

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

----- In the Matter of -----)
WAIKOLOA SANITARY SEWER)
COMPANY, INC., dba)
WEST HAWAII SEWER COMPANY)
For Approval of Rate Increases)
and Revised Rate Schedules.)
_____)

DOCKET NO. 00-0440

ORDER NO. 23635

Filed Sept. 7, 2007
At 2 o'clock P.M.

Karen Higashi.
Chief Clerk of the Commission

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

ATTEST: A True Copy
KAREN HIGASHI
Chief Clerk, Public Utilities
Commission, State of Hawaii.

Karen Higashi.

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WAIKOLOA SANITARY SEWER)

COMPANY, INC., dba)

WEST HAWAII SEWER COMPANY)

For Approval of Rate Increases))

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²See Exhibits A to C, attached. The Parties in this proceeding are WHSC and the Consumer Advocate.

In addition, with respect to the refund issue raised by the Consumer Advocate, the commission finds that, given the recalculation of WHSC's monthly standby charge to \$19.94 per unit, a refund of the amounts over-collected by WHSC from its ratepayers, between November 7, 2001 and October 15, 2007, with interest, is required by Chapter 269, Hawaii Revised Statutes ("HRS").

The actual amount of the refund, however, was not calculated or claimed by the Consumer Advocate. Thus, the commission instructs the Parties to: (1) promptly calculate and reach agreement on the amount of the refund, including interest, and the repayment terms, given the findings and parameters described herein; and (2) submit their joint agreement on these matters for the commission's review and consideration, by September 28, 2007. In the event that an agreement is not reached, each of the Parties shall submit their individual plans (including the refund amounts and repayment terms) and calculations for the commission's review and consideration by the same date.

The commission strongly encourages the parties to reach a reasonable agreement that is fair and equitable to the utility and its ratepayers, which allows utility services to continue.

I.

Background

WHSC is a public utility that provides wastewater collection and treatment service to residences, condominiums, commercial establishments, and public facilities located at Waikoloa Village on the island of Hawaii.

A.

WHSC's 2001 Application for Rate Increase

By application filed on January 19, 2001, as amended on January 30, 2001, WHSC requested the commission's approval to increase its rates and revise its rate schedules, based on a 2001 calendar test year. After discovery was conducted on WHSC's request, the Consumer Advocate filed its Direct Testimony setting forth its recommendations regarding WHSC's request, and WHSC filed its Rebuttal Testimony responding to the Consumer Advocate's recommendations.

An issue in dispute between the Parties was the regulatory treatment of the contributions-in-aid-of-construction ("CIAC")³ tax gross-up collected by WHSC from 1987 to 1996, as a

³"A typical contribution in aid of construction occurs when an individual or group of individuals who desires service from a utility company is located so far from the company's existing main or line that the company is unwilling to bear the expense of constructing the necessary extension of its facilities. The utility company will agree to render the service if the individuals who desire it will pay all or part of the cost of construction. Title to the newly constructed facility passes to the utility which agrees to use such facility to supply the service to those who have paid for the line or main extension. The new plant is thereafter used and maintained by the company similarly to its other facilities. The amount paid by these customers is entered on the books of the company as a

result of the Tax Reform Act of 1986. Prior to the Tax Reform Act of 1986, CIAC received by public utilities from customers was exempted from income tax treatment. The Tax Reform Act of 1986 changed the law so that CIAC was considered taxable income in the year received. As such, from 1987 until the Small Business Job Protection Act was enacted in 1996, small utility companies were permitted to collect CIAC funds, that consisted of monetary amounts for plant facilities, as well as amounts anticipated for income taxes. WHSC recorded the collection of CIAC funds in two separate accounts: (1) CIAC, net of income tax was recorded in the CIAC account; and (2) the income tax related portion was recorded in the income tax payable account.

During the tax years 1987 to 1996, WHSC recorded negative taxable income in all years except 1990 and 1992, in which it paid a sum less than \$57,000 in income taxes to taxing authorities. In those years, WHSC collected approximately \$1,930,444 in CIAC of which an estimated \$732,990 represented the portion for income taxes payable. However, since WHSC recorded negative taxable income in the form of net operating losses ("NOL") in all but two years, WHSC retained approximately \$681,400, which was never paid in taxes to any taxing authority.

On October 15, 2001, the Parties filed a partial stipulation, which incorporated their agreement on an interim revenue requirement and rate increase, pending the commission's issuance of a final decision and order. In their partial

contribution in aid of construction." In re Puhi Sewer & Water Co., Inc., 83 Hawai'i 132, 138 n.2, 925 P.2d 302, 307 n.2 (Haw. 1996) ("In re Puhi Sewer").

stipulation, the Parties notified the commission that they were unable to resolve the CIAC tax gross-up issue.

By Interim Decision and Order No. 18995, filed on November 5, 2001, the commission approved an increase of \$103,944 (17.3 percent) in revenues over present rates. This interim increase in revenues resulted in an increase in the monthly standby charge to \$24.82 per residential unit (or per equivalent residential unit for commercial units), effective from November 7, 2001. The CIAC tax gross-up issue was not addressed in Interim Decision and Order No. 18995.

On December 17, 2001, WHSC and the Consumer Advocate filed their statements of position on the CIAC tax gross-up issue. In its statement of position, the Consumer Advocate argued that "WHSC's current practice of recording the income tax portion of CIAC in the income tax payable account has produced tremendous benefits to WHSC" but "results in an unfair burden to WHSC's ratepayers since the funds received are not considered in the rate setting process. As a result, the Consumer Advocate maintains that WHSC should be required to: (1) refund the funds that were collected to pay for expected taxes on CIAC to the contributors; or (2) reflect these amounts in determining revenue requirements such that [WHSC] would not inequitably benefit from cost-free capital provided by its ratepayers."⁴

⁴Division of Consumer Advocacy's Statement of Position Concerning the Issue of CIAC/Tax Gross-up and Attachments, filed December 17, 2001, at 3.

On February 27, 2002, the commission issued Decision and Order No. 19223, approving an increase of \$139,965 (23.31 percent) in revenues over present rates.⁵ The increase in revenues resulted in an increase in the monthly standby charge to \$27.13 per residential unit (or per equivalent residential unit for commercial units), effective from March 8, 2002.

With respect to the CIAC tax gross-up issue, the commission, in Section IV.B and Ordering Paragraph No. 3 of Decision and Order No. 19223, adopted the Consumer Advocate's primary recommendation that WHSC refund the CIAC balance to the contributors, and stated that "the remaining balance of \$681,400 is not CIAC" and instead "represents the amount collected by WHSC, from 1987 to 1996, for the payment of income taxes for the various projects under which CIAC was assessed."⁶ The commission found that "WHSC's retention of the \$681,400 is inconsistent with the underlying purpose of the full gross-up method" and that "[t]he full gross-up method was not intended to allow a utility to collect and retain cash reserves for purposes other than payment of income taxes for the tax year payable."⁷ Accordingly, the commission directed WHSC to refund to the contributors the

⁵In Section XII, Paragraph No. 7, of Decision and Order No. 19223, the commission stated:

The interim increase of \$103,944, granted under Interim Decision and Order No. 18995, effective on or about November 5, 2001, was just and reasonable. No refunds are required.

Decision and Order No. 19223, at 29.

⁶Decision and Order No. 19223, at 15.

⁷Id. at 16.

\$681,400 balance it had collected for the payment of income taxes and to submit a refund plan for the commission's review and approval. In doing so, the Consumer Advocate's alternative suggestion to recognize the \$681,400 as an adjustment to rate base, or as revenue, was not addressed or ruled upon by the commission.⁸

On March 11, 2002, WHSC filed a motion for reconsideration of Decision and Order No. 19223. By Order No. 19294, filed on April 10, 2002, the commission denied WHSC's motion for reconsideration finding that WHSC had not met its burden of demonstrating that reconsideration or reversal of Decision and Order No. 19223 was warranted. The commission directed WHSC to submit to the commission its refund plan for informational purposes, with copies served on the Consumer Advocate.⁹

B.

WHSC's Appeal

On May 9, 2002, WHSC appealed Decision and Order No. 19223 directing WHSC to refund the \$681,400, and Order No. 19294 denying WHSC's motion for reconsideration, to the Hawaii Supreme Court ("Court"), asserting that the amount it had collected from contributors for the CIAC income tax gross-up

⁸Id. at 15.

⁹Order No. 19294, filed on April 10, 2002.

portion was CIAC, and thus, non-refundable under its CIAC tariff rule.¹⁰

On December 29, 2005,¹¹ the Court issued its opinion reversing Decision and Order No. 19223 and Order No. 19294. According to the Court, the commission erred in directing the refund of \$681,400 to the developers who contributed it, as the filed-rate doctrine applied and CIAC funds collected by WHSC were nonrefundable under a plain reading of WHSC's CIAC tariff rule.¹² Under the filed rate "'doctrine, filed tariffs govern a utility's relationship with its customers and

¹⁰WHSC's Notice of Appeal, Exhibits A-1 and A-2, and Certificate of Service, filed on May 9, 2002. See also Appellant WHSC's Opening Brief, Appendices 1 to 12, Statement of Related Cases, and Certificate of Service, filed on August 27, 2002; Answering Brief of Appellee State of Hawaii, Public Utilities Commission, Appendices A to D, Statement of Related Cases, and Certificate of Service, filed on September 27, 2002; Answering Brief of Appellee Consumer Advocate, Appendices A to C, Statement of Related Cases, and Certificate of Service, filed on November 6, 2002; and Appellant WHSC's Consolidated Reply Brief and Certificate of Service, filed on November 20, 2002.

¹¹On the same day the Court issued its Opinion, on December 29, 2005, WHSC filed another application for a general rate increase, which utilized the 2006 calendar test year ("2006 test year"). In re Waikoloa Sanitary Sewer Co., Inc., dba West Hawaii Sewer Co., Docket No. 05-0329. In this application, WHSC seeks the commission's approval to increase its: (1) monthly standby charge; and (2) monthly quantity charge based on the amount of metered water provided per month. On April 4, 2006, the commission issued Stipulated Procedural Order No. 22370, approving WHSC's and the Consumer Advocate's proposed stipulated procedural order. WHSC's request is currently pending before the commission.

¹²In re Waikoloa Sanitary Sewer Co., dba West Hawaii Sewer Co., 109 Hawai'i 263, 275, 125 P.3d 484, 496 (Haw. 2005) ("In re WHSC").

have the force and effect of law until suspended or set aside.'"¹³ Section 1 of WHSC's tariff (Rule XI) expressly prohibited refunds of CIAC and Section 6 specified the CIAC amount as \$9.50 per gallon of estimated daily sewage discharge ("EDSD") of which Exhibit E submitted in support of the tariff, indicated that \$2.25 of the CIAC amount of \$9.50 was for the purpose of paying income taxes owed because of the receipt of construction funds. As such, the Court reasoned that, under the plain language of the tariff, the entire \$9.50 payment (which included income taxes) was a "CIAC payment [that] was not refundable."¹⁴ In doing so, the Court expressly rejected the commission's argument that the \$681,400 amount that was not directly paid to tax authorities was not CIAC on the ground that to "adopt[] the [c]ommission's position that \$2.25 of the \$9.50 CIAC amount was refundable would 'void' the term 'non-refundable' as used in Section 1 of the tariff."¹⁵ The Court, moreover, stated that, "[WHSC's] allocation of certain portions of the \$9.50 EDSD to separate accounts, such as the income taxes payable account, is not dispositive of whether the \$2.25 portion of the EDSD rate is to be refunded" as WHSC's tariff defined "CIAC as \$9.50 per gallon of EDSD."¹⁶

¹³In re WHSC, 109 Hawai'i at 271, 125 P.3d at 492 (quoting Southwestern Elec. Power Co. v. Grant, 73 S.W.3d 211, 217 (Tex. 2002)).

¹⁴In re WHSC, 109 Hawai'i at 272, 125 P.3d at 493.

¹⁵In re WHSC, 109 Hawai'i at 273, 125 P.3d at 494.

¹⁶In re WHSC, 109 Hawai'i at 273, 125 P.3d at 494.

In addition, with respect to WHSC's use of shareholder-owned NOL to offset its tax liabilities, the Court held that WHSC's "tariff does not contain provisions prohibiting [WHSC] from using NOL to offset [WHSC's] tax liabilities incurred from the construction of new facilities funded by CIAC. Because there is no tariff prohibition prohibiting the use of shareholder NOL to offset [WHSC's] tax liability, there is no conflict in the tariff provisions that must be addressed."¹⁷ The Court did not address the issue of the ratemaking treatment of the NOL:

The Consumer Advocate states that [WHSC] indicated the \$681,400 balance was 'a source of funds from which regulatory assets were purchased.' The Commission maintains that '*if this is true*' then [WHSC] 'failed to make a corresponding adjustment to its test year . . . net plant in service.' (Emphasis added.) This matter is not further discussed, and the parties devote their argument to the use of NOL as a setoff against the CIAC income taxes collected. Thus, we do not express an opinion as to this issue.

In re WHSC, 109 Hawai'i at 274-75 n.13, 125 P.3d 484, at 495-46 n.13 (italics in original) (emphasis added).

Accordingly, the Court remanded the case to the commission "for appropriate disposition."¹⁸ On January 24, 2006, the Court issued its Notice and Judgment on Appeal.

¹⁷In re WHSC, 109 Hawai'i at 275, 125 P.3d at 496.

¹⁸In re WHSC, 109 Hawai'i at 276, 125 P.3d at 497.

C.

Order No. 22275

Promptly after the Court issued its Notice and Judgment on appeal the commission issued Order No. 22275 in which the commission on February 7, 2006:

1. Vacated Section IV.B and Ordering Paragraph No. 3 of Decision and Order No. 19223, which required WHSC to: (A) refund to the affected contributors the \$681,400 balance WHSC had collected for the payment of income taxes; and (B) submit a refund plan for the commission's review and approval; and

2. Vacated Order No. 19294, which denied WHSC's motion for reconsideration and instructed WHSC to submit to the commission its refund plan for informational purposes, with copies served upon the Consumer Advocate.¹⁹

D.

Consumer Advocate's Motion for Reconsideration

On March 7, 2006, the Consumer Advocate filed a Motion for Reconsideration in which it argues that, as a result of the Court's decision, WHSC must now recalculate its 2001 test year revenue requirement and include the CIAC income tax gross-up as a reduction to WHSC's 2001 test year rate base, effectively reducing WHSC's monthly standby wastewater rate.²⁰ The Consumer

¹⁹See Order No. 22275, filed on February 7, 2006.

²⁰By Order No. 22309, filed on March 7, 2006, the commission: (1) granted the Consumer Advocate's request for an extension of time until March 7, 2006, to file a motion for reconsideration; and (2) noted that "WHSC shall have the opportunity to respond to the Consumer Advocate's motion for reconsideration[,]" in

Advocate also argues that, pursuant to HRS § 269-16(d), WHSC must now refund, with interest, the excess monies it collected between the filing of Decision and Order No. 19223 on February 27, 2002 (\$27.13 monthly standby wastewater rate) until the new 2001 test year wastewater rate will take effect (\$19.94 monthly standby wastewater rate). The Consumer Advocate, however, did not calculate the actual amount of the refund it claims is required.

On March 29, 2006, WHSC filed a Memorandum in Opposition to the Consumer Advocate's Motion for Reconsideration in which WHSC argues that the reconsideration motion was untimely and procedurally improper; seeks to relitigate issues already resolved by the Hawaii Supreme Court; and violates the commission's Order No. 22309.²¹

II.

Standard

HAR § 6-61-137 provides:

§6-61-137 Motion for reconsideration or rehearing. A motion seeking any change in a decision, order, or requirement of the commission should clearly specify whether the prayer is for

accordance with Hawaii Administrative Rules ("HAR") § 6-61-140. By letter dated March 8, 2006, commission counsel informed WHSC that pursuant to HAR § 6-61-140, the commission found it "desirable [and] necessary" to allow WHSC to respond to the Consumer Advocate's Motion, no later than March 29, 2006. By this Order, the commission formally adopts said finding, consistent with HAR § 6-61-140.

²¹WHSC's Memorandum in Opposition to the Consumer Advocate's Motion for Partial Reconsideration and Modification; and Certificate of Service, filed on March 29, 2006 (collectively, "WHSC's Opposition").

reconsideration, rehearing, further hearing, or modification, suspension, vacation, or a combination thereof. The motion shall . . . set[] forth specifically the grounds on which the movant considers the decision or order unreasonable, unlawful, or erroneous.

HAR § 6-61-137.

III.

Discussion

A.

WHSC's Procedural Arguments

WHSC argues that the Consumer Advocate's Motion for Reconsideration should be dismissed as it "(1) is untimely and procedurally improper; (2) wrongly seeks to relitigate issues finally and completely resolved by the Hawaii Supreme Court in Opinion No. 25087; and (3) violates the Commission's Order No. 22309."²² The commission disagrees on all three points.

First, WHSC argues that the Motion for Reconsideration is untimely and procedurally improper. According to WHSC, in Decision and Order No. 19223, the commission rejected the Consumer Advocate's request that the income tax gross-up component be reflected in WHSC's revenue requirement and a corresponding adjustment be made to WHSC's rate base. Since the Consumer Advocate did not challenge Decision and Order No. 19223 by filing a timely motion for reconsideration with the commission, WHSC thus argues that the Consumer Advocate is now barred from resurrecting and re-litigating this matter by way of its Motion for Reconsideration.

²²WHSC's Opposition, at 2.

WHSC mischaracterizes the commission's ruling in Decision and Order No. 19223. The Consumer Advocate's primary contention was that WHSC should be required to return the CIAC balance to the affected contributors.²³ In the alternative, "[i]f the refund[ing] of the balance to the affected contributors [was] not feasible, the only remaining option, the Consumer Advocate maintain[ed, was] to recognize this amount as: (1) an adjustment to rate base; or (2) as revenue."²⁴ The commission, in Decision and Order No. 19223, accepted the Consumer Advocate's primary argument to refund the \$681,400 to the contributors. Contrary to WHSC's claim, the commission did not "reject" the Consumer Advocate's alternative proposal in Decision and Order No. 19223. Instead, the commission's acceptance of the Consumer Advocate's primary contention in Decision and Order No. 19223 rendered moot the Consumer Advocate's alternative proposal, until the Court's subsequent decision holding that the entire \$9.50 per gallon of EDSD (including the \$2.25 per gallon of EDSD for income tax payments) represented non-refundable CIAC.

Along the same lines, WHSC argues that the Consumer Advocate failed to appeal its alternative proposal to the Hawaii Supreme Court. As previously noted, just as the Consumer Advocate was not required to file a motion for reconsideration on its alternative theory, it was not required to appeal its alternative theory, as the commission had already ruled in its favor on its primary argument. To attempt to appeal a ruling

²³See Decision and Order No. 19223, at 14-15.

²⁴Id. at 15.

that the commission had not made would have been dismissed by the Court as unripe.

Second, WHSC argues that the Motion for Reconsideration is barred by the Consumer Advocate's failure to file a motion for reconsideration of the Supreme Court's decision in In re WHSC. The Consumer Advocate, however, would only have been required to file a motion to reconsider the Supreme Court's decision if the Court had ruled against it with respect to the issue of recalculation of WHSC's rate base to reflect the CIAC tax gross-up. That issue, however, was neither presented to the Court, nor decided by the Court, because the commission never ruled on that issue. Contrary to WHSC's claim, the Court expressed no opinion on this issue, and remanded Docket No. 00-0440 to the commission for appropriate disposition.²⁵ Accordingly, the commission rejects WHSC's argument that the Consumer Advocate's Motion for Reconsideration wrongly seeks to re-litigate issues finally and completely resolved by the Court in In re WHSC.

Third, WHSC argues that the Motion for Reconsideration violates Order No. 22309, which strictly precluded the Consumer Advocate "from re-litigating in any manner the issues already decided by the Court in In re WHSC."²⁶ As noted above, the Court did not decide the issue of whether WHSC's rate base should be recalculated to reflect the CIAC tax gross-up. Accordingly, the

²⁵In re WHSC, 109 Hawai'i at 274-75 n.13, 125 P.3d at 495-96 n.13.

²⁶See Order No. 22309, at 4 and 5.

Consumer Advocate is not precluded from raising the issue in its Motion for Reconsideration.

B.

WHSC's Test Year Revenue Requirement

With respect to the Consumer Advocate's Motion for Reconsideration, the Consumer Advocate argues that the commission erred in closing the docket without properly disposing of the CIAC tax gross-up by reflecting those amounts in the test year revenue requirement and resulting rates. By way of background, the Consumer Advocate explains:

1. WHSC's CIAC tariff Rule XI required developers to pay \$9.50 per gallon of EDSD, which included the gross-up amount of \$2.25 per gallon of EDSD for income tax payments. WHSC recorded the CIAC funds it received in two separate accounts: (A) CIAC, net of income tax (\$7.25 per gallon of EDSD), was recorded in the CIAC balance sheet account ("CIAC account"); and (B) the income tax portion (\$2.25 per gallon of EDSD) was recorded in the income tax payable account.

2. The amounts recorded in the CIAC account were reflected in WHSC's test year rate base, revenue requirements, and resulting wastewater rates. Conversely, the amounts recorded in the income tax payable account (\$681,400) were not recognized in WHSC's test year rate base, revenue requirements, and resulting wastewater rates.

3. The Court held that under the filed-rate doctrine and a plain reading of WHSC's Rule XI, the \$681,400 balance represented non-refundable CIAC. In essence, the Court concluded that the entire \$9.50 per gallon of EDSD (including the \$2.25 per gallon of EDSD for income tax payments) represented CIAC.

The Consumer Advocate asserts that the amount recorded in WHSC's income tax payable account (\$681,400) should now be reflected as CIAC in WHSC's test year rate base. Hence, the Consumer Advocate contends that the commission must now recalculate WHSC's test year revenue requirement and include the \$681,400 CIAC income tax gross-up balance as a reduction to WHSC's test year rate base in order to determine the just and reasonable wastewater rate in a final decision and order, which would be consistent with the Court's opinion, generally accepted ratemaking principles, Decision and Order No. 19223, and a past commission proceeding.²⁷ The Consumer Advocate claims the commission has sufficient information to recalculate WHSC's test year revenue requirement to include the \$681,400 CIAC income tax gross-up amount as a reduction to WHSC's test year rate base, but does not specify the actual amount it claims should be refunded.

Here, the commission agrees with the Consumer Advocate that, as a result of the Court's opinion, generally accepted ratemaking principles require the commission to recalculate WHSC's revenue requirement and resulting rates. The Court in In

²⁷The Consumer Advocate cites to In re WHSC; Robert L. Hahne, Gregory E. Aliff, and Deloitte & Touche LLP, Accounting for Public Utilities § 4.04[7] at 4-39 (2004); Decision and Order No. 19223, at 7; and In re Puhi Sewer & Water Co., Docket No. 7576, Order No. 15985, filed on September 30, 1997. See also Consumer Advocate's Motion for Reconsideration, at 14 n.28.

re WHSC held that the entire \$9.50 per gallon of EDSD (including the \$2.25 per gallon of EDSD for income tax payments) represented CIAC.²⁸ As such, the commission is required to treat the entire \$9.50 (including the \$2.25 for income taxes) as CIAC for ratemaking purposes. WHSC's test year CIAC, however, was reported net of income tax. Thus, an adjustment should be made to include the income tax component as part of WHSC's test year CIAC, consistent with In re WHSC.

It is well-settled that CIAC must be deducted from rate base in calculating a utility's authorized return on investment.²⁹ "In determining [a public utility's] proper rate base, the 'near-universal rule is that contributions in aid of construction are properly excluded from the rate base.' 'The rule is based on principles of fairness. It is inequitable to require utility customers to pay a return on property for which they, and not the utility, have paid.'"³⁰

WHSC, however, argues that it used the CIAC income tax gross-up fees to reimburse itself for the use of its shareholder-owned NOLs that had been used to pay the tax liability, instead of paying the tax component directly to the taxing authorities. As such, WHSC argues that the Consumer Advocate's Motion for Reconsideration, if granted, will effectively transfer the

²⁸See In re WHSC, 109 Hawai'i at 272-74, 125 P.3d 484, at 493-95.

²⁹In re Hawaii Elec. Light Co., Inc., Docket No. 04-0140, Decision and Order No. 15480, filed on April 2, 1997, at 28.

³⁰In re Puhi Sewer, 83 Hawai'i 132, 137, 925 P.2d 302, 307 (Haw. 1996) (citations omitted); see also In re Kaanapali Water Corp., 5 Haw. App. 71, 79, 678 P.2d 584, 590 (1984).

shareholder NOLs to ratepayers without compensation to WHSC and at WHSC's expense. As noted by the Consumer Advocate, "[i]n recording the cost of utility plant in service, no distinction is made between property purchased with shareholder versus non-shareholder or contributed funds. Therefore, for ratemaking purposes, regulatory commissions eliminate the cost of contributed property when calculating a rate base by reducing the plant in service costs by the amount of contributions received to acquire such utility assets."³¹

Based on the foregoing, the commission grants the Consumer Advocate's Motion for Reconsideration and issues a revised revenue requirement schedule that establishes a new monthly standby charge. The revised revenue requirement schedule attached to this Order incorporates the reduction in WHSC's test year rate base to reflect the CIAC balance of \$732,990, rather than the \$681,400 amount recommended by the Consumer Advocate.³² The Court In re WHSC held that the entire \$9.50 per gallon of EDSD (including the \$2.25 per gallon of EDSD for income tax payments) represented CIAC.³³ Thus, contrary to the Consumer Advocate's position, \$732,990 represents the CIAC balance amount, not \$681,400. The \$681,400 figure merely represents the CIAC income tax gross-up portion that was collected but not remitted to the tax authorities. As a result of this adjustment, WHSC's

³¹Motion for Reconsideration at 14 (footnote and citations therein omitted) (emphasis added).

³²See Exhibits A and B, attached.

³³In re WHSC, 109 Hawai'i at 272-74, 125 P.3d at 493-95.

corrected monthly standby charge is \$19.94 per residential unit (or per equivalent residential unit for commercial units).³⁴

This adjustment is required to ensure that the rates charged are just and reasonable under Chapter 269, HRS. It is well-settled that the commission has general supervision over all public utilities, and is authorized to fix just and reasonable rates. HRS §§ 269-6 and 269-16; see also In re Gray Line Hawai'i, Ltd., 93 Hawai'i 45, 53, 995 P.2d 776, 784 (Haw. 2000); In re Puhi Sewer, 83 Hawai'i 132, 136-37, 925 P.2d 302, 306-07; In re Hawaiian Tel. Co., 67 Haw. 370, 379, 689 P.2d 741, 747 (1984); and In re Kaanapali Water Corp., 5 Haw. App. at 77-78, 678 P.2d at 589.

WHSC's new monthly standby charge shall take effect on October 15, 2007.

C.

Refund Issue

Citing to HRS § 269-16(d), the Consumer Advocate contends that WHSC must return the monies, with interest, it collected through the existing wastewater rates set forth in Decision and Order No. 19233 that are in excess of the rates that must now be reset with the inclusion of the CIAC income tax gross-up amount in WHSC's test year revenue requirement.³⁵ In essence, the Consumer Advocate characterizes the wastewater rate

³⁴See Exhibit C, attached.

³⁵See Motion for Reconsideration, at 22 (WHSC must refund, with interest, "the amounts that were paid from the date on which D&O 19223 was filed, to the date on which a final decision and order properly disposing of the matter is filed.").

set by the commission in Decision and Order No. 19223 as an "interim" rate under HRS § 269-16(d). In response, WHSC counters that requiring a refund will cause WHSC to incur additional borrowing charges and related interest expenses; and is clearly unwarranted and in excess of regulatory authority.

The commission agrees with the Consumer Advocate that a refund is required, but disagrees on the relevant time period. In doing so, the commission disagrees with WHSC that a refund is unwarranted and in excess of its regulatory authority. As described further below, the commission orders a refund for the period between November 7, 2001, and October 15, 2007.

1.

Refund for the Period Between Interim
Decision and Order No. 18995 and Decision and Order No. 19223

HRS § 269-16(d) provides, in relevant part:

(d) The commission shall make every effort to complete its deliberations and issue its decision as expeditiously as possible and before nine months from the date the public utility filed its completed application; provided that in carrying out this mandate, the commission shall require all parties to a proceeding to comply strictly with procedural time schedules that it establishes. If a decision is rendered after the nine-month period, the commission shall report in writing the reasons therefor to the legislature within thirty days after rendering the decision.

Notwithstanding subsection (c), if the commission has not issued its final decision on a public utility's rate application within the nine-month period stated in this section, the commission, within one month after the expiration of the nine-month period, shall render an interim decision allowing the increase in rates, fares and charges, if any, to which the commission, based on the evidentiary record before it, believes the public utility is probably entitled. The commission may postpone its interim rate decision

for thirty days if the commission considers the evidentiary hearings incomplete. In the event interim rates are made effective, the commission shall require by order the public utility to return, in the form of an adjustment to rates, fares, or charges to be billed in the future, any amounts with interest, at a rate equal to the rate of return on the public utility's rate base found to be reasonable by the commission, received under the interim rates that are in excess of the rates, fares, or charges finally determined to be just and reasonable by the commission. Interest on any excess shall commence as of the date that any rate, fare, or charge goes into effect that results in the excess and shall continue to accrue on the balance of the excess until returned.

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HRS § 269-16(d) (emphasis added).

Under a plain reading of HRS § 269-16, subsection (d) contemplates the issuance of a "final decision" within nine months "from the date the public utility filed its completed application[.]" "[I]f the commission has not issued its final decision on a public utility's rate application within the nine-month period stated in [section 269-16], the commission, within one month after the expiration of the nine-month period, shall render an interim decision allowing the increase in rates, fares and charges, if any[.]" Moreover, "[i]n the event interim rates are made effective, the commission shall require by order the public utility to return, in the form of an adjustment to rates, fares, or charges to be billed in the future, any amounts with interest, at a rate equal to the rate of return on the public utility's rate base found to be reasonable by the commission, received under the interim rates that are in excess of the rates, fares, or charges finally determined to be just and reasonable by the commission."

Here, the commission did not issue its final decision within the nine-month period prescribed under HRS § 269-16(d). Instead, on November 5, 2001, the commission issued Interim Decision and Order No. 18995 in which WHSC's monthly standby charge of \$24.82 per unit took effect as of November 7, 2001. Thereafter, on February 27, 2002, the commission issued Decision and Order No. 19223, i.e., the "final decision" contemplated under HRS § 269-16(d) in which WHSC's monthly standby charge increased to \$27.13 per unit as of March 8, 2002.

With the recalculation of WHSC's monthly standby charge to \$19.94 per unit, a refund of the amounts over collected by WHSC from its ratepayers, between November 7, 2001 and March 7, 2002, with interest, is appropriate under Chapter 269, HRS.³⁶ During this period, ratepayers paid \$4.88 per unit/per month in excess of the \$19.94 per unit/per month amount established by this Order as a result of the Court's Opinion in In re WHSC.

Thus, pursuant to HRS § 269-16(d), WHUC is required to refund the amounts it over collected between the period from November 7, 2001 (when the interim rate increase was set) to March 7, 2002 (when the "final decision" took effect).

³⁶Contrary to the Consumer Advocate's position, the commission finds that the refund period must begin from November 7, 2001, the date that WHSC's interim rate took effect, pursuant to Interim Decision and Order No. 18995. This is the "interim decision allowing the increase in rates, fares and charges, if any," described in HRS § 269-16(d).

Refund for the Period Between
Decision and Order No. 19223 and This Order

With respect to the period from March 8, 2002 to October 15, 2007 (the effective date of the \$19.94 per unit/per month charge), the commission likewise finds that WHSC must refund the amounts it over collected during this period, wherein ratepayers have and will be paying \$7.19 per unit/per month in excess of the final \$19.94 per unit/per month amount established by this Order. This conclusion is consistent with HRS § 269-16(d), as noted above, and the commission's general supervision over all public utilities, and its authority to fix just and reasonable rates.

HRS § 269-6 states, in relevant part:

General powers and duties. The public utilities commission shall have the general supervision hereinafter set forth over all public utilities, and shall perform the duties and exercise the powers imposed or conferred upon it by this chapter

HRS § 269-6; see also HRS § 269-7 (commission's investigative powers).

HRS § 269-16 also provides, in relevant part:

Regulation of utility rates; ratemaking procedures. (a) All rates, fares, charges, classifications, schedules, rules, and practices made, charged, or observed by any public utility or by two or more public utilities jointly shall be just and reasonable and shall be filed with the public utilities commission

(b) No rate, fare, charge, classification, schedule, rule, or practice, other than one established pursuant to an automatic rate adjustment clause previously approved by the commission, shall be established, abandoned,

modified, or departed from by any public utility, except after thirty days' notice to the commission as prescribed in section 269-12(b), and prior approval by the commission for any increases in rates, fares, or charges. The commission, in its discretion and for good cause shown, may allow any rate, fare, charge, classification, schedule, rule, or practice to be established, abandoned, modified, or departed from upon notice less than that provided for in section 269-12(b). A contested case hearing shall be held in connection with any increase in rates, and the hearing shall be preceded by a public hearing as prescribed in section 269-12(c), at which the consumers or patrons of the public utility may present testimony to the commission concerning the increase. The commission, upon notice to the public utility, may:

.

- (3) Do all things that are necessary and in the exercise of the commission's power and jurisdiction, all of which as so ordered, regulated, fixed, and cha[r]ged are just and reasonable, and provide a fair return on the property of the utility actually used or useful for public utility purposes.

HRS § 269-16 (emphasis added).

Likewise, in In re Kauai Elec. Div. of Citizens Util. Co. ("In re Kauai Elec. Div."), 60 Haw. 166, 590 P.2d 524 (1978), the Hawaii Supreme Court held that the commission's authority to grant interim rate increases to public utilities, conditioned on a refund provision, was necessarily implied from the commission's express authority to regulate rates and supervise public utilities operating within the State of Hawaii, and was to be implied from the express authority granted to the commission under HRS § 269-16 (now HRS § 269-16(b)(3)) to "do all things . . . which are necessary and in exercise of such power and jurisdiction . . . all of which shall be just and

reasonable."³⁷ Thus, the Court noted that "the Commission's power to order a refund as a condition to an interim rate increase [was] a valid exercise of its authority to regulate rates, provided that the interim rate increase order [was] itself reasonable under the circumstances."³⁸

Here, with the recalculation of WHSC's monthly standby charge to \$19.94 per unit, a refund of the amounts over collected by WHSC from its ratepayers, between March 8, 2002 and October 15, 2007, with interest, is appropriate under Chapter 269, HRS, to ensure just and reasonable rates. For the period between March 8, 2002 and October 15, 2007, WHSC has had the benefit of an additional \$7.19 per unit/per month in excess of the \$19.94 rate that is just and reasonable. Thus, it would be unfair to WHSC's ratepayers to allow WHSC to retain the entire amount without some refund. As asserted by the Consumer Advocate in its Motion for Reconsideration:

. . . when the Commission properly recalculates the revenue requirement to recognize the [\$732,990] as CIAC, the revenue requirement set forth in D&O 19223 will be reduced. This will result in a corresponding reduction to the rates that were deemed just and reasonable in said

³⁷In re Kauai Elec. Div., 60 Haw. at 180, 590 P.2d at 535. On December 19, 1987, the Court issued its decision in In re Kauai Elec. Div. On June 12, 1984, Act 289 took effect, which adopted the language set forth in HRS § 269-16(d), authorizing the commission to issue interim rate decisions based on a finding of probable entitlement, and subject to refund with interest, to the extent applicable. See Act 289 Haw. Sess. Laws §1, at 898-99.

³⁸In re Kauai Elec. Div., 60 Haw. at 181, 590 P.2d at 535-36.

decision. The revenue requirement determined in D&O 19233 and rates intended to produce such revenue requirement are thus overstated and not just and reasonable, based on the Supreme Court's ruling on the matter.

.

As previously discussed, the income taxes collected for CIAC was never recognized in WHSC's rate setting process. Failing to recalculate the test year revenue requirement to include the [\$732,990] as CIAC results in WHSC receiving a windfall at WHSC's ratepayers expense. WHSC's ratepayers continue to be required to pay higher rates than the rates that would be determined to be just and reasonable when the [\$732,990] is properly recognized as CIAC in the test year rate base and revenue requirement.

Motion for Reconsideration, at 20, 22 (footnote and text therein omitted) (emphasis added).

Conversely, however, under the unique circumstances of this case, it is equally important to ensure the financial viability and ability of WHSC to continue providing wastewater utility service within the Waikoloa Village service area, without interruption. As noted by the Court: "The regulation of public utilities ensures continuation of service to the public with reasonable efficiency, at fair rates, and without discrimination against particular users or classes of users."³⁹ Simply put, WHSC should have access to sufficient revenues to meet its daily operational needs.

³⁹In re Wind Power Pacific Investors-III, 67 Haw. 342, 345, 686 P.2d 831, 833-34 (1984) (citing A.J.G. Priest, Principles of Public Utility Regulation, Ch. 1, generally; 73B C.J.S. Public Utilities § 2); see also In re Hawaiian Tel. Co., 67 Haw. at 384, 689 P.2d at 751 ("To insure that rates are 'just and reasonable' includes the power to take into consideration the interests of the ratepayers as well as that of the utility owners.") (quoting Docket No. 4779, Decision and Order No. 7412, at 27).

On balance, therefore, the commission believes that it is consistent with the public interest for WHSC and the Consumer Advocate to calculate and agree on the amount of the refund, including interest, and the repayment terms.⁴⁰ In essence, the commission strongly encourages the parties to reach a reasonable agreement that is fair and equitable to the utility and its ratepayers, which allows utility services to continue. This allowance for mitigation is consistent with the spirit and intent of Chapter 269, HRS,⁴¹ and the commission's ratemaking function of making pragmatic adjustments called for by the particular circumstances, such as the unique circumstances noted by the commission herein. See In re Hawaii Elec. Light Co., Inc., 67 Haw. 425, 432, 690 P.2d 274, 279 (1984); and In re Hawaiian Tel. Co., 67 Haw. at 382-83, 689 P.2d at 749; see also In re Hawaii Elec. Light Co., Inc., 60 Haw. 625, 636, 594 P.2d 612, 620 (1979).

Accordingly, the Parties shall: (1) promptly calculate and reach an agreement on the amount of the refund, including interest, and the repayment terms, given the monthly standby charge amounts of \$24.82, \$27.13, and \$19.94 per unit; and (2) submit their joint agreement for the commission's review and consideration, by September 28, 2007. In the event that an agreement is not reached, each of the Parties shall submit their individual calculations and plans (including the refund amounts

⁴⁰The customer count on file in this docket is based on the 2001 test year.

⁴¹The amounts refunded under HRS § 269-16(d) must be "found to be reasonable by the commission[.]"

and repayment terms) for the commission's review and consideration by the same date.

Based on the reasons set forth in Section III.C herein, the commission grants the Consumer Advocate's Motion for Reconsideration on the refund issue, subject to subsequent determination of the amount of the refund and acceptable repayment terms as provided herein.

IV.

Orders

THE COMMISSION ORDERS:

1. The Consumer Advocate's Motion for Partial Reconsideration and Modification of Order No. 22275, filed on March 7, 2006, is granted.


2. WHSC's new standby monthly charge of \$19.94 per unit shall take effect on October 15, 2007. Consistent thereto, WHSC shall file by September 28, 2007, its updated tariff sheets to reflect the new charge, with the applicable issued and effective dates.

3. The Parties shall: (A) promptly calculate and reach an agreement on the amount of the refund, including interest, and the repayment terms, given the monthly standby charge amounts of \$24.82, \$27.13, and \$19.94 per unit; and (B) submit their joint agreement on these matters for the commission's review and consideration, by September 28, 2007. In the event that an agreement is not reached, each of the Parties shall submit their individual plans (including the refund amounts

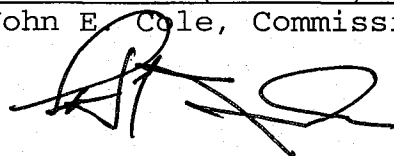
and repayment terms) and calculations for the commission's review and consideration by the same date.

DONE at Honolulu, Hawaii SEP - 7 2007.


PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Carlito P. Caliboso, Chairman

By (EXCUSED)
John E. Cole, Commissioner


By
Leslie H. Kondo, Commissioner

APPROVED AS TO FORM:


Michael Azama
Commission Counsel
00-0440.AC

Revised

Waikoloa Sanitary Sewer Company, Inc., dba West Hawaii Sewer Company Revenue Requirements Test Year Ending December 31, 2001

	<u>Present Rates</u>	<u>Additional Amount</u>	<u>Approved Rates</u>
Revenues:			
Sewer Revenues	\$ 600,418	27,788	\$ 628,206
Miscellaneous Service Revenue	-	-	-
Other Operating Revenues	-	-	-
Total Operating Revenues	<u>600,418</u>	<u>27,788</u>	<u>628,206</u>
O & M Expenses			
Chemicals	23,814		23,814
Contractual Services	40,112		40,112
Insurance	20,241		20,241
Materials/Supplies	34,448		34,448
Power	42,262		42,262
Rent	13,313		13,313
Salaries & Wages	270,429		270,429
Transportation Expense	1,795		1,795
Regulatory Commission Expense	15,481		15,481
Depreciation	58,152 *		58,152 *
Bad Debt	723		723
Miscellaneous Expense	1,155		1,155
Total O&M Expenses	<u>521,925</u>	<u>0</u>	<u>521,925</u>
Taxes Other Than Income Taxes	38,337	1,774	40,111
Interest on Customer Deposits	0	-	0
Income Taxes	12,605	8,166	20,771
Total Operating Expenses	<u>572,867</u>	<u>9,940</u>	<u>582,808</u>
Operating Income	<u>\$ 27,551</u>	<u>\$ 17,848</u>	<u>\$ 45,398</u>
Average Rate Base	<u>\$ 453,982</u>		<u>\$ 453,982</u>
Return on Rate Base	<u>6.07%</u>		<u>10.00%</u>

* Depreciation expense reduced by 1/50th of \$732,990

Revised

Waikoloa Sanitary Sewer Company, Inc., dba West Hawaii Sewer Company Analysis of Rate Increase

	<u>Amount</u>	<u>% Increase</u>
Rate Increase:		
Recon Rate Increase (September 2007 Order)	27,788	4.63%
Less:		
Interim Rate Increase (D&O No. 18995)	103,944	17.31%
Rate Increase (D&O No. 19223)	36,021	6.00%
Increase (Decrease)	<u>(112,177)</u>	-18.68%

Revised

Waikoloa Sanitary Sewer Company, Inc., dba West Hawaii Sewer Company
Taxes Other Than Income Taxes
Test Year Ending December 31, 2001

		<u>Present Rates</u>	<u>Approved Rates</u>
<u>Revenue Taxes:</u>			
Public Service Company Tax	5.885%	\$ 35,335	\$ 36,970
PUC Fee	0.5%	<u>3,002</u>	<u>3,141</u>
Total Taxes Other Than Income Taxes		<u>\$ 38,337</u>	<u>\$ 40,111</u>

Revised

Waikoloa Sanitary Sewer Company, Inc., dba West Hawaii Sewer Company Income Tax Expense Test Year Ending December 31, 2001

	<u>Present Rates</u>	<u>Approved Rates</u>
Revenues:		
Sewer Revenues	\$ 600,418	\$ 628,206
Miscellaneous Service Revenue	-	-
Other Operating Revenues	-	-
Total Operating Revenues	<u>600,418</u>	<u>628,206</u>
O & M Expenses		
Chemicals	23,814	23,814
Contractual Services	40,112	40,112
Insurance	20,241	20,241
Materials/Supplies	34,448	34,448
Power	42,262	42,262
Rent	13,313	13,313
Salaries & Wages	270,429	270,429
Transportation Expense	1,795	1,795
Regulatory Commission Expense	15,481	15,481
Depreciation	58,152	58,152
Bad Debt	723	723
Miscellaneous Expense	1,155	1,155
Total O&M Expenses	<u>521,925</u>	<u>521,925</u>
Taxes Other Than Income Taxes	38,337	40,111
Interest on Customer Deposits	-	-
Total O&M Expenses Before Income Taxes	<u>560,262</u>	<u>562,036</u>
Adjustments:		
Interest Expense	-	-
Meals and Entertainment	-	-
Taxable Income	40,156	66,170
Income Tax Provision Effective tax rate of 31.3910%	12,605	20,771
Less Amortization of :		
State ITC Amortization	<u>0</u>	<u>0</u>
Income Tax Expense	<u>\$ 12,605</u>	<u>\$ 20,771</u>

Revised

Waikoloa Sanitary Sewer Company, Inc., dba West Hawaii Sewer Company Average Rate Base Test Year Ending December 31, 2001

	<u>12/31/2000</u>	<u>12/31/2001</u>
Plant In Service	\$ 3,636,757	\$ 3,665,929
Less: Accumulated Depreciation	<u>962,107</u>	<u>1,070,593</u>
Net Plant in Service	2,674,650	2,595,336
Deduct:		
Unamortized CIAC	1,888,545 *	1,852,871 *
Customer Advances	-	-
Customer Deposits	-	-
Accumulated Deferred Income Tax	260,386	285,083
Deferred Hi Cap Goods Credit	77,760	74,672
Unamortized Gain on Sale of Land	-	-
Subtotal	<u>2,226,691</u>	<u>2,212,626</u>
Add:		
Property Held for Future Use	-	-
Material & Supply Inventory	-	-
Fuel Oil Inventory	-	-
Regulatory Asset	-	-
Subtotal	<u>-</u>	<u>-</u>
Subtotal	447,959	382,710
Average		\$ 415,335
Working Cash at Present Rates		<u>38,648</u>
Rate Base at Present Rates		453,982
Change in Working Cash		<u>-</u>
Rate Base at Proposed Rates		<u>\$ 453,982</u>

* Unamortized CIAC increased by \$732,990

Revised

Waikoloa Sanitary Sewer Company, Inc., dba West Hawaii Sewer Company
Working Cash Calculation
Test Year Ending December 31, 2001

At Present Rates

Operating Expenses	
Chemicals	\$ 23,814
Contractual Services	40,112
Insurance	20,241
Materials/Supplies	34,448
Power	42,262
Rent	13,313
Salaries & Wages	270,429
Transportation Expense	1,795
Regulatory Commission Expense	15,481
Bad Debt	723
Miscellaneous Expense	<u>1,155</u>
Total O & M Expenses	\$ 463,773
Number of Months in a Year	<u>12</u>
Working Cash	<u><u>\$ 38,648</u></u>

Waikoloa Sanitary Sewer Company, Inc., dba West Hawaii Sewer Company

Average Customers for the Test Year

2001 Customers (Stipulated)	1,301
x 12 Months	12
Annual	15,612

Present Standby Charge/Mo.	18.16
	283,513.92

Customer Usage 2001 (Stipulated)	238,274.00
Present Usage Rate	1.33
Usage Revenues	316,904.42

Present Usage Rate

1.33

Present Usage Rate

1.33

Present Rates	600,418.00
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Interim D&O 11/5/01	103,944.00
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D&O 2/27/02

36,021.00

Revised Increase

27,788.00

Total Revenues at Approved Rates	704,362.00
less Usage Revenues	<u>316,904.42</u>
Standby Revenues	387,457.58

Total Revenues at Proposed Rates	740,383.00
less Usage Revenues	<u>316,904.42</u>
Standby Revenues	423,478.58

Total Revenues at Proposed Rates	628,206.00
less Usage Revenues	<u>316,904.42</u>
Standby Revenues	311,301.58

Standby Rate Effective 11/7/01	24.82
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Standby Rate Effective 3/8/02

27.13

Revised Standby Rate

19.94

CERTIFICATE OF SERVICE

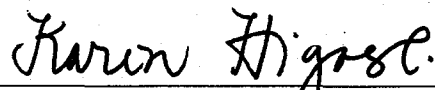
I hereby certify that I have this date served a copy of the foregoing Order No. 23635 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS
DIVISION OF CONSUMER ADVOCACY
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Karen Higashi

DATED: SEP - 7 2007