

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
KUKIO UTILITY COMPANY, LLC)
For a Certificate of Public)
Convenience and Necessity Pursuant)
to Section 269-7.5, Hawaii Revised)
Statutes, to Provide Water and)
Sewage Treatment Services in Kukio,)
North Kona, Hawaii; Approval of)
Water Purchase Agreement with WB)
Kukio Resorts, LLC Pursuant to)
Section 269-19.5, Hawaii Revised)
Statutes; and for Approval of)
Rules, Regulations and Rates.)
_____)

DOCKET NO. 01-0433

DECISION AND ORDER NO. 20103

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DEPT. OF COMMERCE
CONSUMER AFFAIRS
STATE OF HAWAII

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Kris H. Nak
for Chief Clerk of the Commission

ATTEST: A True Copy
CATHERINE SAKATO
Clerk
Public Utilities Commission
State of Hawaii
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DECISION AND ORDER

I.

By an application filed on October 26, 2001, as amended,¹ KUKIO UTILITY COMPANY, LLC (KUC or Applicant) requests that the commission: (1) grant it a certificate of public convenience and necessity (CPCN) to provide water and wastewater treatment services for a master planned community known as the Kukio Beach Club,

¹Applicant amended its initial October 26, 2001 application on September 11, 2002, to reflect, among other things, a \$20 million revolving loan issued to its manager and sole member, WB Kukio Resorts, LLC (First Amended Application). However, by letter filed on February 14, 2003, Applicant informed the commission that WB Kukio Resorts, LLC no longer will be obtaining such revolving loan. Consequently, Applicant states that it desires to revert back to the original application filed on October 26, 2001. Since Applicant represents that the Consumer Advocate had no objection to such amendment to its application, we will treat such submission as a stipulation for leave to withdraw its First Amended Application subsequent to the Consumer Advocate's responsive position statement, pursuant to Hawaii Administrative Rules § 6-61-20.

situated at Kukio, North Kona, Hawaii; (2) determine that its proposed non-potable irrigation water service is an unregulated activity, not subject to commission oversight, and that the rate charged for such non-potable water is not subject to the applicable tariff requirements; (3) approve the method by which utility assets will be transferred to Applicant from its parent entity, WB Kukio Resorts, LLC (Developer), and confirm that the transfer will be deemed for value and not a contribution-in-aid-of-construction; (4) receive and approve (to the extent necessary) the Water Purchase Agreement between Applicant and Developer; and (5) approve its proposed rules, regulations and rates. Applicant filed its application, as amended, pursuant to Hawaii Revised Statutes (HRS) § 269-7.5 and Hawaii Administrative Rules (HAR) Chapter 6-61.²

Applicant served copies of the application on the DIVISION OF CONSUMER ADVOCACY, DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS (Consumer Advocate). On December 13, 2002, the Consumer Advocate filed a statement of position stating that it does not object to the approval of the application. No persons moved to intervene in this proceeding.

²We note that, on May 17, 2000, Applicant initially filed its original application for, among other things, a certificate of public convenience and necessity (CPCN) to provide water and wastewater treatment services in the same geographic area in Docket No. 00-0158. However, by Order No. 18194, filed on November 15, 2000, in that docket, we approved Applicant's withdrawal of its May 17, 2000 CPCN application.

II.

The commission determines the following issues in this docket:

1. Whether the Applicant is fit, willing, and able to properly perform the proposed water and wastewater treatment services and to conform to the terms, conditions, rules, and regulations promulgated by the commission.

2. Whether the proposed water and wastewater treatment services are, or will be required by the present or future public convenience and necessity.

3. Whether the proposed rules, regulations, rates, and charges for the proposed water and wastewater treatment service are just and reasonable.

4. Whether the proposed non-potable irrigation water service is an unregulated activity.

5. Whether the transfer of utility assets to Applicant by the Developer should be deemed for value and not contribution-in-aid-of-construction.

6. Whether the Water Purchase Agreement between Applicant and Developer is reasonable.

III.

Request for CPCN

A.

Description of Applicant

Applicant is a Delaware member-managed limited liability company (LLC) formed on May 8, 2000. Applicant's manager and sole member is the Developer, which is 60 per cent owned by Westbrook

United Land Investments, LP, and 40 per cent owned by G&K Development, LLC. Applicant further represents that it has no authorized preferred stocks and there are no security agreements, mortgages or deeds of trusts, which presently affects Applicant's property. Moreover, Applicant has no bonds, notes or other indebtedness outstanding.

B.

Proposed Potable Water and Wastewater Treatment Services

Applicant proposes to provide potable and non-potable water and wastewater treatment services to a master planned community known as the Kukio Beach Club situated at Kukio, North Kona, Hawaii, and currently being developed by the Developer, Applicant's manager and sole member. The development will be constructed in three phases. When the development is fully completed, it is expected to have up to 300 residential units, several golf courses including an 18-hole golf course mauka of the development area, a 40-50 unit private hotel, and other resort-related amenities (development area). The instant application is limited to only Phase 1 of the development area.³ Phase 1 of the development area will include approximately 139 residential units, 79 acres of park/open space, 7 acres of beach club and member's services, a 10-hole makai golf course, and 10 acres of community facilities.

For Phase 1 of the development area, Applicant proposes to utilize three brackish water wells (aka, KI-1, KI-2 and KI-3

³Applicant states that, at an appropriate time, separate applications will be filed with the commission for future approvals and/or certifications required to serve Phases 2 and 3.

wells or collectively KI Wells),⁴ which are already built, permitted, and presently owned by the Developer.⁵ Applicant represents that the KI Wells, which include well pumps, motor controls and other appurtenances, will supply potable and non-potable water to consumers occupying Phase 1 of the development area through a Water Purchase Agreement executed between Applicant and the Developer.⁶ Applicant further states that the average daily potable water demand on the system is expected to be 262,000

⁴Applicant represents that it obtained the requisite well construction and pump installation permits from the State Commission on Water Resource Management for the KI Wells. Applicant intends to utilize two of the KI Wells while the third well will serve as a backup.

⁵Applicant represents that Phase 2 and 3 of the development area are prospective at this point. Phase 2 consists primarily of an 18-hole mauka golf course to be owned by the The Golf & Beach Club, and serviced by means of brackish water obtained by the golf course lake via the KI Wells. Phase 3 is expected to consist of 100 additional residential lots of up to one acre in size in the mauka upper makai portions of the development area, and a golf clubhouse on the 18-hole mauka golf course. The Developer eventually plans to utilize Huehue Ranch Well Nos. 1-6 (HR Wells) to provide potable water to the entire development area including Phase 1, 2, and 3. Because the KI Wells alone are incapable of servicing the total anticipated water demand for Phase 1, 2, and 3, Applicant plans to utilize the HR Wells to meet all of the potable water demands for Phase 1, 2, and 3 while all of the brackish KI Wells capacity will be converted back to non-potable irrigation water use.

⁶The water service process begins when raw KI brackish well water is pumped up to a 0.5 million gallon (MG) glass-fused steel reservoir at elevation 620' Mean Sea Level (MSL). Some of the well water (approximately 0.3 millions of gallons per day (MGD)) will then be treated by low-pressure reverse osmosis at a 0.3 MGD central water treatment plant to remove salt and minerals before distribution through a 1.0 MG service reservoir at elevation 312' MSL. Applicant represents that such treated water is expected to meet all regulatory standards for potable water including standards established by the State Department of Health, Safe Water Branch. The remainder (approximately 1.0 MGD) of the brackish water pumped from the KI Wells will be used for golf course irrigation (Phase 2 and a portion of Phase 1 water systems) and project landscape irrigation (portions of Phase 1 and 3 water systems).

gallons per day (GPD) when Phase 1 is at full build-out. The capacity of each of the KI wells is expected to be 720,000 GPD.

Applicant's wastewater treatment facilities, which are expected to be complete by June 2002, consist of a collection system that will bring system waste to the sewage pump lift station, then to the wastewater treatment plant.⁷ At full build-out of Phase 1, Applicant expects to collect and treat approximately 60,000 GPD. Applicant represents that the design capacity of the wastewater facilities is 150,000 GPD.

C.

Non-potable Irrigation Water Services

Applicant asserts that its proposed non-potable irrigation water services should be unregulated because it will likely be provided initially to only Developer-created and -controlled customers, and, therefore, should not be subject to Applicant's proposed tariff. In particular, the proposed non-potable irrigation water service will be used to serve common areas (Phase 1 and 3) of the development area and the development's golf courses (Phase 1 and 2), which will be the sole responsibility of the Kukio Community Association (Association) and The Golf & Beach Club (Golf Club), respectively. Kikaua Point Park Maintenance

⁷The wastewater treatment service includes wastewater being treated in rotating biological contractor units. Subsequent to treatment, the secondary effluent will flow by gravity to the irrigation area for horticultural reuse. Applicant represents that the sole user of the secondary effluent will be the Kukio Community Association (Association), which will be responsible for all common area irrigation. Such effluent will be sold by Applicant to the Association for \$1.00 per thousand gallons.

Corporation (Park Maintenance Corporation), a separate non-profit entity created to lease and operate a park, will also be utilizing such irrigation service. Although the Association, Golf Club and Park Maintenance Corporation are presently Developer-created and -controlled at this juncture, Applicant states that it intends to eventually transfer control of these entities to the project residents, in which Applicant acknowledges that it may be appropriate to provide irrigation water as a regulated service.⁸

The Consumer Advocate expresses substantial concerns in deeming the non-potable water irrigation service as unregulated. Specifically, the Consumer Advocate asserts that "if Applicant is allowed to provide irrigation service as an unregulated activity, Applicant may be allowed to subsidize the irrigation water service through the improper allocation of common expenses resulting in higher rates for regulated water and wastewater services and lower and/or non-compensatory irrigation rates to its affiliates."

We agree with the Consumer Advocate's concerns and find that Applicant has not sufficiently convinced the commission that the proposed non-potable irrigation water service should be unregulated, particularly in light of Applicant's representation that the Developer-created and -controlled entities that will be initially utilizing and benefiting from such irrigation service will eventually be assumed by the project residents. We, therefore, conclude that the regulation of Applicant's proposed non-potable irrigation water services is necessary, at the

⁸Applicant's response to CA-SIR-7e.

inception, and Applicant will be required to establish a tariff rate for such service, as set forth in Exhibit A of the Application. In re South Shore Community Services LLC, Decision and Order No. 17822, Docket No. 99-0031 (July 11, 2000).

Furthermore, because Applicant is proposing to offer its water and wastewater treatment services to the public, as a whole, our concerns in this instance are much broader than the issue of whether the proposed consumers of the non-potable irrigation water service will have control over Applicant's decisions with respect to rates and conditions of providing such irrigation service.⁹ Thus, in order to ensure equity amongst all ratepayers in the development area, we will need to maintain oversight of all of Applicant's proposed water and wastewater treatment service and review all of Applicant's proposed rates, as a whole, including its rates for the non-potable irrigation water service. Accordingly, we will require Applicant to include its proposed non-potable irrigation water service rates in its tariff. Regulation of Applicant's non-potable irrigation water service from the beginning, in our view, will protect the public interest by preventing, at the very minimum, the potential for discriminatory

⁹See In re Wind Power Pacific Investors - III, 67 Haw. 342, 686 P.2d 831 (1984). Cf. In re Poipu Kai Water Reclamation Corp., Decision and Order No. 11184, Docket No. 6939 (July 22, 1991). Applicant relies on three state Supreme Court cases from other jurisdictions in support of non-regulation of its irrigation service. Central Oregon Irr. Co. v. Public Service Commission, 101 Or. 42, 196 P. 82 (1921), J.C. Allen v. Railroad Commission of the State of California, 179 Cal. 68, 175 P. 466 (1918), and Thayer v. California Development Company, 184 Cal. 117, 128 P.2d 21 (1912). However, these cases are inapposite, particularly because the non-potable irrigation water service will eventually be devoted to public use, and Applicant acknowledges that subsequent to the transfer of control of the Developer-created and -controlled entities to project residents, such service may need to be regulated.

rates and cross-subsidization between Applicant's captive residential customers and its Developer-created and -controlled customers.

D.

Fitness, Willingness and Ability

As mentioned above, the Phase 1 Facilities are owned and are being constructed by the Developer.¹⁰ Upon issuance of a CPCN in this docket, the Developer intends to transfer the Phase 1 Facilities to Applicant (excluding the KI wells and the related reservoir tank) in exchange for approximately \$8 million in additional capital interests in Applicant. Applicant further represents that subsequent to the transfer, the Developer will contribute to Applicant \$100,000 in cash.

Applicant's pro forma financial statements indicate that a substantial portion of its Phase 1 Facilities are expected to operate at a loss for a couple of years. Specifically, the water facility is projected to operate at a loss from 2002 until 2004, and the wastewater treatment facility is projected to operate at a loss from 2002 until 2003. On the other hand, the non-potable irrigation facility is projected to generate net income starting in 2002. Applicant's 2002 test year balance sheet projects \$8.1 million in assets and \$119,987 in liabilities.

¹⁰From hereinafter, all references to "Phase I Facilities" include all of Applicant's/Developer's facilities constructed to provide potable and non-potable water and wastewater services to the Phase 1 service territory.

Applicant further represents that it will not have any employees to operate and manage any of the facilities necessary to provide the proposed services. Instead, Applicant has retained Island Utility Services, Inc. (IUS) to staff and operate the Phase 1 Facilities. IUS has been in the business of providing water and wastewater system operations and management since 1992 and currently operates and manages various water systems, wastewater systems, and primary irrigation systems including, without limitation, systems for Molokai Ranch, on the island of Molokai, and Hualalai Resort, on the island of Hawaii. IUS employs Grades 1 through 4 water treatment, water system, and wastewater operators and maintains that it is a qualified plant operator with personnel possessing the necessary training and experience to competently operate the Phase 1 Facilities.

Based on the foregoing, the commission finds that Applicant has the requisite facilities, training, experience and capacity to provide both its potable and non-potable water and wastewater services to the entire Phase 1 development area. Accordingly, we find that Applicant is fit, willing, and able to provide the proposed services, and to conform to the terms, conditions, and rules adopted by the commission.

E.

Present or Future Public Convenience and Necessity

In its application, Applicant represents that the County of Hawaii does not provide either municipal water or wastewater treatment service in the proposed service area, and since there are no other water and wastewater treatment facilities in the requisite

area capable of providing the proposed services to the development area, we find that no existing public utility will be impacted by Applicant's proposed services.

In the absence of any other service providers, we, therefore, conclude that the proposed water and wastewater treatment services are, and will be, required by the present and future public convenience and necessity.

F.

Summary

Based on the foregoing, we conclude that Applicant has sufficiently demonstrated that it has satisfied the requirements set forth under HRS § 269-7.5. Accordingly, we conclude that Applicant should be granted a CPCN to provide potable and non-potable water and wastewater treatment services for Phase 1 of a master planned community known as the Kukio Beach Club situated at Kukio, North Kona, Hawaii, subject to the terms, conditions and limitations set forth in decision and order. As acknowledged by Applicant, Applicant must obtain prior approval from the commission should it desire to expand its service territory to, among other areas, the potential Phases 2 and 3 of the development area.

IV.

Proposed Rates, Charges and Rate Base

A.

Proposed Rates and Charges

Applicant proposes rates and charges that are not based upon rate base revenue requirements, and, as previously discussed,

are not expected to recover Applicant's expenses for the first few years. In support of its proposed rates and charges, Applicant represents that it considered the approved rates and charges offered by other water and wastewater utilities in deriving its proposed rates and charges. Applicant's proposed rates and charges for its potable water and wastewater services are set forth in Exhibit P of its application.¹¹ The proposed rates and charges for its non-potable irrigation water service are set forth in Exhibit A of its application.¹²

¹¹As set forth in Exhibit P, Applicant proposes the following rates:

Water Service Rates

<u>Monthly Meter Charge</u>	<u>Meter Size/Service</u>	<u>Monthly Charge/Meter</u>
	¾" (Commercial)	\$11.50 per month
	5/8" (Residential)	\$11.50 per month
	1" (Res/Com)	\$11.50 per month
	1 1/2" (Res/Com)	\$30.00 per month
	2" (Commercial)	\$30.00 per month
<u>Monthly Water Charge</u>	<u>Rate/Gallons</u>	<u>Block(gallons/month)</u>
	\$4.75/TG	I (0-29,999)
	\$6.75/TG	II (30,000-74,999)
	\$8.75/TG	III (75,000-above)

Sewer Service Rates

Monthly Stand-By Charge	Residential	\$50.00/dwelling unit
	Commercial	\$50.00/toilet
Monthly Quantity Charge	\$3.50/1,000 gallons of metered domestic water	
Power Cost Adj. Factor	(Electricity Cost/TG)-\$.38 x 1.06385	

¹²As set forth in Exhibit A of the application, the proposed rates and charges for non-potable irrigation water service are as follows:

Block I	\$1.15	(0-30 TG per month)
Block II	\$2.15	(30-75 TG per month)
Block III	\$3.15	(>75 TG per month)

Although Applicant believes that it is more reasonable to initially develop non-compensatory rates and charges in order to minimize the impact on the small customer base, it is apparent and the Consumer Advocate recognizes that Applicant's proposed rates and charges are not fully compensatory and do not reflect a generally accepted manner of rate design. However, due to a lack of historical experience and the nascent nature of its customer base, the Consumer Advocate recognizes that the use of more acceptable means of deriving utility rates and charges would be difficult and may not be practical; therefore, the Consumer Advocate will not oppose Applicant's proposed rates and charges in this particular application, and will revisit Applicant's rate design methodology in Applicant's next rate proceeding.

We agree with the Consumer Advocate that Applicant's proposed rates and charges do not reflect a generally accepted manner of rate design, and that its rate design methodology will need to be revisited in Applicant's next rate proceeding. However, we also concur with Applicant to the extent that in comparing Applicant's proposed rates and charges with other water and wastewater utilities' approved rates, such rates and charges are within the zone of reasonableness for the purpose of commencing new water and wastewater services in the development area. Accordingly, we conclude that we should accept Applicant's proposed rates and charges for purposes of this application.

B.

Water Purchase Agreement

As previously mentioned, Applicant and the Developer have entered into a Water Purchase Agreement to serve the Phase 1 development area wherein the Developer agrees to provide water to Applicant up to 1,300,000 gallons per day from the KI Wells at a cost of \$2.00 per thousand gallons (reflecting a license fee for use of the Developer's land, and Applicant's pro rata share of the operating expenses and capital costs related to the KI Wells).¹³ In its application, Applicants requests that we receive and approve (to the extent necessary) the Water Purchase Agreement between Applicant and the Developer.

In its position statement, the Consumer Advocate again asserts that the information received from Applicant was insufficient for it to independently assess and determine the reasonableness of the cost of acquiring the water from the Developer because of the affiliated relationship between Applicant and the Developer. In particular, the Consumer Advocate expresses, among other things, the following additional concerns: (1) the uncertainty relating to the ownership of the KI Wells and Applicant's continued access to such water source; and (2) the

¹³Initially, Applicant's proposed cost of water under the Water Purchase Agreement (Agreement) was \$2.29 per thousand gallons. However, it was later revised to \$2.00 per thousand gallons. The Agreement will commence on January 1, 2002 and will continue for a period of ten years until December 31, 2011. Thereafter, the Agreement may be extended as mutually agreeable to Applicant and the Developer. It is also anticipated that the Agreement may need to be amended to replace the KI Wells with the HR Wells at the time that Phase 2 and 3 of the development area are ready to proceed. See KUC Exhibit CA-IR-12.

Consumer Advocate's inability to determine the reasonableness of the royalties related to the Water Purchase Agreement.

HRS § 269-19.5 governs certain contracts or agreements executed between utilities and their affiliates. Generally, "when companies [providing essential utility and regulated transport service to Hawaii consumers] obtain their services, supplies, and equipment from affiliated interests, the contracts and agreements between the regulated entity and its affiliates must be shown by clear and convincing evidence to be in furtherance of the interests of the public." HRS § 269-19.5(b). These types of contracts and agreements made or entered into after July 1, 1988, must be received by the commission to be valid or effective. HRS § 269-19.5(c). Nevertheless, "[n]o affirmative action is required by the commission in regards to the filing of the contract[s] or agreement[s]; provided however, that if the commission, in its discretion, determines that the terms and conditions of the contract[s] or agreement[s] to be unreasonable or otherwise contrary to the public interest, the commission shall notify the public utility of its determination, whereupon the public utility shall have the option to alter, revise, amend, or terminate the contract[s] or agreement[s], or assume the risk that future payment for performance of the contract[s] or agreement[s] will be deemed unreasonable and excluded by the commission for ratemaking purposes." HRS § 269-19.5(c).

In this docket, it is clear that because the Developer is "an affiliated interest" as defined under HRS § 269-19.5(a), Applicant's Water Purchase Agreement with the Developer is subject to the various requirements set forth under HRS § 269-19.5.

In re Kapalua Water Company, Ltd., Decision and Order No. 12628, Docket No. 7683 (September 23, 1993) (Kapalua Water Company). The Water Purchase Agreement is appropriately filed with the commission, pursuant to HRS § 269-19.5. However, we also share the same concerns stated by the Consumer Advocate with respect to, in particular, the reasonableness of Applicant's costs of acquiring the water from the Developer, pursuant to the Water Purchase Agreement. Accordingly, unlike Kapalua Water Company, we will not approve the Water Purchase Agreement as reasonable, at this time, as no affirmative action is required upon the filing of such agreement. Without sufficient evidence in assuring that such agreement is in furtherance of the public interest, we find it appropriate to further review this matter in Applicant's next rate proceeding.

C.

Proposed Rate Base

Although Applicant provides its projected average rate base for its water and wastewater operations, Applicant is not seeking a fair rate of return on its rate base from the rates and charges proposed in the instant proceeding. However, as previously stated, upon receiving commission approval for its CPCN, Applicant states that the Developer will transfer the Phase 1 Facilities to Applicant in exchange for \$8 million in additional capital interest in Applicant. Thus, Applicant is seeking a ruling from the commission that the transfer of utility assets from the Developer to Applicant will be deemed for value and not a contribution-in-aid-of-construction.

In its position statement, the Consumer Advocate expresses the following concerns in evaluating Applicant's proposed rate base:

1. Based on the Application, the Consumer Advocate believed that the entire cost of the plant facilities would be reflected in the \$8 million transfer price. As shown in KUC Exhibit CA-SIR-4(a), the \$8 million reflects approximately \$2.3 million, \$4.6 million and \$1.1 million of plant costs for water, wastewater and irrigation, respectively. Rather than transfer the entire balance to the regulated company's books, Applicant later stated that the total cost of plant facilities is not being recorded in the transfer price. In response to CA-SIR-4, Applicant disclosed that \$5,855,678 of the water, wastewater and irrigation facilities will not be transferred to Applicant and will not be included in rate base. Applicant asserts that the Developer plans to write-off these costs against the costs of the lots sold.
2. Since Developer intends to recover the \$5,855,678 of plant facilities through the sale of lots, this amount should not be included in rate base and Applicant has properly excluded these costs in its forecasted rate base. Applicant, however, did not furnish documentation that would allow the Consumer Advocate to conclude that only \$5,855,678 is being written-off against the costs of the lots. In addition, Applicant maintains that it has made the necessary disclosure to purchasers of the lots to rebut the presumption that not all of the plant facilities' cost is being recovered through lot sales or written-off for income tax purposes. These assertions, however, do not address the Consumer Advocate's concern as to the exact costs that should be included in rate base as compared to those costs that are being recovered by Developer through lot sales.
3. The Developer's intention to recover a portion of the plant facilities cost through a write-off against real estate transactions makes it difficult to determine the cost of the plant that should be recognized in rate base for rate setting purposes. The [Applicant] should be required to provide sufficient documentation to justify the remaining costs

of the plant facilities that are included in rate base. This documentation must describe the basis for the allocation of the plant facilities costs between [Applicant's] rate base and the Developer's lot sales.¹⁴

Upon review of the record, we share the same concerns described by the Consumer Advocate in its position statement, and restated above, particularly as it relates to determining the value of the Phase 1 Facilities that would be transferred from the Developer to Applicant. It is apparent from its stated concerns, that the Consumer Advocate experienced difficulties in obtaining the requisite documentation from Applicant to determine the exact costs of the plant facilities that should be recognized in rate base for rate setting purposes. We also find it difficult from the record before us to determine the exact costs that should be included in rate base as compared to those costs that are being recovered through contribution-in-aid-of-construction. The record is nebulous and speculative on this issue. Accordingly, we are unable to affirmatively hold and provide Applicant with assurances that the transfer of utility assets from the Developer to Applicant will be deemed for value and not a contribution-in-aid-of-construction at this time. We will need to revisit this issue during Applicant's next rate proceeding.

D.

Summary

Based on our review of the record in this proceeding, we find that Applicant's proposed rates and charges do not reflect a generally accepted manner of rate design. However, given the lack

¹⁴Consumer Advocate's position statement, at 18-19.

of historical data and reliable information needed to undertake traditional rate design methodology, we will accept Applicant's proposed rates and charges (including its proposed rates and charges for non-potable irrigation water service) for purposes of this application. Because Applicant's initial rates and charges are based on comparable rates and are not designed to initially recover all of Applicant's expenses, we make no finding that Applicant's rates are reasonable under traditional ratemaking methodology.¹⁵ Further, because we have concerns with Applicant's rate design methodology, such as the calculation of operating expenses, we will defer the determination of revenues, operating expenses, and rate base to Applicant's next rate case.

As articulated above, we have grave concerns with the following issues: (1) whether the transfer of utility assets from the Developer to Applicant should be deemed for value and not a contribution-in-aid-of-construction, and (2) whether Applicant's Water Purchase Agreement with the Developer is reasonable. In our view, Applicant has failed to provide sufficient evidence to allow the commission to adequately resolve these issues. Consequently, we will also defer the determination of these issues to Applicant's next rate case after a full and fair evaluation of the evidence.

V.

Proposed Rules and Regulations

Applicant's proposed rules and regulations governing the rate schedules and the provision of water and wastewater treatment

¹⁵Based on Applicant's projected results of operation, Applicant's proposed initial rates will not recover the operating costs for water and wastewater treatment services.

services to Applicant's consumers are attached as Exhibit P of the initial application filed on October 26, 2001. Based on our review of Applicant's proposed rules and regulations, we conclude that, except as modified herein and/or below, these proposed rules and regulations appear reasonable. In particular, we agree with the Consumer Advocate's recommendations,¹⁶ and, therefore, conclude that Applicant's proposed rules and regulations set forth in its proposed tariff should be amended as follows:

1. *Rule II, General Conditions. (Original Sheet No. 9)* Paragraphs 1 and 2 should refer to paragraph 8 instead of paragraph 10.

2. *Rule IV, Application for Service and Service Connection. (Original Sheet Nos. 12-14)* Paragraph 4 should state that interest would accrue at 1 per cent compounded annually instead of 5 per cent. The word "applicant" stated in Paragraph 15 should be deleted and replaced by the word "customer."

3. *Rule V, Meter Reading and Rendering of Bills. (Original Sheet No. 15)* Revise paragraph 4 to include the address and telephone number of the Hawaii Public Utilities Commission.

4. *Rule VI, Termination of Service and Disconnection. (Original Sheet No. 17)* Consistent with CA-SIR-22, paragraph 2 should be revised to state as follows:

2. Closing bills for both water and sewer service will be determined by measuring the amount of water used since the last bill as indicated by the meter reading (volumetric charge), and adding a pro-rated stand-by sewer and potable water charge (service charge). In pro-rating service charges, a billing month will be considered as 30-days.

¹⁶The record indicates that Applicant has acknowledged and agreed to the majority of the Consumer Advocate's recommendations.

Furthermore, in light of our determination to regulate Applicant's non-potable irrigation water service, we also conclude that Applicant should amend its revised rates schedules to include its proposed rates for non-potable irrigation water service, as set forth in Exhibit A of its application, and amend its proposed rules and regulations to the extent that its proposed non-potable irrigation water service is also governed by such rules and regulations. These amendments shall be incorporated in Applicant's revised tariffs to be submitted to the commission. In all other respects, we conclude that the rules and regulations under which Applicant proposes to operate are reasonable.

VI.

THE COMMISSION ORDERS:

1. The parties' stipulation, filed on February 14, 2003, for leave to withdraw Applicant's First Amended Application, filed on September 11, 2002, subsequent to the service of the Consumer Advocate's position statement, is approved.

2. Applicant's initial application, filed on October 26, 2001, for a certificate of public convenience and necessity to provide potable and non-potable water and wastewater treatment services for Phase 1 of a master planned community known as the Kukio Beach Club situated at Kukio, North Kona, Hawaii, is approved, subject to the terms and conditions set forth in this decision and order and the ordering paragraphs below.

3. Applicant's proposed initial rates and charges for both its water and wastewater treatment services (as set forth in Exhibits A and P of the initial application) are accepted for

Exhibits A and P of the initial application) are accepted for purposes of this application. We defer the determination of Applicant's revenues, operating expenses, rate base, and the remaining unresolved issues in this docket, as described herein, to Applicant's next rate case.

4. Applicant shall submit revised tariff sheets including, without limitation, revised rate schedules and revised rules and regulations that reflect our decisions on the applicable rates, charges, and rules and regulations discussed in Parts IV and V of this decision and order. The revised tariff sheets and rate schedules shall be served on the Consumer Advocate and filed with the commission not later than April 11, 2003.

5. Applicant's proposed non-potable irrigation water service within the service area, described in the instant application, shall be regulated. Applicant shall amend its revised rates schedules to include its proposed rates for non-potable irrigation water service, as set forth in Exhibit A of its application, and amend its proposed rules and regulations to the extent that its proposed non-potable irrigation water service is also governed by such rules and regulations. These amendments shall be incorporated in Applicant's revised tariffs to be submitted in accordance with ordering paragraph no. 4 above.

6. Pursuant to HRS § 269-8.5, Applicant shall file with the commission, with service on the Consumer Advocate, an annual financial report in accordance with the Uniform Systems of Accounts - 1996 of the National Association of Regulatory Utility Commissioners covering its water and wastewater treatment utility

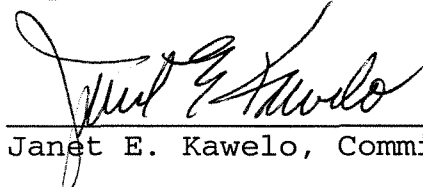
services commencing with the calendar year ending December 31, 2003, and each year thereafter. The reports shall be filed not later than March 31 for the immediate past calendar year.

7. Applicant shall remit, within 30 days of the date of this decision and order, a public utility fee of \$60, pursuant to HRS § 269-30. Additionally, beginning July 31, 2004 and December 31, 2004, and each year thereafter, Applicant shall pay a public utility fee which shall be equal to one-fourth of one per cent of the gross income from its public utility business during the proceeding year, or a sum of \$30, whichever is greater, in accordance with HRS § 269-30.

DONE at Honolulu, Hawaii this 27th day of March, 2003.

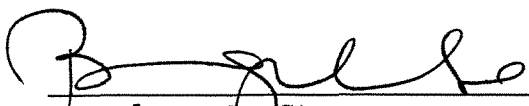
PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Wayne H. Kimura, Chairman

By 
Janet E. Kawelo, Commissioner

By (RECUSED)
Gregg J. Kinkley, Commissioner

APPROVED AS TO FORM:


Benedyne S. Stone
Commission Counsel

01-0433.cs

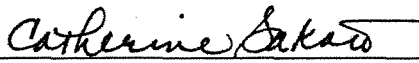
CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 20103 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
DIVISION OF CONSUMER ADVOCACY
P. O. Box 541
Honolulu, HI 96809

KUKIO UTILITY COMPANY, LLC
Attention: Milton K. Morinaga
P. O. Box 5349
Kailua-Kona, HI 96745-5349

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for Karen Higashi

DATED: March 27, 2003