; and irrigation of parks, schools, cemeteries, playgrounds, recreational areas and other facilities.

Residential Use - Water used for residential cooking; drinking; washing clothes; miscellaneous cleaning; personal grooming and sanitation; irrigation of residential lawns, gardens, and landscapes; and washing automobiles, driveways, etc.

Agriculture Use - Water used for producing an agriculture product for sale, transfer, barter, exchange, etc. either through irrigation of pasture and feed for livestock or for livestock which must have clean water for the livestock to drink or for producing plant crops. Residential lawn and garden uses are not included.

CONCLUSIONS:

The Division concludes that the proposed rates as recommended are just and reasonable. The Company has incurred financial losses for the past seven years. Prior to the Company being sold, the losses were subsidized by the White Hills Land Company. In addition, some of the expenses were not reported by the White Hills Water Company, such as the full cost of personnel to operate the system, accounting, and repairs. This kept water rates artificially lower to attract homeowners. The Division recommends:

- a) the definitions be added,

- b) the commercial minimum rate be \$54.00 instead of \$75.00 minimum charge,
- c) the agricultural rate be changed to a \$38.00 minimum of the first 30,000 gallons and the increasing tier rate as recommended, and
- d) the schedule of implementation be modified to increase every six months through January 1, 2010.

The Division concludes that the recommended rates to the modified tariff request of October 20, 2008 are just and reasonable.