

WATER/FLC:jrb

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

WATER DIVISION

RESOLUTION NO. W-4540

June 16, 2005

**R E S O L U T I O N**

**(RES. W-4540), ALL CLASS B, C, AND D WATER AND SEWER COMPANIES. ORDER AUTHORIZING A COST-OF-LIVING RATE INCREASE OR CASH FLOW RATE INCREASE SUBJECT TO REFUND WITH AUTHORIZED RATES EFFECTIVE AS OF FILING OR THE FIRST DAY OF THE TEST YEAR.**

---

**SUMMARY**

Public Utilities Code Section 455.2 allows water companies with greater than 10,000 service connections to make rates effective at the beginning of their test year, even when the General Rate Case (GRC) is not complete until later<sup>1</sup>. This resolution authorizes similar treatment for the smaller water and sewer system utilities.

**BACKGROUND**

On and after January 1, 2003, Section 455.2 has allowed the Commission to approve an interim cost-of-living rate increase for Class A water utilities, subject to refund, effective on or after the first day of the first test year, that is equal to the rate of inflation. Section 455.2 then specifies that these rates are to be adjusted upward or downward consistent with the final rates adopted by the Commission. Section 455.2 applies only to water utilities with greater than 10,000 service connections. On September 4, 2003 the Commission opened Order Instituting Rulemaking 03-09-005 to determine how to implement Section 455.2.

---

<sup>1</sup> Unless stated otherwise, all statutory citations refer to the California Public Utilities Code.

An Interim Order in that proceeding, Decision (D.) 04-06-018, was approved on June 9, 2004 (RCP Interim Decision).

D.92-03-093, March 31, 1992, (the Risk Phase I Decision) authorized each Class C and D water utility to file once a year by advice letter for a rate increase based on the most recent year-end increase in the Consumer Price Index-Urban Consumers (CPI-U) if it were not subject to a test year, attrition year or general rate increase in that year and subject to an earnings test. Later, on February 22, 1996, the Assistant Director for Water of the Commission's Advisory and Compliance Division presented a memorandum describing the Service Guarantee Plan for Small Water Companies. Part of Phase One of the Plan was the preparation of a resolution granting interim rate relief if a cash flow analysis done by an auditor indicated that the utility was operating with inadequate cash flow to pay its bills, including debt service. These two mechanisms have helped the smaller water companies keep up with inflation and provided immediate relief when, as is sometimes the case, the utility has delayed filing for a general rate increase until its financial picture is critical.

Due to lack of resources the Commission has had to strictly prioritize its workload, delaying or eliminating some of the functions that it formerly performed. Within the Water Division, this has resulted in some Class C and D water utility GRCs being delayed, sometimes for an extended period, especially when an audit was required. Although cash flow relief is available, no other relief is, including CPI, and neither of these methods allows the recovery of final rates back to the date of the interim relief, as Section 455.2 does.

## **DISCUSSION**

The purpose of this resolution is to treat the Class B, C and D water and sewer system utilities the same way with regard to GRCs that Section 455.2 treats the Class A water companies. In order to effectuate this change, the Commission must do two things: a) approve an interim change in rates, and b) make those rates adjustable, up or down, to the rates the Commission eventually finds to be just and reasonable.

The Commission must approve an interim change in rates in order to avoid retroactive ratemaking. It can then specify that these interim rates are subject to

adjustment, up or down, to the Commission-approved final rates. In Section 455.2 this interim change is specified as “rate of inflation.” The RCP Interim Decision specifies that this be the CPI-U<sup>2</sup>. D.92-03-093 already authorizes Class C and D water utilities to file once a year by advice letter for a rate increase based on the most recent year-end increase in the CPI-U, but limits the increase to years that are not “subject to test year, attrition year or other general rate increase.”<sup>3</sup> We clarify that language below. Also, as presently processed, the CPI-U increase does not require a resolution and the utility must pass an earnings test. As described below, we will require a resolution for the CPI-U increase in the test year and we will suspend the requirement for an earnings test. We will also extend the CPI-U in the test year and non-test years to Class B water companies and to sewer systems.

With respect to the limitation on CPI-U increase in a test year, D.92-03-093 states in dicta:

“We conclude, therefore that Class C and Class D water companies should be authorized to file advice letter requests once every year for an increase in the prior years’ water service revenue by an amount no greater than the most recent CPI-U Index. This increase is not subject to test year or attrition year rate adjustment as a result of an approved advice letter or general rate increase application, since those increases will have taken CPI factors into account.”<sup>4</sup>

Clearly the limitation on the CPI-U increase in the test year was because we did not intend to allow the CPI increase *in addition* to the just and reasonable rates determined in the GRC. But in this case we are adjusting the CPI-U increase to the rates we find reasonable, so we avoid this problem. Section 1708 would have required us to serve the original service list in the Risk Phase I proceeding if we were “rescinding, altering, or amending a prior order,” but this clarification is consistent with D.92-03-093, so we are not required to serve this resolution on the service list in Order Instituting Investigation 89-03-005 for comment.

---

<sup>2</sup> D.04-06-018 at 24.

<sup>3</sup> D.92-03-093, Ordering Paragraph 1.

<sup>4</sup> *Ibid.*, at 22.

As mentioned above, the Service Guarantee Plan calls for an additional interim increase in rates, for Class C and D water utilities, based upon a cash flow analysis. This increase must be approved by resolution. The justification for this increase was to “provide a relatively simple mechanism to allow for almost immediate interim rate relief for those water companies needing it.” Certainly the same justification applies to a Class B water company or sewer system company that is “running in the red.” Even though a Class B company is large enough to have full-time professional employees, and should be able to avoid delaying to file for a GRC until it is losing money, the same thing is true for some Class C companies, and some Class B companies are multi-district, with some service areas of Class D size. All sewer system utilities we regulate are either Class C or D in size and need the same protections we provided for water utilities (see, for example, Res. No. 4467, April 22, 2004).

So we have already approved two types of interim increases: CPI-U and cash flow. Both are presently subject to refund, but neither allows for adjustment upward to the level of the final rates. The cash flow interim increase must be approved by resolution and in that resolution we can allow the interim rates to be adjusted to the level of the final rates. The CPI-U does not presently require a resolution but for the purpose of establishing the effective date of the GRC rates, the CPU-U increase needs to be done by resolution. Although it is unlikely that a CPI-U increase done in association with a GRC would fail an earnings test, it is possible. We will suspend the earnings test for this type of CPI-U filing, because just and reasonable rates will be made effective on the CPI-U change date, and that will substitute for the earnings test. The normal CPI-U filings (not associated with a GRC) should continue to be processed without a resolution and with an earnings test in accordance with D.92-03-093.

The other issue that must be addressed for informal GRCs is the way they request test years. Normally if the GRC filing occurs during the first six months of the calendar year, the utility asks for that calendar year to be its test year, in the hope that the rates can be effective upon approval of the GRC resolution during that year. If the GRC is filed in the last six months of the calendar year, the utility sometimes asks for the next calendar year to be the test year, since the service guarantee plan allows six months to process the GRC. Obviously, if the utility is asking that its test year be the calendar year in which it files, all the utility will have to do is file an Advice Letter for a CPI-U increase, along with its GRC. The Water Division can prepare a resolution approving the request, or

alternately a resolution approving the cash flow increase if the utility needs one, that also makes the interim rates subject to adjustment to the final rates. If the utility wants its test year to be the following calendar year, it needs to file an advice letter as soon after the beginning of that test year as possible, once the new end-of-the-prior-year CPI-U is known.

Recovery of uncollected revenues or the return of over-collected revenues based on the Commission approved final rates should be identical to those provided for Class A water utilities. In D.04-06-018 we speak of using a “surcharge or surcredit”<sup>5</sup> and will authorize that for these utilities as well. The specific method of calculation is contained in D.04-06-019, June 9, 2004, *In the Matter of the Application of California Water Service Company (U 60 W), a Corporation, for an Order Authorizing It to Increase Rates Charged for Water Service at Its Bear Gulch District And Related Matters*.

### **NOTICE AND PROTESTS**

This change in procedure will affect all Class B, C, and D water and sewer system utility customers for all yet to be filed general rate proceedings for their utilities. Notice will be provided in those GRC proceedings.

### **COMMENTS**

Public Utilities Code Section 311(g)(1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comments prior to a vote of the Commission. Section 311(g)(2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day comment period for the draft of this Resolution was neither waived nor reduced. Accordingly, this draft resolution was mailed to parties for comments. No comments were received.

---

<sup>5</sup> Op. cit. at 23.

**FINDINGS**

1. Pursuant to D.92-03-093, all Class C and D water utilities are authorized to file once a year by advice letter for a rate increase based on the most recent year-end increase in the CPI-U. This authorization should be extended to Class B water and sewer system utilities.

2. When a Class B, C, or D water or sewer system utility files a GRC, it should be allowed to file an Advice Letter for a CPI-U increase, subject to refund or increase to the Commission-approved final rates found reasonable in the GRC resolution or decision for the requested test year.
3. When the Water Division finds the utility needs a cash flow increase per the Service Guarantee Plan, it should prepare a resolution that makes the increase subject to refund or increase depending on the Commission-approved final rates found reasonable in the GRC resolution or decision for the requested test year.
4. The calculation of the surcharge or surcredit for the recoverable revenues should be in accordance with D.04-06-019.

**THEREFORE IT IS ORDERED THAT:**

1. When a Class B, C, or D water or sewer system utility files a general rate case, it may file an Advice Letter for a CPI-U increase, subject to refund or increase to the rates found reasonable in the general rate case resolution or decision, for the requested test year. This advice letter shall be made effective by Commission resolution. No earnings test is required.
2. When the Water Division finds the utility needs a cash flow increase per the Service Guarantee Plan, it shall prepare a resolution that makes the increase subject to refund or increase depending on the Commission-approved final rates.
3. At the completion of the general rate case application, the authorized but not collected revenues shall be adjusted for the CPI-U inflation revenues or the cash flow revenues received by the utility and the difference recovered by surcharge or refunded by surcredit.
4. Class B water and sewer system utilities should be authorized to file once a year by advice letter for a rate increase based on the most recent increase in the CPI-U, if the year does not also qualify for a test year or attrition year increase.
5. These authorizations apply to all Class B, C and D water and sewer system general rate cases filed after the effective date of this resolution.

6. 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 June 16, 2005; the following Commissioners voting favorably thereon:

---

STEVE LARSON  
Executive Director

MICHAEL R. PEEVEY  
President  
GEOFFREY F. BROWN  
SUSAN P. KENNEDY  
DIAN M. GRUENEICH  
JOHN A. BOHN  
Commissioners