

BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

In the Matter of the Application of )  
HAWAII WATER SERVICE COMPANY, INC. )  
For Approval of Rate Increases and )  
Revised Rate Schedules, and to )  
Enter into Financing Arrangements. )  

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DOCKET NO. 03-0275

DECISION AND ORDER NO. 21644

Filed Feb. 11, 2005  
At 10:30 o'clock A.M.

Karun Hignol.  
Chief Clerk of the Commission

DIV. OF CONSUMER ADVOCACY  
DEPT. OF COMMERCE AND  
CONSUMER AFFAIRS  
STATE OF HAWAII

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Docket No. 03-0275  
Decision and Order No. **21644**

DECISION AND ORDER

The commission approves a general rate increase of \$238,500, or 8.31 per cent over revenues at present rates for HAWAII WATER SERVICE COMPANY, INC. ("HWSCI" or "HWSC"), based on a total revenue requirement of \$3,105,840 for the test year, and a rate of return of 8.7 per cent. In so doing, the commission approves in part, and denies in part, the "Stipulation of the Parties in Lieu of Evidentiary Hearing," jointly filed by HWSCI and the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate")(collectively, the "Parties"), on January 7, 2005 (the "Stipulation"). The commission specifically: (A) disallows the inclusion of the costs of HWSCI's proposed two (2) new wells in HWSCI's plant-in-service for the July 1, 2004 to June 30, 2005 test year; (B) rejects the proposed rate design; and (C) instructs HWSCI to submit a new rate schedule for the commission's review and approval, consistent with the terms of this Decision and Order.



I.

Introduction

A.

Hawaii Water Service Company, Inc.

HWSCI, fka KAA NAPALI WATER CORPORATION ("KWC"), is a public utility that provides water service in its service area of Kaanapali, island of Maui, pursuant to a commission-issued certificate of public convenience and necessity ("CPCN"). HWSCI, a Hawaii corporation, is a wholly-owned subsidiary of California Water Service Group ("CWSG"), a holding company incorporated in Delaware.<sup>1</sup> Besides HWSCI, CWSG's operating subsidiaries include California Water Service Company (water service), New Mexico Water Service Company (water and wastewater services), and Washington Water Service Company (water service).

HWSCI pumps its water from two (2) sources: (1) the Honokowai aquifer, located underneath HWSCI's service territory; and (2) the Honolulu aquifer. Maui Land and Pine Company Inc. ("MLP") is the owner of the lands above the Honolulu aquifer.

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<sup>1</sup>Decision and Order No. 6230, filed on June 9, 1980, in Docket No. 3700 (CPCN). Amfac, Inc., the initial owner of KWC, sold its outstanding stock of KWC to AquaSource Utility, Inc. ("AquaSource"), a Texas corporation, in 1999. See Decision and Order No. 16993, filed on May 21, 1999, in Docket No. 99-0056. In May 2003, CWSG: (1) closed on its purchase of all the outstanding stock of KWC; and (2) changed the entity's name to HWSCI. See Decision and Order No. 20102, filed on March 27, 2003, in Docket No. 02-0372; and HWSCI's counsel's letter, dated May 6, 2003.

HWSCI pumps its water from seven (7) wells, including wells P-4, P-5, and P-6.<sup>2</sup> The latter three (3) wells, P-4, P-5, and P-6, collectively, are known as the Mahinahina wells.

HWSCI pays MLP a monthly charge based on the amount of water drawn from the Mahinahina wells, pursuant to a water licensing agreement. HWSCI states that this purchased water expense represents a fee to use MLP's land for the three (3) well sites, a future well site, a replacement well site (to re-locate wells if necessary), and rights-of-way for HWSCI's pipelines. Moreover, the Mahinahina wells are: (1) approximately twice as productive as HWSCI's other wells;<sup>3</sup> and (2) "the preferable water source, particularly given the level of chlorides in the water pumped from the Honokowai aquifer[.]"<sup>4</sup>

In addition to its existing wells, HWSCI's water system consists of pumps, pipelines, a granular activated carbon ("GAC") water treatment plant, and other plant-related equipment listed in Exhibit J of its Application.<sup>5</sup> The GAC treatment plant, constructed in 2000 at an estimated cost of \$1.1 million, treats the groundwater from the Honolua aquifer by removing organic contaminants.

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<sup>2</sup>HWSCI's responses to CA-IR-2 (HWSCI's service area map) and CA-SIR-2 (HWSCI's color-coded service area map); HWSC-RT-200, at 6 (rebuttal testimony of HWSCI's general manager); and HWSC-RT-205.

<sup>3</sup>HWSC-RT-200, at 6 (rebuttal testimony of HWSCI's general manager).

<sup>4</sup>HWSC-RT-100 at 6 (rebuttal testimony of HWSCI's vice president).

<sup>5</sup>See footnote 7, below.

HWSCI's future capital projects include the installation of two (2) new wells.

HWSCI provides water service to resort and residential developments, the latter consisting of the Kaanapali Golf Estates, Kaanapali Hillside, Kaanapali Vista, Kai Ala, and Royal Kaanapali Estates.<sup>6</sup>

HWSCI's customers are served by various meter sizes. During 2003, HWSCI distributed a daily average of 2.8 million gallons of water to its customers.

B.

HWSCI's Request

HWSCI requests the commission's approval to increase its water rates and revise its rate schedules.<sup>7</sup> HWSCI seeks an increase of approximately \$637,890, or 22.35 per cent, over revenues at present rates. The requested increase is based on an estimated total revenue requirement of \$3,491,981 for the July 1, 2004 to June 30, 2005 test year ("test year"), and a rate of return of 8.63 per cent.

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<sup>6</sup>HWSCI's response to CA-IR-5. The condominium projects served by HWSCI are the International Colony Club; Kaanapali Alii; Kaanapali Royal; The Masters; Maui Eldorado; Maui Kaanapali Villas; The Plantation; and The Whaler. HWSCI's response to CA-RIR-16(a). The hotels served by HWSCI are the Hyatt Regency Maui Resort and Spa; Kaapanali Beach Hotel; Maui Marriott Resort; Royal Lahaina Resort; Sheraton Maui; and Westin Maui Resort and Spa. Id.

<sup>7</sup>HWSCI's Application, Verification, Exhibits A - O, Direct Testimonies HWS-1 and HWS-2, and Certificate of Service, filed on February 26, 2004, as amended by HWSCI's correspondence, dated March 4, 5, and 19, 2004, and April 12, 2004 (collectively, the "Application").

HWSCI makes its request pursuant to Hawaii Revised Statutes ("HRS") §§ 269-12(c), 269-16, and Hawaii Administrative Rules ("HAR") § 6-61-87.

HWSCI's most recent general increase in its water rates was in 1995.<sup>8</sup> HWSCI represents that, since its last increase: (1) its annual operating expenses have increased by approximately \$565,000; (2) it has completed significant capital improvement projects; and (3) it proposes to complete certain additional capital improvement projects.

HWSCI requests that its general rate increase and revisions to its rate schedules take effect by increasing its: (1) applicable monthly standby charge, based on each customer's meter size, across-the-board by approximately 22.4 per cent; and (2) monthly water consumption charge, from \$2.49 per 1,000 gallons ("TG") of water to \$3.05 per TG of water, i.e., approximately 22.5 per cent.

HWSCI also proposes to modify the terms of its Automatic Power Cost Adjustment Charge, set forth in Rule XXIX of its tariff, to reflect the cost of electricity currently in effect. Thus, HWSCI proposes an electricity cost factor of \$0.794 per TG of water.

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<sup>8</sup>Decision and Order No. 13951, filed on June 13, 1995, in Docket No. 94-0056, *In re Kaanapali Water Corp.*

C.

Procedural Background

HWSCI served copies of its Application upon the Consumer Advocate. On March 17, 2004, the Consumer Advocate timely objected to the completeness of HWSCI's Application, pursuant to HRS § 269-16(d).<sup>9</sup> On March 19 and April 12, 2004, HWSCI responded to the Consumer Advocate's objection. The commission, by Order No. 20914, filed on April 16, 2004, held that "[c]onsistent with HRS § 269-16(d), the filing date of HWSCI's complete [A]pplication is April 12, 2004, the filing date of HWSCI's most recent correspondence that supplements its [A]pplication."<sup>10</sup>

On June 3, 2004, the commission held a public hearing on HWSCI's Application, at the Lahaina Intermediate School Cafeteria, pursuant to HRS §§ 269-12(c) and 269-16(b) and (c). At the public hearing, HWSCI's general manager and the Consumer Advocate orally testified and submitted written comments. In addition, numerous persons, in their individual capacities or representing certain businesses, homeowners' associations, and other private sector entities or organizations,

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<sup>9</sup>Consumer Advocate's preliminary position statement, filed on March 17, 2004.

<sup>10</sup>Order No. 20914, at 8. See also Consumer Advocate's letter, dated April 19, 2004 (based on HWSCI's April 12, 2004 letter, the Consumer Advocate no longer objects to the completeness of HWSCI's Application).

including the visitor and hotel industries, testified. The commission also received written comments by postal and electronic mail.

The Consumer Advocate and HWSOI proceeded with discovery. HWSOI responded to the Consumer Advocate's initial, supplemental, and rebuttal information requests, and the Consumer Advocate responded to HWSOI's information requests.

On September 24, 2004, the Consumer Advocate filed its direct testimonies and exhibits, and on October 26, 2004, HWSOI filed its rebuttal testimonies and exhibits.

On January 7, 2005, the Parties jointly filed their Stipulation. On January 21 and 28, 2005, HWSOI filed its responses to the commission's clarifying information requests, including its revised Exhibit A-1, consisting of its revised results of operation schedule.<sup>11</sup>

By their Stipulation, the Parties agree to: (1) an increase in HWSOI's revenues of \$238,500, or 8.31 per cent over revenues at present rates; and (2) a revenue requirement of \$3,105,840 for the test year, with a rate of return of 8.7 per cent. In addition, the Parties agree to a future step increase or increases of 8.28 per cent and 7.65 per cent, respectively, upon the installation of the first then

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<sup>11</sup>HWSOI's revised Exhibit A-1 corrects certain amounts. These corrected amounts, in turn, affect other amounts set forth in certain other areas of the Stipulation and the other exhibits attached to the Stipulation. HWSOI did not, however, submit any additional revised exhibits, other than its revised Exhibit A-1. The commission, thus, on its own motion, makes the necessary corrections and adjustments in this Decision and Order.

second proposed new wells. (The future step increases are discussed in Section IV, Two (2) New Wells, below.)

The nine (9)-month deadline governing the issuance of this Decision and Order, pursuant to HRS § 269-16(d), is February 25, 2005.<sup>12</sup> This Decision and Order addresses the Parties' Stipulation.<sup>13</sup>

## II.

### Issues

The underlying issue, as set forth in Stipulated Prehearing Order No. 21072, filed on June 23, 2004, as amended, is the reasonableness of HWSCI's proposed general rate increase. This involves, in turn, a review of the following sub-issues:

1. Are the proposed tariffs, rates, and charges just and reasonable?
2. Are the revenue forecasts for the test year at present and proposed rates reasonable?
3. Are the projected operating expenses for the test year reasonable?

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<sup>12</sup>See Order No. 21476, filed on November 26, 2004; Order No. 21491, filed on December 9, 2004; Order No. 21521, filed on December 29, 2004; and Order No. 21529, filed on January 6, 2005.

<sup>13</sup>The commission previously bifurcated HWSCI's financing request from its request for a rate increase. See Order No. 20914, filed on April 16, 2004. The commission approved HWSCI's request for financing, pursuant to HRS §§ 269-17 and 269-19. See Decision and Order No. 21211, filed on August 5, 2004; and Order No. 21340, filed on September 10, 2004.

4. Is the projected rate base for the test year reasonable, and are the properties included in the rate base used or useful for public utility purposes?
5. Is the requested rate of return fair?

### III.

#### The Parties' Stipulation

The Stipulation reflects the Parties' global settlement of all the issues, and their agreement to waive an evidentiary hearing. In reaching their global agreement, the Parties note:

1. The Stipulation, binding between them, "represent[s] compromises by the Parties to fully and finally resolve all issues in the subject docket on which they had differences for the purpose of simplifying and expediting the proceeding, and are not meant to be an admission by either of the Parties as to the acceptability or permissibility of matters stipulated to herein."<sup>14</sup>
2. They reserve their respective rights to proffer, use, and defend different positions, arguments, methodologies, or claims regarding the matters stipulated to herein, in other dockets or proceedings.
3. They "have stipulated to the various rate components and matters discussed in the [Stipulation] as being appropriate, without necessarily agreeing on the underlying methodologies or justifications asserted by the other Party."<sup>15</sup> Moreover, "nothing contained in this Stipulation shall be deemed to, nor be

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<sup>14</sup>Parties' Stipulation, at 7.

<sup>15</sup>Id.



interpreted to, set any type of precedent, or be used as evidence of either Parties' position in any future regulatory proceeding, except as necessary to enforce this Stipulation."<sup>16</sup>

4. Each provision of the Stipulation is in consideration and support of all other provisions, and is expressly conditioned upon the commission's acceptance of the Stipulation in its entirety.

"In the event the Commission declines to adopt parts or all of the matters agreed to by the Parties and set forth in this Stipulation, the Parties reserve the right to pursue any and all of their respective positions through further negotiations and/or additional filings and proceedings before the Commission."<sup>17</sup>

5. "[T]he Commission may take such steps and actions deemed necessary and appropriate to facilitate its review of this Stipulation, and to determine whether this Stipulation should be approved, including, but not limited to, issuing information requests and holding technical conferences."<sup>18</sup>
6. They agree that: (A) an evidentiary hearing is not necessary; and (B) "briefs are waived in this proceeding if this Stipulation is accepted by the Commission."<sup>19</sup>

The Parties also acknowledge that the Stipulation is subject to the commission's review and approval, and the commission is not bound by the Stipulation.

In this regard, it is well-settled that an agreement between the parties in a rate case cannot bind the commission, as the commission has an independent obligation to set fair and just rates and arrive at its own conclusion. *In re Hawaiian Elec. Co., Inc.*, 5 Haw. App. 445, 698 P.2d 304 (1985). With this

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<sup>16</sup>Id.

<sup>17</sup>Id. at 58.

<sup>18</sup>Id. at 59. See also id. at 2.

<sup>19</sup>Id. at 2 and 59.

mandate, the commission proceeds in reviewing the justness and reasonableness of the Parties' Stipulation.

#### IV.

##### Two (2) New Wells

HWSCI's water system includes seven (7) wells, and its future capital projects include the installation of two (2) new wells.

At the outset, the commission finds it prudent to review the Parties' agreement to include in rate base the costs associated with the installation of HWSCI's two (2) new wells, as part of a future step increase (one (1) well installed) or increases (two (2) wells installed).

HWSCI's justification for the new wells is described in its capital expenditures budget attached to its Application:

Additional source is necessary for growth and water quality issues. During times of high demand the existing wells are over-pumped, which results in undesirable water quality in terms of chlorides. Some of the hotels have complained numerous times about high chlorides in the water. Furthermore, new capacity is needed to serve the new residential developments currently being planned.<sup>20</sup>

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<sup>20</sup>See HWSCI's Application, Exhibits N, HWSCI's 2004 Capital Budget, dated December 2003; HWSCI's 2005 Capital Budget, dated December 2003; and HWSCI's Project Justification for 2004 General Rate Case (2004 and 2005 Capital Budgets). See also HWSC-2, at 9 - 10 (direct testimony of HWSCI's general manager); and HWSC-RT-200, at 7 - 8 (rebuttal testimony of HWSCI's general manager).

"The first new well will be sited in the Hanakoo district of Maui and in the vicinity of [HWSCI's] existing wells P-1 and P-2. The second well will be sited in the Mahinahina district of Maui and in the vicinity of [HWSCI's] existing wells P-4, P-5 and P-6."<sup>21</sup> The estimated cost for installing the two (2) new wells is \$3 million total, or \$1.5 million per well.

The Consumer Advocate, in its direct testimony, proposed to remove from HWSCI's test year plant-in-service the costs for installing the two (2) new wells. The Consumer Advocate asserted that HWSCI did not provide sufficient information to support its contention that the two (2) new wells will be constructed and placed in service during the test year.

In rebuttal, HWSCI: (1) defended the inclusion of the two (2) new wells in its rate base; and (2) stated that while it was uncertain as to when the wells will be placed in service, it "expects to incur substantial costs in connection with the new wells during the test year."<sup>22</sup>

The Parties subsequently agreed to resolve this issue, as follows:

To avoid including plant in rate base that may not be in service during the Test Year and to avoid HWSC and the Consumer Advocate expending resources to process another rate base solely to recognize the increase in revenue requirements resulting from the inclusion of the costs of the additional wells in rate base, HWSC and the Consumer Advocate have agreed to a simplified

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<sup>21</sup>HWSC-2 at 10 (direct testimony of HWSCI's general manager).

<sup>22</sup>HWSCI's rebuttal testimony, HWSC-RT-200, at 8. See also Parties' Stipulation, at 44.

procedure for reflecting the cost of the additional wells in rates. The agreement would allow HWSC to receive an increase in revenue requirement of \$257,300 or 8.28% if one of the wells is placed in service within twelve months after the issuance of the Commission's Decision and Order as discussed below. If HWSC is able to place the second well in service within this same time period, HWSC would be allowed an additional increase in revenue requirement of \$257,900 or 7.65%. The results of operation and supporting schedules with one well and with two wells are shown on Exhibits B and C, respectively. The effect of one and two wells on the revenue requirement is shown in Exhibit D.

. . . . .

Both [P]arties recognize that the circumstances that have led to this agreement regarding the step increases for plant additions that **may occur outside of the test year** and the subsequent increases in rates are **unusual**. It is, however, clearly in the best interest of ratepayers to have the additional new wells placed in service. To reiterate, the Parties gave serious consideration to the following issues:

Amount of the capital improvements compared to the size of HWSC,

Uncertainty of the in service date,

Need for improving water quality and reliability, and

Resources, including cost, associated with another general rate filing.

In weighing these issues, the Parties have agreed that HWSC should be authorized to file new rates that would reflect the revenue requirement associated with one or both of the additional wells, if one or both of the wells are placed in service within 12 months after the effective date of the Commission's decision in this general rate proceeding. Since the Consumer Advocate has agreed to this simplified procedure in part because of the uncertainty of the in service

date, the Consumer Advocate contends that the authority granted HWSC to implement rates for the additional wells should not be open ended and should terminate if not exercised within 12 months from the date of the Commission's Decision and Order in the instant proceeding.<sup>23</sup>

HWSCI's test year is from July 1, 2004 to June 30, 2005, in accordance with HAR § 6-61-87(4)(A). HRS § 269-16(b) provides in part that a public utility's rates "shall provide a fair return on the property of the utility actually used or useful for public utility purposes." As set forth in Issue No. 4, the commission must review whether HWSCI's projected rate base for the test year is reasonable, and whether the properties that are included in HWSCI's rate base used or useful for public utility purposes.

It is axiomatic that allowing the recovery of out-of-test year costs violates the test year concept.<sup>24</sup>

There appears no credible evidence in the docket record that the installation of one (1) or both new wells will be completed and used and useful during the test year. HWSCI is uncertain as to when the construction and installation of the

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<sup>23</sup>Parties' Stipulation, at 44 - 46 (footnotes and text therein omitted) (boldface added).

<sup>24</sup>Decision and Order No. 15480, filed on April 2, 1997, at 10, in Docket No. 94-0140, *In re Hawaii Elec. Light Co., Inc.* ("HELCO") (HELCO's 1996 test year rate case). See also Decision and Order No. 17237, filed on September 14, 1999, at 5 - 6, in Dockets No. 94-0298 and No. 95-0194, *In re GTE Hawaiian Tel. Co., Inc.* (quoting R. Hahne, G. Aliff, and Deloitte & Touché LLP, *Accounting for Public Utilities*, § 7.01 (October 1998)) (test year data); and Decision and Order No. 13762, filed on February 10, 1995, at 36 - 37, in Docket No. 7764, *In re HELCO* (HELCO's removal of a capital project from its plant-in-service due to the project's forecasted completion after the 1994 test year).

two (2) new wells will be completed and used and useful for the provision of water utility service.<sup>25</sup>

HWSCI states that: (1) it is still working on acquiring the new well sites; (2) it is not at the permitting stage; (3) to date, no project time lines are available to identify critical milestones that must be met to develop each new well; and (4) the proposed design capacities of the new wells have not been determined.<sup>26</sup> HWSCI, in essence, has yet to obtain any sites or commence construction of the new wells.

Yet, for purposes of compromise, the Parties agree to a future step increase (one (1) well at \$257,300 or 8.28 per cent) or increases (two (2) well at \$257,900 or 7.65%), in addition to the increase currently agreed-upon by the Parties for the test year. Moreover, the Parties agree to the future step increase or increases, even though the completion and used and useful use of one (1) or both new wells may occur outside of the test year, i.e., beyond June 30, 2005.

The Parties' agreement of an automatic future step increase or increases following the installation of one (1) or both new wells, even though the completion and used and useful use of the two (2) new wells may occur outside of the test year: (1) violates the test year concept; (2) is speculative; (3) sets a precedent this commission declines to establish; and (4) is

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<sup>25</sup>See HWSC-RT-200 at 8 (rebuttal testimony of HWSCI's general manager).

<sup>26</sup>HWSCI's responses to CA-IR-50, CA-IR-52, CA-RIR-5(b), and CA-RIR-11.

neither just nor reasonable under the circumstances. Moreover, if HWSOI believes that it is entitled to a future rate increase for future capital projects completed beyond the test year, State of Hawaii ("State") law affords HWSOI's ratepayers the opportunity to review and comment on any such future request, in accordance with HRS §§ 269-12(c) and 269-16(b) and (c).

The commission recognizes that the Parties' Stipulation is "expressly conditioned upon [the commission's] acceptance . . . of the matters expressed in this Stipulation in their entirety."<sup>27</sup> Nonetheless, consistent with its independent obligation to set just and reasonable rates and arrive at its own conclusion, the commission denies this portion of the Parties' Stipulation involving the future step increase or increases.<sup>28</sup> The Parties are cognizant that the commission is not bound by the terms of the Stipulation.

The commission, in this instance, will not reject the Parties' Stipulation *in toto*. Instead, upon the commission's issuance of this Decision and Order, the Parties "reserve the

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<sup>27</sup>See Parties' Stipulation, at 58, Section IV, Stipulation as a Whole.

<sup>28</sup>The commission also rejects the proposed rate design. See Section IX, Rate Design, below.

right to pursue any and all of their respective positions through further negotiations and/or additional filings and proceedings before the Commission."<sup>29</sup>

In sum, the commission disallows the inclusion of the costs of the two (2) new wells in HWSCI's test year plant-in-service. With this ruling, the commission now proceeds with reviewing the justness and reasonableness of the Parties' agreement of the current test year increase in HWSCI's rates, in the absence of the two (2) new wells. HWSCI confirms that the proposed increase in revenues of \$238,500, or 8.31 per cent over revenues at present rates, does not include the costs of the two (2) new wells in HWSCI's plant-in-service.<sup>30</sup>

## V.

### Operating Revenues

HWSCI's present and proposed rate designs consist of the: (1) applicable monthly standby charge, based on each customer's meter size; and (2) monthly water consumption charge, based on the amount of each customer's water usage.

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<sup>29</sup>Parties' Stipulation, at 58, Section IV, Stipulation as a Whole.

<sup>30</sup>HWSCI's response to PUC-IR-103. In other words, HWSCI's revised Exhibit A-1, which the commission proceeds to review, excludes the costs of both new wells.



A.

Meter Revenues  
(Standby Charge)

HWSCI "counts each meter as a separate account, even if several meters are owned by a single customer."<sup>31</sup> The Parties stipulate to 509 as the total number of customer accounts for the test year, comprising the following customer classes:<sup>32</sup>

|               |  |
|---------------|--|
| Residential:  | 423 accounts.                                      |
| Commercial:   | 13 accounts.                                       |
| Condominiums: | 38 accounts, consisting of eight (8) condominiums. |
| Hotels:       | 17 accounts, consisting of six (6) hotels.         |
| Other:        | 18 accounts.                                       |

The Parties' customer account information represents the most recently available information,<sup>33</sup> and updates the customer account information on file in this docket.<sup>34</sup>

Based on the agreed-upon number of customer accounts, above, the corresponding meter size for each customer account was determined.<sup>35</sup> Next, the meter revenues for the test year at

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<sup>31</sup>HWSCI's letter, dated March 4, 2004.

<sup>32</sup>Parties' Stipulation, Exhibit A-2.

<sup>33</sup>HWSCI's response to PUC-IR-201 and Attachment PUC-IR-201.

<sup>34</sup>See HWSCI's response to CA-SIR-10(a) (account information, as of June 2004); and HWSCI's responses to CA-RIR-15 and CA-RIR-16 (updated customer information, as of September 30, 2004).

<sup>35</sup>HWSCI's response to PUC-IR-201 and Attachment PUC-IR-201.

present rates were calculated, for each meter size, based on HWSOI's present standby charge for each meter size, as follows:<sup>36</sup>

Standby Charge

| <u>Meter Size</u>                 | <u>Customer Accounts</u> | <u>Revenues</u> |
|-----------------------------------|--------------------------|-----------------|
| 5/8"                              | 355                      | \$46,860        |
| 3/4"                              | 22                       | \$2,904         |
| 1"                                | 53                       | \$10,176        |
| 1-1/2"                            | 8                        | \$4,800         |
| 2"                                | 43                       | \$38,700        |
| 3"                                | 9                        | \$31,320        |
| 4"                                | 13                       | \$66,300        |
| 6"                                | 5                        | \$97,800        |
| 8"                                | 1                        | <u>\$28,680</u> |
| Total Revenues,<br>Meter Charges: |                          | \$327,540       |

B.

Consumption Charge

The Parties stipulate to a forecast of 1,020,000 TG of total water sales for the test year, as follows:<sup>37</sup>

|               |                  |
|---------------|------------------|
| Residential:  | 179,010 TG       |
| Commercial:   | 49,327 TG        |
| Condominiums: | 254,267 TG       |
| Hotels:       | 508,420 TG       |
| Other:        | <u>28,976 TG</u> |
| Total:        | 1,020,000 TG     |

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<sup>36</sup>Id. As one (1) example, for the 5/8" meter size: 355 customer accounts multiplied by the present monthly standby charge of \$11, multiplied by twelve (12) months, equals \$46,860. Id.

<sup>37</sup>See HWSOI's responses to PUC-IR-202 and PUC-IR-203. See also Parties' Stipulation, Exhibit A-2.

Based on these figures, the Parties stipulate to the following test year consumption charge revenues:<sup>38</sup>

Consumption Charge  
(per TG of water)

| <u>Customer Class</u>           | <u>Revenues</u> |
|---------------------------------|-----------------|
| Residential                     | \$445,735       |
| Commercial                      | \$122,824       |
| Condominiums                    | \$633,125       |
| Hotels                          | \$1,265,966     |
| Other                           | <u>\$72,150</u> |
| Total Revenues,<br>Water Sales: | \$2,539,800     |

C.

Total Operating Revenues

The commission finds reasonable the Parties' test year estimates for operating revenues at present rates, as follows:

|                                   |                    |       |
|-----------------------------------|--------------------|-------|
| Total Revenues,<br>Meter Charges: | \$327,540          | 11.4% |
| Total Revenues,<br>Water Sales:   | <u>\$2,539,800</u> | 88.6% |
| Total:                            | \$2,867,340        | 100%  |

VI.

Expenses

HWSCI's expenses consist of four (4) categories:  
(1) operating and maintenance expenses; (2) taxes other than

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<sup>38</sup>See HWSCI's responses to PUC-IR-202 and PUC-IR-203. See also Parties' Stipulation, Exhibit A-2. As an example, 179,010 TG of residential water sales multiplied by the present water consumption charge of \$2.49 equals forecasted residential revenues of \$445,735 for the test year.

income taxes; (3) depreciation and amortization expense; and (4) income taxes.

At the outset, the Parties stipulate to the use of a 2.2 per cent inflation factor in calculating the test year expenses for the following accounts, without compounding between each account: outside services; repairs; travel and business; vehicles and equipment; expense allocation; and other expenses. The inflation factor represents the Honolulu Consumer Price Index ("CPI") of 2.2 per cent (composite) for 2004.<sup>39</sup>

The commission finds reasonable the Parties use of a 2.2 per cent inflation factor for the above-noted expense accounts.

A.

Operating and Maintenance Expenses

HWSCI's staff of seven (7) employees consists of its general manager and six (6) field workers. It intends to hire an additional employee, a customer service representative, during the test year. HWSCI also receives: (1) certain support services from its parent entity, CWSG, headquartered in San Jose, California; and (2) other support services from third-parties, including billing, refuse, electrical and pump maintenance, security, and water testing services.

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<sup>39</sup>In its direct testimony, the Consumer Advocate noted that no forecast of the CPI for Maui was available from the State Department of Business Economic Development and Tourism; Bank of Hawaii; or First Hawaiian Bank.

HWSCI presently operates out of a maintenance base yard. Because it shares the base yard with a resort maintenance company, HWSCI explains that the present space is inadequate for an office and customer service purposes. Thus, in addition to the maintenance base yard, it intends to rent office space during the test year.

HWSCI also draws a portion of its water source from the Mahinahina wells, situated on MLP-owned lands. HWSCI pays MLP a monthly charge based on the amount of water drawn from these wells, pursuant to a water licensing agreement (purchased water expense).<sup>40</sup>

The Parties stipulate to the following test year operating and maintenance expenses:

|                                 |                 |
|---------------------------------|-----------------|
| Salaries and Benefits           | \$522,800       |
| Outside Services                | \$33,400        |
| Customer Accounting             | \$8,200         |
| (fka Materials and Supplies)    |                 |
| Chemicals                       | \$28,400        |
| Water Treatment                 | \$67,500        |
| Purchased Power                 | \$891,200       |
| Telecommunications and Pager    | \$6,400         |
| Purchased Water                 | \$157,500       |
| Repairs and Maintenance         | \$29,700        |
| Rent                            | \$29,700        |
| Travel and Business             | \$2,600         |
| Vehicles and Equipment          | \$22,600        |
| Bad Debt                        | \$1,900         |
| Expense Allocation/InterCompany | \$73,500        |
| Other Expenses                  | <u>\$20,300</u> |
| Total                           | \$1,895,700     |

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<sup>40</sup>HWSCI asserts that: (1) KWC's negotiations with MLP that resulted in the water licensing agreement precede CWSG's acquisition of KWC, nka HWSCI; and (2) the fee paid by HWSCI to MLP was set many years ago, has only been modified by the CPI adjustments, and arises from an arms length transaction.

In general, the above-referenced expense amounts represent the normalized level of funds HWSCI will expend during the test year to operate and maintain its facilities and provide water service to its customers. The reasonable expenses incurred by HWSCI for processing this rate case are also included on an amortized basis.

The commission finds reasonable the Parties' stipulated amounts for operating and maintenance expenses.<sup>41</sup>

B.

Taxes Other Than Income Taxes

For HWSCI, taxes other than income taxes consist of: (1) property taxes; (2) the State Public Service Company ("PSC") tax, 5.885 per cent; and (3) State Public Utility fee, 0.5 per cent. The commission finds reasonable the Parties' stipulated amount of \$198,500 for taxes other than income taxes. This estimated sum consists of the following amounts:

|                           |                        |
|---------------------------|------------------------|
| Property taxes            | \$240                  |
| PSC tax (5.885%)          | \$182,779*             |
| Public Utility fee (0.5%) | <u>\$15,529*</u>       |
| Total                     | \$198,500<br>(rounded) |

\*Calculated based on HWSCI's projected revenue requirement of \$3,105,840.<sup>42</sup>

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<sup>41</sup>This finding of reasonableness is based in part on the Parties' good-faith belief during their settlement negotiations that the expenses for the new customer service representative and the rental of the new office space will be incurred by HWSCI during the test year, and reflects the compromises made by the Parties in reaching agreement on the test year operating and maintenance expense accounts as a whole.

<sup>42</sup>See Parties' Stipulation, revised Exhibit A-1 and Exhibit A-6 (as adjusted).

C.

Depreciation and Amortization

The Parties stipulate to depreciation expense of \$409,900 for the test year, based on the Parties' agreement on the plant-in-service amount for the test year (See Section VII, below). The commission finds reasonable this stipulated amount for depreciation expense.

D.

Income Taxes

Although HWSCI calculates its income taxes based on a consolidated tax return with CWSG, for ratemaking purposes the Parties agree to treat HWSCI as a "stand-alone" company. Under this methodology, the Parties thus agree to calculate HWSCI's federal income taxes based on the lower federal rate applicable to a "stand-alone" company. HWSCI also agrees to use the lower effective State income tax rate of 6.015 per cent, as proposed by the Consumer Advocate, in lieu of the 6.4 per cent rate HWSCI initially proposed.

The Parties' methodology for calculating income taxes is set forth in Exhibit A-5 (as adjusted) of the Stipulation, calculated based on HWSCI's net income at proposed rates.<sup>43</sup> The commission finds reasonable the Parties' stipulated amount of \$167,300 for income taxes.

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<sup>43</sup>See Parties' Stipulation, revised Exhibit A-1 and Exhibit A-5 (as adjusted).

VII.

Rate Base

Exhibit A-3 of the Stipulation sets forth the Parties' agreed-upon calculations for HWSCI's average test year rate base of \$4,958,530.<sup>44</sup> HWSCI's rate base consists of its plant-in-service, less accumulated depreciation (i.e., the net plant-in-service), net contributions in aid of construction ("CIAC"), and accumulated deferred income taxes, plus prorated general office and working cash at present rates, as follows:

Average Rate Base, Test Year

|                                   |                          |
|-----------------------------------|--------------------------|
| Plant-in-service                  | \$16,278,098             |
| Accumulated depreciation          | <u>(\$5,034,646)</u>     |
| Net plant-in-service              | \$11,243,452             |
| Net CIAC                          | (\$4,761,700)            |
| Accumulated deferred income taxes | (\$1,741,648)            |
| Prorated general office           | \$60,450                 |
| Working cash, present rates       | <u>\$157,975</u>         |
| Average Rate Base                 | \$4,958,530<br>(rounded) |

A.

Plant in Service

The stipulated plant-in-service amount reflects three (3) key compromises agreed-upon by the Parties for settlement purposes: (A) the two (2) new wells; (B) the two (2) new trucks; and (C) the GAC treatment plant.

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<sup>44</sup>See also Parties' Stipulation, revised Exhibit A-1; and HWSCI's response to PUC-IR-103.



1.

New Wells

For the reasons set forth in Section IV, above, the commission: (A) rejects the Parties' proposed future step increase or increases involving the proposed two (2) new wells; and (B) disallows the inclusion of said costs in HWSCI's test year plant-in-service. HWSCI confirms that the proposed test year increase, as reflected in revised Exhibit A-1, does not include the costs of the two (2) new wells in HWSCI's plant-in-service.<sup>45</sup>

2.

New Trucks

HWSCI does not object to the Consumer Advocate's removal of the costs associated with the purchase of two (2) new trucks, on the basis that HWSCI has deferred said purchase from the test year to 2006. Thus, HWSCI's test year plant-in-service does not include the cost of the two (2) new trucks (approximately \$51,800 total).

3.

GAC Treatment Plant

HWSCI explains that: (1) its GAC treatment plant removes certain contaminants from the Mahinahina wells; and (2) the production capacity of its Mahinahina wells is double

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<sup>45</sup>HWSCI's response to PUC-IR-103.

that of its wells in the Honokowai aquifer, HWSCI's only other water supply source.

The Consumer Advocate initially opposed the inclusion of the GAC treatment plant's costs in rate base, reasoning that: (1) the contaminants were not caused by HWSCI's ratepayers; and (2) HWSCI should "seek remuneration from the parties responsible for the contamination ('Potentially Responsible Parties', or 'PRPs'), such as [MLP] and the manufacturers of the chemicals."<sup>46</sup>

HWSCI countered that:

1. The GAC treatment plant is necessary to treat the water from the Mahinahina wells.

2. The treated water is tested and meets or exceeds State and federal drinking water standards.

3. The water supplied by the Mahinahina wells is critical to meeting the demands of HWSCI's customers, are approximately twice as productive as its other wells, and HWSCI is unable to meet its peak-day usage without these wells.

4. The Mahinahina wells are more productive than the wells that pump water from the Honokowai aquifer, located underneath HWSCI's service territory.

5. The treated water is the lowest cost alternative water supply for HWSCI.

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<sup>46</sup>'Parties' Stipulation, at 38 - 39. HWSCI has a pending first amended civil complaint (products liability and toxic tort) against certain defendants, including MLP, filed in the Second Circuit Court, on June 7, 2004. See HWSCI's response to CA-SIR-23(a). For purposes of the Stipulation, HWSCI and the Consumer Advocate refer to the defendants as the Potentially Responsible Parties ("PRPs").

6. The costs to treat the groundwater are prudently incurred and necessary to provide water service at the lowest cost.

7. The treatment of water containing contaminants is a common practice in the water industry, and other commissions allow the cost recovery of treatment plants.

8. To the extent that HWSCI is successful in recovering any monetary damages from the PRPs, HWSCI intends to "allocate all compensatory net proceeds (after litigation expense) to ratepayers by recording the appropriate amount to [CIAC]. If HWSC receives punitive or consequential damages, HWSC intends to share the net proceeds by recording the determined amount at such time."<sup>47</sup>

As a result of their settlement negotiations, the Parties state that:

1. The Consumer Advocate: (A) agrees that the Mahinahina well supply is needed to serve HWSCI's customers; (B) recognizes that treating the Mahinahina wells to remove the contaminants represents HWSCI's least cost alternative; and (C) accepts as reasonable HWSCI's water treatment costs.

2. Nonetheless, the Consumer Advocate expresses its concern that if all of the capital costs for the GAC treatment plant are included in HWSCI's rates, HWSCI will not have the incentive to continue seeking cost recovery from the PRPs.

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<sup>47</sup>Parties' Stipulation, at 40.

3. While HWSCI does not share the Consumer Advocate's concern, HWSCI, for settlement purposes, is willing to agree to a reduced amount in its rates for the GAC treatment plant, subject to later recovery.

4. Accordingly, the Parties "agree[] to recommend that 75% of the capital costs, including depreciation, for the GAC treatment plant should be included in rates at this time. The Consumer Advocate contends that excluding 25% of the capital costs for the GAC treatment plant, including depreciation, will provide sufficient financial incentive (approximately \$50,000 annually) for HWSC to continue pursuing cost recovery from the PRPs."<sup>48</sup>

5. The Parties further agree that: (A) HWSCI must track all costs associated with excluding twenty-five (25) per cent of the GAC treatment plant, including depreciation, in a memorandum account; and (B) HWSCI shall be reimbursed for any revenue requirement associated with excluding twenty-five (25) per cent of the GAC treatment plant, including depreciation, from any net proceeds from the on-going litigation against the PRPs.<sup>49</sup>

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<sup>48</sup>Id. at 41.

<sup>49</sup>As jointly defined by the Parties:

Net proceeds are defined as total proceeds less litigation expenses, including legal fees, expert witness fees, independent investigator fees, court costs, and related costs, such as travel, lodging, meals, copying, etc.

Id. at 42. In other words, "net proceeds are total proceeds less litigation expenses found to be reasonable." Id.

6. If there are insufficient net proceeds to fully recover the excluded revenue requirement, including depreciation, the Consumer Advocate agrees that HWSCI may seek recovery from ratepayers for the excluded GAC revenue requirement that HWSCI would have received from the effective date of the commission's decision that adopts the Parties' settlement. Concomitantly, the Consumer Advocate reserves its "right to oppose recovery from the ratepayers in such future proceeding."<sup>50</sup>

7. They agree: (A) to distribute any net proceeds received from the litigation, in a certain order;<sup>51</sup> and (B) that

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<sup>50</sup>Id. at 42.

<sup>51</sup>Verbatim:

1. Reimbursement to HWSC for the 25% GAC revenue requirement, including depreciation expense, excluded from rates.
2. Reimbursement to HWSC and ratepayers for any GAC revenue requirement and water treatment expenses after 1 above, as follows:
  - a. First, HWSC will be reimbursed for the revenue requirement and water treatment expenses it incurred prior to the effective date of rates for the Commission order in this proceeding that includes the GAC treatment plant and expenses in rates.
  - b. Next, ratepayers will be reimbursed for the revenue requirement and water treatment expenses in rates from the effective date of rates for the Commission order in this proceeding that includes the GAC treatment plant and expenses in rates.
  - c. Next, ratepayers will be reimbursed for future costs, including expenses, associated with treating water in the Mahinahina aquifer for DBCP and TCP.
3. Equal sharing between HWSC and ratepayers of any remaining proceeds, including consequential and punitive damages, after 1 and 2 above.

Id. at 42 - 43.

any reimbursement or sharing of the remaining proceeds for the ratepayers should be treated as a contribution that reduces HWSCI's rate base and revenue requirement.

In sum, by their settlement of the GAC treatment plant issue, "the Parties intend that the compensatory damages from the litigation only compensate HWSC for the costs it has borne or will bear associated with the GAC treatment plant and related expenses to remove DBCP and TCP contaminants that are not recouped from ratepayers, and the balance will be for the benefit of the ratepayers."<sup>52</sup>

The commission finds that the Parties' settlement of the GAC treatment plant issue represents a reasonable compromise. Thus, the commission finds reasonable: (1) the partial inclusion of the costs for the GAC treatment plant in HWSCI's plant-in-service, as stipulated to by the Parties; and (2) the Parties' agreement governing the treatment and distribution of funds received from HWSCI's pending litigation against the PRPs.

On a semi-annual basis, HWSCI shall inform the commission and Consumer Advocate in writing, on the progress of its efforts in seeking recovery from the PRPs.

B.

Accumulated Depreciation  
and Net Plant-in-Service

Given the agreed-upon amount of \$16,278,098 for HWSCI's plant-in-service, the Parties stipulate to: (1) accumulated

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<sup>52</sup>Id. at 43.

depreciation of \$5,034,646; and (2) a net plant-in-service balance of \$11,243,452. The commission finds reasonable these agreed-upon amounts of \$5,034,646 and \$11,243,452, respectively.

C.

Net CIAC

The Parties stipulate to a net CIAC balance of \$4,761,700. The commission finds reasonable this stipulated amount.

D.

Accumulated Deferred Income Taxes

The Parties stipulate to \$1,741,648 as the appropriate amount for accumulated deferred income taxes. The commission finds reasonable this stipulated amount.

E.

Prorated General Office

HWSCI's parent entity, CWSG, headquartered in San Jose, California, shares certain services with HWSCI, "including corporate oversight, management, accounting, regulatory, and legal services[.]"<sup>53</sup> CWSG's corporate headquarters are referred to as "General Office."<sup>54</sup> HWSCI explains that in California Water Service Company's ("CWSC") last general rate case before the California Public Utilities Commission, the rate base associated

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<sup>53</sup>HWSCI's response to PUC-IR-104.

<sup>54</sup>Id.

with CWSG's corporate headquarters was \$24,001,900, of which 91.5 per cent was allocated to CWSC's customers, with the remaining 8.5 per cent (approximately \$2,040,200) allocated to CWSG's other subsidiaries, including HWSCI.

That said, the Parties stipulate to an allocation of \$60,450 for HWSCI. The commission finds reasonable this stipulated amount.

F.

Working Cash

Working cash represents the sum that HWSCI's investors must supply for HWSCI to meet current obligations incurred in providing water services, pending the receipt of revenues on account of these services. HWSCI is entitled to a return on such services.

The Parties stipulate to a working cash balance of \$157,975 under the 1/12<sup>th</sup> methodology. This amount represents 1/12 of HWSCI's operating and maintenance expenses for the test year.<sup>55</sup> The commission finds reasonable the stipulated amount of \$157,975 for working cash.

G.

Average Rate Base

The commission finds reasonable the Parties' stipulated average test year rate base of \$4,958,530. This amount, HWSCI

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<sup>55</sup>\$1,895,700 divided by 12 = \$157,975.



confirms, does not include the costs of the two (2) new wells.<sup>56</sup> It also excludes the costs of the two (2) new trucks, and includes approximately seventy-five (75) per cent of the costs for the GAC treatment plant.

#### VIII.

##### Rate of Return

The Parties stipulate to the following capital structure, costs of debt and equity, and rate of return for the test year:

|        | <u>Rate Base</u>   | <u>Ratio</u> | <u>Cost</u> | <u>Weighted Cost</u> |
|--------|--------------------|--------------|-------------|----------------------|
| Debt   | \$2,380,094        | 48%          | 6.77%       | 3.2496%              |
| Equity | <u>\$2,578,435</u> | 52%          | 10.65%      | <u>5.538%</u>        |
|        | \$4,958,530        |              |             | 8.7% (rounded)       |

#### A.

##### Capital Structure

HWSCI initially proposed a capital structure of forty (40) per cent debt and sixty (60) per cent equity, based on the actual capital structure it intended to implement upon the commission's approval of its financing request. The Consumer Advocate, by contrast, proposed a hypothetical capital structure of sixty (60) per cent debt and forty (40) per cent equity, raising concerns: (1) that HWSCI's proposed capital structure reflects a high level of equity that unnecessarily raises the costs of service to ratepayers; and (2) of the

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<sup>56</sup>HWSCI's response to PUC-IR-103.

possible inclusion of an acquisition premium that is reflected in HWSCI's capitalization.

In rebuttal, HWSCI asserted that: (1) the Consumer Advocate's position ignored the commission's ruling that precluded HWSCI from issuing long-term debt, except on a going-forward basis;<sup>57</sup> and (2) the commission's ruling resulted in HWSCI having a capital structure of one hundred (100) per cent equity and zero (0) per cent long-term debt, as of the beginning of the test year.

As a result of their settlement discussions, the Parties agree to use a capital structure of forty-eight (48) per cent debt and fifty-two (52) per cent equity for the test year. In stipulating to this capital structure, the Parties note that: (1) CWSG has a target capital structure of fifty-two (52) to fifty-four (54) per cent equity, which compares favorably with the capital structures of large regulated water utilities; and (2) while HWSC serves a resort area, its parent CWSG, unlike typical resort systems, is only in the water business.

B.

Cost of Debt

With the Parties' agreement to utilize CWSG's capital structure in lieu of HWSCI's actual capital structure, which has a significantly higher equity ratio, the Parties stipulate to using CWSG's weighted cost of debt of 6.77 per cent.

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<sup>57</sup>Decision and Order No. 21211; and Order No. 21340.

C.

Cost of Equity

HWSCI initially proposed an eleven (11) per cent return on equity, which the Consumer Advocate proposed reducing to 10.39 per cent, on the basis that HWSCI should utilize the cost of equity of only comparable-sized water utilities, to the exclusion of electric and gas utilities. HWSCI countered that: (1) the Consumer Advocate should not limit the comparable group of utilities solely to the water industry because doing so assumes that water utility investors only invest in water utilities; and (2) its assuming the risks of litigation against the PRPs to the ratepayers benefit should be given considerable weight in determining HWSCI's authorized return on equity.

As a result of their settlement discussions, the Parties stipulate to a return on equity of 10.65 per cent. This amount, the Consumer Advocate notes, is "based on [its] specific analysis of water utilities presented in a recent rate proceeding for another utility authorized to provide service in Hawaii."<sup>58</sup> The agreed-upon amount also takes into consideration HWSCI's aggressive attempts to recover the treatment costs associated with the contaminants from the PRPs.

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<sup>58</sup>Parties' Stipulation, at 52. The Consumer Advocate is referring to Docket No. 03-0025, *In re Hawaii-American Water Co., Inc.* See CA-T-1, at 27 - 28.

D.

Weighted Cost of Capital

Based on the Parties' stipulated capital structure and costs of debt and equity, the Parties' calculated rate of return is 8.7 per cent.

This stipulated amount is: (1) based on HWSCI's hypothetical capital structure, as agreed upon by the Parties; (2) consistent with the 8.85 per cent rate of return approved by the commission in two (2) recent wastewater utility rate cases;<sup>59</sup> and (3) lower than the ten (10) per cent rate of return approved by the commission in other water and wastewater utility cases.<sup>60</sup> The commission finds that the stipulated rate of return of 8.7 per cent is fair.

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<sup>59</sup>*In re Puhi Sewer & Water Co., Inc.*, Decision and Order No. 21312, filed on August 17, 2004, in Docket No. 03-0383; and *In re Hawaii-American Water Co., Inc.*, Decision and Order No. 20966, filed on May 6, 2004, in Docket No. 03-0025.

<sup>60</sup>See, e.g., *In re Mosco, Inc.*, Decision and Order No. 21193, filed on August 3, 2004, in Docket No. 03-0440 (9.83 per cent); *In re Mauna Lani STP, Inc.*, Decision and Order No. 20405, filed on August 29, 2003, in Docket No. 02-0392; *In re Waikoloa Sanitary Sewer Co., Inc., dba West Hawaii Sewer Co.*, Decision and Order No. 19223, filed on February 27, 2002, in Docket No. 00-0440; *In re Waikoloa Resort Util., Inc., dba West Hawaii Util. Co.*, Decision and Order No. 16372, filed on June 9, 1998, in Docket No. 96-0366; and *In re Princeville Util. Co., Inc.*, Decision and Order No. 16053, filed on November 4, 1997, in Docket No. 95-0172.

IX.

Rate Design

The Parties' proposed rate design for the agreed-upon rate increase that excludes both new wells from HWSCI's rate base, is attached as Exhibit F-1 to the Stipulation:

Monthly Standby Charge

| <u>Meter Size</u> | <u>Present Charge</u> | <u>Stipulated Charge</u> |
|-------------------|-----------------------|--------------------------|
| 5/8"              | \$11                  | \$16.75                  |
| 3/4"              | \$11                  | \$16.75                  |
| 1"                | \$16                  | \$24.40                  |
| 1-1/2"            | \$50                  | \$76.15                  |
| 2"                | \$75                  | \$114                    |
| 3"                | \$290                 | \$442                    |
| 4"                | \$425                 | \$647                    |
| 6"                | \$1,630               | \$2,482                  |
| 8"                | \$2,390               | \$3,635                  |

Monthly Water Consumption Charge

(per TG of water)

| <u>Present Charge</u> | <u>Stipulated Charge</u> |
|-----------------------|--------------------------|
| \$2.49                | \$2.55                   |

In its response to the commission's clarifying PUC-IR-204, HWSCI attempts to clearly explain how the amounts for its new charges, above, were calculated and agreed-upon. HWSCI includes its Attachment PUC-IR-204 work paper as support.

HWSCI's Attachment PUC-IR-204 includes data that has not been updated to reflect the agreed-upon amounts and figures included in the Parties' Stipulation, HWSCI's revised Exhibit A-1, and HWSCI's responses to the commission's clarifying

information requests.<sup>61</sup> In addition, based in part on HWSCI's Attachment PUC-IR-204, a clear explanation by HWSCI of how the Parties calculated and agreed-upon the amounts for the new charges is lacking. Nonetheless, after painstaking review of the docket record, innumerable calculations, and reasonable inferences thereto, the commission comprehends HWSCI's methodology in deriving its new charges.

Based on the commission's understanding:

1. Of the \$238,500 increase in revenues, the Parties allocated \$61,200 to the consumption charge.<sup>62</sup> This allocated amount of \$61,200, in turn, was divided by the stipulated amount of 1,020,000 TG of total water sales for the test year, to reach the amount of the consumption charge increase, i.e., \$0.06 per TG of water (from \$2.49 to \$2.55 per TG of water).

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<sup>61</sup>For example, Attachment PUC-IR-204 utilizes a residential customer account number of 421, when the Parties agreed-upon 423 as the stipulated amount. See Parties' Stipulation, Exhibit A-2; HWSCI's response to PUC-IR-102 (HWSCI confirms that the customer account numbers reflected in Exhibit A-2 are correct); and HWSCI's Attachment PUC-IR-201. In two (2) other examples: (1) the residential customer account number at the 5/8" meter size, appears incorrect; and (2) the 72,150 TG of water for the Other customer class is also erroneous. The Parties' stipulated to 28,976 TG of water for the Other customer class under the test year.

<sup>62</sup>See Parties' Stipulation, revised Exhibit A-1, revenues for water sales, additional amount.

2. The remaining increase in revenues, approximately \$171,097, was allocated to the standby/meter charge.<sup>63</sup> HWSCI's total revenues for its meter charge under present rates is \$327,540,<sup>64</sup> thus, its total revenues for its meter charge under proposed rates is \$498,637. Based on the ratio of HWSCI's total revenues at proposed and present rates, respectively, the factor of 1.5223 per cent was then computed.<sup>65</sup>

3. HWSCI's classification for meter charges consists of nine (9) categories, from 5/8" meters to 8" meters. The 1.5223 per cent factor was equally applied across-the-board to each of the nine categories, at present rates, to calculate the new stipulated rate amounts for each category, with rounding to the nearest \$0.05.<sup>66</sup>

4. Thus, the Parties allocated approximately: (A) 26.35 per cent of the increase in revenues, i.e., \$61,200, to the consumption charge; and (B) 73.65 per cent of the increase in revenues, i.e., \$171,097, to the standby/meter charge.

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<sup>63</sup>Although HWSCI claims that it used \$177,300, based on HWSCI's rounding of the stipulated meter rates, the more accurate figure is \$171,097. This decrease by HWSCI, the commission notes, is beneficial to HWSCI's ratepayers.

<sup>64</sup>See Section V(A), Meter Revenues, above; and the Parties' Stipulation, revised Exhibit A-1.

<sup>65</sup>498,637 divided by 327,540.

<sup>66</sup>As an example, the present meter rate for a 1" meter, \$16, was multiplied by 1.5223, in deriving the new stipulated meter rate of \$24.40.

HWSCI states that:

1. "The actual solution achieved was by trial and error."<sup>67</sup>

2. The stipulated rate design "will decrease the volatility of revenue to HWSC by changing the percentage of revenues collected from the [consumption] charge from 88% to 84%."<sup>68</sup>

3. The consumption charge "will still be high enough to support conservation."<sup>69</sup>

4. Its Attachment PUC-IR-204 shows that the impact of its proposed rate design does not unreasonably affect the various customer classes. "Residential customers would see an 8.68% increase on average, while hotels would receive a 7.85% increase on average."<sup>70</sup> The condominium and commercial

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<sup>67</sup>HWSCI's response to PUC-IR-204, at 5.

<sup>68</sup>Id. For HWSCI's total test year operating revenues under present rates, the ratio is approximately 11.4 per cent for the standby/meter charge, and 88.6 per cent for the consumption charge. See Section V(C), Total Operating Revenues, above.

The commission notes that HWSCI calculates its eighty-four (84) per cent figure, as follows: under the Parties' stipulated total new operating revenues of \$3,105,840, the ratio is approximately sixteen (16) per cent for the standby/meter charge, and eighty-four (84) per cent for the consumption charge.

<sup>69</sup>HWSCI's response to PUC-IR-204, at 5.

<sup>70</sup>Id. at 5 - 6. The commission finds that HWSCI's use of incorrect amounts for the residential class in its Attachment PUC-IR-204 does not appear to significantly affect the 8.68 per cent figure for the residential class.



classes, meanwhile, will experience increases on the average of 8.14 per cent and 8.83 per cent, respectively.<sup>71</sup>

Furthermore, in agreeing to the new rates, the Parties jointly explain:

[A]pproximately 88% of the present revenue requirement is recovered from the commodity rate and that applying a uniform percentage increase would increase the quantity rate revenue requirement even more. Accordingly, HWSC proposed a rate design that would increase the service charge revenues by a greater percentage than the quantity rate. HWSC's proposed rate design would increase the present revenue requirement recovered from service charges by 75% of the increase in the revenue requirement and increase the present revenue requirement recovered from quantity rates by 25% of the increase in the revenue requirement. . . . Furthermore, HWSC suggested that the target rate design for further rate changes should recover 100% of HWSC's variable costs (purchased water, purchased power, chemicals, and water treatment expenses) from the quantity rate and 50% of HWSC's fixed costs (all costs excluding variable costs). While the Consumer Advocate supports HWSC's proposal for the purpose of this settlement, the Consumer Advocate believes that, in addition to promoting the alignment of fixed cost recovery with fixed rates, conservation is an important function of rate design. Thus, future rate design changes should balance fixed cost recovery and conservation.

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<sup>71</sup>HWSCI, in its response to PUC-IR-204: (1) states that the increase on average for the Other customer class is 4.4 per cent; and (2) attempts to justify this low percentage increase for the Other customer class, in relation to the overall percentage increases for the commercial, condominium, hotel, and residential customer classes. That said, the commission finds that: (1) HWSCI's calculation of the 4.4 per cent figure is based on its erroneous use of 72,150 TG of water for the Other customer class; and (2) utilizing the correct amount of 28,976 TG of water for the Other customer class, the increase on average for this customer base is approximately 7.16 per cent.

At the public hearing, representatives from the visitor, hotel, and retail industries, homeowners' associations or organizations, and a person representing retirees, together with individual ratepayers, expressed their concerns with HWSOI's proposed rate increase, including the magnitude of the increases.<sup>72</sup> In essence, the testifiers urged the commission to proceed cautiously in its review of HWSOI's request, noting that the proposed increase in their water bills were not budgeted for, while other testifiers outright opposed HWSOI's proposed rate increase,<sup>73</sup> or suggested a nominal or phased-in increase.<sup>74</sup> One testifier, moreover, stated that HWSOI's rate structure provides no incentive to conserve water.<sup>75</sup>

HWSOI initially sought a 23.35 per cent increase in revenues over present rates. In disallowing the costs for the two (2) new wells, currently estimated at \$3 million, the commission, by this Decision and Order, approves an 8.31 per cent increase in HWSOI's revenues over present rates.

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<sup>72</sup>American Association of Retired Persons, South Maui Chapter; Classic Resorts; Hyatt Regency Maui Resort and Spa; County Councilmember; Kaanapali Hillside Homeowners' Association; Kaanapali Hillside resident; Kaanapali Operations Association, Inc.; Lahaina resident; Maui Hotels Association; Maui Marriott Resort; Sheraton Maui; Starwood Corporation; Starwood Hotel and Resorts; Vintage Homeowners' Association; Westin Maui Resort and Spa; and Whalers Village Fine Shops & Restaurants.

<sup>73</sup>Classic Resorts; Kaanapali Hillside Homeowners' Association; Sheraton Maui; Starwood Corporation; and Whalers Village Fine Shops & Restaurants.

<sup>74</sup>County Councilmember; Kaanapali Hillside resident; and a Lahaina resident.

<sup>75</sup>Kaanapali Hillside Homeowners' Association.

The stipulated rate design proposes to implement HWSCI's approved revenue increase by increasing the: (1) applicable monthly standby charge, based on each customer's meter size, across-the-board by approximately fifty-two (52) per cent; and (2) monthly water consumption charge by 2.4 per cent.

The agreed-upon percentage increases for each of the rate classifications (meter vs. consumption) substantially differ from the proposed percentage increases HWSCI initially represented to its ratepayers. Specifically, HWSCI's Application, the Notice of Public Hearing, and the notice HWSCI sent to its customers informed them that HWSCI proposed to increase its charges as follows: (1) increasing the applicable monthly standby charge, based on each customer's meter size, across-the-board by approximately 22.4 per cent; and (2) increasing the monthly water consumption charge approximately 22.5 per cent.<sup>76</sup>

In practical terms:

1. The commission approves an 8.31 per cent increase in HWSCI's revenues at present rates, and denies HWSCI's 22.35 per cent increase, as initially proposed.

2. Yet, under the proposed rate design, the ratepayers' monthly fixed standby charge will increase by 52 per cent per meter, regardless of the amount of water used. By

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<sup>76</sup>At the same time, the commission is cognizant that its Notice of Public Hearing advises that "the increases in rates and charges to be finally approved by the Commission, if any, may be higher or lower than HWSCI's proposed rates and charges[.]"

contrast, under HWSOI's initial rate design, HWSOI proposed to increase the monthly fixed standby charge by 22.4 per cent per meter (in the event the commission approved HWSOI's request for an overall 22.35 per cent increase in its revenues over present rates.)<sup>77</sup>

In the commission's view, the stipulated rate design represents a major shift towards recovering HWSOI's operating revenues through the fixed monthly standby charge, in the absence of credible cost support. Indeed, HWSOI acknowledges that the proposed rate design (Exhibit F-1) was achieved, in large part, through "trial and error."

In addition, the proposed fifty-two (52) per cent increase in the fixed monthly standby charge, with the corresponding proposed 2.4 per cent increase in the monthly consumption charge, does not appear to encourage water conservation. Furthermore, such a disproportionate percentage increase in the fixed charge provides ratepayers with little opportunity to counter-balance the impact of the increase in rates by reducing their water use.

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<sup>77</sup>Ratepayers, in this instance, will understandably be puzzled as to why their monthly water charge increases by a minimum of fifty-two (52) per cent per meter, "right off the bat," when the overall increase in revenues approved by the commission is limited to 8.31 per cent. Moreover, ratepayers that utilize multiple meters on their respective properties, including all of the hotels and a majority of the condominiums and commercial establishments, will be impacted even more.

The commission finds that HWSOI has not met its burden of proving the justness and reasonableness of the stipulated rate design. Thus, the commission rejects the Parties' stipulated rate design.

HWSOI shall submit a new proposed rate design for the commission's review and approval, which implements the increase in revenues approved by this Decision and Order. In the absence of credible cost and allocation data, HWSOI is advised to submit a rate design that proposes a uniform, across-the-board (fixed and variable) percentage increase, or closely aligned thereto.<sup>78</sup> HWSOI shall: (1) clearly explain its calculations; and (2) include all supporting work papers, utilizing correct amounts, figures, and calculations thereto.

X.

HWSOI's Tariff Rules

A.

Rule III(3)

HWSOI agrees to add certain language to its Rule III(3), relating to notice of service shut-offs, in response to the Consumer Advocate's recommendation:

The Company reserves the right at any and all times to shut off water from the mains without notice for the purpose of making repairs, extensions, alterations, or for other reasons

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<sup>78</sup>HWSOI is also advised that, for its future applications seeking a general increase in its rates that attempt to shift its cost recovery to the fixed standby/meter charge, a cost study to justify such a shift should assist the commission in its rate review process.

related to the operation of water service and will not be responsible nor liable for any property loss or damage incurred by the consumer due to such interruption of service. Except in the case of emergency repairs, the Company shall use its best efforts to give the Customer at least 24 hours notice before shutting off service. . . .<sup>79</sup>

B.

Rule VIII(1)

HWSCI also agrees to add certain language to its Rule VIII(1), relating to the acceptable methods of payment, in response to the Consumer Advocate's recommendation:

Payment shall be made in cash at the office of the Company, or by personal check, cashier's check, or money order, in person or by U.S. mail, at the office of the Company, or at the Company's option, to duly authorized collectors of the Company.<sup>80</sup>

C.

Rule XXIX

HWSCI proposes to modify the terms of its Automatic Power Cost Adjustment Charge ("APCAC"), set forth in Rule XXIX of its tariff, to reflect the cost of electricity currently in effect.

HWSCI initially proposed an electricity cost factor of \$0.794 per TG gallons of water. The Consumer Advocate recommended that HWSCI revise the APCAC to \$0.7864, consistent with the Consumer Advocate's proposed revisions to: (1) purchased

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<sup>79</sup>Stipulated additions underscored.

<sup>80</sup>Stipulated additions underscored.

power expenses; and (2) the revenue tax factor, from 4.5 per cent to 6.82 per cent. As part of the Stipulation, HWSCI concurs with the Consumer Advocate's amount of \$0.7864.

D.

Tariff Revisions

The commission finds reasonable the Parties' agreed-upon revisions to tariff Rules III(3), VIII(1), and XXIX, above.

XI.

Approval in Part, Denial in Part

This rate filing represents HWSCI's (fka KWC) first application for a general increase in its rates since 1995. Since its last rate increase, HWSCI's normalized level of operating and maintenance expenses have increased, and HWSCI has completed certain capital improvement projects. HWSCI asserts that the Stipulation gives it an opportunity to recover its operating expenses and income under the terms of the settlement.

Based on the reasons set forth in this Decision and Order, the commission approves in part, and denies in part, the Parties' Stipulation. That said, the commission makes clear that its partial approval of the Stipulation, or any of the methodologies used therein, may not be cited as precedent in any future proceeding. Conversely, the denial of the other portions of the Stipulation: (1) represents reasoning based on sound

ratemaking principles; and (2) may be referred or cited to in future commission proceedings.

## XII.

### Ultimate Findings and Conclusions

The commission finds and concludes:

1. The operating revenues and operating and maintenance expenses for the test year, as set forth in Exhibit 1, attached, are reasonable.

2. The use of an average test year rate base is reasonable.

3. The test year average depreciated rate base under present and approved rates is \$4,958,530.

4. The stipulated rate of return for the test year is 8.7 per cent, which is fair.

5. HWSCI is entitled to an increase in revenues of \$238,500, or 8.31 per cent over revenues at present rates.

6. HWSCI's proposed revisions to its tariff Rules III(3), VIII(1), and XXIX, are reasonable.

7. The inclusion of the costs of the proposed two (2) wells in HWSCI's test year plant-in-service: (A) violates the test year concept and HRS § 269-16(b); and (B) is neither just nor reasonable.

8. The stipulated rate design is neither just nor reasonable under the circumstances, and is unsupported by the docket record.



9. The commission's issuance of this Decision and Order renders moot the issuance of an Interim Decision and Order.

#### XIII.

##### Orders

##### THE COMMISSION ORDERS:

1. The Parties' waiver of an evidentiary hearing is approved.

2. The Parties' Stipulation is approved in part, and denied in part, as explained in this Decision and Order. In particular: (A) the inclusion of the costs of the two (2) new wells in HWSOI's test year plant-in-service is disallowed; and (B) the Parties' proposed rate design is rejected.

3. HWSOI may increase its rates to produce a total annual revenue increase of \$238,500, as shown on Exhibit 1, attached, representing an increase in HWSOI's revenue requirement to \$3,105,840, or a rate of return of 8.7 per cent on its rate base for the test year. The effective date of HWSOI's increase in its rates, consistent with Paragraph 4, below, will be determined later.

4. No later than February 22, 2005, HWSOI shall submit its new proposed rate design for the commission's review and approval, which implements the rate increase approved by this Decision and Order, with copies served upon the Consumer Advocate. HWSOI's filing shall address the specific concerns raised by the commission in Section IX, above. No later than February 28, 2005, the Consumer Advocate shall file its


comments on HWSCI's new proposed rate design. In the alternative, the Parties, at their option, may submit a joint, stipulated filing by February 22, 2005, for the commission's review and approval. HWSCI's individual or joint filing shall: (A) clearly explain its calculations; and (B) include all supporting work papers, utilizing correct amounts, figures, and calculations thereto. Further commission action will follow, including the designated effective date of HWSCI's new rate schedule.

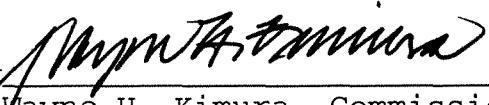
5. On a semi-annual basis, by June 30 and December 31 of each year, HWSCI shall file a status report, with copies served upon the Consumer Advocate, describing the progress of its efforts in seeking cost recovery in its pending litigation against the Potentially Responsible Persons. HWSCI, at its option, may file its status reports on a more frequent basis.

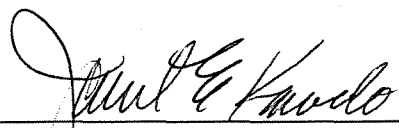
6. The issuance of this Decision and Order renders moot the issuance of an Interim Decision and Order.

DONE at Honolulu, Hawaii: FEB 11 2005.


PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

By   
Carlito P. Caliboso, Chairman

By   
Wayne H. Kimura, Commissioner

By   
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:

  
Michael Azama  
Commission Counsel

03-0275DOR.sl

## Exhibit 1

**DOCKET NO. 03-0275**  
**REVENUE REQUIREMENTS**  
**TEST YEAR ENDED JUNE 30, 2005**

|                                       | <b>Present<br/>Rates</b>   | <b>Additional<br/>Amount</b> | <b>Approved<br/>Rates</b>  |
|---------------------------------------|----------------------------|------------------------------|----------------------------|
| <b>REVENUES</b>                       |                            |                              |                            |
| Water Sales                           | \$ 2,539,800               |                              |                            |
| Meter Charges                         | 327,540                    |                              |                            |
| Others                                | -                          |                              |                            |
| <b>Total Operating Revenues</b>       | <u>\$ 2,867,340</u>        | <u>\$ 238,500</u>            | <u>\$ 3,105,840</u>        |
| <b>O &amp; M EXPENSES</b>             |                            |                              |                            |
| Wages, Benefits, & Payroll Tax        | \$ 522,800.00              |                              | \$ 522,800.00              |
| Outside Services                      | 33,400                     |                              | 33,400                     |
| Customer Accouting (Mat. & Supp.)     | 8,200                      |                              | 8,200                      |
| Chemicals                             | 28,400                     |                              | 28,400                     |
| Water Treatment Expenses              | 67,500                     |                              | 67,500                     |
| Purchased Power                       | 891,200                    |                              | 891,200                    |
| Telecommunications and Pagers         | 6,400                      |                              | 6,400                      |
| Purchased Water                       | 157,500                    |                              | 157,500                    |
| Repairs                               | 29,700                     |                              | 29,700                     |
| Rent Expense                          | 29,700                     |                              | 29,700                     |
| Travel and Business Expenses          | 2,600                      |                              | 2,600                      |
| Vehicles and Work Equipment           | 22,600                     |                              | 22,600                     |
| Bad Debt Expense                      | 1,900                      |                              | 1,900                      |
| Expense Allocation                    | 73,500                     |                              | 73,500                     |
| Misc. Expense                         | 20,300                     |                              | 20,300                     |
| <b>Total O &amp; M Expenses</b>       | <u>\$ 1,895,700.00</u>     | <u>0</u>                     | <u>\$ 1,895,700.00</u>     |
| <br>Taxes, Other Than Income          | <br>\$ 183,300.00          | <br>\$ 15,200.00             | <br>\$ 198,500.00          |
| Depreciation and Amortization Expense | 409,900                    |                              | 409,900                    |
| Income Taxes                          | 82,500                     | 84,800                       | 167,300                    |
| <b>Total Operating Expense</b>        | <u>\$ 2,571,400.00</u>     | <u>\$ 100,000.00</u>         | <u>\$ 2,671,400.00</u>     |
| <b>Operating Income</b>               | <u>\$ 295,940.00</u>       | <u>\$ 138,500.00</u>         | <u>\$ 434,440.00</u>       |
| <br><b>Average Rate Base</b>          | <br><u>\$ 4,958,530.00</u> |                              | <br><u>\$ 4,958,530.00</u> |
| <br><b>Return on Rate Base</b>        | <br><u>5.97%</u>           |                              | <br><u>8.7615%</u>         |

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21644 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

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Counsel for HAWAII WATER SERVICE COMPANY, INC.

  
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Karen Higashi

DATED: FEB 11 2005