

BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

In the Matter of the Application of)
KAPALUA WATER COMPANY, LTD.)
For Approval of Changes to)
its Tariff.)
Transmittal No. 05-01.)

DOCKET NO. 05-0132

DECISION AND ORDER NO. 21950

Filed July 28, 2005
At 2 o'clock P.M.

Karen Higashi
Chief Clerk of the Commission

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

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K. Higashi

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DECISION AND ORDER

The commission, on a temporary, interim basis, authorizes KAPALUA WATER COMPANY, LTD. ("KWC") to implement its proposed new rate structure for its Pineapple Hill, Phase I customers, effective from August 15, 2005.

I.

Background

KWC proposes to modify its rate schedule by Transmittal No. 05-01, filed on April 26, 2005.¹ KWC makes its request in accordance with Hawaii Revised Statutes ("HRS") §§ 269-12(b) and 269-16(b) and Hawaii Administrative Rules § 6-61-111.

¹KWC's Transmittal No. 05-01, Verification, Exhibits 1 and 2, and Certificate of Service (collectively, "Transmittal No. 05-01").

KWC served copies of its transmittal upon the Department of Commerce and Consumer Affairs, Division of Consumer Advocacy ("Consumer Advocate"). On May 24, 2005, the Consumer Advocate filed its protest: (1) objecting to KWC's proposed tariff changes; and (2) recommending the denial of KWC's transmittal.² On June 9, 2005, KWC filed a response to the Consumer Advocate's protest, in compliance with Order No. 21849, filed on June 1, 2005. On June 28, 2005, KWC responded to the commission's information requests.³

II.

KWC's Rate Schedule

KWC is a public utility that provides potable and irrigation water to the residences, condominiums, hotels, and commercial establishments in the Kapalua service area, island of Maui.

KWC's rate schedule consists of: (1) a monthly service charge, based on a customer's meter size; (2) a monthly water consumption charge, with different rates for potable water and irrigation water; and (3) a private fire service charge.

²Consumer Advocate's position statement, filed on May 24, 2005, as amended on June 6, 2005. See the Consumer Advocate's transmittal letter, dated June 6, 2005, with enclosure.

³The commission also acknowledges the receipt of a letter dated June 28, 2005, from a director of the Pineapple Hill Homeowners' Association.

III.

KWC's Position

KWC explains that:

1. Its current rate structure is based on the assumption that KWC provides water under a dual water system: (A) water for residential and domestic use is provided through a potable water system; and (B) water for irrigation use is provided through a separate non-potable system.

2. However, unlike the other developments in KWC's service area, the sole supply of water to Pineapple Hill, Phase I, an existing ninety-nine (99) unit residential subdivision, is potable water from underground wells, with no separate infrastructure for non-potable water deliveries.⁴

3. "As a result, customers in the Pineapple Hill, Phase I subdivision are required to use potable water for all purposes, including irrigation, and have thus been charged at the higher potable water rates."⁵

4. Thus, in an effort to address the concerns of the Pineapple Hill, Phase I customers ("Phase I customers") and to recognize in KWC's rate structure said customers' use of potable water for irrigation purposes, KWC proposes to modify its rate schedule.

⁴The Pineapple Hill, Phase II, residential subdivision has a dual water system.

⁵KWC's Transmittal No. 05-01 at 3.

5. Specifically, with respect to the monthly water consumption charge, KWC proposes to create a separate, new rate structure for the Phase I customers, as follows:⁶

Potable Water:	First 12,500 gallons/mo.	\$3.53/1,000 gallons
	Over 12,500 gallons/mo.	\$5.05/1,000 gallons
Irrigation Water:		\$2.22/1,000 gallons
<u>Pineapple Hill, Phase 1</u>	<u>First 20,000 gallons/mo.</u>	<u>\$2.22/1,000 gallons</u>
<u>only:</u>	<u>Next 12,500 gallons/mo.</u>	<u>\$3.53/1,000 gallons</u>
<u>(domestic and irrigation)</u>	<u>Over 32,500 gallons/mo.</u>	<u>\$5.05/1,000 gallons</u>

KWC's tariff change is supported by its cost study, attached as Exhibit 1 to its transmittal.

In support of its tariff change, KWC represents:

1. The new rate structure will result in a billing decrease and provide some rate relief to the Phase I customers, without detriment to the rates being charged, or the level and quality of service being provided to KWC's other customers. These other customers will not be required to subsidize the use of potable water for irrigation purposes at Pineapple Hill, Phase I.

2. The average rate for all water (irrigation and potable uses) delivered to the Phase I customers will be approximately \$3.13/1,000 gallons, as compared to the system-wide average water rate of \$2.94/1,000 gallons. "Thus, even with the billing decrease that Pineapple Hill, Phase I customers will receive under the new proposed rate structure, the average rate

⁶KWC's proposed additions are underscored. KWC identifies the three (3) components of the new rate structure as the: (1) irrigation component (up to 20,000 gallons/month); (2) initial potable component (20,001 gallons/month to 32,500 gallons/month); and (3) excess potable component (beyond 32,500 gallons/month).

paid for all water at Pineapple Hill, Phase I [will] still be slightly higher than the average paid by [KWC's] other water service customers."⁷

3. The new rate structure will not have a measurable impact on KWC's potable water source capability, as the Phase I customers currently use potable water for irrigation purposes anyway.⁸

4. The new rate structure is reasonable and consistent with the public interest.

IV.

Consumer Advocate's Protest

At the outset, the Consumer Advocate notes that KWC, in its Exhibit 1, claims that: (1) the Phase I customers are unable to receive non-potable water through a separate irrigation transmission because there was no requirement for a dual water system when Phase I was developed; and (2) the Pineapple Hill Homeowners' Association ("Homeowners' Association") requires lot owners to maintain adequate irrigation of their properties, consistent with the Homeowners' Association's rules and covenants.

⁷KWC's Transmittal No. 05-01 at 4.

⁸"Stated otherwise, no additional pumping cost or wear and tear would result from the proposed tariff modification, as the total amount of pumped groundwater used by the Pineapple Hill, Phase I subdivision as a whole will likely remain the same." Id.

The Consumer Advocate objects to KWC's proposed new rate structure for the Phase I customers, reasoning that:

1. In 1993, KWC received authorization to install a dual water system in order to comply with the federal Safe Drinking Water Act and State of Hawaii ("State") regulations.⁹ KWC's dual water system uses surface water for landscaping and other non-potable purposes, and ground water from wells owned by Maui Land & Pineapple Company, Inc. ("ML&P") for potable water use. KWC purchases the ground water from ML&P pursuant to the terms of a water purchase agreement approved by the commission in Decision and Order No. 12618. It is unclear as to why, at that time, the irrigation water system was not extended to include the Pineapple Hill, Phase I project.

2. The Phase I customers "knowingly purchased the lots in the project fully aware of the irrigation/landscaping requirements set forth in the Homeowners' Association documents. In addition, these customers know that a dual water system is not available to serve this phase of the development and have the option of installing the necessary distribution facilities to receive potable and non-potable water, similar to other customers."¹⁰

⁹See Decision and Order No. 12618, filed on September 23, 1993, in Docket No. 7683; and Decision and Order No. 14408, filed on December 8, 1995, in Docket No. 7926.

¹⁰Consumer Advocate's position statement, at 5 (footnote and text therein omitted).

3. It is unclear "whether the estimated tier assumed to represent non-potable water use is reasonable since the benchmark of 20,000 gallons of water per month is derived from usage information for customers in the Phase II subdivision, which may not be representative of the landscaping/irrigation use of the Phase I customers[.]"¹¹

4. While the projected revenue loss of approximately \$35,000 represents only 2.4 per cent of KWC's total reported revenues for 2004, the potential for KWC's other customers to subsidize this revenue shortfall exists. Contrary to KWC's assertion of no cross-subsidization, the proposed tariff will: (A) result in the Phase I customers continuing to receive potable water service, but at a discounted rate from that charged to KWC's other customers for the same potable water service; and (B) ultimately result in the subsidization of potable water service to the Phase I customers by KWC's other customers, which is not reasonable.

V.

KWC's Response to the Consumer Advocate's Protest

KWC, in response to the Consumer Advocate's protest, replies:

1. KWC filed its transmittal in response to the perceived inequity issue raised by the Phase I customers.

¹¹Id.

2. KWC filed its transmittal "under the assumption and belief that the proposed tariff change would not pose any cross-subsidy or other issues that could possibly have a detrimental financial impact on [KWC] at some point in the future. . . . [KWC] does not believe that the proposed tariff change for the Phase I customers results in any subsidization issues because the average rate to be paid by the Phase I customers for potable water service would still be slightly higher than the average rate paid by [KWC's] other water service customers for potable and non-potable water service."¹²

3. Nonetheless, KWC believes that in its next application for a rate increase, the Consumer Advocate will "likely address its concern by seeking some form of imputation or other ratemaking adjustment against [KWC's] revenue requirement in the amount of this subsidy[.] . . . Such an imputation [is not] acceptable to [KWC] because it would negatively impact [KWC] on a financial basis and could also possibly threaten [KWC's] right to earn a fair return on its investment depending on the amount of the subsidy involved."¹³

4. Ultimately, KWC requests that the commission approve the new rate structure, but only if the commission simultaneously determines that the new rates do not result in the subsidization of potable water service to the Phase I customers by KWC's other customers. KWC will no longer support its

¹²KWC's response, at 2 - 3.

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

proposed tariff change unless the commission "can make a simultaneous determination that the proposed tariff change will not result in the subsidization of potable water service to the Phase I customers by [KWC's] other customers."¹⁴

5. Conversely, if the commission finds that subsidization exists or defers this issue, then the commission is left with the Consumer Advocate's recommendation to deny KWC's transmittal based on various reasons, and KWC asserts that the commission should issue its decision accordingly.

VI.

KWC's Responses to the Commission's Information Requests

KWC, in response to the commission's information requests, states:

1. The ballpark estimate of KWC's cost of extending the irrigation water facilities into and throughout the Phase I area is approximately \$800,000 (in 2003\$), excluding the cost to trench, cut roadways or customer driveways.¹⁵ Based on the existing ninety-nine (99) residential lots within Phase I, it will cost a typical Phase I customer approximately \$8,000 (in 2003\$) to pay for the customer's share of the facilities necessary to connect KWC's existing irrigation water facilities.

¹⁴Id. at 4.

¹⁵"KWC is uncertain at this time how much additional costs would be incurred . . . to trench and to cut the roadways and driveways." KWC's response to PUC-IR-101.

In addition, each customer will have to pay approximately \$500 to cover KWC's costs to hook-up and install each customer's irrigation meter.

2. Similar to other developments, it is the prospective customers' obligation to install, at the customers' expense, the distribution facilities within the development necessary to provide service to the development.

3. The necessary work to install an irrigation line within Phase I, if undertaken, would be very difficult and time consuming, and take at least six (6) months to complete, "at substantial noise and disturbance to the existing homeowners within the Pineapple Hill development."¹⁶

4. At the time the Phase I facilities were constructed and contributed to KWC, there was no requirement to install a dual water system.

"As such, although other portions of the KWC system had since been constructed with a dual system as a result of changes in the law that occurred following the construction of the Phase I facilities, KWC should not be required to install a second irrigation line within Phase I, especially when it was not KWC's obligation to install the existing distribution system within Phase I, the existing system was constructed in accordance with laws in effect at that time, and the existing system is in compliance with [then] existing laws. "¹⁷

¹⁶Id.

¹⁷Id. (underscore in original).

5. KWC is not in a position to install the second irrigation line without serious implication to its financial condition. "In such an event, KWC would be required to seek to recover these expenses from its customers through increased rates. However, KWC believes it would not be reasonable to require its customers outside of Phase I to pay for or share in the cost of installing a second line within Phase I of Pineapple Hill."¹⁸

6. Rather, if an irrigation line is installed within Phase I, the work and cost involved to construct the irrigation line should be undertaken by the owners of Phase I entirely at their own expense.

VII.

Discussion

KWC forecasts approximately 20,000 gallons/month of irrigation water use by each of its Phase I customers, based on KWC's analysis of irrigation water use in its other service areas where such usage can be measured under the utility's dual water system. Hence, KWC proposes to provide its Phase I customers with the first 20,000 gallons/month of potable water at its irrigation water rate, then revert to the existing potable water rates for incremental increases in usage thereafter.

The Consumer Advocate objects to KWC's proposed new rate structure for the Phase I customers, while KWC supports its proposal only if the commission simultaneously determines that

¹⁸Id.

the new rates do not result in the subsidization of potable water service to the Phase I customers by KWC's other customers.

On one hand, at the time of Phase I's development, there was no requirement to install a dual water system, thus, the Phase I customers sole supply of water is potable water. On the other hand, as characterized by the Consumer Advocate, the Phase I customers knowingly purchased the lots with a single, potable water system, within a planned subdivision that includes certain Homeowners' Association requirements governing landscaping, and have the option of installing the necessary distribution facilities to receive non-potable water.

The commission, in this instance, will authorize KWC to implement its proposed new rate structure on an interim basis, until KWC's next rate case, or until an irrigation line, if pursued, is installed for Phase I; subject to the commission's right to review, modify, and terminate KWC's new rate structure at any time.¹⁹ Unless ordered otherwise, KWC's new rate structure will sunset upon the conclusion of KWC's next rate case, or until an irrigation line is installed for Phase I, whichever comes first.

During this interim period, KWC will absorb the reduction in revenues resulting from its new rate structure, amounting to approximately 2.4 per cent under its own calculation. "Such a small amount of loss, as a function of the

¹⁹Based on KWC's representation and verification that the new rate structure will result in a billing decrease for its Phase I customers, the rate increase provisions relating to a public hearing and contested case proceeding are not implicated by KWC's transmittal. See HRS § 269-16(b).

[g]ross water sales," KWC states, will not, in and of itself, "justify a general rate increase."²⁰

The commission declines, at this juncture, to address the concerns with cross-subsidization, imputation, and other ratemaking adjustments.

This proceeding arises out of KWC's own initiative and request to implement its new rate structure, and this commission will not prematurely decide the cross-subsidization, imputation, and other ratemaking matters, until KWC's next rate case. Moreover, KWC represents that: (1) the new rate structure will provide some rate relief to its Phase I customers, without detriment to the rates being charged, or the level and quality of service being provided to KWC's other customers; (2) KWC's other customers will not be required to subsidize the use of potable water for irrigation purposes at Phase I;²¹ and (3) the new rate structure is reasonable and consistent with the public interest.

KWC's next rate case application shall include a cost study that demonstrates: (1) whether the costs of the potable and non-potable facilities and services are segregated; and (2) whether any subsidization exists. KWC should also document and explain: (1) how the existing non-potable system was paid for; (2) whether the Phase I customers may have contributed (and continue to contribute) to the cost of the facilities and

²⁰KWC's Transmittal No. 05-01, Exhibit 1, at 4.

²¹Apparently, KWC reasons that since the water rates charged to its non-Phase I customers will not change, these customers will not cross-subsidize the Phase I customers under KWC's proposed new rate structure, at least until the water rates charged to its non-Phase I customers change, ostensibly following the completion of a general rate case.

maintenance expenses associated with the non-potable water service through their payment for potable water service; and (3) why KWC previously did not convert the Phase I water system into a dual water system, as part of its mandate to comply with the federal Safe Drinking Water Act and related State regulations.²² KWC's cost study, documentation, and explanation shall be consistent with the commission's previous decisions and dockets involving KWC.²³

²²A review of the commission's past decisions involving KWC reveals that: (1) on September 2, 1977, the commission approved KWC's initial tariff and water rates (Docket No. 3157); (2) KWC's initial water system, consisting of transmission lines, a one (1) million gallon reservoir, and filter plant, was built at a cost of \$979,922 (Dockets No. 3157 and No. 4890); (3) the commission granted KWC general rate increases based on the 1981, 1982, 1984, 1988, and 1995 calendar test years (Dockets No. 4044, No. 4318, No. 4890, No. 5486, and No. 7926); (4) on June 13, 1995, the commission approved the merger of KWC and Kapalua Waste Treatment Company, Ltd., with KWC as the surviving regulated entity, subject to certain conditions, including the requirement that KWC continue to maintain separate accounts for its sewer and water operations (Docket No. 7926); (5) circa 1994, KWC completed the conversion of its single surface water system into a dual water system, as part of its mandate to comply with the federal Safe Drinking Water Act and related State regulations (Dockets No. 7683 and No. 7926); (6) KWC's dual water system uses surface water for landscaping and non-potable purposes, and ground water from wells owned by ML&P for potable water use (Dockets No. 7683 and No. 7926); and (7) the commission twice approved KWC's expansion of its service territory (Dockets No. 6519 and No. 03-0411).

KWC's initial water system was built by its affiliate, Kapalua Land Co., Ltd. ("Kapalua Land"), and the assets of the water system were transferred at no cost to KWC by Kapalua Land. Decision and Order No. 8363, filed on May 30, 1985, at 3 and 8 - 15, in Docket No. 4890. Thus, KWC's plant-in-service, prior to September 2, 1977, was constructed with contributions-in-aid-of-construction. Id. at 16. Concomitantly, the commission ruled that, for the plant-in-service constructed by KWC since September 2, 1977 to meet anticipated demand, KWC's rate base can include those plant investments. Id. at 14.

²³See footnote, above.

Lastly, the commission also suggests that, consistent with the public interest, KWC continue working with the community to explore a long-term solution to extending its non-potable water system in the Phase I service area, to the extent technically and financially feasible.²⁴

The commission, as a temporary, interim measure, will allow KWC's tariff changes to take effect, as proposed, effective from August 15, 2005; subject to the commission's right to review, modify, and terminate KWC's new rate structure at any time.

VIII.

Orders

THE COMMISSION ORDERS:

1. KWC's proposed tariff changes to its rate schedule, as reflected in its Transmittal No. 05-01, filed on April 26, 2005, are allowed to take effect as a temporary, interim measure, effective from August 15, 2005, until KWC's next rate case, or until an irrigation line, if pursued, is installed for Phase I; subject to the commission's right to review, modify, and terminate KWC's new rate structure at any time. Unless ordered otherwise, KWC's new rate structure will sunset upon the conclusion of KWC's next rate case, or until an irrigation line is installed for Phase I, whichever comes first.

²⁴See KWC's responses to PUC-IR-101 to PUC-IR-103. See also letter dated June 28, 2005, from a director of the Pineapple Hill Homeowners' Association.

2. Within ten (10) calendar days from the date of this Decision and Order, KWC shall file its revised tariff sheets, incorporating the applicable issued and effective dates. Its revised tariff sheets shall clearly explain that its new rate schedule for the Phase I customers is a temporary, interim measure that will sunset upon the conclusion of KWC's next rate case, or until an irrigation line is installed for Phase I; subject to the commission's right to review, modify, and terminate KWC's new rate structure at any time.

3. By August 8, 2005, KWC shall notify all of its customers of the new temporary, interim rate structure, with a clear explanation that its new rate structure will sunset upon the conclusion of KWC's next rate case, or until an irrigation line is installed for Phase I; subject to the commission's right to review, modify, and terminate KWC's new rate structure at any time. KWC shall provide the commission and Consumer Advocate with copies of this written notice.

4. KWC's next rate case application shall include a cost study that demonstrates: (A) whether the costs of the potable and non-potable facilities and services are segregated; and (B) whether any subsidization exists. KWC should also document and explain: (A) how the existing non-potable system was paid for; (B) whether the Phase I customers may have contributed (and continue to contribute) to the cost of the facilities and maintenance expenses associated with the non-potable water service through their payment for potable water service; and (C) why KWC previously did not convert the Phase I water system

into a dual water system, as part of its mandate to comply with the federal Safe Drinking Water Act and related State regulations.

KWC's cost study, documentation, and explanation shall be consistent with the commission's previous decisions and dockets involving KWC.

5. KWC shall conform to all of the commission's orders set forth, above. KWC's failure to adhere to the commission's orders shall constitute cause for the commission to void this Decision and Order, and may result in further regulatory action as authorized by law.

DONE at Honolulu, Hawaii JUL 28 2005.

PUBLIC UTILITIES COMMISSION
OF THE STATE OF HAWAII

By Carlito P. Caliboso
Carlito P. Caliboso, Chairman

By (EXCUSED)
Wayne H. Kimura, Commissioner

APPROVED AS TO FORM:

Michael Azama
Michael Azama
Commission Counsel

By Janet E. Kawelo
Janet E. Kawelo, Commissioner

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Decision and Order No. 21950 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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DATED: JUL 28 2005