

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)

PUUWAAWAA WATERWORKS, INC.)

DOCKET NO. 00-0005

For a Certificate of Public)
Convenience and Necessity Pursuant)
to Hawaii Revised Statutes)
§ 269-7.5, to Provide Water)
Services to Portions of Puuwaawaa)
and Puuanahulu Homesteads at)
North Kona, Hawaii, and for)
Approval of Proposed Rates.)

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

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DECISION AND ORDER NO. 19980

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Kurun Higashi
Chief Clerk of the Commission

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

K. Higashi

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DECISION AND ORDER

I.

BACKGROUND

On January 12, 2000, PUUWAAWAA WATERWORKS, INC. (PWI or Applicant) filed its application for a certificate of public convenience and necessity (CPCN) to provide water service for portions of Puuwaawaa and Puuanahulu homesteads in North Kona, Hawaii, and for approval of its proposed rates. PWI filed its application pursuant to Hawaii Revised Statutes (HRS) § 269-7.5.

The DIVISION OF CONSUMER ADVOCACY of the DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS (Consumer Advocate), ex officio party to any proceeding before the commission,¹ was served copies of the application.

By Order No. 17637, filed on March 29, 2000, the commission granted Pu'u Lani Ranch Homeowners Association (PLRHA) intervenor status to this proceeding. We note, however, that by

¹Hawaii Administrative Rules (HAR) § 6-61-62.

Order No. 19152, filed on January 18, 2002, the commission approved the parties' August 16, 2001 stipulation to change PLRHA's status to that of a participant, subject to the parameters set forth in Order No. 19152. No other persons moved to intervene or participate in this docket. Thus, the sole parties to this docket are PWI and the Consumer Advocate.

PWI first amended its CPCN application through a filing on August 10, 2000, and then filed a second amended application on September 24, 2001 (Second Amended Application). Thus, in an effort to solicit public comments on all matters of this docket, including the above mentioned amendments, the commission held public hearings in Kailua-Kona, Hawaii on two separate occasions: December 12, 2000, and January 24, 2002.

Prehearing Order No. 17841, filed on July 18, 2000, as amended (prehearing order), governs the proceedings in this docket. Pursuant to the prehearing order, the parties filed direct and rebuttal testimonies, exhibits, and workpapers and conducted discovery through the issuance of information requests (IRs), supplemental IRs (SIRs), rebuttal IRs (RIRs); and technical and other meetings.² An evidentiary hearing on the disputed matters of PWI's CPCN application was held on July 24, 2002, and the parties filed post-hearing briefs on these matters on September 12, 2002.

²Upon review of PWI's rebuttal testimony and responses to certain IRs, the Consumer Advocate filed Revised Testimonies, Exhibits, and Supporting Workpapers on July 22, 2002 (Consumer Advocate's Revised Testimony).

II.

ISSUES

The prehearing order, as amended, sets forth the issues in this docket, as follows:

1. Whether Applicant is fit, willing, and able to properly perform the water distribution service proposed and to conform to the terms, conditions, rules, and regulations promulgated by the commission?
2. Whether the proposed water distribution service is or will be required by the present or future public convenience and necessity?
3. Whether the proposed rates, charges, classifications, schedules, and rules for the proposed water distribution service are just and reasonable?

By a stipulation filed on August 16, 2001, the parties stipulated to Issue Nos. 1 and 2, and to PLRHA's status change from that of a party to a participant. By Order No. 19152, the commission approved the parties' agreement on PLRHA's status change, but deferred action on the parties' stipulation on Issue Nos. 1 and 2.

Through this decision and order, the commission will address all outstanding issues regarding PWI's CPCN application.³

³On July 16, 2002, the Consumer Advocate filed a Motion for Sanctions and/or Civil Penalties (sanctions motion) in the instant docket. The issues of the Consumer Advocate's sanctions motion will be addressed in a separate order.

III.

GENERAL FINDINGS AND CONCLUSIONS

PWI is a corporation existing under the laws of the State of Hawaii (State) providing water service to approximately 60 customers who reside in Puuwaawaa Ranch (PWR); Puu Lani Ranch (PLR) subdivision; and Puuanahulu. PWI was incorporated in 1988. The utility's water system consists of, among other things, two water wells and submergible pumps, a 100,000-gallon water tank, and over five miles of main water lines. PWI represents that it began operations without first obtaining its CPCN to do so since PWI believed that it was not a public utility and did not wish to become one. After much posturing over the years, PWI, in January 2000, finally applied for a commission issued CPCN to operate as a public utility, pursuant to the applicable State laws, rules, and regulations.

State law vests the commission with general supervision over all public utilities.⁴ HRS § 269-7.5 requires the commission to determine the reasonableness of the rates, charges, and tariff rules and regulations in accordance to the standards of HRS § 269-16. Thus, the commission must, among other things, evaluate PWI's proposed rates, rules, and regulations to determine whether they are just and reasonable.

There are certain unique aspects of this docket that complicate the commission's review. First, PWI, believing that it was not a public utility, did not apply for a CPCN prior to commencing its operations. Thus, PWI operated for about 12 years

⁴HRS § 269-6.

without applying for a CPCN and any approval of its CPCN application will be one that is granted, *nunc pro tunc*. Second, after filing its application in January 12, 2000, PWI amended it twice. Third, while PWI provided great amounts of financial data and information in its various filings in this proceeding, we found, among other things, its position on certain rate elements, as did the Consumer Advocate, to be questionable; insufficient; and irrelevant. Additionally, it appears that PWI's proposed rates are not based on sound ratemaking principles since they are not reflective of PWI's estimates of operating expenses and revenues. This is problematic since PWI asserts in this proceeding that it does not seek to earn a profit and that it "seeks no more than a rate that allows it to recover its normalized expenses."⁵ However, since its estimated revenues are not equal to its estimated expenses, we are uncertain how PWI's proposed rates were determined. Finally, the parties were unwilling or unable to establish a specific test year for this proceeding. The Consumer Advocate, contending that PWI had not maintained proper accounting and financial records, among other things, stated that it relied on available historical information to discern trends and normalized and/or annualized available financial data, among other things, to ascertain reasonable ongoing normal requirements of PWI to develop its proposed rates.

Upon review, we find the Consumer Advocate's methodology to be reasonable under the unique circumstances of this proceeding. We note that this proceeding is an application for a CPCN filed

⁵PWI's Post-Hearing Brief (PWI's Brief) at 2 (September 12, 2002).

under HRS § 269-7.5 as opposed to an application to increase or change rates filed under HRS § 269-16. Moreover, the commission, in determining just and reasonable rates, "is not limited to specific procedures or fixed formulas, but is empowered to exercise sound discretion in its review and evaluation of the evidence"⁶ "Furthermore, the ratemaking function involves the making of pragmatic adjustments and there is a zone of reasonableness within which the commission may exercise its judgment."⁷

While recognizing certain complications unique to this docket, the commission finds and concludes that through careful review of PWI's historical financial data and the various arguments presented by the parties, there is sufficient information in the record to ascertain PWI's ongoing normal expense requirements, among other things, and to determine just and reasonable rates for this CPCN application proceeding.

IV.

STIPULATED ISSUES

In the stipulation filed on August 16, 2001, the parties stipulated to Issue Nos. 1 and 2 of this docket. Specifically, the parties agreed to the following:

1. That Applicant is fit, willing, and able to properly perform the water distribution service proposed and to conform to the terms,

⁶In re GTE Hawaiian Telephone Company Incorporated, Docket Nos. 7579, 7524, 7523, 7193, and 6404 (consolidated), Decision and Order No. 13950 at 12 (June 9, 1995), quoting In re Hawaiian Tel. Co., 67 Haw. 370 (Hawaiian Tel) at 379.

⁷Ibid (quoting Hawaiian Tel at 382) (internal quotes omitted).

conditions, rules, and regulations promulgated by the commission.

2. That the proposed water distribution service is or will be required by the present or future public convenience and necessity.

Upon review, we find it reasonable and in the public interest to approve the parties' stipulation with regards to Issue Nos. 1 and 2 of this docket. Thus, we conclude that the parties' agreement regarding Issue Nos. 1 and 2 of this docket, as set forth in their stipulation filed on August 16, 2001, should be approved.

V.

RATE ISSUE

The parties primarily disagree on the rates that PWI proposes to charge for its water service. Throughout this proceeding, PWI proposed various sets of rates. For example, in its January 12, 2000 application, PWI proposed to charge \$9.79 per thousand gallons (TG) and a minimum billing charge of \$27.50 per bill for residential accounts, with this charge determined on a case-by-case basis for business or agricultural accounts. PWI proposed different rates in its first amended application and then through its Second Amended Application, PWI ultimately proposed to charge the following: (1) a base (volumetric) rate of \$13.50 per TG; (2) a power fluctuation factor (PFF), otherwise known as a power adjustment charge (PAC), formulated to be (actual kwh cost - \$0.20/kwh) x 19.6 kwh/TG x 1.06385; and (3) a minimum billing charge of \$37.50 for all

customers. PWI contends that its base rate will allow it to recover its normalized operating expenses and that its base rate would only be applied when the customer's monthly water use exceeds the amount covered by its proposed minimum billing charge. PWI's PFF is a charge to be applied only when and if the cost of electricity rises above \$0.20 per kwh. PWI states that this charge will be adjusted every calendar quarter and determined by the average kwh cost for the previous calendar year. PWI proposes to charge the minimum billing charge on customers that use some quantity of water during the applicable month.

The Consumer Advocate rejects PWI's proposed rates and argues that PWI failed to meet its affirmative burden of proving that its proposed rates are just and reasonable. In doing so, the Consumer Advocate proposes that the commission adopt a rate structure which consists of the following: (1) a base consumption rate of \$6.95 per TG; (2) a fixed monthly charge of \$23.00; and (3) a PAC formulated as $(\text{actual kwh cost} - \$0.20/\text{kwh}) \times 19.25 \text{ kwh/TG} \times 1.06385$.

PWI, as the applicant in this CPCN matter, has the burden to prove that its proposed rates are just and reasonable.⁸ Based on our careful review of the record, we conclude that PWI has failed to meet this burden. In our review, we find that PWI often amended its proposed rates and rate-related figures and has proffered support for certain expense items that appear, on the most part, unreliable, inconsistent, and inadequate. On the other hand, we find the Consumer Advocate's position on most rate elements to be

⁸In re Matter of Hawaiian Electric Company, Inc., 56 Haw. 260, 270 (1975).

supported by reliable and probative information. However, upon review and consideration of all relevant factors, the commission was unable to adopt the Consumer Advocate's recommended rates.

Based on our review of the full record established in this docket, the commission finds the following rates to be just and reasonable:

Base (volumetric) Rate:	\$6.02 per TG
Customer (fixed) Charge:	\$37.83 per month
Power Fluctuation Factor:	(Actual kwh cost - \$0.22/kwh) x 19.25 kwh/TG x 1.06385

The support for and details of the commission's determination on specific rate elements, which are utilized to derive the above-mentioned rates, are discussed further below.

A. Water Sales

The parties' estimates for water sales for the purpose of setting rates in this proceeding differ. Initially, PWI estimated water sales of 17,232 TG by annualizing water sales for the six-month period ending March 2001. PWI later revised its water sales estimate to 17,069 TG to account for double counting concerns. Subsequently, during the evidentiary hearing, PWI introduced into evidence water sales information for January to December 2001 that show total water sales of 16,429 TG, which it now purports should be used to determine rates in this proceeding. PWI's water sales data for 2001 was admitted into evidence as Hearing Exhibit 5. PWI argues that its estimate of 16,429 TG for ratemaking purposes is the "most reliable" water sales estimate

since it reflects a full 12-month volume of sales and is PWI's most recent data on water sales.

The Consumer Advocate's water sales estimate for determining rates in this proceeding is 15,787 TG. The Consumer Advocate arrived at this figure by using eight months of data, from January to August 2001. Its estimate incorporates updated water usage information to account for six new and three inactive customers and was annualized per standard estimating practices. The Consumer Advocate states that it used this data since it was the most recent available information (at the time of its review) and contends that its estimate of 15,787 TG per year is reflective of PWI's future normal ongoing water sales.

Upon review, we find that adoption of the Consumer Advocate's water sales estimate of 15,787 TG per year for the purpose of determining rates is appropriate at this time. The commission is wary of accepting PWI's estimate for purposes of determining rates for this proceeding. The data supporting PWI's 16,429 TG water sales estimate was first proffered during the evidentiary hearing. Although PWI argues that its water sales estimate should be accepted since it represents the most recent information and a full year of water sales, we believe that it would be imprudent to do so. In determining rates, most recent data does not automatically mean that it is the most appropriate or reliable data. Due to the late introduction of this information, the Consumer Advocate did not have an opportunity to examine the data contained in Hearing Exhibit 5 for any possible irregularities. Upon our review of Hearing Exhibit 5, it appears that certain anomalies do exist with the data. We are especially

concerned with water sales information contained in Exhibit 5 for September 2001, which appear suspicious.

The Consumer Advocate's water sales estimate of 15,787 TG, for determining rates, appears to be reasonable. This estimate is based on 2001 figures, takes into account changes to PWI's customer base,⁹ and was adjusted to account for double counting concerns. The Consumer Advocate's estimate does appear to be reflective of PWI's future, normal, and ongoing water sales. Thus, we conclude that adoption of the Consumer Advocate's water sales estimate of 15,787 TG per year for determining rates in this proceeding is just and reasonable.

B. Revenues

The Consumer Advocate's proposed rates in this proceeding are derived through a breakeven analysis. PWI asserts that it is not seeking a profit and that it "seeks no more than a rate that allows it to recover its normalized expenses."¹⁰ Based on PWI's assertion, it appears that PWI is inclined to also employ a breakeven analysis to determine rates. Due to these factors, we find that a breakeven methodology for the determination of rates for this proceeding is reasonable.

Under a breakeven analysis, the utility's estimated revenues are determined by first ascertaining its expenses for the utility's normal ongoing operations, since under this type of

⁹We note that the parties agree to use a customer count of 60 for the purpose of determining rates in this proceeding, which we, upon review, find to be reasonable.

¹⁰PWI's Brief at 2.

analysis a utility's estimated revenues is equal to its estimated expenses. Employing the breakeven methodology, the Consumer Advocate determined a revenue estimate of \$126,228 for ratemaking purposes as reasonable. PWI, on the other hand, contends that a revenue estimate of \$232,632 is reasonable. We are uncertain how PWI determined its level of revenues, since PWI's estimated revenues are not equal to its estimated expenses. Nonetheless, we find that the record fails to support either of the revenue estimates proffered by the parties.

Upon review of each of PWI's expense items, the commission finds that a revenue level of \$122,335 is just and reasonable for determining rates in this proceeding. The commission's determination of each expense item is detailed below.

C. Expense Items

1. Electricity

PWI and the Consumer Advocate both recognize that the cost of electricity is PWI's largest operating expense. PWI estimates its annual electricity expense to be \$81,470. It states that this estimate was determined by annualizing the actual cost of electricity for the six-month period from October 2000 to March 2001.¹¹ PWI justifies its cost estimate by arguing that its estimate is reasonable since its actual cost of electricity from June 2001 to June 2002 was \$80,091.58.

On the other hand, the Consumer Advocate estimates annual total electricity expense to be \$66,858. The Consumer Advocate

¹¹PWI's Brief at 17, footnote 7.

states that cost of electricity is a "function of the total amount of water pumped, the kwhs required to pump 1,000 gallons of water from the well, and the price per kwh of electricity."¹² The Consumer Advocate accepts PWI's rate of \$0.20/kwh of electricity (referred to in this decision and order as the base cost of electricity), however, it disagrees with PWI's claim that it requires 19.6 kwh of electricity to pump 1,000 gallons of water (referred to in this decision and order as the pump efficiency factor).¹³ In its review, the Consumer Advocate found that one of PWI's electrical meters measured both the electricity used by PWI's tank and pumping system used to provide service to several customers and the electricity used by a residence. Contending that inclusion of the entire metered amount would not be reflective of PWI's normal ongoing operations, the Consumer Advocate adjusted PWI's kwh figure by excluding the electricity used by the residence

¹²Brief of the Division of Consumer Advocacy (Consumer Advocate's Brief) at 28 (September 12, 2002).

¹³PWI calculated this figure by taking into account a seven-month period ending April 30, 2001 (October 1, 2000 to April 30, 2001). For this period of time, PWI states that it pumped 11,188.3 TG of water and that approximately for that same period of time, Hawaii Electric Light Company, Inc. (HELCO) billed PWI for 219,612 kwh of electricity. PWI's Motion for Approval of Interim Rates and Waiver of Public Hearing (PWI's Motion for Interim Rates) at 4 (September 28, 2001). PWI arrived at its pump efficiency factor of 19.6 kwh/TG by dividing 219,612 kwh by 11,188.3 TG.

to arrive at an adjusted pump efficiency factor of 19.25 kwh/TG.¹⁴ The Consumer Advocate determined the "total amount of water pumped" by multiplying its water sales estimate of 15,787 TG by an estimated 10 per cent loss factor to arrive at total amount of water pumped of 17,365.7 TG. Applying its formula, $17,365.7 \text{ TG} \times 19.25 \text{ kwh/TG} \times \$0.20/\text{kwh}$, the Consumer Advocate determined total electricity expense to be \$66,858.

Upon review of both estimates, the commission finds the Consumer Advocate's method of determining electricity expense to be appropriate and reasonable for this proceeding. The commission is unable to accept PWI's estimate since, among other things, its estimate for electricity expense is not related to our water sales estimate. PWI's electricity expense estimate is an annualized figure based on a six-month period from October 2000 to March 2001. This figure is unacceptable for our determination of just and reasonable rates since the commission has determined water sales for this proceeding based on January to August 2001 figures, see above. We believe that electricity costs are highly correlated to the amount of water sales, thus, we find PWI's electricity cost estimate to be unacceptable.

On the other hand, Consumer Advocate's methodology to determine electricity expense takes into account our water sales

¹⁴Since PWI was unable to provide a detailed accounting of how much electricity is used by the residence, the Consumer Advocate adjusted PWI's calculation (see footnote 13) by applying the average residential use for the Kona area. The Consumer Advocate found that the average amount of electricity used in 2001 by HELCO customers residing in the Kona area was 612 kwh/month or 4,284 kwh for 7 months (October 1, 2000 to April 30, 2001). It adjusted PWI's total amount of electricity used in PWI's calculation, by subtracting 4,284 kwh from 219,612 kwh. Consumer Advocate's Revised Testimony, CA-T-2 at 17-18 (July 22, 2002).

estimate. The methodology also accounts for inefficiencies in PWI's system by factoring in a loss factor of 10 per cent, which the Consumer Advocate contends is a standard allowance. Upon review, we find a loss factor of 10 per cent to be acceptable. Additionally, the Consumer Advocate's rationale and methodology for adjusting PWI's claim that 19.6 kwh of electricity is required to pump 1,000 gallons of water by excluding the electricity used by the residence appears reasonable. Thus, we accept the Consumer Advocate's adjusted pump efficiency factor of 19.25 kwh/TG. However, we are not satisfied with PWI's assertion that its base cost of electricity is \$0.20/kwh, which the Consumer Advocate accepts. PWI's justification for this rate appears to be lacking and unsupported by the record. We were not able to find a sound rationale for PWI's assertion. For example, PWI's explanation of this cost figure in its response to CA-IR-1a is inadequate and unclear.¹⁵ In our review of PWI's calculations and PWI's HELCO electricity bills, it appears that a cost of \$0.22/kwh better represents PWI's base cost of electricity.¹⁶ Thus, applying the Consumer Advocate's methodology with the adjusted base cost of electricity of \$0.22/kwh, the commission arrives at an electricity expense of \$73,544.

Based on the above, the commission concludes that electricity expense of \$73,544 for determining rates in this proceeding is just and reasonable.

¹⁵PWI filed its response to CA-IR-1a on November 16, 2001.

¹⁶PWI's Motion to Amend Application for CPCN, Exhibit 4 (July 31, 2001) and PWI's Motion for Interim Rates, Exhibit G.

2. Other Utility

The only expense category under this heading is for telephone use. PWI estimates its telephone expense to be \$870 per year and states that the difference between its estimated amount and its actual expenditures is negligible. The Consumer Advocate estimates telephone expense to be \$636 per year. The Consumer Advocate arrived at this figure by averaging PWI's 2001 monthly telephone bills. The Consumer Advocate estimated \$53 as PWI's average 2001 monthly telephone bill, producing an annual telephone expense of \$636.

Upon review, we find the Consumer Advocate's estimate for telephone expense to be a reasonable representation of PWI's annual telephone expense. While the Consumer Advocate provided sound support for its estimate, PWI did not. PWI's declaration that its estimate of \$870 is reasonable simply since the difference between its estimated amount and its actual expenditures for one period is negligible is insufficient. Thus, we conclude that the Consumer Advocate's estimate of \$636 per year should be adopted as PWI's telephone expense.

3. Contract Labor

The annual salaries of two PWI contract employees, Ms. Charlene Cousineau (Ms. Cousineau) and Mr. Craig Nichols (Mr. Nichols), are accounted for under contract labor expense. The parties disagree on the appropriate estimate for this cost category. PWI estimates \$33,000 for contract labor expense (\$9,600

for Ms. Cousineau and \$19,500 for Mr. Nichols)¹⁷ while the Consumer Advocate estimate is \$21,264 (\$4,800 for Ms. Cousineau and \$16,464 for Mr. Nichols).

With Regards to Ms. Cousineau, PWI's estimate of \$9,600 is based on 40 hours of work per month times her hourly rate of \$20. Ms. Cousineau is said to provide account management and secretarial services. Mr. Nichols' salary of approximately \$19,500 is said to be based on a half day of work, however, he is purported to be on call twenty-four hours per day, seven days a week.¹⁸ Mr. Nichols operates and maintains the water system.¹⁹

The Consumer Advocate does not support PWI's full amount for contract labor expense. Among other things, the Consumer Advocate contends that: (1) PWI failed to show that its proposed level of salaries are reasonable and justifiable; (2) the records indicate that PWI historically compensated its employees at levels less than its proposal in this proceeding; (3) PWI has

¹⁷PWI estimates its contract labor cost to be \$33,000 a year to cover the salaries for Ms. Cousineau and Mr. Nichols services of \$9,600 and \$19,500, respectively. However, PWI fails to provide any justification or explanation for the difference in its contract labor cost estimate and its estimate for the services of its two contract employees (\$33,000 - \$9,600 - \$19,500 = \$3,900).

¹⁸Transcript of Proceedings held on July 24, 2002 in the matter of the application of PWI for a CPCN (Transcript) at 33 (August 22, 2002).

¹⁹PWI represents that Mr. Nichols is responsible for: (a) monitoring water levels in the closed reservoir; (b) turning on and off the pumps and motors on a daily basis; (c) monitoring the water system for repair and maintenance needs; (d) maintaining and performing repairs on the water system; (e) installing new meters; (f) taking meter readings for all accounts; (g) devising plans for equipment upgrades and assisting with implementation of the same; and (h) ensuring PWI's compliance with water quality monitoring requirements of the State Department of Health. PWI's Brief at 19.

failed to properly track the allocation of its employee's services between various other entities which were operated or once operated by PWI's president, Mr. Bohnett.

First, regarding Ms. Cousineau, the Consumer Advocate contends that much of her work during 2001 was dedicated to the processing of PWI's application. The Consumer Advocate reasoned that CPCN related expenses cannot be categorized as part of PWI's normal ongoing expenses, thus it excluded these costs for purposes of determining rates, and included the corresponding amount in its calculation of "Amortization of CPCN" expense.²⁰

Additionally, the Consumer Advocate contends that, prior to September 2000, Ms. Cousineau was performing services for three different entities (PWI, PWR, and Puu Lani Community Center) and was being paid solely by PWR which was own by Mr. Bohnett until July 2000. The Consumer Advocate states that during this period of time, Ms. Cousineau billed a lump sum amount for her services, and that no allocation of services performed for the three entities were indicated on the invoices. It states that from September 2000, Ms. Cousineau's services were billed entirely to PWI, and that in January 2001, Ms. Cousineau began to bill separately for her services. The Consumer Advocate calculated its proposed salary expense for Ms. Cousineau by reviewing PWI's

²⁰In an attempt to calculate the CPCN related expenses attributable to Ms. Cousineau in 2001, the Consumer Advocate normalized her accounting services of \$4,200 from her total 2001 wages of \$9,036 to arrive at \$4,836. This amount was then amortized over a five-year period, resulting in an amortized CPCN accounting expense of \$967 for ratemaking purposes. Consumer Advocate's Brief at 31. CPCN accounting expenses of \$967 is included as part of the Consumer Advocate's recommendation for "Amortization of CPCN" expense, see Section V.C.10, below.

historical data that indicates that \$350 per month was spent on similar services to those provided by Ms. Cousineau. Based on a historical hourly wage of \$18 per hour, the Consumer Advocate arrived at an average of 20 hours per month dedicated to the types of service provided by Ms. Cousineau. Thus, at her present rate of \$20 per hour, the Consumer Advocate supports its estimate of \$4,800 per year to represent Ms. Cousineau's annual salary expense ($\$20/\text{hr} \times 20 \text{ hrs} \times 12 \text{ months}$).

With regards to Mr. Nichols, the Consumer Advocate stated that while it supports the fifty per cent raise in his salary in 2000, it believes that the 17 per cent increase for Mr. Nichols' services in 2002 is unreasonable. The Consumer Advocate states that Mr. Nichols' raise in 2000, which increased his annual salary of \$10,752 to \$16,464, is reasonable since he received State certification for operating a municipal water system in that year. However, the Consumer Advocate states that PWI did not justify Mr. Nichols' 17 per cent salary increase in 2002, which increased his annual salary to approximately \$19,500. The Consumer Advocate notes that Mr. Bohnett, PWI's witness, stated on the record that while Mr. Nichols is always on call, he usually works six hours and sometimes three hours per day. Additionally, the Consumer Advocate noted that PWI was paying \$650 per month (\$7,800 annually) for repair and maintenance services prior to employing Mr. Nichols. Due to the factors stated above, the Consumer Advocate represents that its estimate of \$16,464 per year is reflective of PWI's normal and ongoing labor cost for the type of services offered by Mr. Nichols.

PWI argues that the Consumer Advocate's estimate for contract labor expense is unreasonable. PWI states that the account management services that Ms. Cousineau provides includes bookkeeping, invoicing, billing, and customer service which PWI argues cannot be completed during the time allocated by the Consumer Advocate, i.e., 20 hours per month. Among other things, it also argues that even though Ms. Cousineau currently bills PWI 40 hours per month inclusive of CPCN application related services, it does not mean that PWI requires less than 40 hours of account services per month. With regards to the Consumer Advocate's estimate of Mr. Nichols' salary expense, PWI argues that the Consumer Advocate does not explain why the 2002 raise is unjustified. PWI argues that TNT Services, the company hired prior to retaining Mr. Nichols, did not perform the full range of services and twenty-four hour coverage that Mr. Nichols now provides. Additionally, PWI contends that TNT Services was retained when its operations were not as expansive as they currently are. Moreover, PWI argues that its annual labor expense estimate of \$33,000 is reasonable since it does not include compensation for PWI's president and manager, Mr. Bohnett.

Upon review, we find it appropriate to adopt the Consumer Advocate's contract labor expense in determining rates. As suggested by the Consumer Advocate, PWI's estimate for contract labor costs does not appear to be based on its normal ongoing requirements nor does it appear to be fully justified. We find PWI's arguments against the Consumer Advocate's efforts to normalize its contract labor costs for ratemaking purposes to be unpersuasive and irrelevant. First, with regards to Ms. Cousineau,

we find the Consumer Advocate's treatment of her services related to the CPCN application process to be reasonable. Expenses for services related to PWI's CPCN application process are not ongoing normal expenses, thus, the Consumer Advocate was correct in segregating such expenses under "Amortization of CPCN" expense. Additionally, documentation of Ms. Cousineau's services is lacking. For example, there is no written contract memorializing Ms. Cousineau's contractual agreement with PWI.²¹ Nor does it appear that there was any effort to allocate the services that she was providing to PWI and Mr. Bohnett's other interests until January 2001. Additionally, we do not find the Consumer Advocate's efforts to normalize the expenses related to the services that Ms. Cousineau provides by referencing historical costs to be unreasonable, since, among other things, no other alternative was proposed.

Second, with regards to Mr. Nichols, as the Consumer Advocate noted, PWI appears to have failed to justify Mr. Nichols' 2002 raise, which increased his salary from \$16,464 to approximately \$19,500. This is his second raise within two years, and while he appears to have a host of responsibilities, the record indicates that he sometimes only works three hours per day. Additionally, while he may be on call twenty-four hours per day seven days a week, it appears that this requirement was imposed on him at the start of his employment with PWI and is not a new requirement justifying his 2002 salary increase. PWI also appears to be under the belief that the Consumer Advocate has the burden to

²¹PWI's response to CA-SIR-13 (December 21, 2001).

"explain why the raise was unjustified".²² However, we must reiterate that as the applicant, PWI has the burden to justify its estimated expenses used to derive its proposed rates. It appears that PWI has clearly not convinced the Consumer Advocate on this issue, nor has PWI met its burden on this issue to the commission's satisfaction. Furthermore, PWI appears to contend that its estimate for contract labor cost is reasonable since this amount does not include the costs of retaining a president or a manager. This argument is irrelevant to our determination of this expense item. We also note that PWI failed to account for \$3,900 in expenses, the difference between its estimated contract labor expense of \$33,000 and the purported salary expenses for its two contract employees, \$29,100.

Accordingly, the commission concludes that adoption of the Consumer Advocate's estimated contract labor expense of \$21,264 to be just and reasonable for the purpose of determining rates.

4. Repair and Maintenance

For repair and maintenance expense, PWI estimates a cost figure of \$9,400 while the Consumer Advocate estimates this expense to be \$7,000 (inclusive of water supplies). The Consumer Advocate reached its expense estimate by first normalizing PWI's 2000 repair and maintenance expense, stated to be approximately \$39,615, by subtracting the largest expense for that year of \$31,315. The Consumer Advocate states that it normalized PWI's 2000 cost figure

²²PWI's Brief at 19.

since PWI was unable to justify the \$31,315 amount,²³ and arrived at a normalized figure of \$8,300. Upon reviewing PWI's 2001 November year-to-date expense figure of \$6,745, the Consumer Advocate states that PWI's initial estimate for this cost figure, \$7,000, is in line with the expenses incurred in recent years.

PWI disagrees with the Consumer Advocate's estimate. PWI states that its estimate of \$9,400 is a closer approximation to actual expenses of \$8,300 in 2001 than the Consumer Advocate's estimate.²⁴ PWI further states that its estimate is a better approximation of actual cost for the full year of 2001 which it states is \$8,809.85, and further contends that actual expenses for the one-year period from June 2001 to June 2002 is \$9,361.81.²⁵

Upon review, we find the Consumer Advocate's cost estimate for repair and maintenance expense to be reasonable. The Consumer Advocate's estimate is based on historical financial data and reasonable assumptions. PWI, on the other hand, fails to justify its cost estimate of \$9,400 to the commission's satisfaction. PWI's estimate appears to be an overstatement of this expense item.²⁶ Although the Consumer Advocate's estimate of

²³The Consumer Advocate speculated that this cost figure represents the cost to replace a pump since this cost figure is comparable to an expenditure in 1992 for the same purpose.

²⁴PWI's Brief at 25. It appears that PWI erred. The commission believes that PWI meant to state that \$8,300 is its actual expenses for repair and maintenance for 2000 as opposed to 2001 since PWI later states that actual expenses for 2001 were \$8,809.85.

²⁵PWI's Brief at 25.

²⁶We note that the only actual cost figure "close" to PWI's cost estimate which PWI proffers is that from June 2001 to June 2002 of \$9,361.81. We place little weight on this proffered data since there was no opportunity to conduct discovery on it.

\$7,000 may be a conservative figure; nonetheless, this estimate does appear to be in line with PWI's historical expenditures, and it also appears to be the more practical and prudent alternative. Accordingly, we conclude that adoption of the Consumer Advocate's estimate of \$7,000 for repair and maintenance expense for ratemaking purposes is just and reasonable.

5. Legal and Accounting

For legal and accounting fees, PWI's estimate is \$4,200. PWI appears to have adopted the Consumer Advocate's position for legal and accounting fees.²⁷ Initially, PWI had proposed an estimated amount of \$4,000 (\$2,000 for accounting fees and \$2,000 for legal fees) based on year 2000 figures. Additionally, a separate cost category was created to account for additional legal expenses that PWI incurred for its CPCN related expenses.

The Consumer Advocate, on the other hand, estimates this cost category to be \$4,220. In the text of its direct testimony, the Consumer Advocate indicated that this cost figure represents \$2,000 in accounting fees and \$2,333 in legal fees.²⁸ The Consumer Advocate states that it accepts \$2,000 to represent accounting expenses based on historical costs and normalized PWI

²⁷PWI's brief at 22. It appears that PWI rounded the Consumer Advocate's \$4,220 expense estimate to arrive at its estimate.

²⁸It appears that the Consumer Advocate misstated this cost category amount since \$2,000 + \$2,333 is \$4,333 rather than \$4,220.

estimated legal fees of \$35,000.²⁹ However, later it created a separate cost category for CPCN expenses, i.e., "Amortization of CPCN" expenses, to account for normalized expenses incurred by PWI for processing its CPCN application and maintained its original "Legal and Accounting" expense category of \$4,220 to account for PWI's normalized accounting and legal expenses based on historical data.³⁰

Upon review, we find that an estimate of \$4,200 for legal and accounting fees in determining rates is appropriate and reasonable. This figure appears to be in line with PWI's historical expenses for this cost category and is basically supported, in one form or another, by the parties. Thus, the commission concludes that estimated legal and accounting expense of \$4,200 for ratemaking purpose is just and reasonable.

6. Insurance

Insurance expense represents PWI's purchase of liability insurance. The parties agree to the cost figure of \$450 per year for this cost category. In 2000, liability insurance for PWI was purchased for this same amount. Based on the above, the commission finds and concludes that an estimated insurance expense of \$450 for ratemaking purposes is just and reasonable.

²⁹The Consumer Advocate first divided \$35,000 by three, representing the three CPCN applications filed in this docket, and then it divided the result by five, which represents a 5-year amortization period.

³⁰Consumer Advocate's Revised Testimony, CA Pre-Hearing Exhibit 1.

7. Office and Miscellaneous

Under this cost category, PWI includes expenses for the following items: "fuel, insurance, licenses and permits, and office expenses."³¹ PWI estimates this cost category to be \$1,140, which it states is a conservative figure. The Consumer Advocate estimates "office expenses and miscellaneous fees" to be approximately \$1,000. The Consumer Advocate stated that it based its estimate on recent data.

Upon review, we find it reasonable, in this instance, to accept PWI's estimate regarding this cost category. The commission's determination is based on our review of PWI's office and miscellaneous expenses for 1999 and 2000. PWI's cost estimate appears to be consistent with historical costs. However, in light of PWI's incorporation of insurance expense into this cost category and the allotment of \$450 for insurance expense, we find it reasonable to adjust PWI's cost figure for this expense accordingly ($\$1,140 - \$450 = \$690$). Thus, we conclude that \$690 for estimated office and miscellaneous expense for ratemaking purposes is just and reasonable.

8. Depreciation or Pump Replacement

PWI states that water pumps are its most important assets and contends that each pump costs approximately \$70,000 (\$35,000 for the pump itself and \$35,000 for pump installation) with a life expectancy of seven years. PWI also states that it currently does not have a spare pump and proposes a pump replacement reserve of

³¹PWI's Brief at 33.

approximately \$20,400 a year. PWI's calculation is based on PWI estimate that it must collect \$140,000 over seven years to replace both pumps.

The Consumer Advocate appears to be against the establishment of a pump replacement reserve since it believes that it would be more prudent for PWI to develop a rate base upon which a return on investment may be made.³² However, in its calculations, the Consumer Advocate includes \$10,000 for depreciation expense for pump replacement.³³ The Consumer Advocate states that it included a depreciation expense for pump replacement to recognize that pumps are important to the water system's operations. The Consumer Advocate's \$10,000 depreciation cost figure represents the replacement cost of \$35,000 for two pumps with a life expectancy of seven years. It contends that evidence in the record does not support a higher amount for this cost category and that without more justification; PWI is unable to support its claim for a higher amount.

PWI argues that the Consumer Advocate's proposal of \$10,000 per year for depreciation expense is inadequate since the Consumer Advocate's estimate would only cover half the cost of pump replacement. It contends that the Consumer Advocate's estimate is based on mistakes and misplaced doubts about PWI's veracity. PWI argues that the record confirms its estimate.

³²Consumer Advocate's Brief at 32-33; and see Section V.C.11, below, under "Operating Contingency Reserve".

³³Consumer Advocate's Direct Testimony, CA-T-2 at 29 and 30 (January 18, 2002).

Upon review and consideration of all matters related to this issue, the commission finds that an establishment of a pump replacement reserve or any type of reserve should not be allowed in this proceeding. The commission recognizes the importance placed on pumps for water service, however, we believe that an establishment of a pump replacement reserve, or any type of reserve for ratemaking purposes, at this time, to be imprudent and unfair. Our reasoning on this matter is consistent with our stance on the establishment of an operating contingency reserve. See Section V.C.11, below, under "Operating Contingency Reserve" for details on our determination on these matters.

We now address the Consumer Advocate's inclusion of a \$10,000 depreciation expense for pump replacement. The Consumer Advocate includes a depreciation expense in this proceeding while recognizing that PWI is "not seeking a return on and of its assets."³⁴ (Emphasis added.) The inclusion of a depreciation expense for pump replacement appears to be inconsistent with the Consumer Advocate's position on PWI's inclusion of a pump replacement reserve, which it appears to be against.³⁵ This inclusion also appears contrary to the Consumer Advocate's own position regarding depreciation. In its March 9, 2001 response to PWI-IR-20, the Consumer Advocate clearly stated that it was not proposing a provision for depreciation "since depreciation is equated with the return of the investment, and Applicant stated in response to CA-SIR-11 that it was not

³⁴Consumer Advocate's Direct Testimony, CA-T-2 at 29.

³⁵Consumer Advocate's Brief at 32 and 33.

seeking a return on or of that total system costs amounting to \$4 million (approximately) in the instant proceeding." (Internal quotes omitted.) Moreover, the Consumer Advocate's position on this matter is contrary to past commission decisions. For instance, the commission in In re Waikoloa Water Co., Inc., Docket No. 3295, Decision and Order No. 5667 (May 23, 1979) disallowed depreciation expense based on the application of the original cost rule. The original cost rule is "[w]here depreciation is not allowed on contributed property, the rationale is that depreciation is designed to permit the utility to recoup its investment in plant, and where there is no investment because the property has been contributed, there is nothing to be recovered."³⁶ PWI is not seeking a return on and of its assets. It appears that PWI's assets are contributed property, thus, applying the original cost rule, a depreciation expense for pump replacement reserve should not be considered for ratemaking purposes in this proceeding. Additionally, the record indicates that PWI's assets have been fully depreciated.³⁷ Since PWI's assets appear to be fully depreciated, there should be no allowance for depreciation expense. Thus, the commission concludes that the Consumer Advocate's inclusion of \$10,000 in depreciation expense should not be allowed in this proceeding.

³⁶Princess Anne Utilities Corporation v. Commonwealth of Virginia ex rel. State Corporation Commission, 179 S.E. 2d 714 (1971), 88 PUR 3d 519, 523-24. (Internal quotes omitted.)

³⁷PWI's balance sheet dated June 30, 2002 (filed during the evidentiary hearing as PWI Exhibit 12) shows that all of PWI's fixed assets have been fully depreciated. This is consistent with PWI's balance sheet dated December 20, 2000 (filed with PWI's Second Amended Application), which shows net fixed assets of under \$800.

Based on the above, the commission concludes that neither PWI's expense of \$20,400 per year for a pump replacement reserve nor the Consumer Advocate's \$10,000 expense estimate for depreciation should be included in our determination of rates in this proceeding.

9. Loan Repayment

PWI's proposed rates include an expense item for loan repayment of \$57,600. PWI contends that this amount, \$5,534.24 for principal and \$52,065.76 for interest, represents approximately \$650,000 in loans that were made to PWI from Mr. Bohnett, PWI's president and sole shareholder, at eight per cent interest amortized over 30 years. In an effort to support this claim, PWI produced 60 promissory notes from April 9, 1991, to May 17, 2002, totaling \$648,224. These notes were presented during the evidentiary hearing and submitted into the record as Hearing Exhibit 7. PWI argues that these are "true loans" since: (1) PWI obligates itself to repay the advances at a fixed maturity date and at a specific interest rate; (2) these obligations are reflected on PWI's balance sheets; and (3) PWI treated the advances as repayable loans. It further contends that the requirements of HRS § 269-17 are not applicable since each note is payable one-year after the issuance of the note.

The Consumer Advocate rejects PWI's contentions and states that PWI's loan repayment expense should not be included in determining rates. In sum, the Consumer Advocate states that PWI's proposed loan repayment expense should be disallowed since: (1) it believes that the alleged loans are payment for water service

rendered to Mr. Bohnett and his other business entities; (2) the alleged loans were made for working capital purposes; and (3) the "promissory notes" were not produced when a request was made for them.

Upon review of the arguments presented by both parties, we find it appropriate to adopt the Consumer Advocate's position on this expense category for ratemaking purposes. First, the Consumer Advocate's contention that the alleged loans should be characterized as payment for rendered water service appears to be plausible. It specifically argues that Mr. Bohnett, as PWI's sole shareholder, benefited from the use of PWI's water service for his other business entities for years without paying for it³⁸ and that it would be unfair to require PWI's ratepayers to pay for the interest and principal on these "loans" since it would constitute a "double windfall" for Mr. Bohnett. In support of its contention, the Consumer Advocate points out that Mr. Bohnett testified that the nine million gallon reservoir, or "lake", on PWR was built to be used as a recreational area and for cattle; that while he owned PWR, Mr. Bohnett liked to keep the lake filled-up; and that at one point, up to 41 per cent of PWI's pumped water ended up in the "lake".³⁹ The Consumer Advocate stressed that Mr. Bohnett testified that no one was billed for this water. The Consumer Advocate also notes that upon the sale of PWR, PWI successfully took measures to significantly reduce the percentage of water flow into the "lake".

³⁸Mr. Bohnett is also the sole shareholder of PLR and the developer of the subdivision, and was the owner of PWR until July 2000.

³⁹Consumer Advocate's Brief at 23-25.

Furthermore, the Consumer Advocate speculates that PWI's water service was used by PLR since the construction of the subdivision and its amenities required water use.⁴⁰

Second, the Consumer Advocate argues that the alleged loans cannot be used to determine rates since the "loan" proceeds were used for working capital and did not contribute to a rate base. It reasons that HRS § 269-17, sets forth the purposes for which notes and other forms of indebtedness, payable at periods of more than twelve months, may be issued; and states that working capital is not an authorized purpose under HRS § 269-17. PWI argues that HRS § 269-17 requirements are inapplicable since its promissory notes were issued for a term of exactly one-year. PWI's argument that HRS § 269-17 is inapplicable since the "loans" are not long-term debt, i.e., payable at periods of more than twelve months, does not appear to be correct, in practice. Additionally, we find PWI's argument to be irrelevant. While each promissory note was constructed as short-term debt, PWI and Mr. Bohnett, the lender, appear to have treated them as long-term debt since the one-year terms of the "loans" were not adhered to. Moreover, PWI's loan repayment proposal for the promissory notes totaling approximately \$650,000 is structured as long term debt, i.e., \$57,600 a year, representing an eight per cent interest on the principal over 30 years. Nonetheless, the heart of the Consumer Advocate's argument is that since the proceeds of the "notes" were used for working capital, there was no contribution to PWI's rate base, thus, it argues the "loans" should not be used to determine PWI's rates. The commission agrees.

⁴⁰Consumer Advocate's Brief at 24.

Third, the Consumer Advocate states that it is wary about the veracity of the "promissory notes" since PWI failed to produce any documentation of the alleged loans until two days prior to the evidentiary hearing. Thus, it states that the promissory notes should not be considered to determine rates. The Consumer Advocate represents that PWI failed to produce these documents when asked (see response to CA-IR-26b, filed on October 31, 2000), and also contends that the notes were not made available for the Consumer Advocate's inspection during its May 9, 2002 field audit. Due to the late production of the documents, the Consumer Advocate objected to the admission of the notes into the record during the evidentiary hearing. The Consumer Advocate urged the commission to accord them little weight, if any. The late production of the documents does give the commission cause to be concerned about the authenticity of the notes. Upon examination of the notes, they appear somewhat dubious. Also, due to the late production of the documents, the Consumer Advocate was not provided an opportunity to review and conduct discovery on them. Thus, the commission believes that the promissory notes should be given little consideration.

Based on the above, the commission concludes that PWI's proposed loan repayment expense should not be included in our calculation of just and reasonable rates. Our determination to disallow "recovery" for this expense item for ratemaking purposes is not based on one factor, but on the totality of the circumstances that surround this proposed expense item; a practice adhered to regarding our determination on all factors of this proceeding.

10. Amortization of CPCN

It is well-established that a utility is allowed to recover the normal cost of being regulated, i.e., the cost of proceedings before the commission, amortized over a specific period of time. Amortized periods may vary since these periods are dependent on when a utility expects to come before the commission for a rate increase. Since this proceeding is an application for a CPCN, the Consumer Advocate utilized a five-year amortization period, which is consistent with the Internal Revenue Code's calculation for business start-up costs. PWI did not indicate when it expects to come before the commission for a rate increase; however, PWI agreed to use a five-year period to amortize its CPCN application costs. Additionally, the parties agree that CPCN costs for legal services for the years 2000 through 2002 are approximately \$86,600. However, the parties disagree on the method to calculate PWI's amortized CPCN expense for ratemaking purposes.

PWI estimates its amortization of CPCN expense to be \$17,320. PWI derived this amount by dividing its estimated CPCN legal expenses of \$86,600 by five, which represents a five-year amortization period. On the other hand, the Consumer Advocate estimates this cost category to be \$6,740 for ratemaking purposes. The Consumer Advocate divided PWI's estimated CPCN legal expense of \$86,600 by three to normalize this cost figure in an effort to estimate the normal cost of filing one application. Then the Consumer Advocate divided the result by five, to account for the agreed-upon five-year amortization period, ending up with amortized legal costs of \$5,773. To this amount, the Consumer Advocate added \$967 to account for Ms. Cousineau's

efforts, which relate to the processing of PWI's CPCN application.⁴¹ The Consumer Advocate argues that the filing of three applications in a CPCN proceeding is not normal.

PWI argues that it should be allowed to recover all of the legal fees it incurred in this proceeding. It disagrees with the Consumer Advocate's decision to divide its legal expenses by three. PWI contends that the first amendment occurred prior to "any work" being performed on the original application and that the second amendment to the application was necessary to account for operational changes. PWI states that it had no viable alternatives.

Upon review, we find the Consumer Advocate's position regarding this cost category to be reasonable. The filing of three applications (an original and two amended applications), is simply not a normal occurrence in proceedings before the commission. While revisions and clarifications do sometimes occur in commission proceedings, PWI's amended filings were more than mere revisions since each amended filing proposed significant varying rates based on changed financial figures and new considerations. In the past, the commission has held that "[t]he function of the allowance of . . . [regulatory] expense, like the allowance of any other expense item, is not to guarantee the dollar-for-dollar actual recovery of the expense, but rather to establish a representative allowance for a normal and necessary

⁴¹See Section V.C.3, above, under "Contract Labor" expense.

utility function."⁴² (Emphasis added.) Additionally, it would be unreasonable and unfair to require PWI's ratepayers to bear the cost of PWI's multiple application filings in this proceeding. The Consumer Advocate made a concerted effort to normalize PWI's estimated legal CPCN expenses and realign Ms. Cousineau's CPCN related costs in its estimate, which we find to be reasonable. Accordingly, the commission concludes that an amortized CPCN expense of \$6,740, as proposed by the Consumer Advocate, is just and reasonable to determine rates in this proceeding.

11. Operating Contingency Reserve

PWI proposes to establish an operating contingency reserve of \$23,000 a year. This proposal is equal to approximately 10 per cent of its estimated revenues of \$232,632. PWI argues that maintaining a reserve is a prudent business practice, which the commission has recommended in past proceedings. To support its proposal, it cites the following proceedings: (1) In re Kaupulehu Water Co., Docket No. 94-0300, Decision and Order No. 14578 (July 1, 1996); (2) In re Puhi Sewer & Water Co., Inc., Docket No. 7576, Decision and Order No. 13304 (June 14, 1994); and In re Waikoloa Water Company, Inc., Docket No. 3295, Decision and Order No. 5667 (May 23, 1979) (Waikoloa). Referencing Waikoloa, it further states that PWI is entitled to an operating reserve since the value of its water system is not included in its rate base.

⁴²In re Laie Water Company, Inc., Docket No. 00-0017, Decision and Order No. 18406 at 12 (March 6, 2001) citing In re East Honolulu Community Services, Inc., Docket No. 7064, Decision and Order No. 12679 at 10 (October 13, 1993).

Moreover, PWI contends that an operating reserve is especially appropriate since its proposed rates do not provide for any profit.

The establishment of an operating contingency reserve was first raised by PWI during the evidentiary hearing. Possibly due to PWI's late proposal of the reserve, the Consumer Advocate does not specifically address the establishment of an operating contingency reserve in its post-hearing brief; however, the Consumer Advocate's post-hearing brief does address the issue of the establishment of a pump replacement reserve.⁴³ Upon review, it appears that the Consumer Advocate's position on this issue can be translated to be applicable to an operating reserve. For example, while addressing the issue of a pump replacement reserve, the Consumer Advocate states that "[w]hile the Consumer Advocate does not argue against being prepared to replace a failed pump or other equipment essential to the Applicant's operations, it does believe a more prudent method of planning would be to develop a rate base upon which a return may be made."⁴⁴ (Emphasis added.) The Consumer Advocate reminds us that a reserve is established by ratepayer funds as opposed to investor contributions, and that a reserve would increase already high rates for PWI's service. It appears that the Consumer Advocate is against the establishment of a reserve since it may discourage investment in PWI's infrastructure and equipment. It also appears that the Consumer Advocate prefers that PWI work towards the development of a rate base upon which investors are capable to earn a return.

⁴³See Section V.C.8, above, under "Depreciation or Pump Replacement" expense.

⁴⁴Consumer Advocate's Brief at 32.

Upon review and consideration of all relevant issues, we believe that establishment of an operating contingency reserve or any type of reserve, in this instance, should not be allowed. We are aware that in the past, the commission has encouraged the development of contingency reserves; however, due to the special circumstances of this case, we believe that establishing a reserve in this instance, would be imprudent and unfair, at this time. As the Consumer Advocate notes, establishing a reserve may discourage investment in PWI. We are mindful of this, and are hesitant to make a determination that may inhibit investment in PWI's infrastructure and/or discourage the development of PWI's rate base upon which a return on investment may be made. Moreover, we believe that establishing a reserve based on PWI's current customer base would be unfair to PWI's ratepayers. The record indicates that PWI expects to increase its customer base within the near future. Therefore, if PWI does not appear before the commission within a corresponding period of time, the rate upon which a reserve is established will be overstated. The record also indicates PWI's reluctance to come before the commission; thus, we are hesitant, at this time, to approve the establishment of an operating contingency reserve or any type of reserve.

Based on the above, we conclude that PWI's proposal to establish an operating contingency reserve or any type of reserve should be denied, at this time.

12. Revenue Taxes

Revenue tax expense is comprised of the Public Service Company tax (5.885 per cent of gross revenues) and the Public

Utilities Commission Fee (0.50 per cent of gross revenues). The parties agree on the formula to establish revenue tax expense (gross estimated revenues multiplied by 6.385 per cent, which is 5.885 per cent plus 0.5 per cent), however, they differ on the amount of estimated revenues. PWI's estimate of \$14,853 is based on gross estimated revenues of \$232,632, while the Consumer Advocate's estimate of \$8,060 is based on gross estimated revenues of \$126,228.

Upon review, we find PWI's revenues for ratemaking purposes to be \$122,335.⁴⁵ Thus, employing the agreed-upon tax formula, the commission concludes that revenue tax expense to determine rates is \$7,811 (\$122,335 multiplied by 6.385 per cent).

D. Rate Design

1. Power Fluctuation Factor (PFF)

The parties both propose a PFF for PWI's rates in this proceeding. After some debate, the parties agree on a basic PFF formula and the parameters of its implementation.⁴⁶ The agreed-upon formula is:

$$\text{PFF} = [\text{Actual kwh Cost} - \text{Base Cost}] \times \text{Pump Efficiency Factor} \times (\text{Taxes and Fees})$$

A PFF, as proposed by the parties, will allow PWI to automatically adjust its volumetric rate on a quarterly basis to account for fluctuations in the cost of electricity. In this formula, "Actual

⁴⁵See Section V.B, above, under "Revenues".

⁴⁶While the parties agree on the basic PFF formula they disagree on one component that makes up the formula, that of the appropriate pump efficiency factor. See above under "Electricity" expense for the parties' position on this issue, and the commission's determination.

kwh Cost" (\$ per kwh) represents the actual electricity costs incurred during the preceding quarter (this amount is to be calculated on a quarterly basis); "Base Cost" (\$ per kwh) represents the total cost of electricity in a specific time period divided by the amount of electricity used in the same time period; "Pump Efficiency Factor" (kwh per TG) is the ratio of electricity used in kwh to the amount of water pumped by PWI's wells within a specific period of time; and "Tax and Fee" account for the Public Service Company tax and Public Utilities Commission fee that PWI is subject to in relation to any revenue adjustment that results from the application of the factor.⁴⁷

Upon review, the commission finds that adoption of the parties' PFF *formula* for PWI in this proceeding is reasonable. The proposed PFF is a mechanism that provides an adjustment to the rates to account for PWI's high electricity expenses. Additionally, similar mechanisms have been approved for other regulated utilities. Thus, upon review of the proposed PFF *formula* the commission concludes that a PFF should be adopted.

While we agree that establishing a PFF is reasonable, and find the parties' agreed-upon PFF *formula* and implementation proposal to be sound, the commission is not able to adopt either of the PFFs proposed by the parties since specific elements of the parties' proposals are not consistent with the commission's determinations. As noted above, the commission determined that an appropriate "Base Cost" and "Pump Efficiency Factor" of \$0.22/kwh and 19.25 kwh/TG, respectively, to be just and reasonable for this

⁴⁷See Section V.C.12, above, under "Revenue Taxes" expense for detailed tax and fee rates.

proceeding.⁴⁸ In all other respects, we find the PFFs proposed by the parties to be reasonable. Thus, the commission concludes that the following PFF is just and reasonable for this proceeding:

(Actual kwh cost - \$0.22/kwh) x 19.25 kwh/TG x 1.06385

2. Customer (fixed) Charge

A customer charge, or a minimum billing charge, is imposed by a utility to account for and recover costs that the utility incurs to provide service to customers regardless of actual usage, i.e., the fixed costs. In this proceeding, PWI proposes a minimum billing charge of \$37.50 per bill for all customers. It proposes to apply this charge only when some quantity of water is used during the month that it is applied, to the extent applicable.⁴⁹ The Consumer Advocate supports a fixed customer charge of \$23.00 for all customers, on a monthly basis, regardless of the amount of usage.

Upon review, the commission is unable to adopt either of the parties' customer charge proposals. Our estimated revenues and expenses, determined upon our review of the record, does not support a customer charge as proffered by either of the parties. Furthermore, the commission finds the basis of the parties' customer charge proposals to be questionable. For example, in response to CA-SIR-1a, PWI stated that it did not "recall the

⁴⁸See Section V.C.1, above, under "Electricity" expense for details.

⁴⁹Under PWI proposal, its volumetric rate applies when the customer's monthly water usage exceeds the amount covered by PWI's minimum charge proposal.

precise formula for deriving" its customer charge of \$37.50.⁵⁰ Concerns also exist with regards to the Consumer Advocate's customer charge proposal. For instance, the Consumer Advocate's \$23.00 minimum charge was derived by adding its estimates of PWI's fixed expenses, as set forth in its initial calculations (see Consumer Advocate's Direct Testimony at CA-204), divided by 12 to arrive at a monthly expense amount, and then divided by 60 to account for PWI's customer base.⁵¹ As this proceeding progressed, the Consumer Advocate changed its labor expense estimate from \$10,000 to \$21,264, a fixed expense used in the calculation of its \$23.00 minimum billing charge,⁵² but failed to account for its altered position with regards to its customer charge proposal.

While we are unable to adopt the customer charge proffered by the Consumer Advocate, the formula that the Consumer Advocate used to derive its customer charge in this proceeding appears sound. We also find that the Consumer Advocate's recommendation to access such a charge to all customers regardless of water usage to be reasonable since a customer charge is meant to account for PWI's fixed costs; costs that are incurred regardless of water use.

Thus, based on our estimates of revenues and expenses, the commission finds and concludes that a fixed customer charge of

⁵⁰PWI filed its response to CA-SIR-1a on December 21, 2001.

⁵¹Consumer Advocate's Direct Testimony, CA-T-2 at 34 and 35. The Consumer Advocate's calculations produce an amount of \$22.65, which is rounded to \$23.00.

⁵²Consumer Advocate's Revised Testimony, CA Pre-Hearing Exhibit 2.

\$37.83, applied to all customers on a monthly basis regardless of water use, is just and reasonable for this proceeding.

3. Base (volumetric) Rate

Due to the commission's determination of a fixed monthly customer charge of \$37.83, as previously discussed, we are unable to accept the parties' base rate proposals in this proceeding. In determining PWI's base rate, the commission must first take into account the revenues derived from the \$37.83 fixed monthly customer charge. From the fixed monthly customer charge of \$37.83, PWI will realize \$27,237.60 in revenues per year.⁵³ As set forth above, the commission determined that estimated revenues of \$122,335 are just and reasonable for determining rates. An amount of \$95,097.40 is obtained by subtracting the estimated revenues derived from the fixed monthly customer charge from the estimated revenues (\$122,335 - \$27,237.60). Then, a base (volumetric) rate of \$6.02 per TG is obtained by dividing \$95,097.40 by the estimated water sales of 15,787 TG.

Accordingly, the commission concludes that a base (volumetric) rate of \$6.02 per TG is just and reasonable for this proceeding.

⁵³This amount is derived by multiplying the fixed monthly customer charge of \$37.83 by 12 to arrive at an annual amount charged per customer, which is then multiplied by 60 customers to account for PWI's customer base.

VI.

RULES AND REGULATIONS

Upon review, the commission finds the majority of PWI's proposed rules and regulations to be just and reasonable, but for two provisions.

First, PWI's proposed rules require two days written notice prior to the discontinuance of water service, see sections 7 and 8 of PWI's proposed rules and regulations. The Consumer Advocate recommends that PWI allow customers five days to resolve any matter that may lead to the discontinuance of water service. It argues that two days notice is insufficient. During the July 24, 2002 evidentiary hearing, PWI agreed to the Consumer Advocate's recommendation on this matter.⁵⁴ Upon review, we find it reasonable and in the public interest to adopt this revision to PWI's rules. Based on the above, we conclude that PWI should amend its proposed rules and regulations, specifically sections 7 and 8, to provide customers five days written notice prior to the discontinuance of water service.

Second, section 4.3 concerning PWI's rules and regulations on deposits state that deposits will be returned to customers upon the establishment of a "record of prompt payment for 12 consecutive months." Section 4.3 makes no mention of the interest that accrues on the customers' deposits. The Consumer Advocate recommends that PWI's rules be amended to require the return of deposits with interest. The Consumer Advocate argues that other water companies have provisions that compensate

⁵⁴Transcript at 74.

customers for the period that a utility retains the customers' deposits. During the evidentiary hearing, PWI stated that it was against this proposed revision to its rules. Aside from its short statement during the evidentiary hearing, PWI failed to specifically address this matter. Upon review, we find it reasonable and in the public interest to adopt the Consumer Advocate's recommendation on this issue. Based on PWI's proposed rules, the customers' deposits, upon establishing a "record of prompt payment", will rightfully be returned to the customers; thus, it is reasonable and fair to require any accrued interest associated with the customers' deposits to also be returned to PWI's customers. Thus, we conclude that section 4.3 of PWI's rules and regulations should be revised by incorporating the following language:

The deposits shall be returned to the Customer with interest. Simple interest shall accrue annually at the benefit of the Customer from the date of deposit on all deposit amounts held by the Company in excess of four (4) months at the passbook savings rate prevailing during such period at financial institutions where such deposits are held.

Based on the above, the commission concludes that PWI's proposed rules and regulations, subject to the required incorporation of the: (1) revisions set forth above; and (2) rates established by the commission in this decision and order, are just and reasonable.

VII.

ULTIMATE FINDINGS AND CONCLUSIONS

1. After due notice to all concerned and in accordance with State law, as applicable, public and evidentiary hearings have been held, evidence has been submitted, the commission has been fully informed, and the matter in Docket No. 00-0005 stands submitted.

2. Upon approval of stipulated Issue Nos. 1 and 2 of the parties stipulation filed on August 16, 2001, the commission finds that PWI is fit, willing, and able to properly perform the proposed services as a water service utility and to conform to the terms, conditions, rules, and regulations promulgated by the commission and that the proposed service is, or will be, required by the present or future public and convenience and necessity. We conclude that a CPCN should be granted to PWI, *nunc pro tunc*.

3. The rates and charges authorized herein are just, reasonable, and non-discriminatory.

4. The revenues and expenses, as set forth in Exhibit A, are found to be reasonable for the purpose of determining the rates to be allowed in this proceeding.

5. With the rates and charges authorized in this decision and order, PWI's anticipated revenues of \$122,335 will cover its anticipated expenses.

6. Those portions of the proposed rules and regulations that have been rejected must be amended in accordance with the commission's determinations, and PWI's proposed rules and regulations, as revised, must be submitted to the commission for approval.

7. The rate schedule, set forth in Section V, above, is just and reasonable and constitutes PWI's rates and charges.

VIII.

THE COMMISSION ORDERS:

1. The parties' stipulation on Issue Nos. 1 and 2, filed on August 16, 2001, is approved.

2. PWI's application for a CPCN, as amended, to provide water utility services for portions of Puuwaawaa and Puuanahulu homesteads in North Kona, Hawaii is approved, *nunc pro tunc*. PWI is granted a CPCN to provide water utility service in the areas more particularly described in Exhibit C of PWI's Second Amended Application, filed on September 24, 2001, subject to the conditions set forth in this ordering paragraph, nos. 3-8.

3. PWI shall submit tariff sheets, revised rate schedules, and revised rules and regulations that reflect our decisions on the rates, rules, and regulations set forth in Sections V and VI of this decision and order. The tariff sheets and rate schedules shall be served on the Consumer Advocate and filed with the commission not later than 15 days from the date of this decision and order.

4. Within 30 days of the date of this decision and order, PWI shall notify, in writing, each of its existing customers of its certification as a public utility and the availability of its published rates and charges, and the rules and regulations governing its water utility service; and file with the commission, with service on the Consumer Advocate, a copy of the written notification.

5. PWI shall file with the commission and serve on the Consumer Advocate quarterly financial reports for the calendar year 2003, setting forth the following: (1) monthly income and balance sheet information; (2) monthly water sales data; (3) monthly customer count information; and (4) data on water sales per customer, on a monthly basis (quarterly reports). PWI shall file the quarterly reports for calendar year 2003 no later than the last day of the month following the end of each quarter. Upon review of the quarterly reports the Consumer Advocate shall have the option of filing comments, as necessary, on various matters including, but not limited to, the completeness of each report.

6. Pursuant to HRS § 269-8.5, PWI shall file with the commission and serve on the Consumer Advocate an annual financial report in accordance with the Uniform Systems of Accounts-1996 of the National Association of Regulatory Utility Commissioners covering its water utility services commencing with the calendar year ending December 31, 2003, and each year thereafter. The annual financial reports shall be filed no later than March 31 of each year, for the immediate past calendar year.

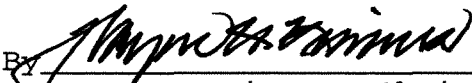
7. PWI shall submit to the commission, with service to the Consumer Advocate, its plan for capital improvements over the next five years. Among other things, the plan must identify the system's deficiencies, the likely future demand, and the means by which the deficiencies and demands will be met. Unless otherwise ordered, PWI shall file the plan not later than 180 days from the date of this decision and order.

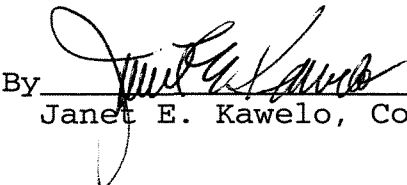
8. PWI shall remit, within 30 days of the date of this decision and order, a public utility fee of \$60, pursuant to HRS

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

DONE at Honolulu, Hawaii this 22nd day of January, 2003.

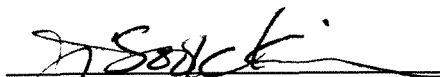
PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By 
Wayne H. Kimura, Chairman

By 
Janet E. Kawelo, Commissioner

By (RECUSED)
Gregg J. Kinkley, Commissioner

APPROVED AS TO FORM:


Ji Sook Kim
Commission Counsel

00-0005.sl

Docket No. 00-0005
Puuwaawaa Waterworks, Inc.
Revenue Requirements

		<u>Approved Rates</u>
Water Sales (in TG)	15,787	
Revenues		\$ 122,335
Electricity Expense		\$ 73,544
Other Utility Expense (Telephone)		636
Contract Labor Expense		21,264
Repair and Maintenance Expense		7,000
Legal and Accounting Fees		4,200
Insurance Expense		450
Office and Miscellaneous Expenses		690
Depreciation Expense or Pump Replacement		-
Loan Repayment		-
Amortization of CPCN Expense		6,740
Net Operating Reserve		-
Revenue Taxes		<u>7,811</u>
Total Expenses		\$ 122,335

CERTIFICATE OF SERVICE


I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 19980 upon the following parties, by causing a copy hereof to be mailed, postage prepaid, and properly addressed to each such party.

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

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PU`U LANI RANCH HOMEOWNERS ASSOCIATION
C/O ARICK YANAGIHARA, PRESIDENT
1001 Bishop Street, Suite 2690
Honolulu, HI 96813



Karen Higashi

DATED: January 22, 2003