

WATER/FLC:jrb

PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

WATER DIVISION

RESOLUTION NO. W-4467

April 22, 2004

R E S O L U T I O N

**(RES. W-4467), ALL WATER AND SEWER SYSTEM UTILITIES.
ORDER ESTABLISHING RESERVE SUB-ACCOUNTS FOR
PURCHASED WATER, PURCHASED POWER, AND PUMP TAX,
AND MEMORANDUM ACCOUNTS FOR EMPLOYEE LABOR,
PAYROLL TAXES, CONTRACT LABOR, AND
UNANTICIPATED REPAIR COSTS.**

SUMMARY

By this resolution we clarify some issues raised by the Class A water utilities with respect to the booking of interest to purchased power, purchased water and pump tax reserve accounts. We also formally establish memorandum accounts for employee labor, payroll taxes and that portion of contract work that is for operation and maintenance of plant facilities for small systems, and extend the protection provided by the unanticipated repair cost memorandum account to Class C and D sewer utilities.

DISCUSSION

Purchased Power, Purchased Water and Pump Tax

This Commission recently modified the provisions under which water utilities could request and receive protection for changes in costs for purchased water, purchased power and pump tax¹. These "offsettable" expenses have

¹ *Order Instituting Rulemaking on the Commission's Own Motion to Evaluate Existing Practices and Policies for Processing Offset Rate Increases and Balancing Account in the Water Industry to Decide Whether New Process are Needed*, Decision 03-06-072, (2003) 2001 Cal. PUC LEXIS 1213 as modified by Decision 04-03-041, March 16, 2004.

traditionally been accorded treatment under Public Utilities Code § 792.5 which mandates that, when an offset rate is approved, the utility must track actual revenues and expenses relating to the offset cost and offset revenues in a reserve account and take into account by appropriate adjustment any positive or negative balance remaining in any such reserve account at the time of any subsequent rate adjustments. Since 1994, the average balances in these accounts have accrued interest at the 90-day commercial paper rate².

These reserve accounts accumulate balances that are tested annually for over-earning and, after potentially being adjusted for over-earning, are authorized for recovery. Once authorized for recovery the utilities may claim the approved balances as assets. As was done in the past, the balances are recovered by instituting a surcharge (or surcredit if overcollected) and tracking the recovery in a separate asset account.

Prior to this change in procedures, the reserve accounts themselves were sometimes treated as asset accounts by some utilities and used to track recovery of these balances. Because the balance in each reserve account carried over from year to year and was almost never zero, the reserve account continued to exist over time and no reestablishment of the account at the time of an offset expense change or tracking of separate calendar year's data was necessary. Under the procedures contained in Decision (D.) 03-06-072, however, the reserve accounts track revenues and expenses from January 1 through December 31 of the calendar year, and the calendar year's ending balances are adjusted after an earnings test and transferred to an account to track recovery of authorized balances. This raises the question of how to handle unrecovered interest in the reserve accounts.

This unrecovered interest comes about because it is not until March 31 that the utility files a request to amortize the December 31 balances in its reserve accounts. Because recovery is not instantaneous as of December 31, interest accrues on the adjusted balance from January 1 until recovery of the adjusted balance is authorized. Additionally, after recovery is authorized, interest will continue to accrue on this accumulated interest. The utilities ask: "How will we track and recover these interest amounts?"

² Decision 94-06-033, June 22, 1994 Ordering Paragraph One.

In order to accurately track this interest, we will authorize the creation of a sub-account for each calendar year within the reserve account.³ In this way, each year's reserve account data (revenues and expense) can be kept separate and distinct from other year's reserve account data. The utilities will be able to book interest on the adjusted balance in the sub-account from December 31, 2003 through the period during which the review and final determination of the prior year's reserve account balance is being made.

For example, the 2003 reserve sub-account will have as a balance on December 31, 2003 that is the recorded balance adjusted for the earnings test. This balance will accrue interest (and interest on interest) in the 2003 reserve account during early 2004, until the date recovery is authorized to start, and will accrue interest on this accrued interest through the rest of 2004. Recovery of this account may be requested either when the balance exceeds 2% of the utility's gross operating revenues, or in the advice letter filing for recovery of the 2004 reserve accounts.

As of December 31, 2004, this same treatment would be accorded the 2004 reserve accounts.

To the extent that the existing offset procedures do not cover Class B, C, and D water and sewer system utilities, we will authorize memorandum accounts to track changes in these costs.

Payroll, Payroll Taxes and Contract Work

In a memorandum to All Hydraulic Branch Technical Staff from Wesley Franklin, Chief, Hydraulic Branch, November 9, 1984, Subj: Procedures for Offset Rate Increases, attachment, p. 1 Robert Bennett and Wesley Franklin explain:

³ Uniform System of Accounts for Water Utilities, January 1, 1955, p.9 "2. Records, D. Subdivisions of any account in the system of accounts prescribed herein may be kept, provided that such subdivisions do not impair the integrity of the prescribed accounts. The titles of all such subdivisions or subaccounts shall refer by number or title to the account or accounts of which they are subdivisions.

“The purpose of an offset rate increase is to permit a utility to pass on to the customer certain changes in costs. This procedure is intended to cover only those increased costs that are beyond the utility’s control and it is not to be used to increase the rate of return or to cover increased expenses due to customer growth or changes in the operation of the utility. These last two items would be considered in a general rate proceeding.

“These offset costs items are: purchased power (electricity and/or natural gas); purchased water; groundwater or pump tax; property taxes; and postage⁴. In general, most of the smaller utilities (Classes C and D) are not covered by attrition allowances and may request an offset increase for *payroll, payroll taxes and that portion of contract work that is for operation and maintenance of the plant facilities*. Requests for offset rate increases are restricted to a minimum of 1% of the gross annual revenues, adopted for the most recent test year, or in the most recent annual report on file at the time the request is made.” (emphasis added)

Water Division (WD) has researched its files but can find no resolution or decision that authorizes establishment of any memorandum accounts or reserve accounts for the costs emphasized above, nor do any individual small water or sewer utilities have approved memorandum account descriptions for these costs in their Preliminary Statement tariff sheets⁵. Without such authorization, WD cannot allow recovery of these expenses since the memorandum or reserve accounts were never approved and such belated recovery would constitute retroactive ratemaking. It is, however, reasonable to allow smaller water and sewer systems to track these costs for potential recovery. Accordingly, we will authorize these memorandum accounts in this resolution.

⁴ Property Tax and Postage were eliminated from the list by D.94-06-033, June 22, 1994, Ordering Paragraph 2.

⁵ 85 Cal.App.4th 1086; 102 Cal.Rptr.2d 684 (Dec 2000) provides: “An advice letter filed with the... PUC... by a public utility... by which the utility sought to add a new memorandum account in its tariff... became effective 40 days after its filing... when the establishment of the memorandum account does not increase rates and the PUC does not act to suspend the tariff...”

Unanticipated Repair Cost Memorandum Account

In D. 92-03-093, March 31, 1992, ordering paragraph two, the Commission authorized:

“2. A Class C or a Class D water utility is authorized to establish a memorandum account to track unanticipated costs of repairs necessary for a utility’s service to its customers and to notify the Water Utilities Branch (Branch) by letter when it has done so. A Class C or Class D water utility is authorized to file by advice letter, or as part of a general rate case to recover costs recorded in the memorandum account for unanticipated repair costs either in rates or in a one-year surcharge when the total cost exceeds 2% of the utility’s last adopted gross revenues. Costs already reflected in rates or recoverable through insurance or other means and costs that with reasonable diligence could have been avoided shall not be recoverable through the memorandum account.”

In addition to small water systems this Commission regulates thirteen small sewer utilities⁶. As demonstrated by Advice Letter No. 15 filed by Watertek, Inc. March 28, 2003⁷ sewer systems can also suffer from unanticipated repair costs. It is reasonable to extend the abovementioned memorandum account protections to the small sewer systems. Accordingly, in this resolution, we will extend Unanticipated Repair Cost Memorandum Account protection to our regulated Class C or D sewer systems.

⁶ Big Basin Sanitation Co., California Hot Springs Sewer Service, California Utilities Service, California-American Water Company, Canada Woods Water Company, Interstate 5 Utility Company, Inc., Lewiston Valley Water Company, Little Bear Water Company, Mayacama Golf Club, LLC., MHC Acquisition One, LLC., Rolling Green Utilities, Inc., Rural Water Co., Inc., Watertek Inc.

⁷ “...request a surcharge to recover expenses in the amount of \$50,123.25 or 23.29% needed to repair and replace a damaged sewer main.”

FINDINGS

1. Public Utilities Code § 792.5 mandates that, when an offset rate is approved, the utility must track actual revenues and expenses relating to the offset cost and offset revenues in a reserve account.
2. Public Utilities Code § 792.5 provides that the Commission shall make any appropriate adjustment to the balance remaining in the account at the time of any subsequent rate adjustments.
3. By D.03-06-072, June 19, 2003 the Commission instituted an earnings test to adjust the balance in the reserve accounts.
4. In the past the reserve accounts continued indefinitely, tracking subsequent changes in expenses and revenues authorized by the Commission for recovery.
5. New accounting procedures are necessary because reserve accounts are no longer continuous but pursuant to D.03-06-072, are reviewed annually and adjusted, as appropriate, for authorized recovery without provision for accumulated post-end of year interest prior to the recovery authorization.
6. Sub-accounts are authorized under the Uniform System of Accounts.
7. Class B, C, and D water and sewer system utilities may need memorandum account protection for unanticipated expense changes, outside of the utility's control for purchased water, purchased power, or pump tax.
8. Water Division can find no Commission authorization for offset treatment for unanticipated changes in payroll, payroll taxes, and that portion of contract work that is for operation and maintenance of the plant facilities for Class C and D water or sewer system utilities.
9. Sewer utilities are not authorized to establish an Unanticipated Repair Cost Memorandum Account.

THEREFORE IT IS ORDERED THAT:

1. Class A water utilities are authorized to create a reserve account sub-account to track post-end of year interest accumulation , for each calendar year for each reserve account for each district. These accounts shall be used to track interest for later recovery.

2. Class B, C, and D water utilities are authorized to establish memorandum accounts to track changes in purchased water, purchased power, and pump tax.
3. Class B, C, and D sewer system utilities are authorized to establish a memorandum account to track changes to purchased power expenses.
4. Class C and D water and sewer utilities are authorized to establish memorandum accounts to track unanticipated changes, beyond the utility's control in payroll, payroll taxes, and that portion of contract work that is for operation and maintenance of the plant facilities.
5. Recovery of expenses booked to Class B, C, and D memorandum accounts may be requested by advice letter at any time or may be considered for recovery in the utility's general rate case.
6. Commission-regulated sewer system utilities are authorized to establish an Unanticipated Repair Cost Memorandum Account.
7. This resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed, and adopted at a conference of the Public Utilities Commission of the State of California held on April 22, 2004; the following Commissioners voting favorably thereon:

WILLIAM AHERN
Executive Director

MICHAEL R. PEEVEY
President

CARL W. WOOD
LORETTA M. LYNCH
GEOFFREY F. BROWN
SUSAN P. KENNEDY

Commissioners