- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

In the Matter of the Request of Pine Valley Irrigation Company for Approval of a Special Assessment and Rate Increase	)))))	DOCKET NO. 09-2179-01 REPORT AND ORDER

ISSUED: May 11, 2010

By The Commission:

This matter is before the Commission on Pine Valley Irrigation Company's (Pine Valley or company) request for approval of a special assessment and rate increase filed on September 1, 2009. The Division of Public Utilities (Division) performed a compliance audit and rate case analysis of the company, for the years from December 31, 2000 through December 31, 2008 and also reviewed the 2009 general ledger. It submitted its initial recommendation March 8, 2010 and presented that recommendation at the hearing held in Saint George, Utah, on March 10 and 11, 2010. The Division ultimately did not recommend a special assessment. It did, however, recommend a rate increase. It also recommended approving the expansion of Pine Valley's service area (an addition of 94 connections) and implementation of a capital reserve account.

The Commission held a hearing at the Fifth Judicial District Court in Saint George, Utah on March 10 and 11, 2010, with public witness testimony taken on both days. Although there were several ratepayers in attendance, only the following ratepayers gave oral testimony: Mary Esther Putnam, John Nichols, Bob Herpel, Kirk Cotterell, Susan Black, and Hans Latschkowski. Additional public testimony was received via fax and e-mail from the following: Phil LiMandri, Brian and Maria Ochs, Keith Kelley, Francine Walker, Marilyn Seay, John and Susan Black, Scott and Colleen Vance, Rita M. Squillante, Edward and Tamara Phillips, Sharon and Ford Northington, Al Kingham, Rick and Lynn Peetz, Joseph and Carol Palmintiero, and Raymond and Elaine Lindblom.

BACKGROUND

Pine Valley registered as an irrigation non-profit corporation on July 13, 1903 and reincorporated as a non-profit mutual water company in 1948. In 1976 the shareholders converted the system to a piped underground spring source and added culinary water service for its customers. At that time, non-shareholders were added to the water system.

Pine Valley is located on the valley in the south slope of the Pine Valley Mountains in Washington County. The service area includes the following developments:

- Town of Pine Valley (22 blocks)
- Pine Valley Meadows
- Pine View
- Mangum Subdivision
- Springer Creek Pines
- Shadow Hills Estate Phase 1
- Mountain View Estates Phase 1
- Pine Tree Subdivision
- Sunflower Acres
- Al Truman's Subdivision
- Deiro Subdivison, and
- Pine Valley Ranchos A-G.

The lot sizes range from as small at ¼ acre to 1 acre. The water company is serving 481-metered customers, 225 lots on stand-by status and the potential of 94 additional connections for a total of 800 authorized connections.

The Commission issued Pine Valley a certificate of public convenience and necessity (CPCN) on July 26, 1991, Docket No. 91-2179-01. The last time the rates were adjusted was in January 2002—about eight years ago. The Company had apparently recorded a profit for the years 2002 through 2008. The 2008 annual report shows a net operating profit of $22,249, but with $31,725 of non-utility income reported. If the $31,725 of non-utility income is removed, then the company realizes a $9,476 loss from its operations. Therefore, Pine Valley is not actually covering its operating expenses. If it is not covering its operating expenses, neither is it placing funds into a capital reserve account.

THE DIVISION'S AUDIT AND ANALYSIS

In performing its audit and rate analysis, the Division used calendar year 2008 as the base year. It made adjustments based on past as well as current trends and activities to arrive a reasonable forecast for the 2010 year. Incidentally, the company does not expect any new connections during the 2010 year. After performing its tasks, the Division recommended an increase in revenues of $48,904, or 19.14% increase to cover expenses of a viable utility company. There are some key operating expenses adjustments the Division noted in its recommendation:

- **Debt service**: The company has two loans from the Division of Water Resources totaling $1,126,413, which principal and interest annual repayment amounts total $100,300 (of this amount, $60,364 is principal). The Division also included the annual interest of a third loan from Village Bank of $1,048. The Division adjusted the operating expenses to allow for the interest expenses, but suggested disallowing the payments of principal, as those payments should be recovered by the allowable rate of return on investment.

- **Bad debt expenses**: The company requested a bad debt expense allowance of $1,273 in 2008 and an estimated amount of $2,000 in 2009. The Division suggested disallowing this expense as the arrearages should be recovered and not borne by other ratepayers.
- **Depreciation expense:** The Division's analysis determined that the assets listed under Utility Plant in Service were incorrectly depreciated due to incorrect service life and depreciation rates as allowed by Commission Rule R746-332. The Division made an adjustment of $22,199 to correct the service life and add depreciation for the additional plant added in 2009.
- **Property taxes:** The Division recommended including the property taxes of $1,800 not originally accounted for in the proposed rate. An adjustment to increase income taxes due to the increase in revenue and rate of return on the investment to $17,996.09 from $6,028 as requested.

Additionally, the Division noted that Pine Valley 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.

Division Recommendation, March 8, 2010, p.4. Therefore, the Division recommended the Commission order Pine Valley to implement the capital reserve account, and order strict guidelines for its implementation, operation, and regulation.

The Division initially recommended the following rate changes:

Description	Current Tariff	Requested by Pine Valley	Recommended by Division
System Expense	$10.00 per month	$14.50 per month	$22.25 per month
First 3,000 gallons/recommend 5,000 gallons	$20.00 per month	$29.00 per month	$34.25 per month
Usage per 1,000 gallons over 3,000 gallons Usage per 1,000 gallons over 6,000 gallons Usage per 1,000 gallons over 9,000 gallons	$.50 per 1,000 gallons $.75 per 1,000 gallons $1.00 per 1,000 gallons	$.80 per 1,000 gallons $1.05 per 1,000 gallons $1.30 per 1,000 gallons	$1.30 per 1,000 gallons over 5,000

It also recommended the following fee changes:

Description	Current Tariff	Requested by Pine Valley	Recommended by Division
Disconnect Fee per incident	n/a	n/a	100.00
Reconnect Fee per incident	n/a	n/a	100.00
Late Fees:	1.5% of the unpaid balance	1.5% of the unpaid balance	$5.00 fee or 1.5% of the unpaid balance, whichever is greater
System Expansion Impact Fee*	$1,500	$1,500	$2,000
Hook- up Fee**	$500	$500	$900
Name Transfer Fee	n/a	n/a	$25
Returned Check/NSF Fee	n/a	n/a	25.00
Unwarranted Service Call	n/a	n/a	50.00

*The system expansion/impact fee is being increased to cover the additional expense to the system for a new water storage tank. This will maintain proper storage capacity for the additional customers of the service area taking the authorized number of authorized connections to eight hundred (800).

**Actual costs for placing the meter, parts, average line, and labor warrant the hook-up fee to be increased to $900.

Division Recommendation, March 8, 2010, p.7-8. The Division also listed the impact the initial proposed rates would have on four of Pine Valley's users based on actual usage:

Customer	**Monthly Usage (Gal.)**	**Current Monthly Amount**	**Proposed Rates**	**Monthly Increase**	**% Increase**
A	10,000	$24.75	$40.75	$16.00	64.65%
B	48,000	$62.75	$90.15	$27.40	43.67%
C	650,000	$664.75	$872.75	$208.00	31.29%
D *(Standby)*	0	$10.00	$22.25	$12.25	122.50%

Id. at p.8.

The Division noted the percentage increase in rates may seem high to many users. In fact, many of the public witnesses complained the proposed increases were exorbitant. However, the Division noted that given the time since the last increase (8 years ago), losses faced by the company, increases in operational costs, the addition of transmission lines and mains, and implementation of the vital capital reserve account, the increase is reasonable.

One public witness, Mr. Latschkowski suggested an alternative for a rate increase and the Division agreed to analyze his recommendation. He essentially proposed the following rate schedule:

	Current Rate	Proposed Rate	% Increase
Standby/ Reservation Fee	$10.00 per month	$15.00 per month	50%
Minimum Usage Fee (Includes 1,000 gallons)	$20.00 per month	$30.00 per month	50%
Next 4,000 gallons	$.50 per 1,000 gal	$1.00 per 1,000 gal	100%

Next 5,000 gallons	$.75 per 1,000 gal	$1.25 per 1,000 gal	100%
Over 10,000 gallons	$1.00 per 1,000 gal	$1.50 per 1,000 gal	50%

Division Recommendation, April 26, 2010, p.2.

The Division analyzed this proposal and concluded that the company would experience an even greater shortfall annually if such a plan were implemented, leading to a deficit of $21,389 annually. The Division was also concerned that although the users paying the standby fee and minimum usage fee would have the percentage increase more evenly applied than if the Division's initial recommendation were implemented, the other tier users would bear a disproportionate share of costs. Specifically, tier 1 rate and tier 2 rate users bear 100% increase while the largest water users, tier 3, would only share a 50% increase in costs. This provides little incentive for larger water users to conserve water. The Division opined that a true conservation rate schedule escalates as more resources are used.

The Division, however, did amend its recommendation based in part on Mr. Latschkowski's recommendations, and submitted that on April 26, 2010. It stated:

> The Division completed further analysis (refer to Exhibit 2.2) to determine a proposed conservation rate using the 1,000 gallon monthly minimum usage allowance, which would maintain the viability of the Company and balance cost causation with implementation of a conservation rate schedule. The conservation rates would be the following:

	Current Rate	Proposed Rate	% Increase
Standby/ Reservation Fee	$10.00 per month	$17.75 per month	77.5%
Minimum Usage Fee (Includes 1,000 gallons)	$20.00 per month	$20.75 per month	3.75%
Next 4,000 gallons	$.50 per 1,000 gal	$ .75 per 1,000 gal	50%
Next 5,000 gallons	$.75 per 1,000 gal	$ 1.50 per 1,000 gal	100%
Over 10,000 gallons	$1.00 per 1,000 gal	$ 3.00 per 1,000 gal	200%

> The Division applied the above rates to the water usage for 2009 and made a conservative water usage adjustment of 20% decrease (13 million gallon decrease) in the water usage to implement a water conservation rate. The Company would meet the revenue requirement of $304,404 and cover their costs. This plan generates enough revenue for the Company to remain viable, meet its revenue requirement, and provide a higher percentage of increase for those who use large amounts of water.

Id. at p.2. With the increase in rates, the Division estimated a 20% decrease in usage. The Division opined that even with this drop, the company would still meet its revenue requirement of $304,404 and cover its costs. Based on this adjustment, the Division provided new examples of how the rates would impact various customers:

Customer	**Monthly Usage**	**Monthly Amount @ Current Rates**	**Public Witness Proposed Rate**	**Division Conservation Proposed Rate**
A	10,000	$24.75	$40.25	$31.25
B	48,000	$62.75	$97.25	$145.25
C	650,000	$644.75	$1,000.25	$1,981.25
D *(Not Connected)*	0	$10.00	$15.00	$17.75
Minimum gallons		3,000	1,000	1,000
Minimum Charge		$ 20.00	$ 30.00	$ 20.75
Tier 1 next 4K gal		$ 0.50	$ 1.00	$ 0.75
Tier 2 next 5K gal		$ 0.75	$ 1.25	$ 1.50
Tier 3 over 10K gal		$ 1.00	$ 1.50	$ 3.00

Id. at p.3. The Division noted that the median monthly use is 48,000 gallons during the summer months and 4,200 gallons during the winter months. Therefore this new proposed conservation rate, "by using a smaller monthly minimum usage allowance of 1,000 gallons a month from 5,000 gallons a month, part of the fixed expenses ($47,000 or $61,000) shift to be funded by water usage fees to meet the remainder of the operational costs." *Id.* It would allow smaller water users to have less of an increase of costs and larger water users to bear a larger increase percentage of costs.

Some other important factors raised by the commission in recommending the rates are as follows:

- **Capital reserve account**: These reserves are funded through rates and are used for qualifying expenses as the need arises, e.g. capital improvements, etc. The capital reserve amounts generated from rates are to be deposited into a restricted account, e.g. an escrow account, within 30 days of their receipt, and should equal $7.16 per month per customer who paid their bill.
- **Rate base**: This is the investor-supplied plant facilities and other investments required to supply water service to customers. Annual reports indicate a total net rate base of $1,120,580.
- **Rate of Return and Return on Investment**: The rate of return is the amount the utility can earn. The rate of return is a percentage of the utility's rate base, in this case 5.75%. The return on investment, or profit, is $64,422.22 ($1,120,579.72 x 5.75%).
- **Revenue requirement adjustments:** The revenue requirement represents the total amount of money that must be collected to pay all costs, including a reasonable return on investment and building reserved. The Division concludes that the revenue requirement is $299,267.02, consisting of: 1) annual profit of 5.75% rate of return of $64,433.33; 2) capital reserve of $60,339.00; 3) estimated state and federal income taxes of $12,858.68; 4) operating expenses and interest expense of $161,636.00 for a total of $299,261.03.

REASONABLENESS OF PROPOSED RATES AND FEES

Many of the comments from the public, if not all, complained of the large increase in costs from the current rates to proposed rates. The Commission appreciates the many concerns and comments voiced by the public about the increase in rates. The rates might seem exorbitant when viewed in isolation, and when compared to neighboring cities and towns.[1] The primary consideration of the Commission, however, is to ensure Pine Valley's ratepayers have access to safe, reliable, adequate, and reasonably priced water service—not only now but in the long term. This consideration necessarily takes into account what a just and reasonable rate is—one 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). Additionally, the rates must allow the utility to establish financial reserves sufficient to maintain an efficient and effective water system. As the Division noted: "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." *Division Recommendation, March 8, 2010*, p.4. Based on the information gathered by the Division during its months-long audit of Pine Valley, the

[1] Some ratepayers complained the rates were higher than the rates charged in towns like Saint George, Santa Clara, and Hurricane. However, it is important to note that these are cities not regulated by the Commission. Additionally, the difference between such municipalities and the company are significant, and account for much of the difference in rates, e.g. subsidies by the municipality, number of users, difference in costs, need for reserves, etc.

Commission finds the proposed rates are both just and reasonable and in the public interest. The rates will provide the company with the appropriate revenue requirement to pay all costs, including a reasonable return on investment and to build a reserve. The rates, although seemingly high, are not confiscatory, but are just and reasonable. Without these rates, the Division opined that the company would continue to under-earn, and not make enough to cover its costs, much less build reserves for any future replacement or upgrade of mainlines, storage reservoirs, wells and surface water intakes, etc. Although the costs might seem high to ratepayers, the costs for not having sufficient funds to meet company needs and provide a viable water system will be much higher, exposing customers to the possibility of having a water system that lacks safe, reliable, and adequate water. Additionally, waiting until the future to start and create the revenue and reserves necessary to fix past mistakes, including raising rates much higher than they are increasing now, and possibly levying special assessments that are cost prohibitive, could put the water system in peril, and expose ratepayers to substandard water service, even service that might violate state laws. Therefore, for the foregoing reasons, the Commission orders as follows:

ORDER

1. The following conservation rate increase is approved:

Item	Rate
Standby/ Reservation Fee	$17.75 per month
Minimum Usage Fee (Includes 1,000 gallons)	$20.75 per month

Tier 1	Next 4,000 gallons	$ .75 per 1,000 gal
Tier 2	Next 5,000 gallons	$ 1.50 per 1,000 gal
Tier 3	Over 10,000 gallons	$ 3.00 per 1,000 gal

2. The following fees are approved:

Item Description	**Fee**
Disconnect Fee per incident	$100.00
Reconnect Fee per incident	$100.00
Late Fees:	$5.00 fee or 1.5% of the unpaid balance, whichever is greater
System Expansion Impact Fee	$2,000.00
Hook- up Fee	$900.00
Name Transfer Fee	$25.00
Returned Check/NSF Fee	$25.00
Unwarranted Service Call	$50.00

3. These rates and fees shall be effective May1, 2010;

4. 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 equal to $7.16 per month per customer who paid their bill;

   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 $92,500 ($1,840,500 *times* 5%) shall require submission of a written report and Commission approval;

d. Pine Valley 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 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.

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.

5. The company's service area shall be increased to allow an additional 94 connections for a total of 800 authorized connections;

6. The company shall read water meters each month during the period of April 1st through October 31st, as to ensure high water usage amounts are billed and used to cover expenses during minimum bill months of November through March.

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

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#66656