

## PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298



March 9, 2020

RE: Rates of Return and Rates of Margin for Class C, Class D Water and Sewer Utilities

TO: COMMISSION

By this memorandum, the Water Division (WD) updates its recommended Rates of Return (ROR) and Rates of Margin (ROM) for Class C, Class D Water and Sewer Utilities. These updates have been calculated in accordance with Resolution W-4524, which revised the Standard Practice that addresses how the ROR and ROM are calculated for Class C and D water utilities.

WD considered several factors in determining the ROR. WD assessed the movement in actual and forecasted interest rates, operational risks faced by the small investor-owned water and sewer utilities, and the constant level of authorized ROR for Class A water utilities averaging 7.77%.

In determining the ROM for Class C, Class D water and sewer utilities, WD considered the Class B water utilities' most recent authorized average rates of return of 10.07%, the most recent authorized equivalent average ROM of 21.86%. Because the changes in the actual annual interest rates from 2015 to 2019 are inconstant, WD recommended to keep the ROR for Class C and D water and sewer utilities the same as in 2019. The pattern of changes in the actual interest rates for 2020 would be considered accordingly in next year's calculation.

For 2020, WD recommends that the following ROR and ROM be used in the water utilities' informal general rate cases (supporting documentation is attached):

Utility Type	Rate of Return (ROR)	Rate of Margin (ROM)
Class C	9.90% to 10.90%	22.57%
Class D	10.40% to 11.40%	23.65%

If you have any questions regarding the ROR and ROM recommendations, please contact Ramon Go of the WD at (415) 703-1350, or [rhg@cpuc.ca.gov](mailto:rhg@cpuc.ca.gov)

Sincerely,

Bruce DeBerry, Program Manager

**CALCULATION OF CLASS C, CLASS D WATER AND SEWER UTILITIES'  
RATES OF RETURN (ROR) & RATES OF MARGIN (ROM)<sup>2</sup>**

- Rates are calculated using both ROR and ROM Methods.
- The Method that produces the higher result is used.
- ROR is set at a level within the recommended ranges.
- Where little or no rate base exists, the ROM is used.
- The ROM is applied to operating expenses to determine the estimated dollar return, which is then compared with the average dollar ROR on rate base.
- Calculations are based on assumption that there is a comparable relationship between authorized Class B ROR and ROM and Class C and D ROR and ROM.
- Class C and D water operations, finances, and risks are more like those of the Class B water utilities than with Class A water utilities.

**Data Used in Determining the Rate of Return and Rate of Margin  
for Class C and Class D Water Utilities**

Year	Recommended ROR Range		Actual Interest Rates from the Federal Reserve			
			U.S. Treasuries			
	Class C Water	Class D Water	90-Day	1-Year	5-Year	30-Year
2014	10.20% - 11.20%	10.80% - 11.80%	0.03%	0.12%	1.64%	3.34%
2015	10.20% - 11.20%	10.80% - 11.80%	0.05%	0.32%	1.53%	2.84%
2016	9.60% - 10.60%	10.20% - 11.20%	0.32%	0.61%	1.33%	2.59%
2017	10.00% - 11.00%	10.50% - 11.50%	0.95%	1.20%	1.91%	2.89%
2018	10.06% - 11.06%	10.56% - 11.56%	1.97%	2.33%	2.75%	3.11%
2019	9.90% - 10.90%	10.40% - 11.40%	2.11%	2.05%	1.95%	2.58%
2020	9.90% - 10.90%	10.40% - 11.40%	1.55%	1.53%	1.56%	2.22%
Forecast for 2021 (As of 02/13/2020)			Forecast Interest Rates from IHS Global Insight			
			1.65%	2.13%	2.33%	2.96%

Calculation of Rate of Margin ("ROM")	Inputs	ROM	
		Class C	Class D
Average Class B Rate of Margin ("ROM")	21.86%	22.57%	23.65%
Average Class B Rate of Return ("ROR")	10.07%		
Average Class C ROR	10.40%		
Average Class D ROR	10.90%		
Average Class C ROM = Average Class B ROM * (Average Class C ROR/Average Class B ROR)			
Average Class D ROM = Average Class B ROM * (Average Class D ROR/Average Class B ROR)			

<sup>1</sup> Class C water utilities have 501 to 2,000 customers; Class D water utilities have 500 or less customers.

<sup>2</sup> Pursuant to Decision 92-03-093, Ordering Paragraph No. 8 and Resolution W-4524.