BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UW 120

In the Matter of CROOKED RIVER RANCH WATER COMPANY Request for Rate increase resulting in total annual revenues of $868,453.	STAFF'S REPLY BRIEF

Consistent with the Administrative Law Judge (ALJ) ruling dated November 1, 2007, Public Utility Commission of Oregon Staff (Staff) respectfully submits its reply brief. In its opening brief, Crooked River Ranch Water Company (CRRWC or Company) basically presents four overall arguments:

1. Staff does not allow enough funds for CRRWC to effectively serve its customers;
2. The Commission should not accept Staff's use of invoices and other specific documentation provided to Staff by the Company, but instead use the Company's unaudited financial statements to develop recommended rates;
3. The Commission's rate-making methodology should not be applied to CRRWC; and
4. The Commission should defer to the Board of Directors and allow the Company to operate at its proposed rates for a one-year transition period.

The Company is incorrect in all its arguments. However, Staff did discover a calculation error in the method the rate of return was calculated and submits the following changes to its recommendation for the Commission to consider.

	Staff UW 120 Testimony	**Staff Revised**	**Staff Revised Lower Manager Pay**
ROR	4.13%	6.16%	6.16%
Net Income	$25,394	$37,912	$37,824
Revenue Requirement	$525,295	$537,844	$528,534
Base Rate	$18.58	$19.03	$18.70
Commodity Rate	$0.86	$0.88	$0.86
Monthly Average Rate	$27.73	$28.41	$27.91

Staff discusses this change later in the brief under the Rate of Return discussion.

Staff's Recommended Revenue and Rates

The Company erroneously states that Staff only allows $457,408 for anticipated cash paid. *See* CRRWC Opening Brief at 2. This is incorrect and highlights the Company's lack of knowledge concerning rate-making. Staff's recommendation actually allows the Company an opportunity to operate on revenues of $525,295, as Staff's proposed rates embeds both the $43,263 depreciation expense and net income of $25,394.[1]

The Company also argues that the Public Utility Commission's established process for rate-setting should be ignored. *See* CRRWC Opening Brief at 2. Staff's rates – based upon the established process for rate-setting - allow recovery of prudent utility expenses and provide a reasonable return on investment.

In its opening brief, the Company continues to argue that unaudited financial statements should be used instead of actual data for establishing rates. While Staff's recommended rates are approximately $223,000 less than the test year amount, its recommendation was based on actual documentation provided by the Company. As mentioned in its opening brief, Staff's lower amount was a result of:

1. Recommended disallowance of the $8 per month surcharge;
2. Recommended lower level of wage expense;
3. Recommended lower level of O&M supplies expense;
4. Recommended lower level of repair expense;
5. Recommended lower level of legal expense;
6. Recommended disallowance of contracted labor expense;
7. Recommended lower level of workers' compensation expense;
8. Recommended disallowance of system capacity expense;
9. Recommended lower depreciation expense; and
10. Recommended lower calculated rate of return.

[1] If the Commission were to accept Staff's revised recommendation, the Company would have an opportunity to operate on revenues of $537,844, a 2.39 percent increase.

The Company has the burden of proof to demonstrate that its rates are just and reasonable. See ORS 757.210 (the “utility shall bear the burden of showing that the rate or schedule of rates proposed to be established or increased or changed is just and reasonable.”) The Company consistently failed to provide documentation to support revenue higher than Staff’s recommendation.

The Company mentions the difference between cash and accrual accounting. *See* CRRWC Opening Brief at 4. These accounting methods basically differ only in the timing of when transactions, including sales and purchases, are credited or debited to accounts.[2] The Commission does not prescribe which of these accounting methods a water utility should use. A water utility may report using either a cash or accrual basis when filing its Annual Report. A water utility is not required by the Commission to transition from a cash basis to an accrual basis. The basis a water utility uses is based upon the water utilities’ needs. Finally, the accounting method a water utility uses is irrelevant for ratemaking. In UW 120, Staff employed historical data (2006 escalated and 2007 annualized) to determine the correct level of rates. This data would be the same under either accounting method.

As the Company correctly states in its opening brief, Staff did not object to the Company using a 2007 test year. *See* CRRWC Opening Brief at 4. However, Staff has consistently stated that additional data is necessary to demonstrate expected 2007 costs. Interestingly, the Company objects to both Staff using a 2006 historical year and annualizing 2007 data. The Company would prefer that Staff and the Commission accept CRRWC’s submitted revenues and expenses at face value without objectively examining and reviewing information. In essence, the Company asks the Commission to ignore its duty to set just and reasonable rates and, instead, rely on unsupported and self-serving statements of the General Manager.

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[2] Under the accrual method, transactions are counted when the order is made, the item is delivered, or the services occur, regardless of when the money for them (receivables) is actually received or paid. Under the cash method, income is not counted until cash (or a check) is actually received, and expenses are not counted until they are actually paid.

Discovery

The Company's Opening Brief states on page 5:

> The alleged failure by CRRWC to produce information pursuant to data requests is not a justification to slash the companies budget for expenses in fact that the opposite is true when viewed from a common senses prospective.

First and foremost, there is no alleged failure to produce information; **the Company failed to produce information**. As illustrated in its opening brief, Staff had not received complete or adequate responses for data requests nos. 3, 15, 47, 49, 50, 51, 52, 53, 60, 67, 68, 81, 101a, 102b, 103b, 110, 114, 120, 121(d), 122(d), 128, 137, 138, 139, 140, 141, 142, 143, and 144 during the period scheduled for discovery.[3] Secondly, the Company's failure to carry the burden of proof and demonstrate that higher expenses are just and reasonable, or to persuade the Commission that Staff's recommendation is incorrect, is justification to establish rates based upon the evidence in the record.

The Company alleges that Staff consistently refused to cooperate or acknowledge the explanations for the difficulties encountered by CRRWC. *See* CRRWC Opening Brief at 5. This is patently false. Staff did not object to the 60-day and the first 30-day extensions of the rate application; a Staff member visited the Company in February 2007; Staff informally allowed extended time for responses to data requests; and Staff scheduled and participated in two settlement conferences.

Staff did not agree to have bilateral settlement discussions with the Company's accountant without the invitation of the other parties to the case because such bilateral settlement discussions are inappropriate in a contested case proceeding. *See* CRRWC Opening Brief at 9. Staff must discharge its responsibilities consistent with the Commission's obligation to conduct fair proceedings. *See* OAR 860-014-0085.

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[3] During a November 5, 2007, Subpoena Duces Tecum served on the members of CRRWC's Board of Directors, the Company provided responses to Staff data requests nos. 15, 50, 68, and 81, and later on November 9, 2007, provided partial responses to data requests nos. 3 and 128. The company has also provided a box of information apparently partially responsive to items 1 and 2 of Staff's Subpoena Duces Tecum. Staff expects that it will be able to review the contents of the box in the next ten business days and report to the Commission.

Operating Expenses

The Company states that Mr. Dougherty was provided a copy of the SCADA contract. *See* CRRWC Opening Brief at 18. This is misleading. Staff only received a copy of the SCADA contract at the November 5, 2007, Subpoena Duces Tecum meeting. If CRRWC had provided this information in response to data requests and motions to compel before Staff's testimony was due, Staff would have considered the SCADA contract in developing its recommendation.

The Company states Staff does not recommend rates that are adequate for the Company to operate. *See* CRRWC Opening Brief at 3. This is inaccurate. In Staff/100, Dougherty/34, Staff points out that the recommended $436,153 in operating expenses,[4] based on a review of documentation received, is actually higher than the two comparable companies of Roats and Agate.

Additionally, during the October 25/26, 2007, UW 120 Evidentiary Hearing, (*See* Transcript[5] at 183), Staff correctly noted that a company that has both a general manager and a Board of Directors must direct their company to ensure that it is managed properly and that expenses are handled in an appropriate manner. Staff recognizes that the recommended level of expenses can not support a "business as usual" approach of high amounts of overtime, incredibly high legal and accounting bills, and high levels of non-utility expenses such as donations and non-necessary meal and entertainment expenses. The Board of Directors is accountable to the members (and not management) and should be expected to make the right decisions that will ensure the sustainability of the Company.

Rate Base

The Company alleges that neither Staff nor the Company know the Company's rate base. *See* CRRWC Opening Brief at 8. The Company is incorrect. Staff used the Company's Federal Depreciation Schedule for its basis of plant. Staff's recommendation for CRRWC's net utility

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[4] This amount increases slightly in Staff's revised recommendation to $436,185 based on the revenue-sensitive gross operating fee increase.

[5] As used herein, refers to the official transcript of the evidentiary hearing.

plant is $543,506, which is an upward adjustment from the $500,549 as shown in the revenue requirement input provided by the Company's accountant.

The Company continues to argue that CIAC, such as main line extensions and meters, should be included in rate base. *See* CRRWC Opening Brief at 8. The Company's argument is contrary to the law and Commission precedent. *See* OAR 860-036-0756. The main line extensions were not paid through rates, but through monetary contributions of customers that are served by these lines. As an example, each customer being served on the Peninsula line extension paid the Company $6,500 to receive water service. As far as meters, the Company, in response to Staff data request no. 59, states: "The only time a meter is not charged to a customer is when the company replaces it due to damage, etc." According to information provided by the Company and reflected on Staff/102, Dougherty/8, the in-service date of the majority of meters (1,121) occurred at or prior to 1998. Additionally, customer payment for main line extensions, based on information provided by the Company for the Peninsula line extension, included $500 for the meter, indicating that the vast majority of meters were customer paid. Therefore, both the main line extensions and meters are properly classified as CIAC and should not be included in rate base.

The Company states that the subjectivity of Staff's review is evidenced by the allowance in plant of one third of land that is used for storing dirt and gravel. *See* CRRWC Opening Brief at 10. The Company purchased this land for expansion and did not purchase this land to store dirt and gravel. Furthermore, the Company can order dirt and gravel as needed. The allowance of one third of the land into rates was recognition that land was being used; however, Staff continues to question the usefulness and purpose of this land. As a result, Staff believed one third inclusion was a compromise to the Company that resulted in just and reasonable rates.

The Company also continues to argue that both the non-existent radio read project and Well No. 3 should be included in rate base. The radio read meters have not been purchased or installed and, thus, their inclusion would be unlawful. *See* ORS 757.355. In addition, the approximate cost of the radio read meter project is $611,810, which the Company cannot currently finance due to insufficient funds. At the October 25/26, 2007, UW 120 Evidentiary Hearing, the Company accountant's admitted that the Company does not have sufficient funds to purchase these meters. *See* Tr. at 99. The Commission should accept Staff's recommendation that radio read meters be excluded from CRRWC's rate base.

The Company incorrectly states they have one well, by stating "We only have one well, and that well is 1,000 feet deep with 500 feet of rubber bearings in it." *See* CRRWC Opening Brief at 15. This is incorrect. The Company has two wells. As Staff/100, Dougherty/5 states, each well has a capacity of 1,152,000 gpd. Because of the limitation of the booster pump, the Company's system is capable of supplying approximately 1,872,000 gpd, almost two times the actual peak demand in August 2006.

The Company also states that "With the advent of PUC regulation a monthly assessment will no longer be available to provide funds for this necessary project." This is incorrect for two reasons. First, as consistently demonstrated by Staff in testimony and its opening brief, the well is unnecessary. Second, none of the assessment funds have been used for the well, with the exception of legal costs surrounding access and other administrative costs.

Despite the statements of Mr. Rooks (*See* CRRWC Opening Brief at 16), except for the 1995 repairs to Well No. 2 reflected in the Company's depreciation schedule ($23,590), Staff is unaware of any major repairs to the wells. As was demonstrated during the October 25/26, 2007, UW 120 Evidentiary Hearing, the Company currently has sufficient pressure, storage, and capability to meet the State of Oregon Fire Marshall Office's requirements for both residential structure fire (1,000 gallons per minute (gpm) for 2 hours) and commercial structure fire (1,500 gpm for 2 hours). As admitted during the October 25/26, 2007, UW 120 Evidentiary Hearing (*See* Tr. at 182; 179), the Company's current plant configuration allows for approximately 1,300 gpm continuously and 1,500 gpm for approximately four hours. This is sufficient fire flow to combat residential and commercial structural fires. As a result, Staff's recommended rates do not "detract from the quality of water service that customers receive on a daily basis." *See* CRRWC Opening Brief at 16-17.

Further and as presented during the October 25/26, 2007, UW 120 Evidentiary Hearing, the Company does not have an in-service date for the well (*See* Tr. at 38), has not presented Staff a project timeline for the well (*See* unanswered data request no. 143), and has not presented Staff total estimated costs of the well (*See* unanswered data request no. 143). The Company has not even provided a known cost that Staff would be able to place into plant and its inclusion would be unlawful. *See* ORS 757.355.

<u>*Rate of Return*</u>

In drafting its reply brief, Staff discovered that its method used to calculate CRRWC's cost of capital (4.13 percent) was performed incorrectly. Staff's initial Rate of Return (ROR) was calculated from the two outstanding loans (Building - $110,000 and 2006 Chevrolet truck - $29,987) and an imputed cost of equity. The cost of equity, although calculated in the method prescribed by Commission Order No. 07-137 (AR 506), *In a Matter of a Rulemaking to Amend and Adopt Permanent Rules in OAR 860, Division 24 and 28, Regarding Pole Attachment Use and Safety* (page 16), was incorrectly calculated by Staff.

Staff's previous method contained two calculation errors. First, Staff should have removed the building loan from the cost of capital calculations because of the balloon payment that is due on March 15, 2008. The maturity of this loan is less than one year and should be removed because it is no longer considered long-term debt. Second, Staff erroneously added 100 basis points to the weighted cost of debt instead of correctly applying the 100 basis points to the embedded cost of debt. When Staff correctly performs the prescribed method, the cost of equity should be 6.90 percent, resulting in a ROR of 6.85 percent. This change would have a significant effect on the Company's net income, revenue requirement, and rates. The result is highlighted in the following table.

	Staff UW 120 Testimony	Staff Revised	Staff Revised Lower Manager Pay
Rate of Return	4.13%	6.85%	6.85%
Net Income	$25,394	$42,177	$42,124
Revenue Requirement	$525,295	$542,120	$532,805
Base Rate	$18.58	$19.19	$18.85
Commodity Rate	$0.86	$0.89	$0.87
Monthly Average Rate	$27.73	$28.64	$28.14

Because the only loan remaining in this scenario is the truck loan, another option to explore (one that was presented by Intervenor Steven Cook) is to remove all the loans, and use the method of adding 200 basis points to the 10-year treasury rate as of the last traded day. That calculation gives the following results:

	Staff UW 120 Testimony	Staff Revised	Staff Revised Lower Manager Pay
Rate of Return	4.13%	6.16%	6.16%
Net Income	$25,394	$37,912	$37,824
Revenue Requirement	$525,295	$537,844	$528,534
Base Rate	$18.58	$19.03	$18.70
Commodity Rate	$0.86	$0.88	$0.86
Monthly Average Rate	$27.73	$28.41	$27.91

Staff supports the second method. If the Commission accepts this method of removing all loans and adding 200 basis points to the 10-year treasury note, the Company should be required to pay off both loans (approximately $54,000) within 60 days of the order and provide documentation of such transactions. Based on information provided by Staff, the Company has approximately $117,774 in a banking account with Community First Bank, sufficient to pay-off both loans. This method also allows the Company to achieve its goal of being debt free, and allows room for CRRWC to borrow money if a situation requires additional capital.

One Year Transition Period

The Company states that it would be reasonable to have a one-year transition period. *See* CRRWC Opening Brief at 7. The Company further states that it should be granted substantial latitude by the Commission in the designation of an appropriate rate. *See* Id. The Company also contends that the Commission should defer to CRRWC. *See* CRRWC Opening Brief at 18.

Staff strongly disagrees that CRRWC's proposed monthly rate of $45.05 be accepted by the Commission instead of Staff's recommended revised rate of $28.41. CRRWC's rate is not justified by the record and cannot be considered just and reasonable. Staff's recommended rate accurately reflects the cost-of-service of a prudently-managed CRRWC. As Staff discussed in both testimony and its opening brief, there are certain areas (*e.g.* wages, ROR) that Staff recommended a higher level than may be warranted. If anything, the Commission should consider rates lower than Staff's recommendation.

The Commission has the duty to establish just and reasonable rates. ORS 756.040. That duty does not allow the Commission to "defer" to the self-serving desires of a regulated utility. Likewise, there should be no transition period. In fact, no such transition period is allowed by law. The Commission has a duty to establish fair and reasonable rates based upon the record in this proceeding.

<u>Intervenor Brief</u>

Intervenor, Steven Cook, also submitted an opening brief. Mr. Cook addresses several issues. First, Mr. Cook suggests that the financial statements were never "accepted" by the Commission for a basis in rates. *See* Cook Opening Brief at 3. However, the Company's unaudited financial statements were provided to Staff as responses to data requests. While these financial statements were received, Staff did not rely on the unaudited financial statements when doing its more thorough review for purposes of rate-making.

Second, Mr. Cook states that there is an inconsistency in the manner that Staff handled the land to store dirt and gravel and Well No. 3. Mr. Cook is correct that Staff made a "call" and came to a compromise on the land to store dirt and gravel. *See* Tr. at 146. As Staff has previously stated, the allowance of one third of the land into rates was recognition that the land was being used; however, Staff continues to question the usefulness and purpose of this land because the land was purchased for expansion. As a result, Staff believed one third inclusion of the land in rate base resulted in just and reasonable rates.

Third, Mr. Cook believes that the return on equity should always be higher than the cost of debt. In Staff's revised analysis, Staff removes all debt and uses the 10-year treasury rate plus 200 points. This change in method results in a higher ROR than what was presented in both Staff's testimony and opening brief.

Fourth, Mr. Cook recommends an inverted block rate. As Staff stated in Staff/100, Dougherty/46, Staff did not propose a two-tier rate for two reasons.

> Firstly, the Company did not provide multiple years of consumption, so I did not want to determine a rate without complete, accurate, and quality information. Secondly, the Company based on its current water permit, current usage, and current wells and distribution system, has an adequate supply of water and additional conservation efforts are not required at this time.

Additionally, as Staff testified during the October 25/26 UW 120 Hearing, Staff did not want to react to a problem (supply, demand, distribution) that does not currently exist. *See* Tr. at 154-55.

Conclusion

Throughout the process of this rate application, Staff's review and been hampered and made difficult by the lack of discovery from the General Manager of CRRWC. Even with the lack of documentation provided by the General Manager, Staff painstakingly developed a record to support revenue and rates that would allow a prudently operated CRRWC to operate while also having its members pay rates that were just and reasonable. Staff's recommendation is based upon a record that has largely been created from Staff's diligent work rather than the Company's production of information to carry its burden of proof. In spite of the barriers presented by CRRWC's General Manager, Staff's recommendation would result in just and reasonable rates.

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For the foregoing reasons, Staff respectfully requests that its recommendation be adopted.

DATED this 19th day of November 2007.

Respectfully submitted,

HARDY MYERS
Attorney General

s/Jason W. Jones________________
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CERTIFICATE OF SERVICE

I certify that on November 19, 2007, I served the foregoing upon all parties of record in this proceeding by delivering a copy by electronic mail and by mailing a true and exact copy by postage prepaid first class mail or by hand delivery/shuttle mail.

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