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California Water Association Small Company Instruction Modules

IM-05: Employee Labor Expense Increase Offset Advice Letter



CWA ADVICE LETTER INSTRUCTION MODULE

IM-05: EMPLOYEE LABOR EXPENSE INCREASE OFFSET ADVICE LETTER

October 30, 2014

I.) OBJECTIVE:

Prepare workpapers and tariff sheets to support an Employee Labor Expense Increase Offset Advice Letter, hereinafter referred to as a Labor Expense Offset AL, requesting a revenue increase to offset an employee labor expense increase which was not comprehended in the utility's last GRC nor requested in subsequent rate actions.

This Instruction Module describes procedures to request new revenue to offset incremental expenses related to new employee labor not previously provided in rates. Other significant employee labor expense increases could occur, which may qualify as an expense subject to offset; the details of the procedures described herein would be amended to reflect that specific circumstance and are beyond the scope of this Instruction Module.

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 Labor Expense 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 substantially found faulty by staff;
- Water Industry Rule 7.3.1 incorporates the wording ordered in W-4664 (see below) deleting the customer notice requirement;
- 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 (Section C), April 16, 2014:

- Defines categories of expenses subject to offset, which include employee labor offsets for Class C and D utilities;
- Confirms requirement that utilities with Commission authorized expense offsets must maintain a reserve per PU Code 792.5.

5.) D.92-03-093, March 31, 1982:

- Authorized recovery of up to 100% of fixed costs in service charges for Class D utilities, up to 65% for Class C, and maintained the Class B limit at 50%.
- Fixed costs include maintenance expenses; transportation and distribution expenses; customer expenses, excluding uncollectibles; administration and general expenses; rent expense; depreciation expense; property tax expense; and gross return on investment (*gross income*).

6.) 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 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 LABOR OFFSET AL:

- 1.) The utility's last GRC Resolution number, date, authorized increase (\$, %), and which also includes the adopted quantity sold, the meter equivalent ratios (MERs) for metered service, and/or the adopted service connection category equivalent ratios for flat rate service, and other adopted quantities.
- 2.) The prior year annual report filed by the utility and accepted by the CPUC.
- 3.) The new employee employment offer letter (or equivalent) specifying the annual salary or wage to be paid, start date, probationary period (if applicable), and benefits.
- 4.) A list of all new employee labor-related annual expense components (post probationary), including percentages of base pay, with supporting documentation:
 - a. Salary or hourly wage;
 - b. Employer's FICA payroll tax;
 - c. Workman's Compensation;
 - d. California EDD unemployment insurance;
 - e. California EDD training tax;
 - f. Company SEP-IRA or equivalent retirement benefit, if any;
 - g. Company provided medical insurance;
 - h. Other benefits or expenses, if applicable.
- 5.) The utility's current tariffs for metered-connection service charges by meter size.
- 6.) The utility's current tariffs for flat rate service charges by service category.
- 7.) For a utility with a mix of metered and flat rate service (mixed service), the adopted quantity for aggregate metered service revenue (service charges and quantity revenue) as a percentage of the total revenue in the last GRC.
- 8.) A description of the job functions to be performed by the new employee and quantification of the workload to justify this labor addition (to be incorporated in the text of the advice letter).

IV.) **STEP-BY-STEP PROCEDURES:**

A. Utilities with All Metered Service:

- A-1 Compute the annual new employee labor expense increase by adding the components listed in Data Item 4 of Section III above. This total is the annual labor expense increase, which is equal to the annual offset revenue increase to be requested.
- A-2 Compute the total number of meter equivalents using the adopted MERs and the current number of active metered connections by meter size (last annual report plus subsequent additions or deletions).
- A-3 Divide the annual offset revenue increase from Step A-1 by the number of billing periods per year and by the total number of meter equivalents from Step A-2. This is the service charge increase for the smallest meter size by billing period. Multiply this smallest meter service charge increase by the MER for each other active meter size. These are the meter service charge increases by meter size by billing period.
- A-4 Add the service charge increases from Step A-3 to the service charges by meter size in the current tariffs. These are the new meter service charge rates by meter size per billing period.

Class D utilities should proceed directly to Step A-6 to complete this Labor Offset AL.

A-5 Possible Fixed Costs % Limitation for Class B and C Utilities:

Aggregate service charge revenues as a percentage of fixed costs (FC) are limited to 50% for Class B utilities and 65% for Class C utilities (the FC % Limit). Class B and C utilities should add the annual labor expense increase from Step A-1 to the utility's current FC before the increase. This is the new FC. Multiply the new service charge rates in Step A-4 by the number of active services by meter size and by the number of billing periods per year to compute the annual new service charge (SC) revenue. Divide this new SC revenue by the new FC. If the computed percentage is equal to or less than the FC % Limit, the entire labor expense increase may be recovered in service charges. Proceed to Step A-5.

If the computed percentage exceeds the FC % Limit, the portion of the annual offset revenue increase that may be recovered in service charge increases must be reduced by the difference between the FC percent Limit less the current SC revenue prior to the offset, which is the allowed service charge revenue increase. Allocate this portion of the offset revenue increase as in Step A-3 to determine the allowed service charge increases by meter size. Add these allowed service charge increases to the current charge by meter size to determine the allowed new service

charge rates by billing period. If the current SC revenue exceeds the FG % Limit, the entire offset revenue increase should be recovered in metered quantity rates as discussed below.

The utility is authorized to recover the full amount of the offset revenue increase computed in Step A-1. The portion not recovered in service charges should be recovered in metered quantity rate(s). The revenue amount not recovered in the allowed service charge revenue increase is equal to the annual offset revenue increase less the allowed service charge revenue increase as calculated above. This is the new quantity revenue portion of the offset revenue increase. Divide this remainder by the adopted metered quantity sold to compute the increase in your metered quantity rate(s). Add this increase to your current metered quantity rate(s) to determine the new metered quantity rate(s).

- A-6 Divide the annual offset revenue increase (Step A-1) by the annual revenue at current rates prior to the labor offset to determine the revenue percentage increase. The revenue increase amount and percentage will be needed for the advice letter and its cover sheet.
- A-7 Prepare and file a Tier 1 Labor Expense Offset AL (see IM-01) requesting the amended tariffs with the new service charge rates determined in Step A-4 or with the new service charge rates and new metered quantity rate(s) determined in Step A-5. Include your workpapers and tariff sheets as attachments to the AL. This completes preparation of the labor offset rate increase. To maximize the expense offset revenue received, file the Tier 1 AL before the start date of the new employee, with an effective date concurrent with the start date.
- A-7 Establish the required balancing account per the procedures in Paragraph D below.

B. Utilities with Flat Rate Service:

- B-1 Compute the annual new employee labor expense increase by adding the components listed in Data Item #4 of Section III above. This total is the annual labor expense increase, which is equal to the annual offset revenue increase to be requested.
- B-2 Compute the total service charge equivalents using the adopted service connection category equivalent ratios and the current number of active connections by flat rate service category (last annual report plus additions or deletions).
- B-3 Divide the annual offset revenue increase from Step B-1 by the number of service charge equivalents from Step B-2. This is the lowest flat rate service charge increase by billing period. Multiply this lowest rate increase by the service charge equivalent for each other service category. These are the flat rate service charge increases for each service category by billing period.

- B-4 Add the service charge increases by flat rate service category from Step B-3 to the flat rate service charges by category in your current tariffs. These are the new flat rate service charges by category per billing period.
- B-5 Divide the annual offset revenue increase (Step B-1) by the annual revenue at current rates prior to the labor offset to determine the revenue percentage increase. The revenue increase amount and percentage will be needed for the advice letter and its cover sheet.
- B-5 Prepare and file a Tier 1 Labor Expense Offset AL (see IM-01) requesting the amended tariffs with the new flat rate service charges determined in Step B-4. Include your workpapers and tariff sheets as attachments to the AL. This completes preparation of the utility's offset rate increase. To maximize the expense offset revenue received, file the Tier 1 AL before the start date of the new employee, with a concurrent effective date.
- B-6 Establish the required balancing account per the procedures in Paragraph D below.

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

- C-1 Compute the annual new employee labor expense increase by adding the components listed in Data Item #4 of Section III above. This total is the annual labor expense increase, which is equal to the annual offset revenue increase to be requested.
- C-2 Multiply the annual offset revenue increase in Step C-1 by the adopted percentage of metered service revenue in the last GRC (Data Item #7, Section III above). This is the metered service revenue increase portion of the annual offset revenue increase.
- C-3 Allocate the metered service portion of the offset revenue increase from Step C-2 among the service charges for all active metered service connections using the adopted MERs as in Steps A-2 and A-3 above. These are the metered connection service charge increases by meter size per billing period.
- C-4 Add the service charge increases by meter size from Step C-3 to the metered connection service charges in the current tariffs. These are the new meter service charge rates by meter size per billing period.
- C-5 Subtract the annual metered service revenue increase in Step C-2 from the annual offset revenue increase in Step C-1. This is the flat rate service portion of the annual offset revenue increase.
- C-6 Allocate the flat rate service portion of the offset revenue increase by billing period among the service charges for all active flat rate service connections according to the adopted service category equivalent ratios as in Steps B-2 and B-3 above.

These are the service charge increases by flat rate service category per billing period.

- C-7 Add the flat rate service charge increases by category from Step C-6 to the flat rate service charges by category in the current tariffs. These are the new flat rate service charges by service category per billing period.
- C-8 Divide the annual offset revenue increase (Step C-1) by the annual revenue at current rates prior to the labor offset to determine the revenue percentage increase. The revenue increase amount and percentage will be needed for the advice letter and its cover sheet.
- C-9 Prepare and file a Tier 1 Labor Expense Offset AL (see IM-01) requesting amended tariffs for the new meter service charge rates determined in in Step C-4 and for the new flat rate service charges determined in Step C-7. Include your workpapers and tariff sheets as attachments to the AL. This completes preparation of the labor offset rate increase. To maximize the expense offset revenue received, file the Tier 1 AL before the start date of the new employee, with an effective date concurrent with the start date.
- C-10 Establish the required balancing account per the procedures in Paragraph D below.

D. Employee Labor Balancing Account:

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

Period entries commence at the employee start date and continue open ended.

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

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

Determine the incremental employee labor offset Revenue billed per Period:

- a.) For an all-metered utility, multiply the service charge increases by meter size from Step A-2 or from Step A-4 by the number of active service connections in each size category;

- b.) For an all flat rate service utility, multiply the service charge increases by flat rate service category from step B-2 by the number of active connections in each category;
- c.) For a mixed service utility, multiply the service charge increases by meter size from Step C-3 by the number of active metered services by size; then, multiply the service charge increases by flat rate category from Step C-6 by the number of active flat rate connections in each category. Add these two totals to compute the incremental revenue.

Determine the incremental employee labor expense for each month or billing period:

Divide the annual labor expense increase from Steps A-1, B-1, or C-1 (plus any subsequent pay or benefit adjustment) by the number of billing periods per year; enter this figure for the Period expense.

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-service customers over twelve months.
- d.) Apply the surcharge (surcredit) proportionately 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 customers as in c.) above. The remainder of the Balance is allocated to the flat rate service customers as in above.