

TABLE OF CONTENTS

I. Introduction.....2
A. Kaupulehu Water Company.....2
B. KWC's Water System.....3
C. KWC's Requests.....4

II. Procedural Background.....6
A. Sufficiency of the Application.....6
B. Information Requests.....7
C. Public Hearing.....8
D. Position Statements.....8

III. Issues9

IV. Results of Opertion Schedule.....9

V. KWC's Case-in-Chief.....11

VI. Consumer Advocate's Position.....11
A. Rate of Return and Revenue Requirement.....12
B. Revenue Requirement Components and Projections.....14

VII. Operating Revenues.....15

VIII. Expenses.....18
A. Operating and G&A Expenses.....21
B. Depreciation.....25
C. Taxes25
 1. Revenue Taxes26
 2. Income Taxes26

IX. Rate Base.....28

X. Rate of Return.....32

XI. Rate Design.....33

XII. Tariff Rules.....35
A. Power Cost Adjustment Charge.....35
B. Tariff Revisions Proposed by KWC.....37
C. Tariff Revisions Proposed by the Consumer Advocate..39

XIII. Findings and Conclusions.....43

XIV. Orders45

Exhibit 1

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
KAUPULEHU WATER COMPANY) Docket No. 05-0124
For a Change in Rates and Other) Decision and Order No. 22199
Approvals.)
_____)

DECISION AND ORDER

By this Decision and Order, the commission approves a general rate increase of \$521,065, or 24.07 percent over revenues at present rates for KAUPULEHU WATER COMPANY ("KWC"), based on a total revenue requirement of \$2,685,869 for the July 1, 2005 to June 30, 2006 test year, and a rate of return of 3.45 percent. In so doing, the commission authorizes: (1) an increase in KWC's monthly water consumption charge for potable water, from \$3.75 per thousand gallons ("TG") to \$6.65 per TG; (2) an initial rate of \$0.75 per TG for non-potable reject water; and (3) a change in the electricity cost used in computing KWC's power cost adjustment charge, from \$0.61605 per TG to \$2.01325 per TG. The commission also approves certain changes to KWC's tariff rules, as discussed in Section XII of this Decision and Order.

I.

Introduction

A.

Kaupulehu Water Company

KWC is a Hawaii limited partnership: (1) ninety-nine percent (99%) owned by Kaupulehu Makai Venture, a California general partnership; and (2) one percent (1%) owned by Kaupulehu Utility Corporation, a Hawaii corporation.¹ Kaupulehu Utility Corporation is the general partner, while Kaupulehu Makai Venture is the limited partner. Kaupulehu Utility Corporation has the sole and exclusive right to manage KWC.

KWC holds a certificate of public convenience and necessity ("CPCN") to provide water utility service in the service area of Kaupulehu, island of Hawaii.² KWC provides water utility service to "hotel, residential, commercial, and recreational projects" within its service area.³ KWC states that following the issuance of its CPCN in 1996, Kaupulehu Makai Venture transferred certain water system improvements to KWC in exchange for additional capital interests in KWC.

¹Kaupulehu Makai Venture and Kaupulehu Utility Corporation are both owned by Kajima Kona Company, Inc., ultimately owned by Kajima Holdings, Inc., a United States corporation. See KWC's response to CA-IR-5(c).

²See Docket No. 94-0300, Decision and Order No. 14649, filed on April 26, 1996 ("D&O 14649"; Order No. 14758, filed on July 1, 1996; and Order No. 15333, filed on January 24, 1997.

³D&O 14649, at 2; Docket No. 00-0166, Decision and Order No. 17996, filed on August 29, 2000, at 1 (amended CPCN).

B.

KWC's Water System

KWC's water system consists of facilities owned by KWC and Kaupulehu Makai Venture. The facilities owned by KWC include: (A) two (2) deep water wells (Wells 1 and 2); (B) three (3) reservoirs with a total storage capacity of 1,020,000 gallons; (C) transmission lines; (D) a pressure reducing system; and (E) electric and telephone systems. The facilities owned by Kaupulehu Makai Venture are: (A) Wells 3 and 4; (B) a Water Treatment Plant; and (C) the 413' Reservoir (collectively, "KMW's Facilities").

KWC initially provided water service to its customers using two (2) deep water wells (Wells 1 and 2) and related storage and transmission facilities originally constructed by Kaupulehu Makai Venture. The capacity of each well is approximately 526,400 gallons per day ("gpd"), with one (1) of the two (2) wells designated as a back-up well. In 1994, when KWC applied for its CPCN, its projected average daily consumption for the years 2000, 2001, and 2002 was 456,901, 522,901, and 583,701 gpd, respectively.

Presently, the average daily consumption by KWC's customers is approximately 940,000 gpd, with the average daily consumption projected to "increase to approximately 1,033,000 gallons per day by July 1, 2005 and to 1,210,000 gallons per day by June 30, 2006."⁴ KWC's "water source requirements must also take into account the need for

⁴KWC's Application, at 4.

treatment of the water which results in the loss of approximately 25% of the water initially pumped from [KWC's] wells."⁵

The Water Treatment Plant produces approximately 344,000 gpd of non-potable reject water suitable for use in the irrigation of landscaping and golf courses within KWC's service area. Presently, irrigation water for landscaping and golf courses within KWC's service area is provided from non-potable wells owned and operated by Kaupulehu Makai Venture. However, Kaupulehu Makai Venture has agreed to accept the non-potable reject water from the Water Treatment Plant, which, after dilution with brackish water, will be used for landscape and golf course irrigation purposes. Accordingly, as part of the rate case, KWC seeks to establish a rate of \$0.75 per TG, charged to Kaupulehu Makai Venture and other users for the non-potable reject water produced by the Water Treatment Plant.

By Decision and Order No. 22178, filed on December 9, 2005, the commission approved the transfer of KMV's Facilities to KWC, in accordance with Hawaii Revised Statutes ("HRS") § 269-19.5(c).

C.

KWC's Requests

KWC requests commission action approving: (1) a change in KWC's monthly water consumption charge for potable water, from \$3.75 per TG to \$6.65 per TG; (2) an initial rate of \$0.75 per TG for non-potable reject water; (3) a change in the electricity

⁵KWC's Application, at 4.

cost used for computing the automatic power cost adjustment charge, from \$0.61605 per TG to \$2.01325 per TG, or such other cost factor as approved by the commission; and (4) certain changes to KWC's tariff rules.⁶ KWC makes its requests pursuant to HRS § 269-16.⁷

KWC, in effect, seeks commission approval of a general rate increase of approximately \$521,065, or 24.07 percent over revenues at present rates. The requested increase is based on an estimated total revenue requirement of \$2,685,869 for the July 1, 2005 to June 30, 2006 test year ("test year"). KWC asserts that the increase in revenues "will allow it to recover (i) increased expenses and (ii) depreciation and a reasonable return on KWC's rate base after the transfer" of the facilities to KWC.⁸

⁶KWC's Application, Exhibits A - H, Verification, and Certificate of Service, filed on May 24, 2005 (collectively, the "Application"). On June 13, 2005, KWC filed an Amended Certificate of Service, certifying that three (3) copies of its Application were served upon the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate"). On June 27, 2005, KWC filed supplemental exhibits to its Application.

Unless noted otherwise, the phrase "amended Application" collectively refers to KWC's filings on May 24, 2005, June 13, 2005, and June 27, 2005.

⁷See also Hawaii Administrative Rules ("HAR") chapter 6-61, subchapter 8.

⁸KWC's amended Application, Exhibit H, at 5.

II.

Procedural Background

A.

Sufficiency of the Application

On June 9, 2005, the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate") filed a statement of position objecting to the completeness of KWC's Application.⁹ See HRS § 269-16(d). KWC requested a hearing on the Consumer Advocate's objections, pursuant to HRS § 269-16(d).¹⁰ In response thereto, the commission scheduled a hearing for June 29, 2005.¹¹

On June 17, 2005, the commission, on its own motion, bifurcated KWC's request to transfer certain facilities from its other requests involving proposed changes to its tariff, including changes to its water rates.¹² The commission stated its "inten[t] to address KWC's transfer request first, followed by its review of KWC's remaining requests that involve proposed changes to its tariff pursuant to HRS § 269-16, including changes to its water rates."¹³

On June 27, 2005: (1) the Parties filed a joint letter in which they stipulated to certain matters, including the

⁹KWC and the Consumer Advocate are collectively referred to as the "Parties."

¹⁰See commission's letter, dated June 9, 2005; and KWC's response letter, dated June 13, 2005.

¹¹Notice of Hearing on Objections, dated June 15, 2005.

¹²See Order No. 21878, filed on June 17, 2005.

¹³Id. at 3 (footnote and text therein omitted).

agreement that a hearing on the completeness of KWC's Application was no longer necessary based on additional information provided by KWC in supplemental exhibits; and (2) requested that the commission find that KWC's Application, as amended, was complete and properly filed under HRS § 269-16(f) and HAR § 6-61-88.¹⁴

On July 1, 2005, the commission ruled that "[t]he filing date of KWC's complete Application, as amended, is June 27, 2005."¹⁵

B.

Information Requests

On August 8, 2005 and September 12, 2005, the Consumer Advocate served information requests on KWC. The commission also served information requests on KWC on September 9, 2005 and November 3, 2005. KWC responded to the: (1) Consumer Advocate's information requests on August 22, 2005 and September 22, 2005; and (2) commission's information requests on September 13, 2005 and November 14, 2005.¹⁶

¹⁴KWC also formally withdrew its request for a hearing on the completeness of its Application, and the commission subsequently cancelled the hearing. See commission letter, dated June 28, 2005.

¹⁵Order No. 21906, filed on July 1, 2005, at 12, Ordering Paragraph No. 1.

¹⁶The Consumer Advocate's initial set of information requests inadvertently uses two (2) designations of CA-IR-23 and CA-IR-24, respectively, and KWC's responses to these information requests refer to these same duplicate designations. The commission, on its own motion, corrects the mislabeled designations such that the Consumer Advocate's initial information requests now run from CA-IR-1 to CA-IR-31.

C.

Public Hearing

On August 9, 2005, the commission held a public hearing on KWC's amended Application, pursuant to HRS §§ 269-12(c) and 269-16. At the public hearing: (1) KWC's representative and the Consumer Advocate submitted written statements and orally testified; and (2) no other persons testified.¹⁷

D.

Position Statements

On October 31, 2005, the Consumer Advocate filed its Direct Testimony, and stated that it does not object to the rate relief requested by KWC. On December 2, 2005, KWC filed its Statement of Position and Supplemental Written Testimony "to complete the record in this docket in lieu of presenting such testimony at a hearing on the relief requested by KWC[.]"¹⁸ KWC further stated that its amended Application is "ready for determination by the Commission and that no hearing is required in connection with such determination."¹⁹

KWC requests that its proposed rate relief take effect on January 1, 2006, to coincide with its calendar accounting year.

¹⁷The commission received three (3) written comments from two (2) individuals by electronic mail on July 29 and August 3 and 6, 2005.

¹⁸KWC's Supplemental Written Testimony, at 1.

¹⁹KWC's Statement of Position, at 7.

III.

Issues

The issues, as identified in Stipulated Prehearing Order No. 21958, filed on August 3, 2005, are as follows:

1. Are the revenue forecasts for the test year at proposed rates reasonable.

2. Are the projected operating expenses for the test year reasonable.

3. 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.

4. Whether the requested rate of return is reasonable.

5. Is the proposed monthly water consumption rate for potable water just and reasonable.

6. Is the proposed rate for non-potable reject water just and reasonable.

7. What electricity cost should be used in establishing the power cost adjustment charge.

8. Are the proposed changes to KWC's tariff rules just and reasonable.

IV.

Results of Operation Schedule

The Results of Operation Schedule approved by the commission is attached as Exhibit 1 to this Decision and Order. The Results of Operation Schedule shows that KWC, with respect to

the transfer of KMV's Facilities, will: (1) include the transferred facilities in rate base; (2) reflect the annual straight-line depreciation of the transferred facilities in depreciation expense; and (3) remove from operating expenses the payments made to Kaupulehu Makai Venture under the terms of each applicable Agreement, to reflect the discontinuance of said payments as a result of the transfer of the facilities to KWC.²⁰

The commission timely issues this Decision and Order in accordance with Order No. 21958, filed on August 3, 2005, and HRS § 269-16(d).²¹

²⁰See KWC's Supplemental Exhibit H; KWC's responses to CA-IR-1, CA-IR-2, and CA-IR-3; KWC-CA-IR-1(a); KWC-CA-IR-2(b); KWC-CA-IR-3(b); and KWC-PUC-IR-302. See also Decision and Order No. 22178.

²¹Initially, KWC was entitled to the issuance of a Proposed Decision and Order by December 27, 2005, within six (6) months from the date of the filing of KWC's complete Application. HRS § 269-16(f). However:

KWC, by agreeing to numerous deadline dates beyond December 27, 2005, effectively waived the issuance of a Proposed Decision and Order. Instead, KWC seeks the issuance of a Decision and Order within nine (9) months from the date of its complete Application, as amended, i.e., by March 27, 2006[, pursuant to HRS § 269-16(d).] Concomitantly, as a trade-off, KWC is now entitled to a contested case hearing, and the right to appeal the commission's Decision and Order under HRS § 269-15.5.

Order No. 21958, at 2 (footnotes, citation, and text therein omitted). Subsequently, however, KWC waived its right to a contested case hearing under HRS § 269-16(a) and (b), as stated in KWC's Statement of Position, at 7, which is hereby approved by the commission.

V.

KWC's Case-in-Chief

KWC's case-in-chief is set forth in: (1) its amended Application and supporting exhibits, which include the pre-filed Direct Testimony of KWC's representative (Exhibit H); and (2) its responses to the Consumer Advocate's and commission's information requests.²² Exhibit KWC-PUC-IR-302 sets forth KWC's proposed Results of Operation Schedule.²³

VI.

Consumer Advocate's Position

The Consumer Advocate's position is set forth in its Direct Testimony.

The Consumer Advocate states that, in general, in reviewing a public utility's request for rate relief:

The most critical component of the revenue requirement calculation is the overall rate of return. The reason is because changing the rate of return by a few basis points can result in a significant change to the overall revenue requirement. That change could effectively negate the impact of any adjustments proposed to the other revenue requirement elements (i.e., revenues, expenses, and/or rate base).

Next, the revenue and expense projections are important because adjustments to these items generally have a corresponding dollar-for-dollar impact on the overall revenue requirement calculation.

Although rate base represents a significant dollar component of the test year revenue requirement, adjustments to the rate base elements

²²See also KWC's Statement of Position and Supplemental Written Testimony.

²³See also KWC's Supplemental Exhibit H.

do not result in corresponding dollar-for-dollar adjustments to the revenue requirement. The general rule of thumb at current effective tax rates is that for each dollar adjustment to rate base, there is less than a \$0.20 corresponding adjustment to the test year revenue requirement.

CA-T-1 at 4 - 5 (emphasis added).

A.

Rate of Return and Revenue Requirement

For rate of return, the Consumer Advocate finds that:

1. KWC's proposed rate of return of 3.3972 percent simply reflects the return that is derived from KWC's requested revenue requirement of \$2,685,869 at proposed rates.

2. The 3.3972 percent rate of return is well below the 8.7 to 8.85 percent rate of return authorized by the commission for other privately-owned water and wastewater utilities.²⁴

3. KWC projects a net operating income of \$464,579 at proposed rates. To achieve a return on rate base that is comparable to the commission-authorized rate of return of other water and wastewater utilities, KWC will need to realize a net operating income of approximately \$1.2 million on its proposed

²⁴The Consumer Advocate cites to three (3) examples: (1) In re Hawaii Water Serv. Co., Docket No. 03-0275, Decision and Order No. 21644, filed on February 11, 2005 (8.7 percent); (2) In re Puhi Sewer & Water Co., Inc., Docket No. 03-0383, Decision and Order No. 21312, filed on August 17, 2004 (8.85 percent); and (3) In re Hawaii-American Water Co., Inc., Docket No. 03-0025, Decision and Order No. 20966, filed on May 6, 2004 (8.85 percent).

average test year rate base of \$13,714,955.²⁵ This amount is approximately \$749,198 more than KWC's projected net operating income of \$464,579 at proposed rates.

4. KWC is precluded from increasing its proposed revenue requirement beyond the \$2,685,869 it requested in its amended Application.²⁶

5. In In re Keauhou Comm. Serv., Inc., Docket No. 00-0194, a rate case similar to this docket, the public utility's "proposed rate increase was expected to provide the utility with a rate of return that was below that authorized for similar utilities in the state of Hawaii."²⁷

In Docket No. 00-0194, the Consumer Advocate's proposed downward adjustments to the utility's various revenue requirement components, which reduced the utility's requested revenue requirement and resulted in a lower return on rate base, were ultimately offset by the utility's proposed upward adjustment to its requested rate of return to a level that was comparable to the return authorized by the commission at the time for similarly sized public utilities.

6. Accordingly, the Consumer Advocate does not object to the rate relief requested by KWC in this docket:

Similar to the situation in Docket No. 00-0194, the Consumer Advocate recognizes that in the instant proceeding, potential adjustments which

²⁵Rate of return (8.885 percent) x rate base (\$13,714,955) = \$1,213,777.

²⁶In support, the Consumer Advocate cites to In re Hawaii Elec. Light Co., Inc., Docket No. 7764, Decision and Order No. 13762, filed on February 10, 1995.

²⁷CA-T-1 at 7.

would reduce KWC's projected revenue requirement at [KWC's] proposed rates would be offset by a proposal to increase the projected rate of return to the level requested by KWC in its filing, namely 3.3972%. In other words, any adjustments that would be proposed by the Consumer Advocate would be negated and KWC would still be able to support the requested revenue requirement at proposed rates.

Thus, although the Consumer Advocate may not necessarily agree with all of KWC's projected test year revenue requirement components, the Consumer Advocate will not oppose the rate relief requested by KWC in the instant proceeding and the resulting proposed rates. However, the Consumer Advocate reserves its right to take issue with matters that may not have been addressed in the instant proceeding in future rate proceedings. The Consumer Advocate's silence on these matters should not be construed to be acceptance of [KWC's] recommendation.

CA-T-1 at 8 - 9 (emphasis added).

B.

Revenue Requirement Components and Projections

For the test year, the Consumer Advocate: (1) examined KWC's water sales projections; and (2) identified and examined the critical expenses which comprise KWC's total operating expenses.

The Consumer Advocate notes that: (1) electricity, chemical cleaning, contractual services, general and administrative ("G&A"), and repair and maintenance expenses constitute ninety-five percent (95%) of KWC's total operating expenses for the test year; and (2) inter-company allocation, regulatory commission/rate case amortization, outside professional services, and insurance expenses constitute ninety-nine percent (99%) of KWC's G&A expenses. Accordingly,

the Consumer Advocate focused its review on these critical operating expense components in determining the overall reasonableness of KWC's total test year operating expenses.

The Consumer Advocate did not identify any significant adjustments to KWC's test year revenue requirement projections, and is not proposing any adjustments in this proceeding.

Concomitantly, the Consumer Advocate makes certain comments in this proceeding to reserve its right to take a different position on these matters in future rate proceedings. Specifically, the Consumer Advocate comments on: (1) KWC's use of an inflationary factor in calculating its expenses for certain accounts; (2) KWC's expenses for electricity and contractual services; and (3) KWC's plant-in-service balance. The Consumer Advocate's comments are discussed in Section VIII, Expenses, and Section IX, Rate Base, of this Decision and Order.

VII.

Operating Revenues

In Exhibit KWC-PUC-IR-302, KWC calculates its revenues at present rates as follows:

<u>Revenue Source</u>	<u>Present Rates</u>	<u>Additional Amount</u>	<u>Proposed Rates</u>
Metered/Usage	\$1,414,226	\$1,093,669	\$2,507,895
Power Cost Adj. Clause	\$561,919	(\$561,919)	
Fixed Charges	\$72,790		\$72,790
Meter Installation	\$10,902		\$10,902
Reject Water	\$104,967	(\$10,685)	\$94,282

Metered/usage consists of the revenues KWC receives from its ratepayers, including a resort hotel, residential units, a golf clubhouse, tennis facility, and beach club, based on water usage.²⁸ KWC's metered/usage revenues are based on a projected 377,127 TG in total potable water sales for the test year.²⁹

The offset in KWC's test year revenues from the power cost adjustment clause ("PCAC") reflects the re-setting of the PCAC to zero (0) for purposes of this rate case.

Fixed charges represent the revenues KWC receives from the monthly fixed meter charge, based on meter size.³⁰ For the test year, KWC's meter count consists of: ten (10) 5/8" meters; eighty-three (83) 1" meters; ninety (90) 1-1/2" meters;

²⁸See D&O 14649, at 2; KWC's amended Application, Exhibit G, KWC's History of Water Consumption; KWC's Supplemental Exhibit H; KWC's responses to CA-IR-7, CA-IR-24, CA-IR-28, and CA-IR-31; KWC-CA-IR-7(c), KWC-CA-IR-24(1), KWC-CA-IR-24(m), KWC-CA-28(b); KWC-CA-IR-31(a); and KWC-PUC-IR-302.

²⁹\$3.75 per TG multiplied by 377,127 TG = \$1,414,226, metered/usage revenues at present rates. See KWC's amended Application, Exhibit G, KWC's History of Water Consumption; KWC's Supplemental Exhibit H; and KWC-PUC-IR-302.

³⁰See KWC's responses to CA-IR-8(a), CA-IR-29, CA-IR-30, and CA-SIR-1; KWC-CA-IR-8(a), KWC-CA-IR-29, and KWC-CA-SIR-1(b); and KWC's Water Rate Schedules. For reasons not explained by KWC, KWC refers to the revenues it generates from its monthly fixed charge as rental income. In addition, in KWC-CA-IR-29 and KWC-CA-SIR-1(b), KWC appears to use \$77,568 instead of \$72,790 as the appropriate amount. Yet later, in its response to KWC-PUC-IR-302, KWC again refers to \$72,790 as the correct amount in its Results of Operation Schedule. See KWC-PUC-IR-302. The commission, in this Decision and Order, utilizes \$72,790 as the appropriate amount for revenues generated from KWC's monthly fixed charge.

three (3) 3" meters; one (1) 4" meter; eight (8) 6" meters; one (1) 8" meter; and two (2) 12" meters.³¹

Meter installation represents the revenues KWC receives from the installation of water meters.³² For the test year, KWC intends to install approximately forty-eight (48) 1" meters, at a cost of \$227.13 per installation.³³

Revenues from non-potable reject water represent the amount of monies KWC is projected to receive in the sale of such water for irrigation purposes, at the proposed rate of \$0.75 per TG.³⁴ KWC's revenues from non-potable reject water are based on a projected 125,560 TG in sales for the test year.³⁵

³¹See KWC's responses to CA-IR-29 and CA-SIR-1; and KWC-CA-IR-29 and KWC-CA-SIR-1(b).

³²See KWC's response to CA-IR-8(b); and KWC-CA-IR-8(b).

³³Forty-eight (48) meters multiplied by \$227.13 per installation = \$10,902. See KWC's response to CA-IR-8(b); and KWC-CA-IR-8(b).

³⁴Such revenues include a reduction or credit due to certain problems with the golf course grass resulting from the use of the non-potable reject water for irrigation purposes. In particular, Kaupulehu Makai Venture reduced the credit to an amount equal only to the approximate direct power and repair costs of the brackish irrigation water. See KWC's responses to CA-IR-24(i) and CA-SIR-5. Nonetheless, "[c]ontinuing problems with grass have prompted preliminary discussions with neighboring golf courses with a different variety of grass that could possibly utilize the reject water. Indication is that they may be willing to purchase the water delivered for \$.70 per [TG] of water." KWC's responses to CA-IR-24(i) and CA-SIR-5. The \$.70 was rounded up to \$.75 per TG, ostensibly as a result of negotiations. See KWC's response to CA-SIR-5.

³⁵\$0.75 multiplied by 125,560 TG (or 344,000 gpd x 365 days) = approximately \$94,282 in revenues for non-potable reject water, as adjusted. See KWC's amended Application, Section 4(e), Reject Water Rate, at 7 - 8; KWC's Supplemental Exhibit H; and KWC-PUC-IR-302.

The commission finds reasonable KWC's test year estimates for operating revenues.

VIII.

Expenses

KWC utilizes a 2.3295 percent inflation factor based on the Honolulu Consumer Price Index ("CPI") for 2003 in calculating its test year expenses for certain of its accounts.³⁶ The Consumer Advocate does not "oppose the use of a general inflator in determining the test year expense projections in this proceeding[,]" but "reserves its right to take issue with the use of a general inflator in future rate proceedings."³⁷

In In re Waikoloa Water Co., Inc., dba West Hawaii Water Co., Docket No. 04-0373 ("Waikoloa Water"), the commission found reasonable the use by West Hawaii Water Co. ("West Hawaii") of a three (3) percent inflation factor in calculating its test year expenses for certain of its accounts. West Hawaii based its inflation factor on the United States CPI of 2.956 percent (composite) for the West Urban area - all items, from October 2003 to October 2004.³⁸ While the Consumer Advocate did not oppose West Hawaii's use of a three (3) percent inflation factor, the Consumer Advocate suggested that "if a general inflation factor is used, it prefers using the Honolulu CPI,

³⁶See KWC's Supplemental Exhibit H, at 2. See also KWC-CA-IR-13, at 1.

³⁷CA-T-1 at 12.

³⁸See Proposed Decision and Order No. 21885, filed on June 22, 2005, at 5; and Decision and Order No. 21919, filed on July 15, 2005.

recognizing that there is no available CPI for each of the islands within the State."³⁹

KWC's 2.3295 percent inflation factor: (1) is 0.6705 percent lower than the inflation factor approved by the commission in Waikoloa Water; and (2) is based on the Honolulu CPI, since there is no available CPI for the island of Hawaii.

The commission finds reasonable KWC's use of a 2.3295 percent inflation factor for certain of its expense accounts.

KWC's expenses consist of four (4) categories: (1) operating expenses; (2) G&A expenses; (3) depreciation expense; and (4) taxes. The breakdown of KWC's test year expenses are as follows:

<u>Expenses</u>	<u>Present Rates</u>	<u>Additional Amount</u>	<u>Proposed Rates</u>
<u>Operating</u>			
Power Purchased (electricity at \$2.013 per million gallons)	\$767,651		\$767,651
Chemical Cleaning, Reverse Osmosis (Vitec 4000 and Avista P112)	\$103,877		\$103,877
Contractual Services (Hawaii-American Water Co.)	\$266,135		\$266,135
Testing (AECOS Laboratory of Hawaii LLC)	\$1,785		\$1,785
Security Services (Four Seasons Resort Hualalai)	\$18,638		\$18,638

³⁹Proposed Decision and Order No. 21885, at 25 (footnote, citation, and text therein omitted).

<u>Expenses</u>	<u>Present Rates</u>	<u>Additional Amount</u>	<u>Proposed Rates</u>
<u>Operating</u>			
Chemical Additives (sodium metahexaphosphate, soda ash, and sodium hypochlorite)	\$29,581		\$29,581
Miscellaneous/General (dues, checks, stationary, office supplies, postage)	\$2,285		\$2,285
Repairs & Maintenance ⁴⁰	\$77,567		\$77,567
<u>G&A</u>			
Overhead (Hualalai Dev. Co.)	\$57,375		\$57,375
Consulting (rate case amortization/ regulatory commission)	\$25,000		\$25,000
Outside Services - Legal, Accounting, Engineering	\$17,392		\$17,392
Insurance (property and liability)	\$44,466		\$44,466
Telephone	<u>\$1,226</u>		<u>\$1,226</u>
Total, Operating/G&A	\$1,412,978		\$1,412,978
<u>Depreciation</u>			
Depreciation	\$590,986		\$590,986
<u>Taxes</u>			
Taxes (Other Than Income Taxes)	\$139,039	\$33,270	\$172,309
Interest Income (dividends)	(\$12,781)		(\$12,781)
Income Taxes	<u> </u>	<u>\$57,798</u>	<u>\$57,798</u>
Total Expenses	\$2,130,222	\$91,068	\$2,221,290
Net Operating Income	\$34,582	\$429,997	\$464,579

⁴⁰See KWC's Supplemental Exhibit H, at 2 and 4 - 5.

A.

Operating and G&A Expenses

Hualalai Development Company, an affiliated entity, provides certain administrative services to KWC, including billing, collection, accounting, and general support.⁴¹ Island Utilities Service, Inc. formerly operated and managed KWC's water system and Water Treatment Plant pursuant to a written agreement.⁴² Since February 2004, Hawaii-American Water Company ("HAWC") has operated and managed KWC's water system and Water Treatment Plant pursuant to a two (2)-year written agreement.⁴³

⁴¹See KWC's amended Application, Exhibit C, at 8 (KWC's Financial Statements for the Years Ending 2004 and 2003, and Independent Auditors' Report, at 8); and KWC's response to CA-SIR-6.

⁴²See KWC's amended Application, Exhibit C, at 8 (KWC's Financial Statements for the Years Ending 2004 and 2003, and Independent Auditors' Report, at 8). See also KWC's responses to CA-IR-27(a) to (f); and KWC-PUC-IR-101(E) (2002 contracts).

⁴³See KWC's amended Application, Exhibit C, at 8 (KWC's Financial Statement for the Years Ending 2004 and 2003, and Independent Auditors' Report, at 8).

KWC's written agreement with HAWC is scheduled to expire on January 31, 2006, the third quarter of KWC's test year. HAWC was the low bidder for the new contract, scheduled to commence in February 2006. KWC is seeking a five (5)-year agreement with HAWC. The new agreement is projected to increase the current contract price by 11.8 percent in the first year, with annual increases of three percent (3%) per annum thereafter. KWC's test year estimate for contractual services incorporates the 11.8 percent increase. See KWC's responses to CA-IR-5(d) and CA-SIR-4; and KWC-CA-SIR-4. See also KWC's responses to CA-IR-27(a) to (f); and KWC-PUC-IR-101(E) (2004 contracts).

According to KWC: (1) HAWC underestimated the cost of hiring water operators on the island of Hawaii; (2) "11.8% is reasonable due to the very tight labor market in Kona and due to the quality of the operator's staff needed to perform the extensive amount of management or preventive maintenance and general repairs and maintenance performed during the past two years[;]" and (3) "[t]he 11.8% averages to an approximate 6% labor price

The Consumer Advocate comments on two (2) areas of KWC's operating expenses, electricity and contracting services, respectively:

1. In calculating test year electricity expense, KWC did not determine the per kilowatt-hour ("kWh") cost of pumping a thousand gallons of water. Instead, KWC determined the per kWh cost of electricity based on the volume of water sold. According to the Consumer Advocate:

Although [KWC's] methodology may appear to be unreasonable, the methodology was consistently applied when determining the test year expense projection. In other words, the electricity expense was based on the projected volume of water sold, as opposed to the water pumped. This per kwh price was also used for purposes of determining the base price of electricity in the power cost adjustment clause. . . . In future rate proceedings, [KWC] may want to consider modifying the methodology for determining the electricity expense and power cost adjustment factor to recognize the pump efficiency factors.⁴⁴

2. KWC utilizes a contractor for the daily operations and maintenance ("O&M") of the water system. KWC initially retained Island Utilities Service Inc. to provide the daily O&M

increase for two years[,] which is acceptable with only a 3.4% unemployment factor for this island in 2005." KWC's response to CA-SIR-4(b).

⁴⁴CA-T-1 at 16 - 17. In response to the Consumer Advocate's comments, KWC explains:

The water from KWC's wells must be treated and approximately 25% of that water is lost as 'reject water' during that treatment. As a result, KWC feels that it is more appropriate to spread its electrical cost over the amount of gallons sold which more accurately reflects the cost per [TG] of providing water to KWC's customers.

KWC's Supplemental Written Testimony, at 3.

service. Subsequently, the service was put out to bid, and KWC selected HAWC to provide the daily O&M service. With KWC's retention of HAWC:

KWC has recognized the assumed 11.8% increase in the [HAWC] contract fee in determining [KWC's] test year expense projections. It should be noted that although KWC has the right to request copies of the financial statements prepared by [the] contractor reflecting the costs of the services provided in each year of the contract, KWC stated in response to CA-IR-25d. that such statements were never requested nor received. The Consumer Advocate recommends that in a future rate proceeding, KWC be required to demonstrate the reasonableness of any proposed increase in the contract before such increase is included in the test year revenue requirement. That demonstration should include the information regarding the cost of services provided by HAWC to KWC.

Furthermore, if KWC is allowed to include any increase in the contract in the test year revenue requirement, based on representation by HAWC that the costs of providing the service have increased, there should be a comparable adjustment to remove the associated costs in the test year revenue requirements for HAWC in Docket No. 05-0103, HAWC's pending rate application.

CA-T-1 at 15 - 16.

In general, the operating and G&A expenses (excluding regulatory commission expense) represent the normalized level of funds KWC will expend during the test year to operate its water system and provide water utility service to consumers.⁴⁵ KWC's operating expenses also include monies for security services provided by the Four Seasons Resort Hualalai for the water

⁴⁵ See KWC's amended Application, Exhibit E; KWC's Supplemental Exhibit H, at 1 - 6; KWC's responses to CA-IR-9 to - CA-IR-17, CA-IR-27, CA-SIR-2, CA-SIR-3 and CA-SIR-6; KWC-CA-IR-10 to KWC-CA-IR-16 and KWC-CA-IR-27(h); and KWC-PUC-IR-302. See also KWC's responses to CA-IR-21, CA-IR-23, and CA-IR-24.

system, including the wells, Water Treatment Plant, and reservoirs.⁴⁶

For regulatory commission expense (i.e., rate case amortization), KWC: (1) estimates expending \$75,000 in legal fees and costs to process this rate case; and (2) amortizes this amount over a three (3)-year period. In Waikoloa Water, the commission found reasonable an amount of \$82,750 for regulatory commission expense, amortized over a five (5)-year period.⁴⁷ As in Waikoloa Water, this docket involves a similar provider of water utility service on the island of Hawaii and as in Waikoloa Water, this docket did not involve an evidentiary hearing.

KWC's regulatory commission expense represents the reasonable amount of expenses incurred by KWC to process this rate case, amortized over a three (3)-year period, since KWC estimates that it will file its next application for rate relief in three (3) years. KWC's overall estimate of \$75,000 is approximately \$7,750 lower than the amount approved by the commission in Waikoloa Water.

For purposes of this rate case, the commission finds reasonable KWC's test year operating and G&A expenses, including regulatory commission expense.

⁴⁶See KWC's Supplemental Exhibit H, at 1 and 3; KWC's response to CA-IR-27(h); KWC-CA-IR-25(h); and KWC-PUC-IR-302. In justifying the need for security services, KWC explains that since HAWC's "normal hours are from 7:00 a.m. to 3:00 p.m., security staff are especially needed from 4:00 p.m. to 7:00 a.m. when there are no operators on duty." KWC's response to CA-SIR-7(b).

⁴⁷Proposed Decision and Order No. 21885, Section VI(C)(3), Regulatory Commission/Rate Case Amortization, at 37 - 42.

Consistent with the Consumer Advocate's comments, KWC, in its next rate proceeding, shall: (1) consider the feasibility of modifying the methodology for determining its electricity expense and power cost adjustment factor to recognize the pump efficiency factors; and (2) request copies of HAWC's financial statements that reflect the costs of the operational services provided by HAWC during each contract year.⁴⁸

B.

Depreciation

KWC's test year depreciation expense: (1) reflects the transfer of KMW's Facilities to KWC; and (2) is based on KWC's plant-in-service balance for the test year.⁴⁹ The commission finds reasonable KWC's test year depreciation expense.

C.

Taxes

KWC's taxes consist of its revenue taxes and income taxes, respectively.

⁴⁸The Consumer Advocate also seeks a comparable adjustment to remove certain costs from HAWC's pending request for rate relief in In re Hawaii-American Water Co., Docket No. 05-0103. The commission, however, affirmatively declines to bind HAWC, a non-party to this docket, by this Decision and Order. The Consumer Advocate has the option of pursuing its comparable adjustments in Docket No. 05-0103.

⁴⁹See KWC's Supplemental Exhibits I to L.

1.

Revenue Taxes

KWC's revenue taxes is comprised of the (1) State of Hawaii ("state") Public Service Excise ("PSE") Tax, 5.885 percent; and (2) State Public Utility Fee, 0.5 percent. The commission finds reasonable the amount of \$172,309 for revenue taxes, which is calculated based on KWC's projected revenue requirement of \$2,685,869, plus interest income of \$12,781.⁵⁰ This estimated sum of \$172,309 consists of the following amounts:

PSE Tax (5.885%)	\$158,816
Public Utility Fee (0.5%)	<u>\$13,493</u>
Total	\$172,309

2.

Income Taxes

KWC's partners are Kaupulehu Utility Corporation and Kaupulehu Makai Venture. Both partners are owned by Kajima Kona Company, Inc., which in turn are ultimately owned by Kajima Holdings, Inc., a United States corporation.⁵¹

KWC states that as a partnership it is not subject to federal or state income taxes:

Income Taxes - [KWC] is not subject to federal and state income taxes. The distributive shares of

⁵⁰See KWC's Supplemental Exhibit H, at 1, 7, and 8; and KWC-PUC-IR-302.

⁵¹See KWC's response to CA-IR-5(c).

income or loss and other tax attributes from [KWC] are reportable by the individual partners in their respective income tax returns.

KWC's amended Application, Exhibit C, at 6 (KWC's Financial Statements for the Years Ending 2004 and 2003, and Independent Auditors' Report, at 6).

Nonetheless, KWC explains that, for ratemaking purposes, KWC's results of operations are ultimately included in the consolidated income tax filing and payments of Kajima Holdings, Inc. As a result, income tax expense (federal and State) is calculated and included as a component of cost of service based on KWC's operations and status as a "stand alone" entity. KWC also maintains that the inclusion of income tax expense as a component of its cost of service is consistent with the "inclusion of deferred income taxes as a deduction in the calculation of the average rate base."⁵²

KWC's estimated income taxes for the test year is calculated based on the applicable federal and state income tax brackets.⁵³ For purposes of this rate case, the commission accepts the sum of \$57,798 for income taxes. This estimated sum of \$57,798 consists of the following amounts:⁵⁴

State Income Tax	\$9,435
Federal Income Tax	<u>\$48,363</u>
Total	\$57,798

⁵²KWC's response to CA-IR-5(c). See also KWC's response to CA-IR-26.

⁵³See KWC's Supplemental Exhibit H, at 1 and 8; and KWC-PUC-IR-302.

⁵⁴See Supplemental Exhibit H, at 1 and 8; and KWC-PUC-IR-302.

IX.

Rate Base

KWC's rate base consists of: (1) its net plant-in-service (i.e., plant-in-service less accumulated depreciation and deferred income taxes); (2) plus working cash and materials and supply inventory; and (3) as adjusted by the capital goods excise tax credit.⁵⁵

KWC notes that in calculating its net plant-in-service:

Utility Plant in Service and Depreciation - Property is stated at cost. Major replacements, renewals and betterments are charged to property accounts, while maintenance and repairs that do not improve or extend the life of an asset are charged to expense as incurred. When property is retired or otherwise disposed of, any resulting gains or losses are included in income. Depreciation is computed using the straight-line method over the estimated useful lives of the respective assets.

KWC's amended Application, Exhibit C, at 6 (quoting KWC's Financial Statements for the Years Ending 2004 and 2003, and Independent Auditors' Report, at 6).

The Consumer Advocate comments on two (2) areas of KWC's plant-in-service:

1. The Consumer Advocate finds it reasonable to include the cost of the assets transferred from Kaupulehu Makai

⁵⁵See KWC's amended Application, Exhibit C, at 6 - 7 (KWC's Financial Statements for the Years Ending 2004 and 2003, and Independent Auditors' Report, at 6 - 7); KWC's Supplemental Exhibit H, at 1 and 8; KWC's Supplemental Exhibits I to L; KWC's responses to CA-IR-18, CA-IR-20, CA-IR-23, and CA-IR-24; and KWC-CA-IR-18.

Venture to KWC in KWC's plant-in-service at the beginning and end of the test year, reasoning that:

. . . the assets are being utilized to provide the regulated water service at the beginning of the test year. . . . KWC paid [Kaupulehu Makai Venture] to use the assets under the terms of various agreements with [Kaupulehu Makai Venture]. The payment to [Kaupulehu Makai Venture] represented the annual straight-line depreciation and a return on the average undepreciated plant value. Since KWC has not included the payment to [Kaupulehu Makai Venture] in the operating expense even though the assets are being utilized to provide service at the beginning of the test year, it is reasonable to recognize the cost of the assets in the beginning plant balance for the instant proceeding.

CA-T-1 at 14 - 15.

2. The Consumer Advocate notes that KWC includes the cost of two (2) pumps in its test year plant-in-service, even though these two (2) pumps were disposed of prior to the beginning of the test year. The Consumer Advocate explained that the pumps are no longer in service, and thus, should be removed from KWC's test year rate base, and the remaining net book value of the disposed pumps should no longer be reflected in KWC's plant-in-service in any future KWC rate cases.⁵⁶ The Consumer Advocate also recognized, however, that "[t]he cost of the pumps in question amount[s] to \$250,092. Therefore, the inappropriate inclusion of the costs will not have a significant

⁵⁶The Consumer Advocate cites to Paragraph 16(F) of the National Association of Regulatory Utility Commissioners' Uniform System of Accounts for Water Utilities (1984) ("NARUC USOA") as support. See CA-T-1 at 13.

impact on the test year rate base and revenue requirements in the instant proceeding."⁵⁷

"It is axiomatic that allowing the recovery of out-of-test year costs violates the test year concept."⁵⁸ Moreover, a public utility's return on its rate base is limited to utility property that is used and useful for public utility purposes.⁵⁹

The commission finds that, under the facts and circumstances of this case, KWC's inclusion of the two (2) abandoned pumps in its test year plant-in-service balance is inconsistent with recognized principles of ratemaking. Both pumps were removed from service in 2004, prior to the inception of KWC's test year, because the pumps failed and could not be repaired.⁶⁰ Both pumps, moreover, are not used and useful for the provision of water utility service during the test year.⁶¹

⁵⁷CA-T-1 at 13. The Consumer Advocate also notes that KWC did not seek the commission's approval to dispose of the two (2) pumps, pursuant to HRS § 269-19. Nonetheless, "although the disposed assets in the instant situation required replacement to enable KWC to provide the regulated water service, [KWC] should, at a minimum, notify the Commission of the need to replace the pump and dispose of the old pump." CA-T-1 at 14.

⁵⁸In re Hawaii Water Serv. Co., Inc., Docket No. 03-0275, Decision and Order No. 21644, filed on February 11, 2005, at 14 (footnote and citations therein omitted).

⁵⁹See HRS § 269-16(b) (fair return on utility property used or useful for public utility purposes).

⁶⁰See KWC's Supplemental Exhibit I; KWC's responses to CA-IR-5(b) and CA-IR-25; KWC's Statement of Position, at 5 n.1; and KWC's Supplemental Written Testimony, at 4. See also CA-T-1, Section III, at 12 - 14.

⁶¹See KWC's Supplemental Exhibit I; KWC's responses to CA-IR-5(b) and CA-IR-25; KWC's Statement of Position, at 5 n.1;

Accordingly, the commission removes from KWC's plant-in-service the costs of the two (2) pumps, in the amount of \$250,092.⁶² For purposes of simplicity and in this rate case only, the commission will disallow from KWC's rate base the costs of both pumps, without any related adjustments to KWC's test year expenses for depreciation and taxes.⁶³ With this adjustment to

and KWC's Supplemental Written Testimony, at 4. See also CA-T-1, Section III, at 12 - 14.

⁶²See In re Hawaii Water Serv. Co., Inc., Docket No. 03-0275, Decision and Order No. 21644, Section IV, Two (2) New Wells, at 11 - 17 (disallowance of two new wells in the utility's plant-in-service due to the non-installation of one (1) or both wells during the test year).

⁶³As stated by the Consumer Advocate, the inclusion of the costs of KWC's two (2) pumps in the test year will not significantly impact KWC's rate base and revenue requirement. In particular, the commission notes that the \$250,092 amount represents approximately 1.8 percent of KWC's rate base, and the corresponding adjustments to KWC's expenses will likewise have a *de minimis* effect on KWC's overall revenue requirement. Cf. In re Hawaiian Elec. Co., Inc., Docket No. 04-0274, Decision and Order No. 21518, filed on December 23, 2004 (Hawaiian Electric Company, Inc.'s share of costs in the amount of \$21,733 to convert secondary lines from overhead to underground will have a *de minimis* effect on ratepayers, if at all).

KWC explains that the commission's disallowance of the two (2) pumps from rate base will have a minimal effect on its test year expenses:

. . . the depreciation in the test year for these items is \$5,014. If the depreciation is eliminated, income taxes will increase by approximately \$2,151. Thus, the net effect would be to increase income in the test year by \$2,863 which would not significantly increase KWC's rate of return.

KWC's Supplemental Written Testimony, at 3.

KWC also explains that while it is more appropriate to reclassify the two (2) pumps as "Extraordinary Property Losses" under Paragraph 182 of the NARUC USOA, "the issue does not have to be resolved in this docket because of the relatively low rate of return KWC has agreed to accept for the test year." Id. at 4 - 5. See also KWC's Statement of Position, at 6 n.1.

KWC's average rate base, KWC's proposed rate of return is increased to 3.45 percent.⁶⁴ (See Section X, Rate of Return, below.)

X.

Rate of Return

KWC's proposed rate of return is 3.45 percent. As noted by the Consumer Advocate, KWC's requested rate of return: (1) reflects the return that is derived from KWC's requested revenue requirement of \$2,685,869 at proposed rates; and (2) is well below the 8.7 to 8.85 percent rate of return authorized by the commission for other privately-owned water and wastewater utilities.

In In re Kaupulehu Waste Water Co., Docket No. 01-0275, the commission accepted the parties' stipulated rate of return of 3.38 percent.⁶⁵ Docket No. 01-0275 involved KWC's affiliated utility, Kaupulehu Waste Water Company ("KWWC"), and similar to this docket, the 3.38 percent rate of return represented KWWC's acceptance of the percentage figure that resulted from its restructured, commission-approved wastewater rates.⁶⁶ Under the circumstances, the commission likewise finds that KWC's 3.45 percent rate of return is fair.

⁶⁴Net operating income (\$464,579) divided by new rate base (\$13,464,863) = rate of return (3.45 percent).

⁶⁵See In re Kaupulehu Waste Water Co., Docket No. 01-0275, Decision and Order No. 19812, filed on November 22, 2002.

⁶⁶See Decision and Order No. 19812, Section IX, Rate of Return, at 14 - 15.

XI.

Rate Design

KWC's present rate design consists of: (1) a monthly water consumption charge, based on water usage; and (2) a monthly fixed meter charge, based on meter size.⁶⁷

KWC proposes to increase its monthly water consumption charge from \$3.75 per TG to \$6.65 per TG, with no proposed increases to its monthly fixed charges. The Consumer Advocate does not affirmatively object to KWC's proposal.

The commission finds reasonable KWC's proposal to generate its additional revenues from its water usage charge, with no increases in the monthly fixed charges. The increase in the water usage charge is designed to promote water conservation, and provides ratepayers with the opportunity to counter-balance the impact of the increase in rates by reducing their water usage.⁶⁸

KWC also seeks to establish a rate of \$0.75 per TG, charged to Kaupulehu Makai Venture and other users for the non-potable reject water produced by the Water Treatment Plant.

⁶⁷See KWC's Water Rate Schedules. KWC is also authorized to assess a monthly fixed private fire service charge for hydrants and standpipes. See *id.* KWC, however, does not presently assess such a charge, explaining that "[t]here are only 8 hydrants that would be subject to these charges at the rate of \$3.00 per month each and KWC has not charged its customers for these amounts due in part to the monthly meter charges paid by the affected customers." KWC's Supplemental Written Testimony, at 2.

⁶⁸See Decision and Order No. 21644, Section IX, Rate Design (a water utility's proposed fifty-two (52) percent increase in the fixed monthly standby charge, with a corresponding proposed 2.4 percent increase in the monthly consumption charge, was not designed to encourage water conservation, and was rejected by the commission).

KWC states that "the requested charge for reject water is reasonable when the avoided cost to [Kaupulehu Makai Venture] is adjusted due to the fact that the reject water must be mixed with brackish water in order to be used by [Kaupulehu Makai Venture] for irrigation purposes."⁶⁹

The Consumer Advocate does not object to KWC's proposed rate for non-potable reject water, finding that:

1. The proposed rate is less than the \$1.20 per TG rate set forth in the Water Treatment Facility Agreement with Kaupulehu Makai Venture.

2. The \$0.75 per TG rate is a result of negotiations between KWC and Kaupulehu Makai Venture, and "[a]s with any negotiation, the parties that were privy to the negotiations are best able to assess the reasonableness of the rate since they are the ones who know first hand the factors considered in reaching agreement."⁷⁰

3. Kaupulehu Makai Venture has an alternate, available source of irrigation water. Specifically, water drawn from neighboring irrigation wells, at the cost of pumping.⁷¹

The commission finds reasonable KWC's initial tariff rate of \$0.75 per TG for non-potable reject water. This initial rate, ostensibly arrived at through negotiations, represents a *de facto* market rate upon which Kaupulehu Makai Venture and possibly other users are willing to pay for irrigation water that is not

⁶⁹KWC's Supplemental Written Testimony, at 6.

⁷⁰CA-T-1 at 19 - 20.

⁷¹See KWC's response to CA-SIR-5(b).

suitable for human consumption. These same users, moreover, have the option of using water drawn from neighboring irrigation wells, at the cost of pumping.

In essence, KWC's rate design, including the initial tariff rate of \$0.75 per TG for non-potable reject water, provides KWC with a reasonable opportunity to earn its test year revenue requirement.

XII.

Tariff Rules

A.

Power Cost Adjustment Charge

Pursuant to KWC's Automatic PCAC Rule XXIX, its water rates are subject to automatic increases or decreases if the electricity cost per TG is more or less than \$0.61605. As of March 31, 2005, KWC's electricity cost per TG was \$2.01325.⁷²

KWC proposes to amend Rule XXIX by:

1. Changing the date used to calculate the PCAC, from the 10th to 20th day of January, May, and September, to allow KWC sufficient time to receive and process its electric bills from Hawaii Electric Light Company, Inc.; and

2. Changing the base amount used to compute the PCAC from \$0.61605 per TG to \$2.01325 per TG (i.e., \$.00201325 per gallon of water sold), or such other cost factor as approved by the commission, to accurately reflect electrical cost increases

⁷²See KWC's amended Application, Exhibit B.

KWC has experienced since its initial rates were established in 1996 - 1997.⁷³

The Consumer Advocate states that it does not object to KWC's first proposal,⁷⁴ and it concurs with KWC's second proposal.⁷⁵ The Consumer Advocate notes that: (1) electricity expense represents approximately fifty-four (54) percent of KWC's total operating expenses; and (2) the PCAC is expected to provide KWC a better opportunity to recover its electricity expense without having to adjust its water rates through a general rate application.

The Consumer Advocate concludes that KWC's PCAC will provide for the timely recovery of changes in the per kWh cost of electricity:

In the instant rate proceeding, the Commission will determine the test year electricity expense based upon a given per [kWh] price of electricity. The monthly water consumption rates authorized by the Commission will allow for recovery of the test year electricity expense. When the actual per [kWh] cost of electricity is more or less than [the] per [kWh] cost used to determine the test year electricity expense, KWC is allowed a corresponding increase or decrease in the monthly water consumption rate through the [PCAC]. Thus, changes through the [PCAC] are only implemented when the per [kWh] electricity cost deviates from the Commission approve per [kWh] electricity cost for purposes of determining the revenue requirement in a rate proceeding. After the Commission approves the rates in this proceeding,

⁷³See Docket No. 94-0300, Order No. 15333, filed on January 24, 1997 (KWC's \$3.75 per TG water consumption rate established); and Order No. 14758, filed on July 1, 1996 (KWC's initial base power cost of \$0.61605 per TG established).

⁷⁴See CA-T-1 at 20.

⁷⁵See CA-T-1 at 17 - 19, Section IV(A), Automatic Power Cost Adjustment Charge.

customers will not be subject to the [PCAC] until [KWC's] per [kWh] electricity cost deviates from the Commission approved electricity rate.

CA-T-1 at 18 - 19.

The \$2.01325 per TG base amount is based on the average electricity costs associated with pumping a thousand gallons of water from May 2004 through March 2005.⁷⁶ The commission finds reasonable KWC's proposed changes to its Rule XXIX, including the change in the date used in calculating the PCAC, from the 10th to 20th day of January, May, and September.

B.

Tariff Revisions Proposed by KWC

The Consumer Advocate does not object to the other changes proposed by KWC to its tariff rules,⁷⁷ as reflected in KWC's Exhibit A of the amended Application:⁷⁸

1. Amend Rule III(1), governing KWC's water supply, to read as follows:

Water Supply. The Company will exercise reasonable diligence and care to deliver an adequate supply of water to the consumer and to avoid shortages or interruptions in water service and to maintain pressure in its water mains, but will not be liable for any interruption, shortage, insufficiency of supply, lack of pressure, water quality (so long as the water quality meets the requirements of the Safe Drinking Water Act, or any or damage occasioned thereby.

⁷⁶See KWC's response to CA-IR-12; and KWC-CA-IR-12. See also KWC's amended Application, Exhibit B.

⁷⁷CA-T-1 at 20.

⁷⁸Unless noted otherwise, proposed deletions are bracketed, while proposed additions are underscored.

2. For Rules VI(4), (5), (8), and XVI, changing the phrases "employees of the Company" and "officer or employee of the Company" to "officer, employee, agent or independent contractor of the Company" to reflect the fact that KWC may use agents or independent contractors to perform KWC's inspections, testing, repairs, maintenance, and other obligations for its consumers.
3. Amend Rule VI(14), governing check valves, to read as follows:

Check Valve. A check valve shall be installed by the Company after the shut-off valve and paid for by the consumer. [The consumer shall test, inspect and make necessary repairs and replacements at the consumer's expense to keep the check valve in good working condition. The Company shall have access to make periodic inspection of such devices.] The consumer shall, at the consumer's expense, keep the check valve in good working condition. The Company shall inspect and test the check valve at required intervals. If the consumer fails to make any necessary repairs or replacements of a check valve within thirty (30) days after receipt of written notice from the Company to do so, then Company, at the expense of the consumer, may repair or replace any check valve in need of repair or replacement.

4. For Rule VIII(2), governing late payment charges, changing "shall" to "may" "so that the imposition of the late payment charge of 1% per month is left to the discretion of [KWC] depending on the facts and circumstances of each late payment."
5. Replace its pre-printed Application for Water Service form for new consumers, attached as Exhibit B to its tariff rules, with a revised, updated Application for Water Services form, which is attached as Exhibit App-1 and -2 to its Application.
6. Amend its pre-printed Shut-Off of Water Service forms, attached as Exhibits C and D to its tariff rules, by changing KWC's street address and business telephone number to: 100 Kaupulehu Drive, Kaupulehu-Kona, Hawaii, 96740, (808) 325-8400.

The agreed-upon revisions: (1) clarify and update some of KWC's tariff provisions; (2) seek to ensure that a consumer's

check valve is in proper working condition; and (3) make the assessment of a late payment charge discretionary. The commission finds reasonable the Parties' agreed-upon revisions to KWC's tariff rules.

C.

Tariff Revisions Proposed by the Consumer Advocate

With the exception of the Consumer Advocate's proposal to add certain language to Rule VIII governing billing disputes (see Item No. 9, below), KWC agrees to incorporate other changes to its tariff rules, in response to the Consumer Advocate's recommendations:⁷⁹

1. Amend its tariff throughout by changing "consumer" to "customer" "to recognize that a consumer of water may not necessarily be a customer of [KWC]."⁸⁰
2. Amend Rule I to include a definition of "Notice to stop" "to make clear what actions are required from the customer to inform [KWC] of a request for the termination of service:

"Notice to stop" means written notice to the Company by a customer that the customer wishes to discontinue service. Written notice is effective the date correspondence is stamped received by the Company.

3. For Rule II(2), correct "Rule XXV" to "Rule XXVI."
4. For Rule III(2), adding a provision for determining the priorities for restricting water use:

Conservation Measures. Whenever, in the Company's opinion, special conservation

⁷⁹See CA-T-1 at 20 - 23. Unless noted otherwise, proposed deletions are bracketed, while proposed additions are underscored.

⁸⁰CA-T-1 at 20.

measures are advisable in order to forestall water shortage and in a consequent emergency, the Company may restrict the use of water by any reasonable method of control. In determining the priorities for restricting water use, the health and safety of the public shall be given first consideration over other uses.

5. Amend Rule III(3), governing KWC's interruption of its water supply, by making it clear that KWC will shut off water without notice only for reasons related to the operation of the water system:⁸¹

Company Shut Offs. 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 [and will not be responsible nor liable for any property loss or damage incurred by the consumer due to such interruption of service. Consumers] related to the operations of the Company. Customers depending upon a continuous supply of water shall provide emergency water storage and any check valves[, backflow preventers] or other devices necessary for the protection of plumbing or fixtures against failure of the pressure or supply of water in the Company's mains. Repairs or improvements will be prosecuted as rapidly as practicable and, insofar as practicable, at such times as will cause the least inconvenience to the [consumer. The Company will not be liable or responsible for any damage to person or property caused by spigots, faucets, valves and other equipment that may be open when water is turned on at the meter, either when turned on originally or when turned on after a temporary shutdown.] customer. Except in the case of emergency repairs, the Company shall use best efforts to give the Customer as least 24 hours notice before shutting off service.

⁸¹In CA-T-1, the Consumer Advocate's proposed deletions are represented by the removal of such language in its entirety from Rule III(3). See CA-T-1 at 21. Thus, the Consumer Advocate also proposes to delete language that limits KWC's liability.

6. Amend the last sentence of Rule V(1) to include a missing reference to KWC:

. . . When an application for water service is made by a consumer who was responsible for and failed to pay all bills previously rendered by the Company, regardless of the location or time at which the bill was incurred, the Company may refuse to furnish water service to the applicant until the outstanding bills are paid.

7. Amend Rule VI(2), governing contours and elevations, to reflect the current name of the agency responsible for the geodetic function:

Contours or Elevations. When required by the Company, contours or elevations shall be furnished by the applicant, based upon [U.S. Coast and Geodetic Survey ("U.S.G.S.") National Geodetic Survey or County of Hawaii datum.

8. Amend Rule VIII(1) and Rule XI(1), to make it clear that service is subject to discontinuance for non-payment of a bill that is not in dispute:

Rule VIII(1)

. . . If any bill not in dispute is not paid within thirty (30) days after presentation or deposit in the United States mail, the water service shall be subject to discontinuance.

Rule XI(1)

Nonpayment of Bills. Water service may be discontinued for nonpayment of a bill not in dispute within thirty (30) days after the mailing or presentation thereof to the consumer.

9. Add a new paragraph to Rule VIII, Payment of Bills, outlining the customer's and KWC's responsibilities for billing disputes:

The customer shall submit any dispute regarding the charges appearing on the bill to the Company in writing no later than twenty (20) days following the due date for the bill. The Company shall furnish a written response regarding its investigation and determination as to the correctness of or

any adjustments to the bill within fifteen (15) days of its receipt of the written dispute. The customer may pay the disputed bill under protest within the time required by this rule to avoid discontinuation of service, in which event the dispute may be submitted to the Hawaii Public Utilities Commission for final determination.

KWC, in response, proposes certain changes to the Consumer Advocate's recommendation, as follows:

The customer shall submit any dispute regarding the charges appearing on the bill to the Company in writing no later than twenty (20) days following the due date for the bill. The Company shall furnish a written response regarding its investigation and determination as to the correctness of or any adjustments to the bill within fifteen (15) days of its receipt of the written dispute[. The] within said 20-day period. If the customer still disputes any of the charges appearing on the bill, the customer [may] must pay the disputed bill under protest within [the time required by this rule to avoid discontinuation of service, in which event the] twenty (20) days of the date the Company's response is mailed to the customer to avoid discontinuation of service. The dispute may be submitted to the Hawaii Public Utilities Commission for final determination.⁸²

10. Add a new paragraph to Rule VIII, Payment of Bills, that describes the handling of dishonored checks and the consequences of a dishonored check:

Any bill for which a bank check written in payment has been dishonored will be due and payable immediately upon written notice to the customer by the Company of the check's dishonorment. Within 5 days of issuance of written notice, the full amount of the bill must be paid in cash at the Company's office, along with a \$10.00 service charge. Should the customer fail to make payment on the dishonored check, the Company may discontinue service under Rule XI, with the thirty-day period running from the date that

⁸²See KWC's Statement of Position, at 7 - 8; KWC's Supplemental Written Testimony, at 5; and KWC's Exhibit 1.

the original bill was mailed or presented to the customer.

11. Amend Rule XIV(1), by including language that outlines the customer's responsibility to report any damage of KWC's facilities as soon as possible:

Any damage to Company facilities shall be reported as soon as possible.

In general, the agreed-upon revisions are consistent with prior commission rulings, explain certain terms, and clarify KWC's existing tariff provisions. The commission finds reasonable the Parties' agreed-upon revisions to KWC's tariff rules.

For Rule VIII governing billing disputes, KWC seeks certain changes to the Consumer Advocate's proposal in order to minimize or avoid the situation where a customer disputes a bill or bills for the purpose of evading payment.⁸³ The commission, in this instance, finds reasonable KWC's version of Rule VIII governing billing disputes. Under both the Consumer Advocate's and KWC's versions, the commission is the ultimate decision-making body for billing disputes.

XIII.

Findings and Conclusions

This rate filing represents KWC's first application for a general increase in its rates since its inception of water service in 1996. Since that time, KWC's normalized level of operating and G&A expenses has increased. In addition, KWC's

⁸³In essence, KWC seeks to change "may pay the disputed bill under protest" to "must pay the disputed bill under protest."

plant-in-service now includes the facilities transferred from Kaupulehu Makai Venture.

The increase in revenues approved by the commission in this Decision and Order provides KWC with a reasonable opportunity to earn its test year revenue requirement.⁸⁴

The commission finds and concludes:

1. KWC's operating revenues and expenses for the test year, as set forth in Exhibit 1, attached, are reasonable.

2. KWC's use of an average test year rate base is reasonable.

3. KWC's inclusion of the costs of the two (2) abandoned pumps in its plant-in-service is: (A) inconsistent with ratemaking principles; and (B) neither just nor reasonable. Accordingly, the costs of the two (2) abandoned pumps are disallowed from KWC's plant-in-service, and ultimately, from rate base.

4. KWC's test year average depreciated rate base under present and approved rates is \$13,464,863.

5. KWC's 3.45 percent rate of return is fair.

6. KWC is entitled to: (A) an increase in revenues of \$521,065, or 24.07 percent over revenues at present rates; and (B) total operating revenues of \$2,685,869.

7. KWC's increase in the base rate of KWC's water consumption charge from \$3.75 per TG to \$6.65 per TG is reasonable.

⁸⁴The issuance of this Decision and Order renders moot the issuance of an Interim Decision and Order.

8. KWC's proposal to establish a non-potable reject water charge of \$0.75 per TG is reasonable.

9. KWC's PCAC, as modified and set forth in Section XII(A), Power Cost Adjustment Clause, above, is reasonable.

10. The tariff revisions proposed by KWC and the Consumer Advocate, respectively, as set forth in Sections XII(B), Tariff Revisions Proposed by KWC, and XII(C), Tariff Revisions Proposed by the Consumer Advocate, are reasonable.⁸⁵

XIV.

Orders

THE COMMISSION ORDERS:

1. KWC's waiver of its right to a contested case hearing under HRS § 269-16(a) and (b) is approved.

2. KWC may increase its rates to produce a total annual revenue increase of \$521,065, or 24.07 percent, as shown on Exhibit 1, attached, representing an increase in KWC's revenue requirement to \$2,685,869.

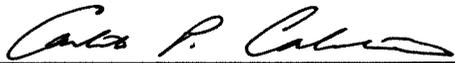
3. No later than January 10, 2006, KWC shall file its revised tariff sheets and rate schedules, which implement the tariff changes and increase in rates authorized by this Decision and Order, with copies served upon the Consumer Advocate, for the commission's review and approval. KWC's tariff changes shall take effect upon the commission's review and approval of said filing.

⁸⁵The commission, in this instance, accepts KWC's version of Rule VIII governing billing disputes.

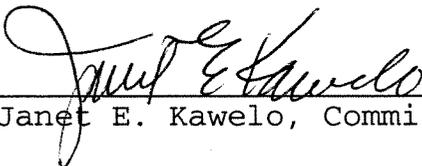
4. KWC, in its next rate proceeding, shall:
(A) consider the feasibility of modifying the methodology for determining its electricity expense and power cost adjustment factor to recognize the pump efficiency factors; and (B) request copies of HAWC's financial statements that reflect the costs of the operational services provided by HAWC during each contract year.

DONE at Honolulu, Hawaii December 29, 2005.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Carlito P. Caliboso, Chairman

By (EXCUSED)
Wayne H. Kimura, Commissioner

By 
Janet E. Kawelo, Commissioner

APPROVED AS TO FORM:


Michael Azama
Commission Counsel

05-0124.sl

Exhibit 1

**DOCKET NO. 05-0124
KAUPULEHU WATER COMPANY
REVENUE REQUIREMENTS
TEST YEAR ENDED JUNE 30, 2006**

	Present Rates	Additional Amount	Approved Rates
REVENUES			
Metered Revenue	\$ 1,414,226	\$ 1,093,669	\$ 2,507,895
Power Cost Adjustment	561,919	(561,919)	-
Rental Charges	72,790		72,790
Other Income (Reject)	104,967	(10,685)	94,282
Installation	10,902		10,902
	<u>\$ 2,164,804</u>	<u>\$ 521,065</u>	<u>\$ 2,685,869</u>
OPERATING & MAINT. EXPENSES			
Power Purchased	\$ 767,651		\$ 767,651
Chemical Cleaning R.O.	103,877		103,877
Contractual Services - Mgt	266,135		266,135
Testing - AECOS	1,785		1,785
Security	18,638		18,638
Chemical Additives	29,581		29,581
Fees	-		-
Miscellaneous Gen.	2,285		2,285
Repairs & Maintenance	77,567		77,567
Overhead - HDC	57,375		57,375
Consulting Services	25,000		25,000
Outside Svc - Legal/Acctg/Eng	17,392		17,392
Insurance	44,466		44,466
Telephone	1,226		1,226
Total O & M Expenses	\$ 1,412,978	-	\$ 1,412,978
Depreciation	\$ 590,986	\$ -	\$ 590,986
Taxes, Other Than Inc Tax	139,039	33,270	172,309
Interest Income	(12,781)	-	(12,781)
Income Taxes	-	57,798	57,798
Net Operating Expense	<u>\$ 2,130,222</u>	<u>\$ 91,068</u>	<u>\$ 2,221,290</u>
Net Operating Income (Loss)	<u>\$ 34,582</u>	<u>\$ 429,997</u>	<u>\$ 464,579</u>
Average Rate Base	<u>5,045,544</u>	<u>8,419,319</u>	<u>13,464,863</u>
Return on Rate Base	<u>0.6854%</u>		<u>3.45%</u>

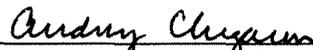
CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 22199 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
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Honolulu, HI 96809

DENISE HILL
KAUPULEHU WATER COMPANY
P. O. Box 5560
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ROBERT E. STRAND, ESQ.
DUANE R. MIYASHIRO, ESQ.
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ASB Tower, Suite 2200
1001 Bishop Street
Honolulu, HI 96813



for Karen Higashi

DATED: December 29, 2005