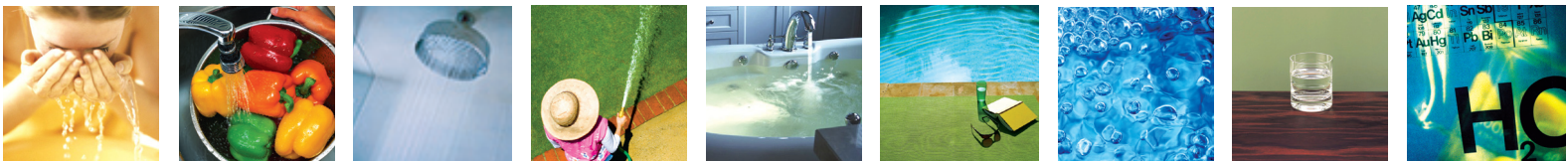


California Water Association Small Company Instruction Modules

IM-03: PURCHASED WATER EXPENSE INCREASE OFFSET ADVICE LETTER



CWA ADVICE LETTER INSTRUCTION MODULE

IM-03: PURCHASED WATER EXPENSE INCREASE OFFSET ADVICE LETTER

October 15, 2014

I.) OBJECTIVE:

Prepare workpapers and tariff sheets to support a Purchased Water Expense Increase Offset Advice Letter, hereinafter referred to as a Purchased Water Offset AL, requesting a revenue increase to offset (pass through) an increase in purchased water costs.

II.) AUTHORIZING DOCUMENTS: (with reference to applicable findings and orders)

CWA recommends that the utility obtain copies, on-line or in hard copy, of these documents for reference in the preparation of your Purchased Water Offset AL:

1.) GO-96 B, November 2007, last Revised January 2012:

- Established three tiers for review and disposition of advice letters. Tier 1 is “deemed approved” and is effective five days after the date of filing (or later at the utility’s request), subject to correction if found substantially faulty by staff;
- Water Industry Rule 7.3.1 incorporates the wording ordered in Res.W-4664 (see below) deleting the customer notice requirement for Tier 1 ALs;
- Water Industry Rule 7.3.1(7) reclassifies allowable expense offset advice letters as Tier 1 (see W-4664 below);
- Water Industry Rule 8.4 authorizes a concurrent change in rates to offset an increase of an expense subject to offset.
- Water Industry Rule 8.5 discusses balancing account amortization.

2.) Resolution W-4664, November 1, 2007:

- Reclassified expense offset advice letters as Tier 1;
- Authorized filing of Tier 1 advice letters without requirement for customer notice, which is an exception to GO-96 B, General Rule 4.2.

3.) **Public Utilities Code 792.5:**

“Whenever the commission authorizes any change in rates reflecting and passing through to customers specific changes in costs ... the commission shall require as a condition of such order that the public utility establish and maintain a reserve account reflecting the balance, whether positive or negative, between the related costs and revenues, and the commission shall take into account by appropriate adjustment or other action any positive or negative balance remaining in such reserve account at the time of any subsequent rate adjustment”. This is a Balancing Account.

4.) **Standard Practice U-27-W, April 16, 2014:**

- Defines categories of expenses that are subject to offset, which includes purchased water offsets;
- Presents general methodology to offset expense increases for purchased water for metered water systems and for flat rate water systems.
- Confirms requirement that utilities with Commission authorized expense offsets must maintain a reserve account to track the difference between actual costs incurred by the utility and the revenue collected through the offset rate increase. (repeats requirement put forth in PU Code 792.5)

3.) **Resolution W-XXXX, Pending:**

- Resolution W-4294, November 1, 2001, requires that a utility must perform an earnings test (ET) to demonstrate that it is not over-earning prior to filing an offsettable expense offset advice letter.
- This Resolution eliminates the ET requirement for offsettable expense offset advice letters for Class B, C, and D water utilities.

III.) **DATA REQUIRED TO PREPARE A PURCHASED WATER OFFSET AL:**

- 1.) The utility’s last GRC Resolution number, date, authorized increase (\$, %), and specifying the adopted meter equivalent ratios (MERs) for metered service and/or the adopted service connection category equivalent ratios for flat rate service.
- 2) All water-related adopted quantities in the last GRC including:
 - a.) adopted purchased water quantity;
 - b.) adopted total water supply quantity, if total supply includes both purchased water and water from other source(s);
 - c.) adopted metered water sales quantity;
 - d.) adopted percentage of metered service revenue for mixed service utilities;
 - e.) adopted system water loss percentage;

- 3.) Proof from the purchased water supplier of the pending (or actual) increase in the wholesale water price (the new wholesale rate) charged to the utility;
- 4.) The current wholesale water rate charged to the utility;
- 5.) The utility’s current tariffs for metered service quantity rates, if applicable;
- 6.) The utility’s current tariffs for flat rate service, if applicable;
- 7.) The number of active connections by flat rate service category, if applicable.

IV.) **STEP –BY-STEP PROCEDURES:**

Nomenclature:

In order to simplify the presentation of the procedures described below, the following terms are used throughout, as applicable:

adopted PW QTY is the adopted purchased water quantity at the last GRC

adopted TWS QTY is the adopted total water supply at the last GRC

adopted MWS QTY is the adopted metered water sales at the last GRC

loss % is the adopted system water loss percentage at the last GRC

PWRI is the purchased water rate *increase*

MQRI is the metered quantity rate *increase*

A. Utilities with All Metered Service:

- A-1 Convert both the current and the new wholesale rates charged to the utility to \$/Ccf.
- A-2 Subtract the current wholesale rate from the new wholesale rate. This is the PWRI
- A-3 The purchased water expense increase is fully offset when the following condition is satisfied: the utility’s MQRI in \$/Ccf multiplied by the adopted MWS QTY in Ccf equals the PWRI in \$/Ccf multiplied by the adopted PW QTY in Ccf. That is:

$$(MQRI)(\text{adopted MWS QTY}) = (PWRI) (\text{adopted PW QTY})$$

Thus, the utility’s requested MQRI is equal to the PWRI from Step A-2 multiplied by the ratio of the adopted PW QTY divided by the adopted MWS QTY.

- A-4 a.) For a utility system supplied 100% with purchased water, the adopted MWS QTY is equal the adopted PW QTY adjusted down to account for system water losses (1-loss %). That is, adopted MWS QTY = (adopted PW QTY) (1-loss %). The MQRI will be larger than the PWRI by the reciprocal factor:

$$\text{MQRI} = \text{PWRI} \times \frac{\text{adopted PW QTY}}{\text{adopted MWS QTY}} = \frac{\text{PWRI}}{(1-\text{loss } \%)}$$

- b.) For a utility system with other water source(s) in addition to the purchased water supply, the adopted MWS QTY includes both purchased water and water derived from the other source(s), after system water losses are taken out:

$$\text{adopted MWS QTY} = (1-\text{loss } \%) (\text{adopted TWS QTY})$$

The purchased water expense increase is fully offset when

$$\text{MQRI} \times (1-\text{loss } \%) (\text{adopted TWS QTY}) = (\text{PWRI}) (\text{adopted PW QTY})$$

and,
$$\text{MQRI} = \frac{\text{PWRI}}{(1-\text{loss } \%)}$$
 x
$$\frac{\text{adopted PW QTY}}{\text{adopted TWS QTY}}$$

The adopted PW QTY for a mixed source utility equals Z% of the adopted TWS QTY, where Z% is less than 100%. Thus,

$$\text{MQRI} = \frac{\text{PWRI}}{(1-\text{loss } \%)}$$
 x
$$\frac{(Z \%)(\text{adopted TWS QTY})}{\text{adopted TWS QTY}} = \frac{\text{PWRI}}{(1-\text{loss } \%)}$$
 x (Z %)

- A-5 Add the MQRI from Step A-4 to the utility’s current metered quantity rate(s), single level or tiered rates if applicable. This (these) is (are) the utility’s new metered quantity rate(s).

- A-6 Multiply the utility’s MQRI (\$/Ccf) from the applicable option in Step A-4 by the adopted MWS QTY. This is the annual revenue increase for this offset. Divide the annual revenue *increase* by the current authorized annual revenue (adopted MWS QTY at current metered quantity rate(s) plus aggregate current service charge revenues) to calculate the utility’s annual revenue percentage increase.

These figures will be required for the Purchased Water Offset AL and related cover sheet.

- A-7 Prepare and file a Tier 1 Purchased Water Offset AL (see IM-01) requesting amended tariffs with the new metered quantity rates determined in Step A-5. Include all workpapers as attachments to the AL. This completes the utility’s offset rate request in this case. To maximize the expense offset revenue received, file the Tier 1 advice letter before the onset of the new wholesale rate increase, with an effective date concurrent with the onset of the new wholesale rate.
- A-8 Establish the required balancing account per procedures in Paragraph D of this Section IV.

B. Utilities with All Flat Rate Service:

- B-1 Convert both the current and the new wholesale rates charged to the utility to \$/Ccf.
- B-2 Subtract the current wholesale rate from the new wholesale rate. This is the PWRI.
- B-3 Multiply the PWRI from Step B-2 by the adopted PW QTY from the last GRC. This is the total annual purchased water expense *increase*.
- B-4 a.) The purchased water expense *increase* in Step B-3 is fully offset when the annual flat rate water service revenue is increased by the equivalent amount. That is,

$$(PWRI)(\text{adopted PW QTY}) = \text{annual flat rate water service revenue } \textit{increase}$$

which is allocated as follows:

b.) For a utility supplied 100% with the purchased water, allocate the annual water service revenue *increase* in Step B-4a by billing period among your active flat rate service connections according to your utility’s adopted flat rate service category equivalent ratios. These are the flat rate service charge *increases* by billing period and by service connection category.

c.) For a utility supplied with other water source(s) in addition to the purchased water, the adopted PW QTY is Z% of the utility’s adopted TWS QTY, where Z% is less than 100%. In this case, the requested flat rate service charge *increases* will be Z% of the flat rate water service charge *increases* by service connection category determined in Step B-4b above, because no rate increase applies to the adopted (100% - Z%) portion of the adopted TWS QTY, upon which the current rates are based.

- B-5 Add the applicable flat rate service charge *increases* by service connection category in Step B-4 to the corresponding charges per service connection category in your current flat rate schedule to obtain the new flat rate service charge schedule.

B-6 The utility’s annual revenue percentage increase is the annual water service revenue increase in Step B-4 divided by aggregate flat rate water service revenues at current rates.

The annual revenue *increase* and the percentage *increase* will be required to prepare the Purchased Water Offset AL text and the related AL cover sheet.

B-7 Prepare and file a Tier 1 Purchased Water Offset AL (see IM-01) requesting amended tariffs with the new flat rate service charge schedule determined in Step B-5. Include all worksheets as attachments to the AL. This completes the utility’s offset rate increase request in this case. To maximize the expense offset revenue received, file the Tier 1 advice letter before the onset of the new wholesale rate increase, with an effective date concurrent with the onset of the new wholesale rate.

B-8 Establish the required balancing account per procedures in Paragraph D of this Section IV.

C. Utilities with a Mix of Metered Service and Flat Rate Service (Mixed Service):

C-1 Convert the current and the new wholesale rates charged to the utility to \$/Ccf.

C-2 Subtract the current wholesale rate from the new wholesale rate. This is the PWRI.

C-3 Multiply the adopted PW QTY by the PWRI from Step C-2. This is the total annual purchased water expense increase. An equal annual water sales revenue increase will exactly offset this expense increase.

C-4 a.) For a mixed service system supplied 100% by purchased water, the PWRI grossed up by the adopted loss % is passed through to the metered services as the utility’s MQRI to offset a portion of the purchased water expense increase. As in Step A-4a,

$$MQRI = \frac{PWRI}{(1 - \text{loss } \%)}$$

b.) For a mixed service utility with other supply source(s) in addition to the purchased water supply, the MQRI will be less than it would be if the purchased water were the only supply. As in Step A-4b, the adopted PW QTY is Z% of the adopted TWS QTY, where Z% is less than 100%; and the utility’s metered quantity rate increase is:

$$MQRI = \frac{PWRI}{(1 - \text{loss } \%)} \times Z\%$$

- C-5 Add the appropriate MQRI from Step C-4, depending on the water supply, to the utility's current metered quantity rate(s). This (these) is (are) the new utility metered quantity rate(s).
- C-6 Compute the annual metered water revenue increase by multiplying the adopted MWS QTY by the appropriate MQRI from Step C-4.
- C-7 Subtract the annual metered service revenue *increase* in Step C-6 from the total annual water sales revenue increase in Step C-3. This is the annual revenue increase for the aggregate flat rate water service connections.
- C-8 Allocate the annual flat rate water revenue *increase* from Step C-7 by billing period among your active flat rate service connections according to your utility's adopted flat rate service connection category equivalent ratios. These are the flat rate service charge increases by service connection category per billing period.
- C-9 Add the flat rate service charge *increases* allocated by service connection category in Step C-8 to the corresponding charges per service connection category per billing period in your current flat rate schedule to obtain the new flat rate service charge schedule.
- C-10 The utility's annual revenue percentage increase is equal to the annual water sales revenue increase from Step C-3 (also the sum of Steps C-6 and C-7) divided by the sum of a.) the current metered service revenues (adopted MWS QTY at current rates plus aggregate metered service charge revenues) and b.) the aggregate flat rate revenues at current rates.
- C-11 Prepare and file a Tier 1 Purchased Water Offset AL (see IM-01) requesting the amended tariffs for metered service in Step C-5 and for flat rate service in Step C-9. Include the amended tariffs and all workpapers as attachments to the AL. This completes the utility's offset rate increase request in this case. To maximize the expense offset revenue received, file the Tier 1 advice letter before the onset of the new wholesale rate increase, with an effective date concurrent with the onset of the new wholesale rate.
- C-12 Establish the required balancing account per procedures in Paragraph D of this Section IV.

D. Purchased Water Balancing Account:

- D-1 Establish a Purchased Water Balancing Account spreadsheet, either programmed or manual, with the following column headings organized horizontally and with data entries running vertically:
- Month or Billing Period (Period)
 - Incremental Purchased Water Revenue Billed (Revenue)*
 - Incremental Purchased Water Expense (Expense) **
 - Billing Period Net (Net)
 - Cumulative Balance (Balance)

Period entries commence at the effective date of the purchased water expense increase.

* Assumes accrued revenue accounting. If revenue is accounted on a cash basis, use revenue received.

** Note that the purchased water expense period and the utility’s billing period may not exactly overlap. Ignore the period discrepancy because the offset will integrate out in the cumulative balance computations.

- D-2 At the end of each Period, calculate the data entries:

For Utilities with All Metered Service:

- a.) Determine the incremental Revenue billed by multiplying the total water quantity billed for the Period by the applicable MQRI from Step A-4.
- b.) Determine the incremental Expense by multiplying the total water quantity billed to the utility by the PWRI from Step A-2.

For Utilities with All Flat Rate Service:

- a.) Determine the incremental Revenue billed by multiplying the applicable flat rate service charge increases per billing period and by service connection category from Step B-4 by the number of active service connections in each service account category.
- b.) Determine the incremental Expense by multiplying the total purchased water quantity for the period by the PWRI from Step B-2.

For Utilities with Mixed Service (metered service and flat rate service):

- a.) Determine the incremental Revenue by multiplying the utility’s total metered water quantity billed by the applicable MQRI from Step C-4 and add this sum to the flat rate service charge increases from Step C-8 multiplied by the number of active service connections in each service connection category.
- b.) Determine the incremental Expense by multiplying the total water quantity purchased for the period by the PWRI from Step C-2.

For All Utilities:

Net = incremental Revenue – incremental Expense, for the Period.

Balance = previous Period Balance plus current Net.

D-3 Amortization of the Balancing Account:

- a.) When the cumulative Balance exceeds 2% of the last adopted revenue (positive or negative), file a Tier 1 advice letter requesting recovery or refund over twelve months by = surcharge if the balance is negative, or by surcredit if the balance is positive.
- b.) No earnings test is required for amortization of a balancing account.
- c.) Apply the surcharge (surcredit) proportionally by meter size using the adopted MERs to the service charge rates for metered customers over twelve months.
- d.) Apply the surcharge (surcredit) proportionally by service category using the adopted service connection category equivalency ratios to the service charge rates for flat rate customers over twelve months.
- e.) For a mixed service utility, multiply the Balance to be amortized by surcharge or surcredit by the adopted percentage of the metered service revenue and allocate this sum to the metered service connections as in c.) above. The remainder of the Balance is allocated to the flat rate service connections as in above.