



Antelope Valley Water Rates

Various Factors Contribute to Differences
Among Water Utilities

Report 2013-126

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July 8, 2014

2013-126

The Governor of California
President pro Tempore of the Senate
Speaker of the Assembly
State Capitol
Sacramento, California 95814

Dear Governor and Legislative Leaders:

As requested by the Joint Legislative Audit Committee (committee), the California State Auditor presents this audit report concerning the rates charged by four water utilities in the Antelope Valley (valley). Specifically, we were asked to audit the rates that three government-owned utilities (public utilities)—Los Angeles County Waterworks, District 40 (LA District 40), Palmdale Water District, Quartz Hill Water District (Quartz Hill)—and one investor-owned utility (investor utility), California Water Service Company (Cal Water) charge their respective customers. In addition, the committee requested that we identify and evaluate significant factors contributing to each water utility's rates.

This report concludes that water rates differ considerably among the four water utilities and that various cost factors affect the water rates that each of them charges. For example, investor utilities incur costs that public utilities do not, including property and franchise taxes. In addition, each utility has access to different revenue sources, with public utilities receiving revenues in addition to monthly water rates, primarily property taxes, which help them cover their costs and contribute to lower rates. A utility's sources of water also contribute to cost variations.

Our review also found that all four utilities increased their water rates between 2011 and 2013 and the utilities were generally able to substantiate reasons for their increases. Furthermore, processes are in place to protect consumers from unreasonable rate increases, which each water utility could demonstrate it followed, with some exceptions for Quartz Hill and LA District 40. However, the requirements for notice under Proposition 218 could be clarified by the Legislature to provide further guidance to public utilities. In addition, a constitutional provision under that same law allowing parcel owners to protest a rate increase is unlikely to prohibit increased rates because it requires that a majority of parcel owners submit a written request.

Finally, the utilities attested to a variety of cost saving efforts to keep their water rates reasonable, but were not always able to demonstrate that these efforts generated any quantifiable cost savings to their customers. Additionally, Cal Water offers two rate assistance programs to qualified customers in the valley while the three other utilities do not currently offer rate assistance programs or discounts to their customers' monthly water bills.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

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Summary

Results in Brief

The Antelope Valley region (valley) occupies northeastern Los Angeles, southeastern Kern, and western San Bernardino counties, and its water customers are served, depending on location, by four main water utilities: Los Angeles County Waterworks, District 40 (LA District 40), Palmdale Water District (Palmdale), Quartz Hill Water District (Quartz Hill), and California Water Service Company (Cal Water), and by several smaller utilities. Water rates differ considerably among these four water utilities. For example, in April 2013 a typical residential customer of Cal Water paid just over 304 percent more than a customer of LA District 40 with similar water usage. Although there are legal and other differences among the four water utilities, the primary explanation for the differences in rates and rate increases is the difference in the costs paid by each water utility. Also, the four utilities can pass through inflation and increased costs of purchased water as rate increases to their customers.

One major factor that contributes to the dissimilarity in costs among the utilities is the inherent difference between investor-owned utilities (investor utilities), such as Cal Water, and government-owned utilities (public utilities), such as Palmdale, Quartz Hill, and LA District 40. For example, investor utilities incur costs that public utilities do not, including property and franchise taxes. In addition to the dissimilarities in costs, each water utility has access to different revenue sources due to the legal distinctions between public and investor utilities. For example, as an investor utility, Cal Water can receive revenues only through monthly water rates, which includes a return on its investments in capital improvements. Public utilities receive revenues from monthly water rates and from additional sources, primarily taxes based on the assessed value of properties in their service area. These additional revenue sources help public utilities cover their costs, and therefore can contribute to lower monthly water rates for their customers. Other factors specific to each water utility can also contribute to variations in their costs, including the sources of water and energy costs to pump water. We grouped these costs into the major expenditure categories of personnel, operations, water purchases, power, water treatment, and, where applicable, taxes. Although the four water suppliers have similar types of expenditures, the costs they incurred varied.

Furthermore, processes are in place to protect consumers from unreasonable rate increases, and each of the water utilities generally followed these processes. The investor utility we reviewed, Cal Water, must file a general rate case every three years with the

Audit Highlights . . .

Our audit concerning Antelope Valley water rates revealed the following:

- » *Of the four water utilities we reviewed—Los Angeles County Waterworks, District 40 (LA District 40), Palmdale Water District (Palmdale), Quartz Hill Water District (Quartz Hill), and California Water Service Company (Cal Water)—water rates differed considerably based on the various costs they incur.*
 - *Cal Water, an investor-owned utility, incurs costs that government-owned utilities (public utilities) do not, which include property and franchise taxes.*
 - *Public utilities—LA District 40, Palmdale, and Quartz Hill—receive revenues, primarily from property taxes, that help cover costs and contribute to lower rates.*
 - *A utility's source of water contributes to cost variations.*
- » *Processes are in place to protect consumers from unreasonable rate increases and each of the water utilities generally followed these processes.*
- » *In some cases, the water utilities could not quantify their efforts to reduce water rates.*
- » *Cal Water offers two rate assistance programs while the three public utilities do not offer discounts to their customers.*

California Public Utilities Commission (commission) for review and approval before adjusting rates. The three public utilities we reviewed also must adhere to an approval process. Proposition 218, a constitutional provision that limits the authority of local government agencies to impose property-related assessments, fees, and charges, requires public utilities to provide parcel owners with written notice of any proposed rate increase at least 45 days in advance of a public hearing, and to explain the purpose for any increase. However, although Quartz Hill included the basis for calculating its rate increase in this notice, we believe it could have included more detail for the basis of its fee methodology. We noted that the requirements for the level of detail contained in the notice could be clarified by the Legislature to provide further guidance to public utilities. Furthermore, Quartz Hill and LA District 40 followed Proposition 218's public notice requirements, but they lacked documentation showing that they followed statutory provisions requiring them to notify parcel owners of automatic increases in water rates to pass through inflation and increased costs of purchased water for all three years we reviewed. Additionally, Quartz Hill did not adopt a schedule of fees showing the effect of its pass-through increases, as required by law. Proposition 218 also prohibits public utilities from increasing rates if a majority of parcel owners submit written protests; however, due to the number of property owners served by each public utility, we believe it is unlikely that a majority of them would protest.

In an effort to keep rates reasonable, the four water utilities shared with us examples of their efforts to reduce their costs. Because of concerns expressed by valley water customers regarding increasing water rates, we would expect that the water utilities would be able to quantify these efforts. However, in some instances this was not the case. For example, Palmdale suggested that the annual efficiency audit of the electrical usage for its groundwater wells, conducted by its electricity utility, was a cost-saving effort. However, because the electricity utility performs this annual audit, we did not consider this to be an effort that Palmdale took outside the normal course of business to keep its water rates reasonable. In contrast, LA District 40 will begin a five-year effort in fiscal year 2014-15 to replace its vehicle fleet with more efficient vehicles, which it was able to demonstrate could save \$148,000 a year once completed.

As an investor utility, Cal Water is authorized by the commission to offer rate assistance programs and currently offers two different types of assistance to certain demographics of valley water customers. For example, the Low-Income Rate Assistance program provides a monthly discount of 50 percent of the water customer's service charge, up to a maximum of \$12 per month, for water customers whose annual income for a family of four is at or below \$47,700. The public utilities we visited do not currently

offer rate assistance, nor are they required to do so. In fact, Proposition 218 prohibits public utilities from using revenues from water rates to offer rate assistance programs to any one water customer demographic. However, the public utilities are not prohibited from using revenues from other sources to offer rate assistance programs.

Recommendations

To ensure that water customers are able to have a better understanding of how rate increases are determined, Quartz Hill should include information in its public notices providing reasonably sufficient details regarding the basis of its fee methodology.

To provide guidance to local public agencies in implementing the notice requirements of Proposition 218, the Legislature should enact legislation that provides guidance to public utilities regarding the level of detail to include in the public notices required by Proposition 218.

LA District 40 and Quartz Hill should ensure that they can demonstrate compliance with the statutory requirements of Proposition 218 when adopting any future pass-through rate increases. Furthermore, Quartz Hill should ensure that it adopts a schedule of fees showing the effect of its pass-through rate increases.

To show water customers that they are attempting to keep rates reasonable, each water utility should ensure that it can demonstrate any savings expected or achieved as a result of its cost-saving efforts.

The three public utilities should work with their respective governing bodies to consider the feasibility of offering rate assistance programs for low-income water customers.

Agency Comments

LA District 40, Palmdale, and Cal Water generally agreed with our conclusions and recommendations. However, Quartz Hill disagreed with our concerns regarding its compliance with the notice requirements of Proposition 218.

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Introduction

Background

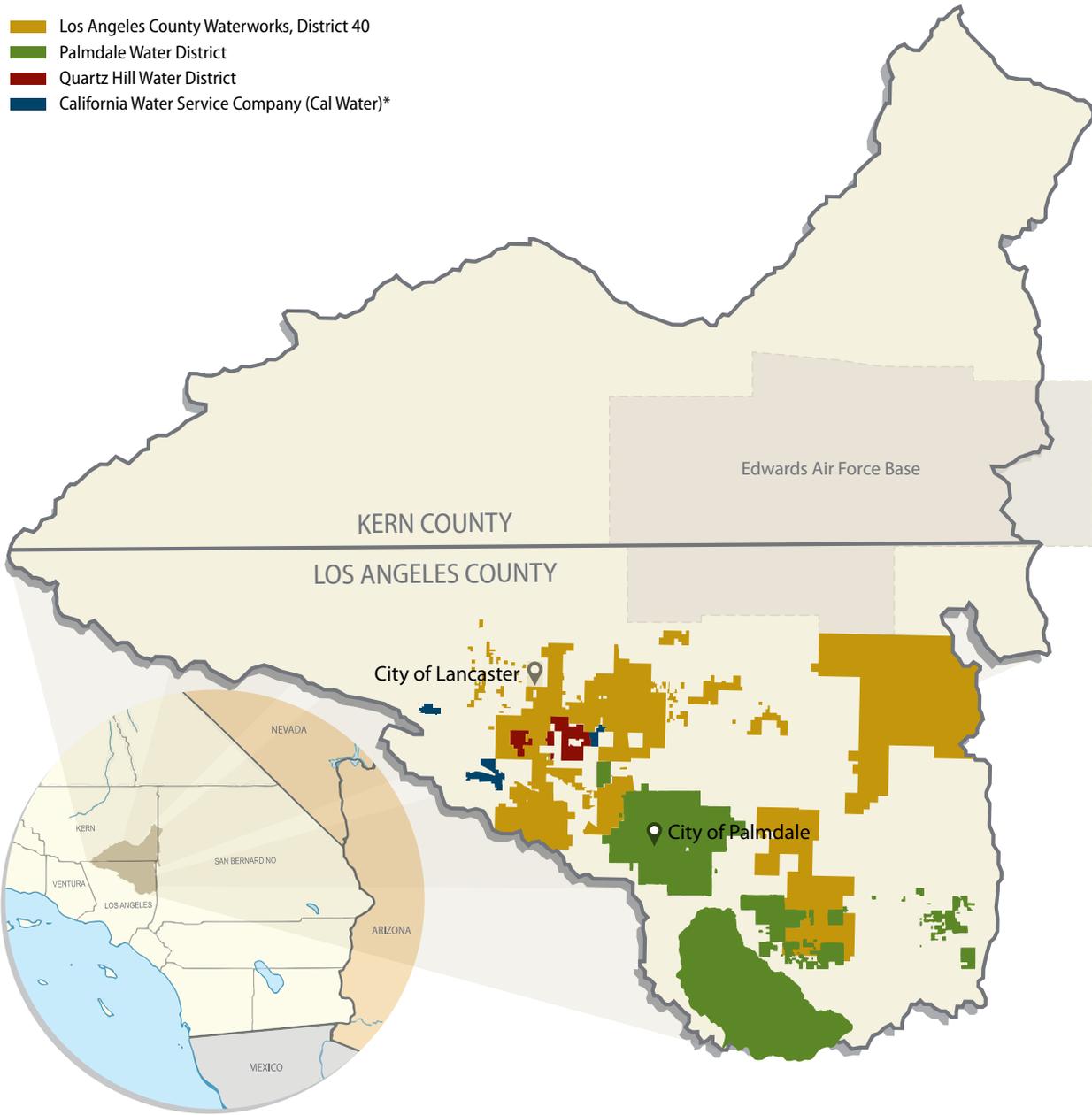
The Antelope Valley region (valley) encompasses approximately 2,400 square miles occupying northeastern Los Angeles, southeastern Kern, and western San Bernardino counties. The largest population centers are within the Los Angeles County (county) portion of the valley and include the cities of Palmdale and Lancaster. A significant portion of the valley's water supply comes from water purchased from the State Water Project, either directly from the California Department of Water Resources (Water Resources) or through the Antelope Valley–East Kern Water Agency (AVEK), a regional wholesaler. The State Water Project, California's water storage and delivery system, transports water via the California Aqueduct between Northern and Southern California. Groundwater, which accumulates naturally in local aquifers beneath the land surface, is also an important source of water in the valley. Groundwater is obtained from wells owned and operated by local water utilities.

As shown in Figure 1 on the following page, four main water utilities serve the county portion of the valley: Los Angeles County Waterworks, District 40 (LA District 40), Palmdale Water District (Palmdale), Quartz Hill Water District (Quartz Hill), and California Water Service Company (Cal Water). Water customers cannot select their water utility; they are served by one of these four utilities or another of the smaller utilities in the valley, depending on their home or business location.

Table 1 on page 7 provides an overview of the major characteristics of these four water utilities. Three are government-owned utilities (public utilities), while Cal Water is an investor-owned utility (investor utility) headquartered in San Jose and subject to state regulation. Each of the water utilities primarily serves residential customers.

With more than 55,000 service connections and 54 wells, LA District 40, which serves parts of the cities of Lancaster and Palmdale, as well as other parts of the valley, has more than twice as many service connections and wells as the next largest utility, Palmdale. LA District 40 is managed by the Los Angeles County Department of Public Works, and its policy-making body is the county board of supervisors. Palmdale is the second largest water utility in the valley, with 26,000 service connections and 25 wells. It serves the central and southern parts of the city of Palmdale, as well as some unincorporated areas of Los Angeles County. Unlike the other utilities, Palmdale contracts directly with Water Resources for the water it purchases through the State Water Project. Palmdale also owns the Littlerock Reservoir, which has a capacity of 3,500 acre-feet of water and in 2013 provided about 7 percent of Palmdale's water supply.

Figure 1
Antelope Valley Service Locations of the Four Water Utilities We Reviewed



Sources: Service areas are approximate based on Antelope Valley’s Integrated Regional Water Management Plan, and information each water utility provided.

Note: This map represents the Antelope Valley (valley), which covers parts of Los Angeles and Kern counties and is intended to provide the relative size and approximate location of each water utility’s service areas. Other water utilities provide water to the unmarked areas.

* Cal Water has an additional service area—Fremont Valley—not shown on this map. Although it is outside of the valley, the California Public Utilities Commission considers Fremont Valley to be part of Cal Water’s valley service area.

Table 1
Characteristics of Water Utilities in Antelope Valley

	LOS ANGELES COUNTY WATERWORKS, DISTRICT 40 (LA DISTRICT 40)	PALMDALE WATER DISTRICT (PALMDALE)	QUARTZ HILL WATER DISTRICT	CALIFORNIA WATER SERVICE COMPANY
Utility type	Government-owned	Government-owned	Government-owned	Investor-owned
Date established in Antelope Valley	1993*	1918	1954	2000
Population served	174,000	109,400	17,000	3,400
Service connections	55,600	26,000	5,500	1,400
Number of wells	54	25	10	8
Sources of water in 2013				
Groundwater	37%	44%	33%	87%
Purchased from the Antelope Valley–East Kern Water Agency	63	NA	67	13
Purchased from the California Department of Water Resources	NA	49	NA	NA
Other source [†]	NA	7	NA	NA
Types of services offered[‡]				
Residential	94%	96%	97%	96%
Nonresidential	6	4	3	4
Service area	Eight regions that include parts of the cities of Lancaster and Palmdale and all of Pearblossom, Little Rock, Sun Village, Rock Creek, and Lake Los Angeles	The central and southern parts of the city of Palmdale and unincorporated portions of Los Angeles County	Parts of the cities of Lancaster and Palmdale and unincorporated portions of Los Angeles County	Parts of the city of Lancaster and all of Lake Hughes and Leona Valley, which are west of Lancaster. It also serves the Fremont Valley, north of Lancaster
	554 square miles	140 square miles	6 square miles	7.6 square miles
	Noncontiguous service areas	Noncontiguous service areas	Noncontiguous service areas	Noncontiguous service areas

Sources: California State Auditor's review of each water utility's 2010 urban water management plan and other documents.

NA = Not applicable.

* LA District 40 has eight regions, the first of which was established in the Antelope Valley in 1919, and the last in 1968. The eight regions merged to create LA District 40 in 1993.

† Palmdale's other source of water is the Littlerock Reservoir.

‡ Percentages based on number of water meters. Nonresidential types of services include government, industrial, commercial, landscape, and other services.

Quartz Hill provides services to residents in parts of Lancaster and unincorporated areas of the county. It has 5,500 service connections and is the most dependent of the four utilities on purchased water, which it purchases from AVEK. Cal Water is the smallest of the four water utilities, with only 1,400 service connections. It serves parts of Lancaster and other smaller, isolated communities in four separate locations. Unlike the other three water utilities, which receive less than one-half of their water supply from local groundwater, Cal Water is almost entirely reliant on local groundwater.

Differences Between Public and Investor Utilities

As Table 2 illustrates, there are several fundamental differences between public and investor utilities, including their governance, the process to increase water rates, and their access to different revenue sources. Public utilities are governed by a publicly elected board of directors. Under state law, the board of directors has the authority to collect the funds necessary to cover public utilities' operations and maintenance costs. On the other hand, the California Public Utilities Commission (commission) regulates all investor utilities, including water utilities.

Table 2
Fundamental Differences Between Investor-Owned and Government-Owned Utilities

	INVESTOR-OWNED UTILITIES	GOVERNMENT-OWNED UTILITIES
Governance	Regulated by the California Public Utilities Commission (commission)	Report to a publicly elected governing body
Process to increase rates	File a general rate case every three years	Comply with Proposition 218 requirements
Impact of taxes	Pay property and franchise taxes; receive no tax revenues	Pay no taxes; can receive property tax revenues
Have balancing accounts	Yes; used to account for differences between projected and actual revenues and expenditures	No
Can make a profit on capital improvements	Yes, as permitted by the commission	No
Can use revenues from water charges for rate assistance and discounts	Yes	No

Sources: California State Auditor's review of a 2010 Rate Difference Study that the California Water Service Company provided, other documents, interviews with staff at each water utility, and state law.

In addition to differences in governance, public and investor utilities must follow different processes to increase their rates. Public utilities must comply with Proposition 218¹ when seeking rate increases. Proposition 218 protects parcel owners from unreasonable rate increases by limiting the authority of local government agencies to impose property-related assessments, fees, and charges, including increases in water rates. Specifically, Proposition 218 requires that public utilities provide parcel owners with written notice of any proposed rate increase at least 45 days in advance of a public hearing at which the board of directors decides whether to approve the rate increase. This notice must explain the amount of and purpose for any increase and the basis upon which

¹ Proposition 218, which voters approved in the November 5, 1996, statewide general election, amended the California Constitution to add the requirements described in this paragraph.

the increase is calculated. In addition, Proposition 218 prohibits public utilities from increasing rates if a majority of parcel owners submit written protests against the proposed rate increase.

Investor utilities such as Cal Water, on the other hand, must justify their proposed rates by presenting cost information to the commission during general rate case proceedings, which take place every three years. The commission regulates all investor utilities in the State and is responsible for authorizing the rates these utilities may charge water customers. It has broad authority over investor utilities, including the authority to inspect and audit their records at any time. A general rate case proceeding is intended to provide the commission, the Office of Ratepayer Advocates,² advocacy groups, and the public the opportunity to determine whether the costs that an investor utility proposes to recover in its rates are necessary, reasonable, and fair.

Additionally, the three public utilities we reviewed receive revenues from taxes based on the assessed value of properties in their service areas, which they generally use for infrastructure projects and operating expenses. Unlike public utilities, investor utilities do not receive property tax revenues; they can receive revenues only through monthly water rates, which includes a commission-approved return on any investments they make in capital improvements. Investor utilities also must pay property and franchise taxes and business license fees. In 2013 Cal Water reported paying \$66,000 in taxes and fees for its valley office.

Water Sources and Costs

All four water utilities acquire water from two main sources—they purchase water from the State Water Project, either directly or through a water wholesaler, and they pump groundwater—and the costs for these two sources are significantly different. Specifically, all four water utilities we reviewed purchase water from the State Water Project, but the cost of this water depends on whether the water utility purchases directly from Water Resources or from a wholesaler. Palmdale is a state water contractor, so it purchases untreated water directly from Water Resources. To remove impurities and toxins from the water to make it drinkable for customers, Palmdale operates a water treatment plant. The other three water utilities, LA District 40, Quartz Hill, and Cal Water,

² The Office of Ratepayer Advocates is an independent office within the commission that represents the interests of investor-utility customers, with the goal of obtaining the lowest possible rate for service consistent with reliable and safe service levels.

purchase water from AVEK, a regional water wholesaler. Because AVEK must treat the water before selling it to these utilities, it charges higher rates to recover its water treatment costs.

In addition to obtaining water from the State Water Project, all four water utilities obtain water from groundwater wells. Costs to pump groundwater include electricity to power the pumps, chemical costs to treat the water, and labor costs to maintain the pumps. Ultimately, these costs are lower than the cost of purchasing water. For example, in the last year of our review—either fiscal year 2012–13 or calendar year 2013, depending on the utility—the four water utilities we reviewed spent an average of \$441 per acre-foot³ to purchase and treat water, but incurred costs averaging only \$178 per acre-foot to pump and treat groundwater. This cost is lower partly because each utility obtains groundwater itself and partly because groundwater generally costs less to treat.

Other Factors That Contribute to Water Rates

Other common factors that contribute to differences in water rates include the size of the service area and its elevation. For instance, as shown in Table 3, the nature of a water utility's service area can have an impact on its rates. Service areas with a dense population of service connections allow water utilities to disperse their fixed costs over a larger number of water customers, resulting in lower overall monthly bills, whereas service areas with fewer service connections result in higher monthly bills because the water utilities must spread their fixed costs across fewer water customers.

Potential Changes in Groundwater Rights May Increase Water Rates in the Future

Depending on the outcome of nearly 10 years of litigation involving the adjudication of groundwater rights in the valley, the water utilities' access to groundwater may be reduced. The Los Angeles Superior Court (superior court) has determined that the valley's groundwater basin has been in overdraft for over 50 years—that is, the amount of water that is being pumped out of the basin is more than the amount that is being replenished into the basin—and the superior court is determining the priority to pump groundwater and other matters. The litigation is nearing an end and the parties are negotiating an agreement to settle the remaining issues, which the court will hear in August 2014. If the superior court approves a settlement agreement, some water utilities may lose water rights—

³ One acre-foot is equivalent to 325,850 gallons of water.

the right to pump an allocated amount of groundwater from their wells—which will cause them to purchase more water from the State or a wholesaler to make up for the loss. As we discussed earlier, purchased water is considerably more expensive than groundwater, meaning that the utilities’ water rates would increase to offset the higher water costs. However, it is still unclear when and to what extent this loss of water rights will occur.

Table 3
Significant Factors That Contribute to Water Rates

FACTOR	RATES WILL TEND TO BE:	
	HIGHER IF:	LOWER IF:
Sources of water	Imported	Groundwater
	Reliance on wholesaler that purchases from State Water Project	Direct from State Water Project
Energy costs	Higher elevation	Lower elevation
Service area characteristics	Low-density population	High-density population
	Remote	Accessible
	Fewer service connections	More service connections
Maintenance needs of infrastructure	More maintenance	Less maintenance
Water quality needs	More treatment	Less treatment
Pays taxes and fees	Yes	Few or none
Receives property tax revenues	No	Yes

Source: California State Auditor’s review of a 2010 Rate Difference Study that the California Water Service Company provided.

Scope and Methodology

The Joint Legislative Audit Committee (audit committee) directed the California State Auditor to perform an audit to evaluate the rates charged by four water utilities in the Antelope Valley—LA District 40, Palmdale, Quartz Hill, and Cal Water—as they relate to the increased costs of water and the variations in rates within the same neighborhood. The audit analysis the audit committee approved contained five separate objectives. We list the objectives and the methods we used to address them in Table 4 on the following page.

Table 4
Audit Objectives and the Methods Used to Address Them

AUDIT OBJECTIVE	METHOD
1 Review and evaluate the laws, rules, and regulations significant to the audit objectives.	Reviewed relevant laws, regulations, and other background materials applicable to the four utilities we reviewed.
2 For a time period to be determined by the California State Auditor, and to the extent possible, evaluate the process each water utility used to establish its water rates and the reasons why its rates increased.	<ul style="list-style-type: none"> • Because some water utilities have different rates for different classes of water, we focused our review on water utilities' largest group of customers, the single-family residential customer. • For the four utilities we reviewed, identified, documented, and summarized the water rates charged and rate structures in effect between 2011 and 2013. We identified and documented changes in water rates over this period to determine whether the utilities sufficiently justified them. We also identified the extent to which the public was informed of the rate increases and whether the public was afforded an opportunity to provide input into proposed rate changes.
3 Identify and analyze the significant factors that contributed to each water utility's rates and, to the extent possible, assess the causes of major differences between the utilities' rates.	<ul style="list-style-type: none"> • We interviewed key staff and reviewed accounting and budget documents the water utilities used when increasing their rates to better understand what costs have a significant effect on water rates and the extent to which these costs have increased over time. Because Los Angeles County Waterworks, District 40, and the Antelope Valley office of the California Water Service Company are part of a parent entity, we worked with their staff to segregate their revenues and expenditures from those of the parent entities. Our analysis focused on those costs that are directly related to providing water service and did not include non-cash expenditures. • We established a baseline consumer usage level and determined the water bills paid by single-family residential customers purchasing water from each of the four suppliers we reviewed.
4 To the extent possible, identify actions that each retail water utility has taken to keep its rates reasonable.	Interviewed key staff at each utility and gathered documentation on ways they have attempted to keep rates reasonable, and the impact of any rate assistance programs between 2011 and 2013.
5 Review and assess any other issues that are significant to water rates in the Antelope Valley.	We did not identify any other significant issues.

Sources: California State Auditor's analysis of Joint Legislative Audit Committee audit request number 2013-126, planning documents, and analysis of information and documentation identified in the table column titled *Method*.

Audit Results

Water Utilities Charge Different Water Rates Based on the Different Costs They Each Incur

As mentioned in the Introduction, a variety of cost factors contribute to the water rates of the four water utilities in the Antelope Valley (valley). Although the four water utilities we reviewed—Los Angeles County Waterworks, District 40 (LA District 40), Palmdale Water District (Palmdale), Quartz Hill Water District (Quartz Hill), and California Water Service Company (Cal Water)—have similar types of expenditures, the costs they incurred varied. Figure 2 on the following page shows each cost category’s percentage of the total costs for each water utility. These costs are grouped into the major expenditure categories of personnel—which consists of salaries, benefits, pension contributions, and other postemployment benefits—operations, water purchases, power, and water treatment. We reviewed each water utility’s costs over a three-year period; however, Figure 2 shows only the last year reviewed. The Appendix has data for all three years that we reviewed. As Figure 2 notes, the last year we reviewed was either fiscal year 2012–13 or calendar year 2013, depending on how each utility maintains its accounting records.

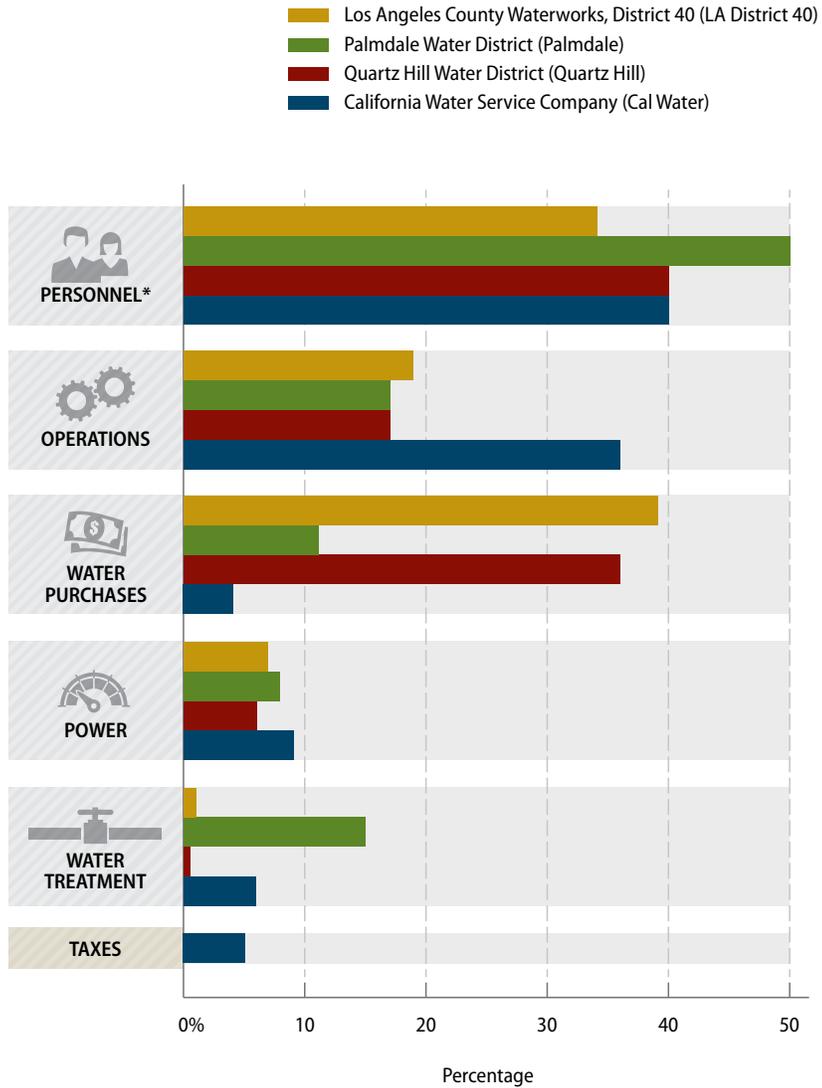
Personnel costs are generally one of the larger cost categories for each water utility. Palmdale’s proportion of personnel costs is slightly higher than those of the other three water utilities, amounting to approximately 50 percent of its total expenditures. According to its financial manager, this can largely be attributed to the fact that Palmdale purchases water directly from the California Department of Water Resources (Water Resources) and therefore operates a water treatment plant, which requires additional staffing. The personnel costs for the other utilities range between 34 percent and 40 percent of their total expenditures.

Another large category is operations costs—which include administration, maintenance, supplies, insurance, and facilities. The four water utilities’ operations costs ranged from 17 percent to 36 percent of their total costs. Power costs are the most consistent category among the four water utilities, ranging from 6 percent to 9 percent. As noted previously, the water utilities all incur power costs to pump the water from groundwater wells and to pump water to their customers.

In addition to the differences in expenditures, a water utility’s source of water has a significant impact on water rates. As shown in Table 5 on page 16, all four water utilities have two main sources of water: purchased water—either from a water wholesaler or, in the case of Palmdale, directly from Water Resources—and groundwater pumped from local wells. As discussed in the Introduction, purchased water

A water utility’s source of water has a significant impact on water rates.

Figure 2
Relevant Cost Factors for the Four Utilities in Calendar Year 2013 or
Fiscal Year 2012–13



Sources: California State Auditor's analysis of each utility's relevant cost factors.

Note: Financial data for Palmdale and Cal Water are for calendar year 2013, while the data for Quartz Hill and LA District 40 are for fiscal year 2012–13.

* Personnel costs include salaries and benefits, including postemployment benefits.

has a significantly higher cost per acre-foot⁴ than groundwater. For example, in 2013 Cal Water spent \$482 per acre-foot for purchased water but only \$276 per acre-foot on pumped groundwater. The costs of purchased water vary depending on the source and time of year

⁴ One acre-foot is equivalent to 325,850 gallons of water.

purchased, and they also include the costs of labor and treatment. LA District 40, Quartz Hill, and Cal Water purchase water from the Antelope Valley–East Kern Water Agency (AVEK), a State Water Project wholesaler. AVEK's prices reflect what it paid the State for the water, plus its treatment costs. Palmdale purchases its water directly from Water Resources at a lower wholesale rate. However, because the water it purchases is untreated, Palmdale incurs costs to ready this water for consumption.

As shown in Figure 2, Cal Water's cost to purchase water was only 4 percent of its total costs, the lowest among the water utilities. As noted in the Introduction, Cal Water relies on groundwater wells for 87 percent of the water it supplies to its customers. The cost to pump this groundwater is reflected in Cal Water's operating and power costs. LA District 40 and Quartz Hill purchased 63 percent and 67 percent, respectively, of their water supply from wholesalers. As a result of their heavier reliance on wholesalers, their cost to purchase water represents a greater proportion of their total costs—39 percent and 36 percent, respectively. Additionally, Palmdale receives water from the Littlerock Reservoir, which it transports through a gravity-driven system to its water treatment facility. Palmdale's general manager stated that this process generates no costs and that the only labor involved is to open the valve a few times a year. In 2013 roughly 7 percent of Palmdale's water supply—1,600 acre-feet—came from the Littlerock Reservoir. Had it needed to purchase this water at the wholesale rate, we estimate that Palmdale would have paid approximately \$292,000.

Other factors related to non-operating expenditures and revenues differ between government-owned utilities (public utilities) and investor-owned utilities (investor utilities), and these may also affect water rates. For instance, Cal Water allocates some costs from its central headquarters in San Jose for services such as water quality and engineering to its field offices across the State, including the valley. Cal Water's records show that this allocation ranged from \$140,000 to \$215,000 in calendar years 2011 through 2013, which according to Cal Water, represents less than 0.5 percent of the central headquarters' operating costs. We have included these costs in operations in Figure 2 since they reflect the costs related to Cal Water's services in the valley.

With regard to non-operating revenues, public utilities have a source of revenue other than rates that they can rely on for their operations. As mentioned in the Introduction, the three public utilities we reviewed receive revenue from property taxes based on the assessed value of properties in their service areas. For example, Palmdale received property tax revenues of \$7.3 million in calendar

Public utilities have a source of revenue other than rates that they can rely on for their operations.

Table 5
Annual Sources and Costs of Water for the Four Water Utilities We Reviewed

		LOS ANGELES COUNTY WATERWORKS, DISTRICT 40 (LA DISTRICT 40)			PALMDALE WATER DISTRICT (PALMDALE)			QUARTZ HILL WATER DISTRICT (QUARTZ HILL)			CALIFORNIA WATER SERVICE COMPANY (CAL WATER)		
		ACRE-FEET*	COST PER ACRE-FOOT	TOTAL COST†	ACRE-FEET*	COST PER ACRE-FOOT	TOTAL COST†	ACRE-FEET*	COST PER ACRE-FOOT	TOTAL COST†	ACRE-FEET*	COST PER ACRE-FOOT	TOTAL COST†
Pumped groundwater	2011	11,471	\$260	\$2,983,129	7,025	\$113	\$796,376	1,389	\$145	\$201,921	863	\$172	\$148,664
	2012	19,756	206	4,074,769	7,543	102	770,877	1,720	135	232,440	917	254	232,943
	2013	19,992	193	3,865,586	9,378	107	998,930	1,959	135	265,250	704	276	194,377
California Department of Water Resources	2011	NA	NA	NA	14,333	390	5,593,175	NA	NA	NA	NA	NA	NA
	2012	NA	NA	NA	19,056	366	6,971,186	NA	NA	NA	NA	NA	NA
	2013	NA	NA	NA	10,567	499	5,277,457	NA	NA	NA	NA	NA	NA
Antelope Valley— East Kern Water Agency	2011	36,294	296	10,744,609	NA	NA	NA	4,234	269	1,138,746	105	336	35,287
	2012	30,705	403	12,373,868	NA	NA	NA	3,868	327	1,263,346	109	405	44,174
	2013	33,151	406	13,471,862	NA	NA	NA	3,963	374	1,483,722	108	482	52,106
Other sources‡	2011	NA	NA	NA	2,569	—	—	NA	NA	NA	NA	NA	NA
	2012	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
	2013	NA	NA	NA	1,600	—	—	NA	NA	NA	NA	NA	NA

Sources: California State Auditor's analysis of the water utilities' rate schedules, meter readings, and accounting records.

Note: LA District 40 and Quartz Hill report their costs by fiscal year, while Palmdale and Cal Water report their costs by calendar year.

NA = Not applicable.

— = No cost associated with the water.

* One acre-foot is equivalent to 325,850 gallons of water.

† Total cost includes the costs to acquire and treat the water.

‡ Other sources of water include water that Palmdale receives from the Littlerock Reservoir, at no cost.

year 2013, most of which—\$4.9 million—pays its assessment for the capital costs related to the State Water Project. The remaining amount is derived from other property taxes. Similarly, LA District 40 and Quartz Hill received property taxes of \$1.3 million and \$323,000, respectively, in fiscal year 2012–13. The public utilities indicated that these property taxes help support their operations, in addition to the revenues they receive from customers for water service, and also pay for infrastructure improvements.

Water Utilities Must Undergo Public Review Processes to Justify Their Rates

Public utilities must comply with Proposition 218, which limits the authority of local government agencies to impose property-related assessments, fees, and charges. On the other hand, investor utilities must receive approval from the California Public Utilities Commission (commission) before increasing rates. Our review found that all four utilities generally followed the required process before increasing their rates. However, although Quartz Hill included the basis for calculating its rate increases in the notice it is required to send to parcel owners, we believe that it could have included more detail. Furthermore, LA District 40 and Quartz Hill could not demonstrate that they met certain requirements of the implementation statute of Proposition 218 when making pass-through rate increases for one or more of the three years we reviewed.

The Three Public Utilities Substantially Met Public Notice Requirements When Increasing Water Rates

Proposition 218, a constitutional provision, requires public utilities to follow a number of procedural requirements before seeking increases to their water rates. As seen in the text box, Proposition 218 specifies the procedural steps a local government entity must take before it adopts, extends, or increases a property-related fee or charge for public utilities, including water service.

Proposition 218 Constitutional Requirements for Public Utilities

Procedural

- The parcels that the fee or charge will be imposed on are identified.
- The amount of the proposed fee or charge is calculated.
- Written notice by mail is provided to parcel owners.
- The written notice will include:
 - The amount of the fee or charge.
 - The basis upon which the amount of the proposed fee or charge was calculated.
 - The reason for the fee or charge.
 - The date, time, and location of a public hearing, which is to be held not less than 45 days after the notice is mailed.
- At the public hearing, the agency considers all written protests against the proposed fee or charge. If a majority of parcel owners object, the agency cannot impose the fee or charge.

Substantive

- Revenues derived from the fee or charge cannot exceed the funds required to provide the property-related service.
- Revenues derived from the fee or charge cannot be used for any purpose other than that for which the fee or charge was imposed.
- The amount of a fee or charge imposed on a parcel or property owner shall not exceed the proportional cost of the service attributed to the parcel.
- No fee or charge may be imposed for a service unless that service is actually used by, or immediately available to, the owner of the property in question. Fees or charges based on potential or future use of a service are not permitted.
- No fee or charge may be imposed for a general governmental service that is available to the public at large in substantially the same manner as it is to property owners.

Source: California Constitution, Article XIII D, Section 6.

Although Quartz Hill satisfied the procedural requirement to set forth the basis on which it calculated a fee increase, we believe it did not provide the public with a full understanding of its rationale for the increase.

As Table 6 shows, all three public utilities complied with the procedural requirements for increasing water rates under Proposition 218, with some exceptions for Quartz Hill and LA District 40. Although Quartz Hill satisfied the procedural requirement to set forth the basis upon which it calculated the fee increase, we believe the level of detail fell short of providing the public with a full understanding of its rationale for the increase. This requirement is contained in Proposition 218 but is not clearly defined, nor has the Legislature provided any statutory guidance, nor has any court construed the meaning of this provision. Our legal counsel has advised us that an agency would likely comply with this procedural requirement if it provided reasonably sufficient information in the notice to allow a water customer to determine whether or not to file a written protest against the proposed rate increase. Quartz Hill's notice of public hearing provided only a short statement describing the two costs—a flat rate that covers the cost of maintaining water service and a water usage rate determined by the water wholesaler. In contrast, Palmdale included detailed information regarding its rate structure in its notice of public hearing for the 2009 rate increase. LA District 40 did not increase its general water rates during the period we reviewed, but it did pass through cost increases, as discussed in the next paragraph.

Further, as Table 6 shows, LA District 40 and Quartz Hill could not demonstrate that they complied with statutory requirements for pass-through rate increases for one or more of the three years we reviewed. In implementing the requirements of Proposition 218, the Legislature enacted a statutory provision that permits water utilities to adopt a schedule of fees or charges that authorizes automatic rate adjustments without an additional public hearing for a period of no more than five years after a general rate increase, provided the utility gives 30 days' notice to water customers before each rate increase. These adjustments, known as pass-through rate increases, offset increases in wholesale water costs, inflation, or both. LA District 40 and Quartz Hill implemented pass-through rate increases during 2011 to 2013 and both attested to meeting the requirement to provide a 30-day notice. However, we were unable to verify that LA District 40 had done so for its 2012 rate increase and that Quartz Hill had done so for all three years because they did not retain documentation to show when they mailed the notices for those years. A senior civil engineer for LA District 40 stated that it retained a copy of the 2012 notice but not the mailing information. Quartz Hill's general manager explained that it provided the notice on customers' water bills, but he could not show us this notice because the company that prints and mails its water bills can retrieve data only for the previous three months.

Table 6
Government-Owned Utilities’ Level of Compliance With the Public Disclosure Requirements of Proposition 218 During Our Three-Year Audit Period

PROCEDURAL REQUIREMENTS	LOS ANGELES COUNTY WATERWORKS, DISTRICT 40 (LA DISTRICT 40)	PALMDALE WATER DISTRICT	QUARTZ HILL WATER DISTRICT (QUARTZ HILL)
Parcel identified	✓	✓	✓
Written notice of rate increases by mail	✓	✓	✓
Notice includes amount of proposed increase	✓	✓	✓
Notice includes basis for calculating increase	✓	✓	✓
Notice includes reason for increase	✓	✓	✓
Notice includes date, time, and location of public hearing	✓	✓	✓
Public hearing held not less than 45 days after mailing	✓	✓	✓
Written protests against increase were considered	✓	✓	✓
Adopted a schedule of fees or charges for pass-through rate increases to offset increases in wholesale water costs or inflation*	✓	NA	✗
Period that the schedule covers does not exceed five years*	✓	NA	✓
Notice of a pass-through rate increase was given no less than 30 days before the effective date	●	NA	●

Source: California State Auditor’s analysis of government-owned utilities’ compliance with Proposition 218.

NA = Not applicable.

✓ = The water utility complied with procedural requirements of state law (Proposition 218 amendments to state constitution and implementation statute) with regard to notification of parcel owners or ratepayers prior to a rate increase and the contents of those notifications.

✗ = The water utility did not comply with the requirement.

● = We were unable to determine whether LA District 40 complied with the requirement for 2012 and whether Quartz Hill complied with this requirement for 2011 to 2013.

* Although Quartz Hill’s public notice did not include a schedule of pass-through fees or charges, it did indicate that the time period for the increase would not exceed five years.

In addition, Quartz Hill did not adopt a schedule of fees or charges authorizing pass-through rate increases, as is required of utilities that approve such increases. This schedule might have been included in the public notice showing projected increases over the period the schedule was in effect, or it might have provided a reference to an inflation index that would be used to calculate increases. Instead, Quartz Hill’s notice explained only that it would adjust the rate to reflect changes in wholesale costs, without indicating what the new rate may be or giving water customers a way to estimate it. Thus, Quartz Hill’s water customers would

The procedural requirements imposed on public utilities give property owners the opportunity to contest proposed rate increases through written protests.

have difficulty determining how a pass-through rate increase was calculated. According to its general manager, Quartz Hill did not adopt a schedule of fees authorizing pass-through rate increases because it did not have information from AVEK regarding future wholesale rate increases at the time the rate increases were proposed. However, LA District 40 was able to make water customers aware—both at the time the pass-through rate increase was proposed and for each annual increase thereafter—of how much their bills might increase based on projected increases in AVEK water costs and inflation.

The procedural requirements imposed on public utilities by Proposition 218 give property owners the opportunity to contest such fees or charges through written protests. However, the likelihood that a majority of the individual property owners in a service area would submit written protests seems remote, based on our review. For example, Palmdale provides water service to over 26,000 connections. Therefore, if each connection represents a parcel of land, Palmdale would need to receive over 13,000 written protests from property owners in its service area to reject a proposed rate increase. Given that the over 2,100 protests submitted by property owners in Palmdale's service area were insufficient to stop proposed rate increases in 2009—the highest number of protests received among the three public utilities—it seems unlikely that there would ever be sufficient protests to reject a rate increase in most circumstances. Similarly, LA District 40 and Quartz Hill received few written protests against their most recent rate increases.

Finally, Proposition 218 also imposes a number of substantive requirements that local governments must meet to justify their fees or charges. These requirements are primarily meant to restrict local governments' ability to impose property-related fees and charges. The substantive provisions of Proposition 218 are outside of the scope of this audit. However, in 2011 a state appellate court found Palmdale in violation of the substantive portions of Proposition 218, including the proportionality requirement for using differing water budget allocation proportions for single-family residential, commercial/industrial, and irrigation customer classes. Following the ruling, Palmdale changed its usage rate structure so that the proportion of water allocated in each of the five tiers was equal across customer classes and issued credits to affected water customers.

Cal Water Complied With the Commission's Process for Rate Approval

State law prohibits investor utilities from making any changes to rates unless the commission finds that the rate change is justified. The water rates Cal Water charged between 2011 and 2013 were approved by the commission. Further, Cal Water's general rate case complied with the commission's process. State law requires that investor utilities

with more than 10,000 service connections,⁵ such as Cal Water, file a general rate case application every three years to propose rate increases for the subsequent three-year period. This application includes projected revenues and costs in addition to proposed rates. As described in the Introduction, a fundamental component of this review process includes an examination of the application by the commission and other parties to ensure that the costs a utility presents in support of its proposed rate increases are reasonable, necessary, and fair. The proposed rate increases are subject to change during this process, and the commission ultimately authorizes the rates the utility will charge its customers after hearing testimony from all involved parties. Because of the time needed to review the documents supporting the rates and to reach agreement on the proposed rates, the review process for Cal Water's general rate case for 2011 to 2013 was scheduled to take 20 months.

As described in the text box, state law also requires Cal Water to notify water customers within 45 days after it submits the general rate case application and specifies the items to include in this notification. Similar to the Proposition 218 process, the general rate case process allows the public to participate in the rate change process through public hearings before the commission. At the conclusion of the general rate case process for Cal Water's proposed rates for 2011 to 2013, the commission approved the proposed rate increases but with modifications, after various parties that disagreed with Cal Water's proposed rates reached a settlement agreement. Additionally, Cal Water complied with the commission's general rate case process by submitting the general rate case application on time, notifying water customers within 45 days of the submitted application, holding public hearings, receiving feedback on the application from both the commission and other parties, and participating in all required conferences and hearings related to the application.

Investor utilities also can make requests to the commission for various approvals and authorizations, including changes to the utility's rates, through an informal filing known as an advice letter. Cal Water submitted 13 advice letters between 2011 and 2013 that requested changes to rates in the valley. For example, Cal Water requested a surcharge of approximately 44 cents per unit of water used each month over an 18-month period for water customers in all four locations it serves to recover a shortfall in projected revenues. Cal Water indicated that under commission rules, additional advance customer notification of

General Rate Case Customer Notification Requirements

Within 45 days of submitting an application to the California Public Utilities Commission (commission), the investor-owned utility (investor utility) shall notify its customers affected by the rate increase of the following items:

- The amount of the rate change, expressed in both dollar and percentage terms, for each customer classification.
- A brief statement of the reasons the rate change is required or sought.
- The mailing address or e-mail address at the commission to which any customer inquiries may be directed regarding how to participate in or receive further notices regarding the date, time, or place of any hearing regarding the application.
- The investor utility's mailing address for any customer inquiries about the proposed rate.

Source: California Public Utilities Code, Section 454.

⁵ Cal Water has over 10,000 service connections throughout California.

these changes was not required because the commission had previously approved them as part of Cal Water's general rate case and customers had been notified during the general rate case process.

Each Water Utility Increased Its Water Rates Between 2011 and 2013

Each of the four water utilities serving the valley increased its rates between 2011 and 2013 and, as noted previously, generally followed the processes outlined in state law. Figure 3 shows that in April 2013 a typical residential customer with a family of three using the utilities' most common⁶ meter size and approximately 21 units⁷ of water per month would have paid the most—\$110—if Cal Water was the utility, followed by \$46 if served by Palmdale, \$38 if served by Quartz Hill, and \$36 if served by LA District 40. Figure 3 also shows that Cal Water's rate increases were the highest between 2011 and 2013, increasing by almost 18 percent, or over \$16, during this period. The monthly bills of Quartz Hill and LA District 40 customers increased by 8 percent and nearly 15 percent, respectively, during the three-year period. Finally, Palmdale's monthly bill increased by 7 percent during this same period.

Of the four utilities we reviewed, each uses a different formula and factors to determine how much a customer will pay for water each month.

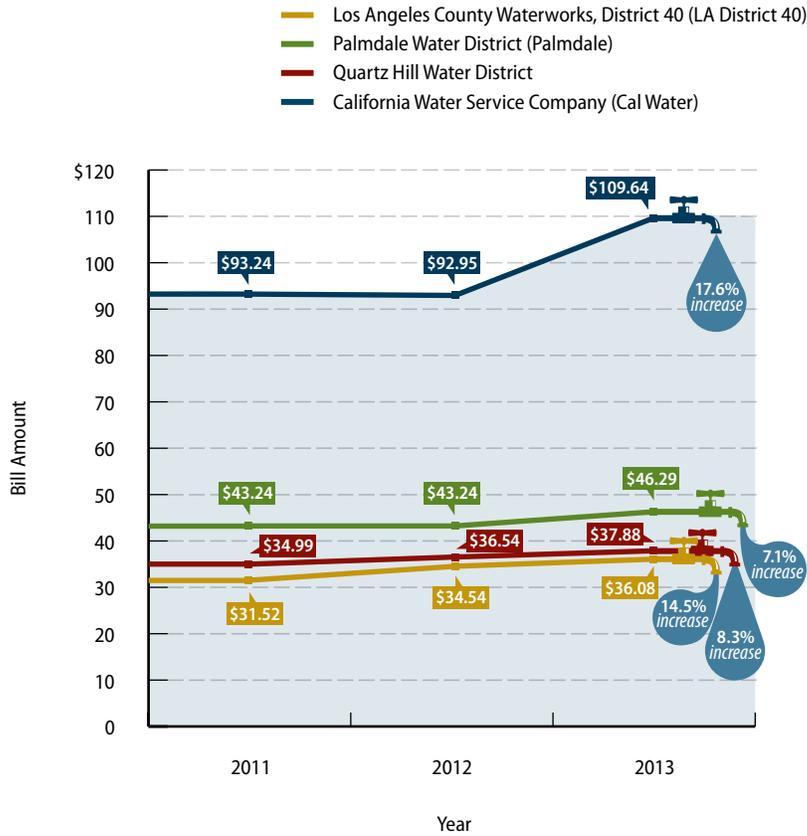
Each of the four utilities we reviewed uses a different formula and factors to determine how much a customer will pay for water each month. Therefore, we used certain benchmarks in order to ensure an accurate comparison across utilities. For example, we chose the month of April because the water utilities agreed that it was one of the most comparable months. The benchmark meter size is either 5/8 inch or 3/4 inch because at each utility the meters of a majority of the single-family residential customers were of this size. Finally, 21 units of water is the average monthly consumption for a family of three living in the valley, based on our analysis using data from Water Resources' *20x2020 Water Conservation Plan*.

As Table 7 on page 24 shows, the water rate of each water utility generally comprises three categories: a flat monthly service charge for basic service; tiered usage charges, which for public utilities must be proportional based on the quantity of water used; and various surcharges to cover special circumstances. Each utility determined the general rate increases applied to these charges using a water rate study or model that considered anticipated future costs or, for the pass-through rate, increases in wholesale water costs, inflation, or both. As we describe in the sections that follow, in addition to using a water rate study or model to determine rate increases, each utility also provided specific reasons why the rate increases were necessary.

⁶ Either a 5/8-inch or 3/4-inch meter size.

⁷ One unit of water is equivalent to 100 cubic feet, which is equivalent to 748 gallons of water.

Figure 3
 Typical Monthly Water Bill for a Family of Three Between 2011 and 2013



Assumptions for all water utilities:

<i>Meter size</i>	Residential meter: 5/8 or 3/4 inch, depending on the utility
<i>Customer type</i>	Single-family residential
<i>Household size</i>	3 people in household
<i>Consumption</i>	21 hundred cubic feet per month
<i>Month of bill</i>	April of each year

Additional assumptions for LA District 40:

<i>Region</i>	Region 04 Lancaster
<i>Surcharges and/or fees</i>	Facilities/construction surcharge

Additional assumptions for Palmdale:

<i>Base elevation</i>	2,800 feet
<i>Lot size</i>	7,000 square feet

Additional assumptions for Cal Water:

<i>Region</i>	Lancaster
<i>Surcharges and/or fees</i>	Varies by year

Sources: California State Auditor's analysis of water utilities' rate schedules and related documents.
 Note: Bill amounts for Cal Water and LA District 40 include surcharges and surcredits that were in effect.

Table 7
Water Rate Increases by Utility and Type of Charge

	2010		2011		2012		2013	
	WATER RATES	NEW RATES	PERCENTAGE INCREASE	NEW RATES	PERCENTAGE INCREASE	NEW RATES	PERCENTAGE INCREASE	
Los Angeles County Waterworks, District 40								
Monthly service charge*	\$15.28	\$16.03	4.9%	\$17.57	9.6%	\$18.34	4.4%	
Usage charge (tier I)†	0.77	0.81	4.7	0.89	9.5	0.93	4.5	
Facilities surcharge‡	0.08	0.08	5.1	0.09	9.8	0.09	4.0	
Palmdale Water District								
Monthly service charge*	\$23.78	\$24.97	5.0%	\$24.97	0.0%	\$26.97	8.0%	
Usage charge (tier I)†	0.64	0.67	5.0	0.67	0.0	0.72	7.5	
Elevation booster surcharge‡	0.23	0.16	(30.4)	0.16	0.0	0.15	(6.3)	
Water quality fees‡	0.20	0.20	0.0	0.20	0.0	0.20	0.0	
Quartz Hill Water District (Quartz Hill)‡								
Monthly service charge*	\$20.63	\$21.13	2.4%	\$21.63	2.4%	\$22.13	2.3%	
Usage charge (tier I)								
Winter†	0.63	0.66	4.8	0.71	7.6	0.75	5.6	
Summer†	0.78	0.81	3.9	0.87	7.4	0.91	4.6	
California Water Service Company (Cal Water)§								
Monthly service charge*	\$31.22	\$41.63	33.3%	\$41.94	1.0%	\$41.36	(1.0%)	
Usage charge (tier I)†	1.49	1.99	33.6	2.01	1.0	1.98	(1.0)	
Surcharges†	0.40	0.49	22.5	0.77	57.0	1.06	38.0	
Surcredits (per month)	0.13	2.50	1,823.1	1.82	(27.0)	2.26	24.0	

Source: California State Auditor's review of the water utilities' rate schedules.

* The monthly service charge is based on the water utilities' most common meter size for a single-family residential customer.

† Except for the monthly service charge, or as otherwise noted, amounts are per 100 cubic feet of water consumed.

‡ Quartz Hill has no surcharges.

§ The surcharges and surcredits for Cal Water are often limited in duration. Therefore, those shown are based on the last rate sheet for the year.

Palmdale Water District

Palmdale based its proposed rate increase on a water rate study that its consultant prepared. That study included an update to Palmdale's five-tier structure for water usage rates and developed indoor and outdoor water budgets for each single-family residential customer. The indoor budget was calculated for each water customer based on household size, allowable water usage, and the number of days in the month; the outdoor budget was based on property square footage, local weather data, and drought conditions. Water customers who use 100 percent of their water budget or less fall

into tier 1, with each subsequent tier increasing by increments of 30 percent. In addition, the study recommended that Palmdale adopt an additional surcharge—a water quality fee—to fund upgrades to its water treatment plant and that it extend an existing surcharge to water customers at higher elevations. The consultant’s study recommended increases in the monthly service charge, the tiered usage charges, and the elevation surcharge. These increases consisted of a 14 percent increase in the monthly and tiered usage charges in 2010 followed by an 8 percent increase each year through 2014. The elevation surcharge was to increase by 8 percent over the same period. Additionally, the consultant recommended that Palmdale establish the water quality fee at 20 cents per 100 cubic feet of water, with small annual increases that would bring the fee to 23 cents in 2014. However, as Table 7 shows, although the board approved the recommended increases, Palmdale never fully implemented them. In fact, between 2011 and 2013, the monthly service charge increased less than recommended, the water quality fee never increased, and the elevation surcharge either decreased or remained flat. According to Palmdale’s financial manager, the board was concerned about the impact on water customers, and so it directed Palmdale to make an effort to control costs.

Palmdale also cited a number of specific reasons for its rate increases in the notice of public hearing it mailed to property owners before approving the increases. These included a 16 percent increase in past costs due to inflation; water treatment plant upgrades to comply with federal and state environmental and safe drinking water rules; the increased cost of purchased water; and the need to operate, maintain, repair, and replace infrastructure. Palmdale was generally able to substantiate these reasons. Specifically, Palmdale’s records show that it made upgrades to its water treatment plant, spending nearly \$5 million between 2010 and 2013 for equipment that filters impurities. In addition, Palmdale’s expenditures for purchased water increased by 65 percent between 2005 and 2008. However, the consumer price index that Palmdale provided us shows only a 10 percent increase in inflation between 2005 and 2008, the years between the last and most current rate increases. Palmdale was unable to explain why its public notice cited a 16 percent increase in past costs when its supporting documentation showed that past costs had increased by 10 percent.

Palmdale was unable to explain why its public notice cited a 16 percent increase in past costs when its supporting documentation showed past costs increased by only 10 percent.

Quartz Hill Water District

Other than the fact that it has no surcharges, Quartz Hill’s rate structure for a single-family residential customer is similar to Palmdale’s, with a monthly charge and a tiered usage charge. For the tiered usage charge, Quartz Hill calculates a total water allotment for each water customer by combining a fixed indoor allotment of

4,200 gallons of water, which is based on three persons living full-time in the residence, with an outdoor allotment based on the square footage of a water customer's lot. Water customers fall into one of five tiers, depending on their water usage. The base rate tier establishes the charge for water customers who stay within their allotment. Those who are under the allotment by 25 percent or more pay 94 percent of the base rate. Those who use more than their allotment pay a higher rate. For instance, water customers who use between 101 percent and 150 percent of their allotment are charged one and a half times the base rate.

Additionally, Quartz Hill used a water rate model that it developed internally in November 2010 to determine how much it needed to increase general rates to cover projected costs. According to the general manager, using this model, Quartz Hill determined that it needed to increase rates for the monthly service charge on 3/4-inch meters, the meter size used by most residential users in its service area, by 50 cents, or roughly 2 percent, each year between 2011 and 2015. Unfortunately, we were unable to recalculate Quartz Hill's rates because, according to its general manager, Quartz Hill did not retain the supporting information for the water rate model. We did, however, verify that the percentage increases in the pass-through rate matched increases in wholesale water costs that AVEK charged between 2011 and 2013. In the public notice sent to property owners before the approval of the rate increase, Quartz Hill cited increased electricity costs as well as new environmental regulations requiring that all new water fixtures be lead free as the main reasons for higher rates. Quartz Hill's general manager was unable to provide documentation to support the increased electricity prices. However, citing billing invoices, Quartz Hill asserted that the price it paid for similar water fixtures increased by 73 percent between 2007 and 2010.

Los Angeles County Waterworks, District 40

LA District 40 has three categories of charges: a monthly service charge, a tiered usage charge, and a facilities surcharge. The monthly service charge provides for 500 cubic feet of water per billing unit per month for a 3/4-inch residential meter. Unlike Palmdale and Quartz Hill, LA District 40 does not develop separate indoor and outdoor water allocations for each customer. However, the range of its tiers fluctuates between higher allocations in summer and lower allocations in winter to reflect seasonal variations in water demand, although the rate for each tier remains the same regardless of the season. The facilities surcharge is used to fund the construction and replacement of water system facilities.

Unlike Palmdale and Quartz Hill, LA District 40 does not develop separate indoor and outdoor water allocations for each customer.

Unlike Quartz Hill, which applied a pass-through rate increase only to the usage charge, between 2011 and 2013 LA District 40 increased each of its three charges by the amount of the pass-through rate increase. LA District 40 determined the pass-through rate increase by calculating increases in the costs of water purchased from AVEK and inflation. Using this methodology, LA District 40 increased its monthly service charge by 4.9 percent in 2011, 9.6 percent in 2012, and 4.4 percent in 2013. Documentation that LA District 40 provided us substantiated both the increased cost of purchased water and the inflation adjustments. LA District 40's facilities surcharge was less than \$2 in each year's monthly bill amount as shown in Figure 3 on page 23.

California Water Service Company

Cal Water's rate structure and its method for determining rate increases are similar to those of the three public utilities. Cal Water has two main charges: a monthly service charge and a tiered usage charge. The tiered usage charge was approved as a trial program in 2008 in response to a commission effort to promote water conservation. Prior to that, Cal Water customers were charged a single-quantity rate. The usage charge consists of three tiers. The first tier covers the first 1,400 cubic feet of water used, with increased rates for usage above that amount. As explained previously, the commission approves water rates for investor utilities through the general rate case process.

Similar to the public utilities, Cal Water calculated its proposed water rate increase using a rate model. In its 2009 general rate case, which established the water rates for 2011, Cal Water proposed increases in the tiered usage charge of 118 percent. The proposed increase for its monthly rate was just 5 percent. However, as shown in Table 7, the commission ultimately approved increases of 33 percent for both rates. Further, under the advice letter process, Cal Water increased its rates in 2012 to recover increased costs associated with the construction of a water storage tank and lowered them in 2013 to decrease the rate of return it would earn on capital investments, but the rates in these two years deviated only slightly from those for 2011. Cal Water offered a number of reasons for increasing its rates in 2011 for the valley, the primary of which was the need to replace aging infrastructure and to add water supply facilities. Documentation that Cal Water provided indicates that of the \$1.4 million for 23 infrastructure projects included in its general rate case settlement agreement for 2011 and 2012, it completed eight at a total cost of \$214,000, or only 16 percent of the cost of the planned projects. Cal Water's documentation further indicates that nine projects with a value of \$724,000 have been initiated or are in progress, while the remaining

Cal Water proposed increases in the tiered usage charge of 118 percent in its 2009 general rate case, which established the water rates for 2011, but the commission ultimately approved an increase of 33 percent.

six projects were cancelled. According to Cal Water, its 2012 general rate case does not include the value of these cancelled projects as part of its revenue requirement.

As described earlier, investor utilities such as Cal Water can submit advice letters seeking adjustments to their rates. As with public utilities, this is often done, but unlike public utilities, investor utilities reimburse water customers for overcharges included in rates through surcredits. Some of Cal Water's surcharges apply to all of its customers and may fund activities not directly related to water service, such as a surcharge for a rate assistance program. These surcharges are a uniform amount across all of Cal Water's customers in California. Other surcharges are temporary or one time, allowing Cal Water to request changes to its rates to account for differences between projected and actual revenues or costs on an ongoing basis as a condition of its general rate case. For example, the water revenue adjustment mechanism ensures that Cal Water and its customers are not at risk for the under- or over-collection of revenues following the commission's approval of rate structure changes to encourage water conservation. Therefore, if Cal Water overestimates its costs, the difference would show up as a surcredit on water customers' bills. The surcharges per month are significant. For example, in the April 2013 bill amount of nearly \$110 shown in Figure 3 on page 23, the net amount of the commission-approved surcharge is \$25.67 for Cal Water, which increased from the previous amount of \$6.51 for April 2012.

Some of the Water Utilities Have Undertaken Cost-Saving Efforts, but They Cannot Always Document the Amounts Saved

Because the increasing cost of water has been a concern for valley residents, we would have expected the water utilities that we reviewed to be able to demonstrate how much they have saved with the various efforts they have undertaken. Each water utility expressed to us its intention to operate as efficiently as possible to keep rates low for water customers. However, although each of the four utilities provided examples of various ways it manages operating costs in order to keep rates reasonable, the utilities were not always able to quantify the savings that resulted from these actions.

Palmdale shared with us several efforts to reduce its energy costs; however, none of these constituted a specific effort directed toward curbing escalating water rates.

Palmdale shared with us several efforts to reduce its energy costs; however, none of these constituted a specific effort directed toward curbing escalating water rates. For example, Palmdale suggested that one cost-saving effort was an annual efficiency audit of the electrical usage for its groundwater wells that its electricity utility conducts. However, because the electricity utility performs this

audit annually, we did not consider this to be an effort that Palmdale took outside the normal course of its business as a way to keep its water rates reasonable.

In contrast, LA District 40 could demonstrate that some of the actions it was taking could result in cost savings. LA District 40 estimated that it could save nearly \$148,000 a year after completing a five-year plan to replace its current vehicles with more efficient vehicles. LA District 40 plans to begin the vehicle replacement in fiscal year 2014–15. Also, a senior civil engineer for LA District 40 indicated that as a division within the Los Angeles County Department of Public Works (public works), LA District 40 has the ability to transfer staff to other units within public works and leave positions temporarily unfilled if it identifies a need to keep operating costs low. He also stated that LA District 40 will postpone less critical maintenance until it has adequate funding to cover the maintenance costs. However, the senior engineer could not cite any specific instances in which it transferred employees to other units or postponed maintenance during our period of review.

Further, using a process known as water banking, both LA District 40 and Quartz Hill pre-purchased water from AVEK for later use during dry years when purchased water rates are higher. LA District 40 banked 11,500 acre-feet of water in 2011 and 2012 at a cost of \$4.2 million and plans to withdraw 10,350 acre-feet between fiscal years 2013–14 and 2014–15. Had it needed to purchase this water from AVEK at the current dry-year rates, we estimate LA District 40 would have spent between \$8.3 million and \$10.4 million for the same amount of water. Similarly, Quartz Hill banked 3,430 acre-feet of water between 2010 and 2013 at a cost of \$736,000. While Quartz Hill plans to withdraw some water from its water bank in 2014, as of May 2014, it was unsure of how much it will need to extract.

In addition, Quartz Hill's general manager described two other recent cost-saving efforts. In January 2013 its board of directors approved the purchase of solar panels at a cost of \$1.3 million. The vendor that sold the solar panels to Quartz Hill estimated that the solar panels will provide nearly \$5.6 million in electricity savings over 30 years. The general manager also indicated that in 2012 Quartz Hill reached an agreement with its employees' union to reduce medical coverage for all represented employees. However, Quartz Hill has not quantified the savings that have resulted from this effort.

As a statewide water utility, Cal Water centralizes engineering, water quality, water conservation, accounting, billing, and information technology functions at its San Jose headquarters and allocates a proportional share of these costs to its customers

LA District 40's senior civil engineer could not cite any specific instances in which it transferred employees to other units or postponed maintenance to keep operating costs low during our period of review.

across California, including those in the valley. Cal Water asserted that centralizing these functions ensures that each of its customers receives the full benefit of these services, but at a significantly lower cost. To illustrate, Cal Water indicated that it charges valley customers less than 0.5 percent of the costs for these centralized services, which amounted to \$140,000 in 2013. Cal Water also installed an alert system in the valley to eliminate the need for staff to manually monitor the status of water facilities. Cal Water did not provide the cost savings that resulted from installing this system, but it stated that the system has improved operational efficiency. Further, Cal Water contended that being regulated by the commission helps ensure that it is operating as efficiently as possible and that its expenses are prudent and justified. Cal Water indicated that the general rate case process provides the commission and other parties the opportunity to review Cal Water's records to ensure that its costs are in the best interests of customers. However, all investor utilities are subject to the commission's review, and thus this process is not a specific cost-saving effort that Cal Water undertook.

Cal Water Offers Rate Assistance Programs, While the Three Public Utilities Currently Do Not

Of the four water utilities we reviewed, only Cal Water—the investor utility—offers rate assistance programs, as authorized by the commission. It currently offers two different programs to qualified customers in the valley: the Low-Income Rate Assistance (LIRA) program and the Rate Support Fund (RSF). The LIRA program assists water customers whose income is below a certain level—for example, below \$47,700 for a family of four. This program provides a monthly discount of 50 percent of the water customer's service charge, up to a maximum of \$12 per month. The RSF program is offered to water customers in high-cost service areas. For the period we reviewed, Cal Water offered the RSF program to water customers in only one of the four locations it serves in the valley, providing a discount of \$12.10 off their monthly water bill. Cal Water funds two rate assistance programs with surcharges to other water customers. In its most recent general rate case, which began in 2012,⁸ Cal Water has proposed expanding the number of water customers who qualify for the RSF program and increasing the amount of the discounts offered by both programs.

Cal Water funds two rate assistance programs with surcharges to other water customers.

⁸ As of May 2014 Cal Water's 2012 general rate case was still in progress, and no decision had been reached.

Unlike investor utilities such as Cal Water, public utilities must adhere to the requirements of Proposition 218 when increasing rates, as we discussed earlier. Proposition 218 prohibits public utilities from increasing water rates or making changes in their rate structures unless they comply with specified substantive requirements. In particular, a public utility may not use revenues derived from water fees for any purpose other than delivering water and may not impose a fee that exceeds the proportional cost of providing water service to the parcel. Because a rate assistance program funded by revenues derived from water fees would result in one group of ratepayers subsidizing the fees paid by another group of ratepayers, Proposition 218 would prohibit such a program. However, water utilities can use other funding sources to offer rate assistance programs. For example, the city of Davis—although not a public utility—adopted a Lifeline Water Utility Rate Assistance Program in May 2013 that uses revenues from late fees to assist up to 250 low-income water customers by discounting their monthly bills by \$10 a month.

Currently, none of the three public utilities we reviewed offer rate assistance programs. However, Palmdale's finance manager stated that the finance committee of its board of directors recently considered implementing a rate assistance program to assist low-income senior water customers, which would be funded using revenues from cell phone tower leases. Palmdale proposed this program in a March 2014 finance committee meeting, but the finance committee has yet to make a decision as to whether it will propose this program to the board of directors. Similarly, Quartz Hill proposed a low-income rate assistance program to its board of directors in December 2013, but the board did not approve the proposal because it would have required some customers to pay for other customers' bills and it believes the proposal would conflict with Proposition 218. LA District 40's senior civil engineer stated that no formal consideration has been given to implementing a rate assistance program. Alternatively, pending legislation that, if enacted, would be known as the Low-Income Water Rate Assistance Act, would require the California Department of Community Services and Development to develop a plan to fund and implement a program and report to the Legislature no later than January 2016 on the feasibility of such a program.

Recommendations

To ensure that water customers are able to have an understanding of how rate increases are determined, Quartz Hill should include information in its public notices providing reasonably sufficient details of the basis of its fee methodology.

Under Proposition 218, a public utility may not use revenues derived from water fees for any purpose other than delivering water, such as a rate assistance program.

To provide guidance to local public agencies in implementing the notice requirements of Proposition 218, the Legislature should enact a statute that specifies the level of detail required to satisfy the requirement that the notice specify “the basis upon which the amount of the proposed fee or charge was calculated.”

To ensure that LA District 40 and Quartz Hill can demonstrate that they comply with the public notification requirements of Proposition 218, they should retain documentation demonstrating that they mailed required Proposition 218 notifications of pass-through rate increases to water customers during the period that the increased rates are in effect.

To ensure that water customers are aware of pass-through rate increases, Quartz Hill should adopt a schedule of fees showing how these increases will affect its tiered usage charges before the new rates take effect.

To ensure that its water customers have access to Quartz Hill’s rate methodology and other factors that help it determine rate increases, the utility should keep all documentation it uses to calculate or otherwise explain the need for rate increases for as long as the rate increases are in effect.

To show water customers that they are attempting to keep rates reasonable, each water utility should maintain documentation to demonstrate any cost savings expected or achieved as a result of its cost-saving efforts.

To assist low-income water customers, Palmdale, LA District 40, and Quartz Hill should work with their respective governing bodies to consider the feasibility of using revenues from sources other than water rates to implement rate assistance programs for low-income water customers.

We conducted this audit under the authority vested in the California State Auditor by Section 8543 et seq. of the California Government Code and according to generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives specified in the scope section of the report. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Respectfully submitted,



ELAINE M. HOWLE, CPA
State Auditor

Date: July 8, 2014

Staff: John Baier, CPA, Audit Principal
Amber Ronan
Brianna J. Carlson
Joseph S. Sheffo, MPA

Legal Counsel: J. Christopher Dawson

For questions regarding the contents of this report, please contact Margarita Fernández, Chief of Public Affairs, at 916.445.0255.

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Appendix

EXPENDITURES FOR THE WATER UTILITIES WE REVIEWED

Table A shows the relevant cost factors for each water utility for the three years we reviewed. As mentioned in the Introduction, a variety of cost factors contribute to water rates of the four water utilities in the Antelope Valley. For the purposes of this table, these costs are grouped into the major expenditure categories of personnel—which is made up of salaries and benefits—operations, water purchases, power, water treatment, and, when applicable, taxes. Table A shows the percentage increases for each category and for total expenditures between fiscal years 2010–11 and 2012–13, or calendar years 2011 through 2013, depending on the water utility. It also shows the proportion of cost types to total costs for each water utility for the last year shown. Figure 2 on page 14 in the Audit Results presents this information for only the last year that we reviewed.

Table A
Relevant Cost Factors for the Four Water Utilities We Reviewed
(Dollars in Thousands)

TYPE OF COST*	2011	2012	2013	PERCENTAGE CHANGE†	PERCENTAGE OF TOTAL COSTS (2013)
LOS ANGELES COUNTY WATERWORKS, DISTRICT 40 (LA DISTRICT 40)					
Personnel‡	\$14,689	\$12,117	\$11,736	(20%)	34%
Operations	8,334	6,379	6,591	(21)	19
Water purchases	10,745	12,374	13,472	25	39
Power	1,782	2,445	2,337	31	7
Water treatment	272	332	370	36	1
Taxes	NA	NA	NA	NA	NA
Totals	\$35,822	\$33,647	\$34,506	(4%)	100%
PALMDALE WATER DISTRICT (PALMDALE)					
Personnel‡	\$10,717	\$10,560	\$10,353	(3%)	50%
Operations	4,721	3,922	3,600	(24)	17
Water purchases	2,658	3,615	2,247	(15)	11
Power	1,259	1,214	1,608	28	8
Water treatment	2,936	3,356	3,031	3	15
Taxes	NA	NA	NA	NA	NA
Totals	\$22,291	\$22,667	\$20,839	(7%)	100%

continued on next page ...

TYPE OF COST*	2011	2012	2013	PERCENTAGE CHANGE†	PERCENTAGE OF TOTAL COSTS (2013)
QUARTZ HILL WATER DISTRICT (QUARTZ HILL)					
Personnel‡	\$1,388	\$1,517	\$1,649	19%	40%
Operations	959	611	708	(26)	17
Water purchases	1,139	1,263	1,484	30	36
Power	204	225	261	28	6
Water treatment	34	37	16	(53)	§
Taxes	NA	NA	NA	NA	NA
Totals	\$3,724	\$3,653	\$4,118	11%	100%
CALIFORNIA WATER SERVICE COMPANY (CAL WATER)					
Personnel‡	\$433	\$477	\$507	17%	40%
Operations	425	500	461	8	36
Water purchases	35	44	52	49	4
Power	62	106	121	95	9
Water treatment	87	129	76	(13)	6
Taxes	57	63	66	16	5
Totals	\$1,099	\$1,319	\$1,283	17%	100%

Sources: California State Auditor's analysis of each utility's relevant cost factors.

NA = Not applicable.

* LA District 40 and Quartz Hill report their costs by fiscal year, while Palmdale and Cal Water report their costs by calendar year.

† Percentage change is between 2011 and 2013.

‡ Personnel costs include salaries and benefits, including postemployment benefits.

§ Less than 1 percent.

July 2014



GAIL FARBER, Director

COUNTY OF LOS ANGELES

DEPARTMENT OF PUBLIC WORKS

"To Enrich Lives Through Effective and Caring Service"

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ALHAMBRA, CALIFORNIA 91803-1331
Telephone: (626) 458-5100
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ADDRESS ALL CORRESPONDENCE TO:
P.O. BOX 1460
ALHAMBRA, CALIFORNIA 91802-1460

June 17, 2014

IN REPLY PLEASE

REFER TO FILE: FI-2

Ms. Elaine M. Howle
State Auditor
California State Auditor's Office
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

Dear Ms. Howle:

RESPONSE TO STATE AUDITOR RECOMMENDATIONS ANTELOPE VALLEY WATER RATES

On behalf of the Los Angeles County Waterworks District No. 40, Antelope Valley (LA District 40), the Department of Public Works thanks you for the opportunity to comment on the proposed audit report for the Antelope Valley Water Rates: Various Factors Contribute to Differences Among Water Utilities. We have the following comments and would like to submit for your review and consideration to be incorporated in the final audit report.

Recommendation 1:

To ensure that Los Angeles County Waterworks District No. 40, Antelope Valley (LA District 40), can demonstrate that they comply with the public notification requirements of Proposition 218, they should retain documentation demonstrating that they have mailed Proposition 218 notifications of pass-through rate increases to the water customers during the period that the increased rates are in effect.

Response: Agree

While Proposition 218 does not stipulate a record retention requirement establishing proof of mailing, we will endeavor to retain those records going forward. In the future we will retain notice information including:

- the district number of the mailer;
- the number of notices mailed;
- the invoice for the vendor that performed the notice printing and mailing;
- the date of the notice mailing; and
- the confirmation that vendor completed the notice printing and mailing.

Ms. Elaine M. Howle
June 17, 2014
Page 2

We complied with the notice requirement and the inability to produce a complete paper trail is not evidence that the LA District 40 failed to provide the requisite notice. LA District 40 has been diligent in following Proposition 218.

Recommendation 2:

To show water customers that they are attempting to keep rates reasonable, LA District 40 should maintain documentation to demonstrate any cost savings expected or achieved.

Response: Partially Agree

During the audit, LA District 40 provided a list and reference documents citing various cost-saving measures. For some of the measures, LA District 40 was able to provide documentation that quantified the costs savings exclusively for LA District 40. Examples of cost saving with sufficient documentation were the Right Sizing of the Fleet and the Water Banking Program. There were other cost savings measures that LA District 40 could not provide sufficient documentation quantifying the specific cost savings to LA District 40 (LA County Department of Public Works oversees six [6] separate water agencies). Examples, of these savings were:

- Staff Reduction – from 2011 to 2012 staffing for all districts was reduced by 29 employees;
- Energy Management – LA District 40 installed time clocks at their pump stations to avoid paying higher Time of Use power rates; and
- Deferred Maintenance – LA District 40 deferred lower priority maintenance activities until there was funding available to complete these tasks.

LA District 40 will work in the future to quantify and document cost savings measures and provide this information to their customers upon request.

Recommendation 3:

To assist low-income water customers, LA District 40 should work with their respective municipalities to consider the feasibility of using revenues from sources other than water rates to implement a rate assistance program for low-income water customers.

Response: Agree

LA District 40 will assess the feasibility of securing state or local grants or other financing mechanisms from the local agencies to provide a low income rate assistance program, consistent with State Law. Per the cost of service rules embedded into the language of Proposition 218 laws, the LA District 40 cannot use

Ms. Elaine M. Howle
June 17, 2014
Page 3

water sales revenues to fund or subsidize a discount to a specific group of customers. Water agencies regulated by the Public Utilities Commission do not have such restrictions and can provide low income rate assistance programs to its customers.

If you have any questions, please contact Ms. Angelica Cobian of our Internal Audit Group at (626) 458-6551.

Very truly yours,


GAIL FARBER
Director of Public Works

AC:dbm

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July 2014



PALMDALE WATER DISTRICT

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June 12, 2014

Elaine M. Howle, State Auditor
 621 Capitol Mall, Suite 1200
 Sacramento, CA 92814

RE: ANTELOPE VALLEY WATER RATES - REPORT NO. 2013-126

Dear Ms. Howle:

The District appreciates the opportunity to comment on the above-referenced report. Several comments in the body of the report were discussed with your staff during a telephone conversation on June 11, 2014. The comments generally focused on clarifications and consumer controls over public agencies.

The report contains two recommendations for Palmdale Water District. The first is to maintain documentation to demonstrate anticipated and experienced cost savings that help keep water rates reasonable. The District agrees with this recommendation and will develop methods or procedures to better document those efforts.

The second recommendation is to continue with existing efforts to develop a method to provide assistance to low-income water customers. The District began investigating this type of program prior to being notified of the work performed by your office. Staff will continue to develop a program with the intention of presenting it to the Board of Directors for consideration later this year. Therefore, the District agrees with this recommendation.

Please feel free to contact me at (661) 456-1017 if you have any questions.

Very truly yours,


 DENNIS D. LaMOREAUX,
 General Manager

DDL/dh

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QUARTZ HILL WATER DISTRICT

42141 50th Street West • Quartz Hill, CA 93536
661-943-3170 • www.qhwd.org

6/18/2014

John Baier, Principal Auditor*
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

RE: STATE AUDIT OF THE ANTELOPE VALLEY WATER RATES COMPLETED BY THE CALIFORNIA STATE AUDITOR

Dear Mr. Baier

We appreciate the time and effort that was put forward by you and your staff in shepherding this audit regarding the “various factors contribute to difference among water utilities.” Quartz Hill Water District is continually striving to improve our product and the method in which it is delivered.

Quartz Hill Water District generally agrees with the findings and recommendations of the California State Auditors (CSA). However, with such a large scope of assignment and complexity of the issue(s) at hand the District feels that some generalizations garble the facts. Our comments on specific items are enclosed. ①

The District appreciated cooperative method in which your staff conducted the work leading to this report, and always welcomes the opportunity to examine our practices. Several common practices have been modified as a result of this audit as denoted in our response to the recommendations.

If you have any additional questions or concerns please feel free to contact me anytime at (661) 943-3170.

Sincerely,

CHAD J. REED

Chad J. Reed
General Manager

* California State Auditor's comments appear on page 47.

Recommendations

R.1.

“To ensure that water customers are able to have an understanding of how rate increases are determined, Quartz Hill Should include information in its public notices providing reasonably sufficient detail of the basis of its fee methodology.”

②

Quartz Hill Water District has consulted with the CSA, and agrees that the Legislature should provide additional instruction on what is required. The District will also follow the CSA advice of consulting with the League of Cities. It is the belief of Quartz Hill Water District that during the Proposition 218 process, the District went above and beyond the legal requirements in providing ample explanations as to why the rates were increasing. The District provided specific examples, as denoted in your audit. On several different occasions, Quartz Hill Water District held and participated in different public forums explaining the basis of the rate and why the increase was necessary. One technique used to demonstrate the methodology was a power point. That was publicly shown on multiple occasions and at different sites, allowing for a question and answer session after the presentation. Since Quartz Hill Water District is a not for profit organization, it was assumed that if operating cost increased then rates would have to increase likewise.

R.2.

“To provide guidance to local public agencies in implementing the notice requirements of Proposition 218, the Legislature should enact a statute that specifies the level of detail required to satisfy the requirement that the notice specify “the basis upon which the amount of the proposed fee or charge was calculated.”

Quartz Hill Water District agrees with this recommendation.

R.3.

“To ensure *** (Quartz Hill) can demonstrate that they comply with the public notification requirements of Proposition 218, they should retain documentation demonstrating that they mailed required Proposition 218 notifications of Pass-through rate increase to water customers during the period that the increased rates are in effect.”**

③

Quartz Hill Water District will maintain a sample copy of the invoice that denotes the increase to water fees. To the District’s knowledge Quartz Hill Water District has never had a request for the exact printed statement beyond what our computer system was able to generate. Quartz Hill Water District did send out the statements of the increase as signified by the provided paid invoices for the service of mailing all printed statements. It was Quartz Hill Water District belief that the paid invoices was the “retained documentation demonstrating that they [Quartz Hill] mailed required Proposition 218 notifications of pass-through rate increased to water customers”. However, since consulting with the CSA the District feels this recommendation can be resolved hence forth.

R.4.

“To ensure that water customers are aware of pass-through rate increase, Quartz Hill Should adopt a schedule of fees showing how these increases will affect its tiered usage charges before the new rates take effect.”

Quartz Hill Water District will modify current practices to include a schedule of possible pass through rates.

R.5.

“To ensure that its water customers have access to Quartz Hill’s rate methodology and other factors that help it determine rate increase, the utility should keep all documentation it uses to calculate or otherwise explain the need for rate increases for as long as the rate increase are in effect.”

Quartz Hill Water District agrees with this recommendation. Though, all laws of record retention were satisfied QHWD sees how transparency could be improved with this practice.

R.6.

“To show water customers that they are attempting to keep rates reasonable, [Quartz Hill] *** should maintain documentation to demonstrate any cost saving expected or achieved. “**

Historically, items of this nature have been presented orally during the regularly scheduled Board of Directors monthly meeting. Since participating in this audit it has become apparent to Management that all cost saving and similar items need to be written and shared publicly to simplify documentation of such events.

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Comments

CALIFORNIA STATE AUDITOR'S COMMENTS ON THE RESPONSE FROM QUARTZ HILL WATER DISTRICT

To provide clarity and perspective, we are commenting on Quartz Hill Water District's (Quartz Hill) response to our audit. The numbers below correspond to the numbers we have placed in the margin of Quartz Hill's response.

As part of the quality control process that we are required to follow under generally accepted government auditing standards, we provide auditees, including Quartz Hill, a draft copy of the audit report for review and comment. Further, we spoke with the general manager of Quartz Hill on several occasions to provide him the opportunity to discuss any questions or concerns he had with the draft report. However, none of the general manager's comments caused us to make any edits to the draft report.

①

Quartz Hill misstates the point of our finding. As we describe on page 18 of the report, Quartz Hill's notice of public hearing provided only a short statement indicating that the fee increase was based on describing the two costs—a flat rate that covers the cost of maintaining water service and a water usage rate determined by the water wholesaler. Our legal counsel determined that this statement met the Proposition 218 procedural requirement to set forth the basis for which Quartz Hill calculated the rate increases, however, we believe this statement is devoid of any detail to inform the public of the basis Quartz Hill used to determine its rate increases. Although Quartz Hill asserts it explained the basis for the rate increases in public forums, as we note in the text box on page 17, Proposition 218 requires that the basis for a rate increase be explained in the written notice mailed to parcel owners.

②

Although Quartz Hill continues to assert that it mailed the required notices for the pass-through rate increases for 2011 through 2013, as we note on page 18 it did not retain these notices. Lacking the actual notices it asserts to have sent, Quartz Hill was unable to demonstrate to us that it sent the appropriate notices at least 30 days before each pass-through rate increase was to take effect.

③

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July 2014



CALIFORNIA WATER SERVICE COMPANY
1720 NORTH FIRST STREET • SAN JOSE, CA 95112

June 16, 2014

Elaine M. Howle, CPA
California State Auditor
621 Capitol Mall, Suite 1200
Sacramento, CA 95814

RE: Audit 2013-126 - Antelope Valley Water Rates: Various Factors Contribute to Differences Among Water Utilities

Ms. Howle:

Thank you for providing California Water Service Company (Cal Water) the opportunity to review and comment on the California State Auditor's report entitled "Antelope Valley Water Rates: Various Factors Contribute to Differences Among Water Utilities" (Report).

At the outset, please allow me to commend your staff for the amount of time and effort they put into completing the Report. The thoroughness of the Report is a testament to their dedication. It was a pleasure working with each member of your staff who participated in the preparation of the Report.

Cal Water is committed to providing safe, reliable water utility service to our customers at the lowest cost possible. As such, we concur with the Report's recommendation that utilities enhance their ability to document and demonstrate what they are doing keep water utility rates reasonable. We will be sure to keep your office informed of the efforts we are undertaking to implement this recommendation.

Again, we truly appreciate having had the opportunity to work with you staff. We believe that the Report provides valuable insight into the various processes by which water utility rates are established and adds a great deal of clarity to a subject that is often difficult to understand.

Respectfully,

(Signed by: Paul Townsley)

Paul Townsley
Vice President, Regulatory Matters & Corporate Relations