

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION OF)
INLAND BAYS PRESERVATION COMPANY,)
L.L.C., FOR APPROVAL OF RATES TO) PSC DOCKET NO. 05-59WW
GOVERN THE PROVISION OF WASTEWATER)
SERVICES IN DELAWARE)
(FILED FEBRUARY 18, 2005))

ORDER NO. 6892

This 25th day of April, 2006, the Commission finds, determines, and Orders the following:

1. Inland Bays Preservation Company, L.L.C. ("Inland Bays"), is a privately-owned wastewater operation that became subject to the Commission's supervisory authority in July, 2004.¹ Because Inland Bays was a pre-existing, "grandfathered" utility, the Commission must review the rates it was charging in June, 2004 (as well as any rate changes the utility might currently propose).² In conducting this review, the Commission is guided by the central principle of all utility rate regulation: the (existing) rates cannot be unjust or unreasonable nor can they give any undue or unreasonable preference or advantage.³ By this Order, the Commission finds Inland Bays' existing rates to be reasonable.

¹See 26 Del. C. § 203D(a)(2) (2004 Supp.).

²See 26 Del. C. § 301(c) (2004 Supp.). Inland Bays' rates have been "frozen" at their June, 2004 levels until the completion of the Commission's review. Inland Bays has not sought any change to those existing rates as part of this rate review.

³See 26 Del. C. § 303(a).

2. Inland Bays currently has two annual rates for its wastewater services: \$160 for those customers served by its "Pot-Nets" system and \$368 for those served by the "Baywood" system. The two rates reflect the differences between the two systems. The "Pot-Nets" plant (currently serving 562 residential units) is solely a collection system; it collects and conveys the wastewater to a treatment facility owned and operated by Sussex County. The Baywood system serves 163 residential and commercial units via both a collection system and a spray irrigation treatment process. In addition to these annual charges, Inland Bays collects, in both systems an initial "hook-up" fee of \$2,950.

3. By an earlier Order, the Commission directed Inland Bays to inform its customers that this Commission would be reviewing the utility's current rates. The notices asked customers to submit any objections to the utility's current rates as well as any comments about the quality of the utility's services.⁴ Inland Bays mailed these notices to its customers in July, 2005.⁵ Several customers responded with written comments; others with telephone inquiries to Staff. In some of those responses, customers expressed confusion not only about

⁴See PSC Order No. 6672 (July 5, 2005). That Order also directed publication of a general notice that the Commission would be reviewing the rates of Inland Bays and another utility. Because of miscommunications between the two affected utilities and Staff, that notice was never published. In light of the fact that individual notices were delivered to Inland Bays' customers, the Commission does not believe it would be efficient to require publication of such general notice now. In fact, given the lapse of time from the original individual customer notices, publication of a similar notice in a newspaper now might only cause confusion. The Commission thus rescinds and waives its earlier directive for newspaper publication in this matter.

⁵See Mailing receipt reflecting notices sent July 25, 2005.

the status of Inland Bays as a separate utility subsidiary of Tunnell Companies, L.P., but also this Commission's oversight of its rates and operations. Almost all the comments questioned the "hook-up" fee amount, particularly if it was going to now be charged to homes and establishments that have been connected to these wastewater systems for years.⁶ Staff reports that it contacted the commenting customers and explained to them that the hook-up fee would only be applicable to future connections.

4. Staff has filed a report of its investigation of Inland Bays' expenses and costs and whether its current rates are reasonable.⁷ According to Staff, its investigation focused on two questions: (a) are Inland Bays' current rates just and reasonable? and (b) will those rates provide sufficient revenues to allow the utility to maintain safe and adequate service to the public on an ongoing basis? To answer those two questions, Staff applied the "cost of service/rate base, rate of return" methodology traditionally used in utility rate review. In doing so, it looked not only to the company as a whole but scrutinized each system separately.⁸ Thus, using "actual" booked entries for the year 2004 as a baseline (somewhat akin to a "test year"), Staff developed both current and projected (2005-2009 revenues

⁶See Letter of G. Murchie (Aug. 3, 2005); Letter of D. Roe (Aug., 2005); Letter of C. Walton and others (Aug. 10, 2005); and Letter of F. Bailey (Aug. 24, 2005).

⁷Staff Memorandum (Mar. 9, 2006).

⁸Each system was examined separately because of Inland Bays' historical practice of charging differing rates for the systems and because the two systems have different operational characteristics. Staff recommends that the regime of a separate annual charge for each system be continued.

and expenses for each system.⁹ Similarly, Staff constructed a rate base for each system for year-end 2005, and also projected adjustments to each rate base for every year through 2009.¹⁰ Based on its review of these current (historical) and projected numbers, Staff concludes that Inland Bays' existing (June, 2004) rates are not producing excess return to the utility currently, nor will they do so over the 2005-2009 projected period. In the case of the Pot-Nets system, Inland Bays currently has a positive Operating Income and can expect similar positive Operating Incomes for each year in the projected period. However, those positive income positions will generate only a nominal return to the Inland Bays' owners. Looking to the more recently constructed Baywood system, Staff posits that the current rates will, in the first year of the analysis period (2005), produce an Operating Income loss. However, by the second year, that will reverse due to customer growth. But even then, Baywood's current rates will still only produce only a small return to its owners. Based on its analysis, Staff concludes that Inland Bays' current annual rates are

⁹Staff projected both expenses and capital infusion for the 2005-2009 period in order to determine whether the current rates would produce excess return as the systems "fill-out" (and produce greater revenues) over the upcoming five years. The year 2005 was included in the projection period because actual data for 2005 was not available at the time of preparation of the Staff rate report.

¹⁰Staff utilized an "original cost" method in constructing its rate base for each system. It did so by adjusting Inland Bays' current price estimates "backward" utilizing CPI Indexes. It then made the required adjustments for accumulated depreciation, contributions, and cash working capital. See 26 Del. C. § 102(3) (rate base based on original cost either to first person who committed plant to public use, or at Commission option, the first recorded book cost of plant). In the past, capital for the systems has come from investor capital and customer contributions in the form of "hook-up" fees. For the year 2005, Staff calculated a rate base of \$1,318,641 for the Baywood system and \$2,002,454 for the Pots-Net system.

reasonable and will not, at current levels, produce excessive return over the five-year projected period.¹¹ Staff also finds the \$2,950 "hook-up" fee - representing a capital contribution from the new customer - to be reasonable.

5. Beyond its rate analysis, Staff also recommends that the Commission, on a going-forward basis, direct Inland Bays to promptly implement various accounting practices. For example, Staff recommends that Inland Bays move to compliance with the National Association of Regulatory Utility Commissioners' uniform system of accounts and that the utility keep those accounts separately for each system. Such accounts should also be maintained independently of the books for any other entities owned by other Tunnell Companies, L.P. Finally, Staff has reviewed Inland Bays proposed Tariff that contains terms and conditions beyond rates. It recommends that such proposed Tariff be approved by the Commission.

6. The Commission accepts all of Staff's accounting recommendations. Inland Bays, although now small, is still an investor-owned utility. In such situation, the interests of ratepayers and owners can often diverge. If the Commission is to perform its regulatory duties, it is essential that Inland Bays keep accurate sets of utility-style books. Adherence to accepted utility accounting practices will protect both ratepayers and owners.

¹¹The Commission notes that the Commission is reviewing current (that is 2004) rates. Inland Bays is not now seeking any increase in its existing rates. In this context, the Commission does not believe it is necessary that the Commission determine a particular "acceptable" rate of return for these systems. To determine the "reasonableness" of existing rates, it is enough to conclude, as Staff has found, that the return to owners is "nominal."

Now, therefore, **IT IS ORDERED:**

1. That, based on Staff's analysis and for the reasons set forth in the body of this Order, the existing annual per customer rate now charged by Inland Bays Preservation Company, L.L.C., consisting of \$160 for its Pot-Nets collection system and \$368 for its Baywood collection and treatment system, are hereby declared just and reasonable under 26 Del. C. §§ 301(c) and 303(a). Similarly, the \$2,950 "hook-up" or connection fee applicable to both systems is found just and reasonable as a new customer contribution in-aid-of construction. Inland Bays Preservation Company, L.L.C. shall file, and make available for public review, a final Tariff for its services that includes such rates and fees within fifteen days of this Order. That Tariff shall be effective upon Staff's final approval.

2. That Inland Bays Preservation Company, L.L.C. shall create, and maintain, separate financial and operating records for its Pot-Nets and Baywood operating systems. Such records shall be maintained separate from any records for any other entity owned by Tunnell Companies, L.P.

3. That Inland Bays Preservation Company, L.L.C. shall develop property records for each service area reflecting the original cost and year of installation of plant in accordance with accounting standards recognized by the National Association of Regulatory Utility Commissioners' uniform system of accounts.

4. That Inland Bays Preservation Company, L.L.C. shall implement as the accounting regime for its two wastewater systems the uniform system of accounts adopted by the National Association of

Regulatory Utility Commissioners. Such uniform system shall be implemented for calendar year 2006, and continued thereafter. In addition, Inland Bays Preservation Company, L.L.C. shall, by December 31, 2006, submit a report to this Commission setting forth the "costs" of its utility plant under the uniform system of accounts adopted by the National Association of Regulatory Utility Commissioners.

5. That Inland Bays Preservation Company, L.L.C. shall continue to comply, in all relevant aspects, with the "Minimum Standards for Service Provided by Public Wastewater Utilities" adopted by PSC Order No. 6661 (June 21, 2005).

6. The Commission reserves the jurisdiction and authority to enter such other or further Orders in this matter as may be deemed necessary or proper.

BY ORDER OF THE COMMISSION:

/s/ Arnetta McRae
Chair

/s/ Joann T. Conaway
Commissioner

/s/ Jaymes B. Lester
Commissioner

/s/ Dallas Winslow
Commissioner

ATTEST:

/s/ Jeffrey J. Clark
Commissioner

/s/ Karen J. Nickerson
Secretary