

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Request of Sherwood)
Water Company for Approval of a Rate) DOCKET NO. 09-075-01
Increase) REPORT AND ORDER
)

ISSUED: May 11, 2010

By The Commission:

This matter is before the Commission on Sherwood Water Company's (Sherwood or the company) request for approval of a rate increase. The company filed its request August 14, 2009. The company's rates have not changed since the current owner purchased the company about eleven years ago. Its operating expenses have increased and it requires an appropriate rate of return to cover its debt and expenses.

A hearing was held on March 30, 2010. Sherwood company representatives Scott Johnson and Peggy Bryner appeared. Two public witnesses, Marion Robins and Roy Peterson, commented. Patricia Schmid, assistant attorney general, represented the Division of Public Utilities.

The company was granted a certificate of public convenience and necessity (CPCN) on March 31, 1983. It was first owned and operated by Mrs. Flora Wood until July 1, 1998 when Mark Johnson bought the company. He ran the company until his passing, December 31, 2008. His widow, Beth Johnson, became the president and his six children became vice presidents. Scott Johnson is the operations manager. Peggy Bryner is the Secretary/Treasurer and Breanne Johnson is the bookkeeper.

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The Division audited the company and also assisted them in filing their past-due 2008 annual report and completing 2009's annual report. It submitted its recommendation on February 22, 2010.

The Division, after its audit, noted that the company was being heavily subsidized. It stated that Beth Johnson was also president of Mark's Backhoe Service (Mark's Backhoe). Since Mark Johnson purchased Sherwood, Mark's Backhoe has regularly paid for many of Sherwood's expenses. Its employees have also donated many hours of labor to maintaining Sherwood. As a result, the Division asked the company to review Sherwood's and Mark's Backhoe expenses for 2009, to differentiate between expenses of the two. The review revealed a loss of \$41,494.00 each year for Sherwood.

During its audit, the Division also learned that the company had increased their rates unauthorizedly in August 2008 without Commission approval from \$15 to \$35 for the first 8,000 gallons , and from \$15 to \$25 for a standby fee, and for \$.50 to \$1.00 per gallon over 1,000 gallons. The Division notified the company that it might need to refund amounts collected if the rates charged were too high. But after the audit, the Division found the company was still operating at a significant loss even after the unauthorized increase. After reviewing Sherwood's accounts and other records, the Division used the 2009 year as the test year. Revenue adjustments were made from \$24,317 to \$51,726. Based on its audit, the Division recommended the following rate and tariff changes, which were higher than those initially proposed by Sherwood:

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Description	Current Tariff	Recommended by Division
System Expense	\$15.00 per month	\$31.25 per month
First 8,000 gallons		\$10.50 per month
Standby Fees	\$15.00 per month	\$31.25 per month
Usage per 1,000 gallons over 8,000 gallons	50¢ per 1,000 gallons	\$1.75 per 1,000 gallons
Water Service Turn-on & Turn-off charges	\$25.00	\$100.00
Late Fees on bills past due by 30 days or more.	None	18% per annum or 1.5% per month
First time service connection fee	\$2,200.00	\$2,500.00
Fee for unwarranted service call: (Unwarranted service call defined as a service call that is determined to be customer responsibility.)	None	Actual cost
Transfer of ownership fee	None	\$50.00 ¹

In the Division’s Exhibit 1.9, submitted after the hearing, the Division showed the impact the proposed rates would have on five of Sherwood’s customers based on their actual twelve-month usage:

Customer	Annual Gallons	Current Unauthorized Rates		Recommended Rates		Overall increase
		\$35 Minimum to 8,000 gallons; \$1.00 per 1,000 over 8,000 \$25 Standby Fees	% increase from approved rates	\$41.75 Minimum to 8,000 gallons; \$1.75 per 1,000 over 8,000; \$31.25 Standby fees	% increase from current unapproved rates	
A	0 (Stand-by fee only)	\$300.00	67%	\$375.00	25%	108%
B	96,000	\$420.00	133%	\$501.00	19%	178%
C	107,560	\$464.94	130%	\$579.65	25%	186%
D	153,230	\$525.23	126%	\$685.15	30%	195%
E	317,890	\$671.53	120%	\$941.18	40%	208%

¹ The Division’s recommendation had a typographical error that listed this amount as \$500.00. At the hearing, the Division affirmed that the amount should be \$50.00, not \$500.00.

The Division noted some significant donations of time, labor, and other financial considerations Mark's Backhoe was willing to donate or provide at reduced cost to allow Sherwood to operate effectively at a lower cost than otherwise possible. It also mentioned the need for Sherwood to begin maintaining liability insurance.

1. Payment on Tank Loan

In 2006, a new 136,000 gallon water storage system was built to provide adequate water supply and to replace old obsolete tanks. Mark's Backhoe built and financed the new water tank. The documented expenses associated with the construction came to \$156,354. Division review of the financial transactions regarding the tank revealed that additional significant labor and materials were donated by Mark's Backhoe, although an exact amount could not be determined. In 2007 Mark's Backhoe Service financed the amount of \$136,000 still owed by Sherwood for 10 years at 18% simple interest. Since it would have been virtually impossible for Sherwood Water to obtain financing elsewhere the terms of this loan were considered appropriate. In order to keep the rates as low as possible for the rate payers, Mark's Backhoe volunteered to refinance Sherwood's remaining loan balance of \$126,197.92 over 20 years at 6% simple interest. The \$18,556 adjustment represents the annual savings based on the new terms of this loan.

2. Services - Billing, Accounting, Office

This includes billing, accounting and all other office duties performed by Peggey Bryner and Breanne Johnson. They are willing to be paid for a combined 30 hours per month at \$10 per hour, with no benefits, to perform these duties. Based on the number of hours spent last year in performing the office duties, 30 hours per week is a conservative time estimate.

3. Water Master Duties

This includes all functions of keeping the water company running smoothly, efficiently and in accordance with all state and federal regulations. These duties include, but are not limited to, reading and testing the meters, performing routine maintenance and repairs, routinely checking the system for proper operation as well as performing administrative duties as needed/required. The \$5,400 is based on the time Scott Johnson spent last year on the above mentioned duties at \$20 per hour. As in the past, as well as going forward, Mr. Johnson is paying for all his own transportation expenses such as wear and tear on his vehicle, gas and automobile insurance as well as various field tools and instruments. The Division determined that the labor amounts of \$5,400 are reasonable. In order to help keep rates affordable, Scott Johnson has agreed to perform the same duties at the same level of care for \$1,000 less per year, therefore, the Division recommends that \$4,400 (\$366.67 monthly) be funded in the rates.

4. Repairs

During 2009, \$11,229 was spent on repairs and replacements for Sherwood's aging infrastructure. Much of this was paid for through Mark's Backhoe and not charged to Sherwood. Scott Johnson volunteered to charge Sherwood no more than \$7,500 for repairs in the upcoming year. Any additional repair expenses, within reason, will be donated by either Scott Johnson or Mark's Backhoe.

5. Liability Insurance

Sherwood presently has no liability insurance. This \$2,500 adjustment is an estimation of the annual amount needed in purchasing liability insurance for which Breanne Johnson is currently seeking bids.

Division Recommendation, February 22, 2010, p.4-5.

Additionally, the Division noted that Sherwood faces the same risk as other water companies in not having adequate amounts in a capital reserve account. As the Division stated:

Setting aside reserves is critical to developing and maintaining financial stability and can mean the difference between a system that is self-sustaining and one that may fall victim to disrepair or become financially unstable during even a relatively small emergency.

Id. at p.5. Therefore, the Division recommended the Commission order Sherwood to implement the capital reserve account, and order strict guidelines for its implementation, operation, and regulation.

Perhaps one of the most concerning issues with the Sherwood rate increase is the likely possibility that rates will likely have to rise in the future. This is because there will likely be limits on the amount of subsidization Mark's Backhoe and/or its employees or Sherwood's employees are willing or able to provide. The Division summarized its concerns in its recommendation:

Typically, a developer of a sub-division would retain ownership of the water company and subsidize the water system until the lots are sold and the water system is fully developed since the developer's best interests are served by maintaining a high quality water system with low rates in order to sell more lots.

After the subdivision is fully developed, the developer generally either sells the water company or turns it over to the water users. . . . Regardless, the water company must, at a minimum, cover their expenses through rates.

Sherwood's situation is unique because after Mr. Johnson purchased the Water Company in 1998 he continued to subsidize expenses through personal and business (Mark's Backhoe) contributions, making the rates artificially low for many years. To obtain an accurate financial picture of Sherwood's operation, all of Sherwood's expenses were accounted for and recorded to determine what rates were necessary to fund these expenses. *These rates were approximately double the rates recommended in this analysis.* . . . Some of the expenses were shifted to Mark's Backhoe and Scott Johnson as future contributions in the form of both labor and supplies. Additionally, refinancing the loan to Mark's Backhoe at a much lower interest rate and over more years significantly lowered the rates.

. . . the Division is concerned about the day that the subsidies stop or the Water Company is sold and the actual expenses must be covered by the rates. Also of concern is the pending project regarding the reduction of arsenic in order to comply with the Division of Drinking Water's requirements. This has the potential of being very expensive and must be covered by the rate payers.

Id. at 8-9 (emphasis added). *Without the subsidizations provided, the Division found the proposed rates would be double what is being proposed.* However, if the Commission were to actually implement rates double what is being proposed here, there is the likelihood that the drastic increase in price would so reduce demand, that the company's income would experience a large decrease, exposing the company to severe instability and make it even more likely the company would not be able to fund its operations. That would make it unlikely the company could continue to provide ratepayers access to safe, reliable, and adequate, water service. The subsidizations offered by Mark's Backhoe, its employees, and the company's employees, allow the Sherwood's rates to be ½ of what they should be. Given the possibility that the rates could be much higher, the

Commission finds the current proposed rates to be just and reasonable, and in the public interest.

In accepting Mark's Backhoe's and Sherwood employees' subsidies, in their efforts to provide as low rates as possible for Sherwood ratepayers, the Commission is not finding or concluding that utilities generally must always subsidize rates when potential increases might be offensive to ratepayers. The Commission is well aware that in determining what a just and reasonable rate is, it must find a rate that will protect consumers from exploitive rates while still allowing a utility just and reasonable compensation for the service it provides. *See e.g. Stewart v. Public Serv. Comm.*, 885 P.2d 759, 767 (Utah 1994) (holding that "the commission can no more permit the utility to have confiscatory rates for their service it performs than it can compel a utility to provide service without just and equitable compensation.") (internal citations omitted). In this case, the Commission recognizes that Mark's Backhoe and Sherwood employees are *willing* to provide such subsidies, and considers those subsidies as a factor in determining just and reasonable rates. If there comes "the day that the subsidies stop or the Water Company is sold and the actual expenses must be covered by the rates" as the Division hypothesizes, then the Commission will look to the circumstances surrounding the company then in determining just and reasonable rates. This might take into account lack of, or a limited amount of subsidies.

Another factor the Commission considers in finding that allowing Mark's Backhoe and Sherwood employees to subsidize the rates is just and reasonable and in the

public interest, is the fact that Mark's Backhoe and Sherwood employees often wear the same hats. Employees involved in operating Mark's Backhoe are often the same employees running or serving Sherwood. They have been intimately involved in the Sherwood's operations since Mark Johnson purchased Sherwood. They are aware of the technicalities and regulations involved in operating a water company in the state, and as time passes, will become more proficient in the operation and administration of Sherwood. Thus, in this case, allowing them to subsidize the company is in the public interest, specifically, in the interest of Sherwood ratepayers. The Commission might be less hesitant to allow subsidization if others less familiar with operations, or with less expertise were to offer to administer various functions of operating the water system. There may be some cases when such subsidization, in the long-term, might lead to piecemeal operation of the water system by those not capable of running a water system. Allowing such subsidization might not be in the ratepayer's best interest. But in this matter, however, the Commission finds such subsidization offered by Mark's Backhoe is appropriate and is in the best interest of the public.

ORDER

For the foregoing reasons, the Commission orders as follows:

1. The following rates and fees are approved:

Description	Rate/Fee
System Expense	\$31.25 per month
First 8,000 gallons	\$10.50 per month
Standby Fees	\$31.25 per month

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Description	Rate/Fee
Usage per 1,000 gallons over 8,000 gallons	\$1.75 per 1,000 gallons
Water Service Turn-on & Turn-off charges	\$100.00
Late Fees on bills past due by 30 days or more.	18% per annum or 1.5% per month
First time service connection fee	\$2,500.00
Fee for unwarranted service call: (Unwarranted service call defined as a service call that is determined to be customer responsibility.)	Actual cost
Transfer of ownership fee	\$50.00

2. Regarding capital reserve amounts:
 - 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. For expenditures in excess of five percent of total Utility Plant in Service, the company shall file a report with the Commission, at least 30 days before the purchase or acquisition of the asset or project, and shall obtain written Commission approval before transacting such acquisitions. In this matter, expenditures over \$11,934 (\$238,674 x 5%) shall require submission of a written report and Commission approval;

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- d. Sherwood shall provide an annual accounting of the Capital Reserve Account with its Annual Report and at any such other time as the Commission or Division may request. The annual accounting shall be in the form of a 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.
- f. To further clarify, what shall be considered qualifying expenditures for replacement or improvements that may be made from the Capital Reserve Account, the following guidelines are provided:
 - i. “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.
 - ii. 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 shall be classified as “operating and maintenance” expenses.

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

Pursuant to Sections 63G-4-301 and 54-7-15 of the Utah Code, an aggrieved party may request agency review or rehearing of this Order by filing a written request with the Commission within 30 days after the issuance of this Order. Responses to a request for agency review or rehearing must be filed within 15 days of the filing of the request for review or rehearing. If the Commission does not grant a request for review or rehearing within 20 days after the filing of the request, it is deemed denied. Judicial review of the Commission's final agency action may be obtained by filing a petition for review with the Utah Supreme Court within 30 days after final agency action. Any petition for review must comply with the requirements of Sections 63G-4-401 and 63G-4-403 of the Utah Code and Utah Rules of Appellate Procedure.

DATED at Salt Lake City, Utah, this 11th day of May, 2010

/s/ Ruben H. Arredondo
Administrative Law Judge

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Approved and confirmed this 11th day of May, 2010, as the Report and Order of
the Public Service Commission of Utah.

/s/ Ted Boyer, Chairman

/s/ Ric Campbell, Commissioner

/s/ Ron Allen, Commissioner

Attest:

/s/ Julie Orchard
Commission Secretary
G#66659