

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION)
OF UNITED WATER DELAWARE INC. FOR) PSC DOCKET NO. 06-174
AN INCREASE IN WATER RATES)
(FILED MAY 26, 2006))

ORDER NO. 7120

AND NOW, this 23rd day of January, 2007;

WHEREAS, the Commission has received and considered the Findings and Recommendations of the Hearing Examiner ("Report") issued in the above-captioned docket, which was submitted after a duly noticed public evidentiary hearing;

AND WHEREAS, the Hearing Examiner recommends that the Proposed Settlement Agreement, dated January 3, 2007, which is endorsed by all the parties, and which is attached to the original hereto as "Attachment B", be approved;

AND WHEREAS, the Commission finds that the proposed rates and tariff changes are just and reasonable and that adoption of the Proposed Settlement Agreement is in the public interest; now, therefore,

IT IS ORDERED:

1. That, by and in accordance with the affirmative vote of a majority of the Commissioners, the Commission hereby adopts the January 11, 2007 Findings and Recommendations of the Hearing Examiner, appended to the original hereto as "Attachment A".

2. That the Commission approves the Proposed Settlement Agreement, and the tariff changes and rates contained therein, which

is attached to the original hereto as "Attachment B," effective for water service rendered after January 23, 2007, and which reflect a total test period operating revenue requirement of \$22,569,384, including purchased power costs and purchased water costs of \$1,684,179 and \$659,180, respectively.

3. That the Commission reserves the jurisdiction and authority to enter such 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

/s/ Jeffrey J. Clark
Commissioner

ATTEST:

/s/ Karen J. Nickerson
Secretary

"A T T A C H M E N T A"

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FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATED: JANUARY 11, 2007

WILLIAM F. O'BRIEN
SENIOR HEARING EXAMINER

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FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

William F. O'Brien, duly appointed Hearing Examiner in this Docket pursuant to 26 *Del. C.* § 502 and 29 *Del. C.* ch. 101, by Commission Order No. 6966, dated July 11, 2006, reports to the Commission as follows:

I. APPEARANCES

On behalf of the Applicant, United Water Delaware Inc.:

MORRIS, JAMES, HITCHENS & WILLIAMS LLP
BY: P. CLARKSON COLLINS, JR., ESQUIRE.

On behalf of the Public Service Commission Staff:

ASHBY & GEDDES
BY: REGINA A. IORII, ESQUIRE.

On behalf of the Division of the Public Advocate:

JOHN C. CITROLO, DEPUTY PUBLIC ADVOCATE.

II. BACKGROUND

1. On May 26, 2006, United Water Delaware Inc. ("UWDE" or the "Company") filed an application with the Delaware Public Service Commission ("Commission") seeking approval for an overall increase in rates of \$5,866,240, or approximately 24 percent over test year book

revenues.¹ The Application also includes a complete set of new tariff sheets, which incorporate proposed changes to UWDE's Rules and Regulations concerning, among other things: (1) providing that property owners will be liable for water service and account balances at properties they own; (2) addressing cross connection and giving UWDE the ability to require cross connection controls to eliminate or minimize backflow or contamination of UWDE's water system; (3) updating miscellaneous fees and charges to present day costs; and (4) adding a new charge for reimbursement when meters have been damaged due to negligence.²

2. On June 20, 2006, the Commission entered PSC Order No. 6947 suspending the rates proposed in the Application and appointing a Hearing Examiner and Rate Counsel to process the docket. On June 23, 2006, UWDE filed with the Commission revised tariff leaves designed to increase its water rates by \$2,500,000 annually, which it is permitted to do under 26 Del. C. §306(c)(authorizing an interim rate increase of up to \$2.5 million annually or 15 percent, whichever is less). On July 11, 2006, the Commission, by PSC Order No. 6966, approved the requested interim increase to become effective July 25, 2006, under bond and subject to refund.

¹ The requested increase includes existing surcharges of approximately \$787,000 for the Distribution System Improvement Charge ("DSIC") and approximately \$19,000 for the PSC Assessment Charge, both of which will be rolled into the new base rates, if approved.

² Certain of the tariff sheets attached to the Application were intentionally left blank as a place saver for provisions pending the Commission's approval of UWDE's tariff filing in compliance with the Commission's *Regulations That Will Govern the Terms and Conditions Under which Utilities Require Advances and/or Contributions from Customers or Developers, and the Proper Ratemaking Treatment for such Contributions and Advances* adopted in Order No. 6873 in PSC Regulation Docket No. 15 (the "Docket 15 Regulations"). On October 9, 2006, UWDE filed a Supplement to the Application to substitute, for the blank sheets in the proposed tariff sheets, those tariff sheets filed on August 3, 2006, in compliance with the Docket 15 Regulations, which tariff sheets have been approved by the Commission by Order No. 7092, effective December 5, 2006.

3. On the evening of August 29, 2006, a duly noticed public comment hearing was conducted within UWDE's service territory, in Newport, Delaware. No oral public comments were offered. Several customers, however, submitted written comments, which are summarized below.

4. After conducting discovery, and pursuant to the schedule set in the proceeding, Commission Staff and the Division of the Public Advocate ("DPA") filed written direct testimony on October 25, 2006. Staff took the position that UWDE should be allowed an additional revenue requirement of \$2,487,571, while DPA recommended an increase of \$2,673,110. On November 21, 2006, UWDE filed rebuttal testimony revising its original rate increase request from \$5,866,240 to \$5,207,942.

5. Pursuant to the procedural schedule, the parties met on December 20, 2006, for the first day of the evidentiary hearings.³ At the hearing, the parties represented that they had reached an agreement in principle that, if adopted, would result in an additional annual revenue increase of \$3,800,000, and would otherwise resolve all contested issues in the case. Tr. 23. Consequently, after the parties introduced their pre-filed testimonies into the record, they described the terms of the agreement, and called witnesses to testify in support of the agreement. Then, on January 5, 2007, the parties submitted a signed proposed settlement agreement, dated January 3,

³The affidavits of publication of notice for the evidentiary hearings (as well as the public comment hearings and the filing of the Application) from *The News Journal* are included in the record as Exhibit 1. Exhibits will be cited as "Ex. __" and references to the hearing transcript will be cited as "Tr. __."

2007, which was placed into the evidentiary record as Exhibit Number 6 ("Proposed Settlement").

6. After the admission of the Proposed Settlement, the record, which then consisted of six exhibits and a 52-page verbatim transcript, was closed. As there were no matters in dispute, briefs were deemed unnecessary. I have considered the entire record of this proceeding and, based thereon, I submit for the Commission's consideration these Findings and Recommendations.

III. SUMMARY OF PUBLIC COMMENT

7. On the evening of August 29, 2006, a public comment hearing was conducted at the Minquas Fire Hall in Newport, Delaware. One customer and one reporter (from WILM radio station) attended the public comment hearing, and no public comment was offered. Notice of the hearing consisted of publication in the legal classified section of *The News Journal* newspaper (Ex. 1) and a press release issued by Staff, which led to an article published in *The News Journal*.

8. Eight customers submitted e-mails objecting to the proposed rate increase. These customers argued that with rising electric rates and gasoline prices, and without commensurate wage increases for residents, a large water rate hike would not be affordable. One customer complained that most of his bills are based on estimated readings and he questioned the accuracy of the actual readings. Two customers asserted that their water tastes like chlorine and therefore must purchase bottled water. One customer objected to paying higher rates in order to fund the expansion of the water system needed to serve new development. Three customers asserted that UWDE has done nothing new for its customers regarding service quality and therefore deserves no rate increase.

IV. SUMMARY OF THE EVIDENCE

9. **UWDE.** With its Application, the Company filed the written testimony and schedules of six witnesses. Ex. 2. The Company calculated its rate base to be \$68,222,556 through the end of the test period, or September 30, 2006. The filing supported a rate-of-return on equity of 11.15 percent with an overall cost of capital of 8.97 percent. The Company requested an increase in annual revenues of \$5,866,240, or 32.17 percent over previously approved base rates. Excluding the existing \$787,000 DSIC and \$19,000 PSC Assessment Charge, which customers are already paying, results in a net increase, as originally requested, of about 24 percent over test year book revenues. On November 21, 2006, UWDE filed rebuttal testimony (from five witnesses) revising its rate increase request to \$5,207,942, based on adjustments to its claim from Staff and DPA that it accepted and based on an updated overall rate of return of 9.07 percent (reflecting an updated common equity cost rate of 11.35 percent). Ex. 3.

10. Regarding service quality, the Company described numerous programs it has undertaken in the last few years to improve customer service. In addition, in October of 2005, UWDE added a new position of Water Quality Assurance Supervisor to address water quality at the local level, including the quantity and quality of chemical treatment. Over the past three years, UWDE has averaged fewer than six informal complaints to the Commission per year, despite serving over 36,000 customers. Ex. 2 (Skomorucha) at 6-13.

11. **Commission Staff.** Staff filed direct written testimony from three witnesses, making adjustments to the Company's test period

revenue, claimed expenses, taxes, rate base and rate of return. Ex. 5. The adjustments resulted in reducing the Company's overall revenue increase proposal from \$5,866,240 to \$2,487,571. Staff calculated a rate base of \$65,494,634 (*i.e.*, \$2,727,922 lower than UWDE's original filing), a cost of equity of 9.55 to 10 percent and an overall rate of return of 8.29 percent. Staff also recommended changes to the Company's proposed rate design and objected to the Company's proposal for a rule change that would make owners of rental properties liable for their former tenants' unpaid account balances.

12. **Division of the Public Advocate.** DPA filed the testimony of Andrea C. Crane, who addressed the Company's revenue requirements and made numerous adjustments to cost of capital, rate base and operating income. Ex. 4. DPA recommended that the Company be authorized to collect an additional \$2,673,110 in revenues, based on a test period rate base of \$67,395,439, a rate of return calculation of 8.31 percent (with a 9.82 percent cost of common equity), and *pro forma* operating income at present rates of \$4,026,441. To determine operating income, DPA utilized a simple five-year average for residential consumption, excluding the trend adjustment that the Company had incorporated into its five-year average. Ex. 4 at 27.

13. **The Proposed Settlement Agreement.** On January 5, 2007, the parties submitted a proposed settlement agreement ("Proposed Settlement"), dated January 3, 2007, which will be attached to the proposed Order in this case as "Attachment B." Ex. 6. Under the Proposed Settlement, the parties agree that the additional annual revenue increase awarded the Company will be \$3,800,000, representing a total revenue requirement of \$22,569,384. Excluding the revenues from the DSIC and PSC assessment charges that already are being

collected in customer bills, the increase in revenues allowed by the settlement represents a 16 percent increase over the Company's normalized test period revenues. Under the settlement agreement, the Company's rates will be derived from the rate structure outlined by the cost of service analysis and rate design attached to the agreement as "Exhibit A."

14. In addition to the changes in rates, the parties have agreed to certain changes to UWDE's Rules and Regulations, all as set forth in UWDE's revised Tariff, which is attached to the Proposed Settlement as "Exhibit B." The changes in Rules and Regulations include those provisions relating to cross connection, miscellaneous fees and charges, and reimbursement for negligent damage to meters, as proposed by the Company. (See paragraph number 1, *supra*.) The settlement does not, however, include the proposed provision relating to property owners' liability for water service charges, which would have rendered property owners liable for the outstanding balances of their former tenants. Tr. 27-28.

15. In addition, the parties agree that the proposed revenue requirement reflects a base level of cost for purchased power and water of \$1,684,179 and \$659,180, respectively. According to the Company, the parties specified the base levels for purchased water and purchased power costs in the agreement in the event that there is legislation or changes in Commission policy that would permit semi-automatic rate changes to reflect changes in such costs. Tr. 24. At the December 20, 2006 hearing, each party presented a witness who testified that adoption of the Proposed Settlement would be in the public interest because it sets just and reasonable rates,

accomplishes a balancing of the interests involved, and avoids the cost of further litigation. Tr. 25, 33-34, 43.

V. DISCUSSION

16. The Commission has jurisdiction over this matter pursuant to 26 Del. C. § 201(a).

17. All parties to this proceeding entered into the proposed settlement agreement (Ex. 6), dated January 3, 2007, which is attached to the proposed Order as "Attachment B." Under the Proposed Settlement, the parties stipulate to a revenue increase of \$3,800,000, which represents a total revenue requirement of \$22,569,384. Based on these numbers, the requested increase is 20.25 percent. Excluding the DSIC and PSC Assessment charges, which customers are already paying, the proposed increase is roughly 16 percent. This level of increase is not substantial, considering that UWDE has not increased its base rates since 1999 (in PSC Docket No. 98-98). Tr. 41.

18. The contested issues underlying the agreed-upon revenue requirement (including cost of capital issues) are not specifically resolved in the terms of the Proposed Settlement. In other words, the revenue requirement is based on a compromise between the parties on all issues achieved as an overall resolution of the case and does not reflect any particular position on any issue. To this extent, therefore, the agreement constitutes a "black box" settlement. Tr. 25. The only specifics, other than revenue requirement, are the Company's purchased power and purchased water expenses (to establish a starting point in case automatic rate adjustments for these items are authorized in the future), the rate design (as set out in "Exhibit A" to the settlement) and the changes in the Company's Rules and Regulations (which are attached to the settlement as "Exhibit B.")

19. Based upon my review of the entire record, I find that the approval of the Proposed Settlement is in the public interest because it balances the interests of ratepayers and the Company and obviates the need to fully litigate the complex issues raised in the Company's Application. It is clear from the record that the agreement was a product of extensive negotiation between the parties, conducted after the completion of thorough investigations by Staff and DPA, and that it reflects a mutual balancing of various issues and positions. In addition, it is significant that the parties, all of whom maintain that the Proposed Settlement is in the public interest, represent a wide variety of interests. Finally, I note that settlements are encouraged under Delaware law, particularly when supported by all parties. 26 Del. C. § 512.

VI. RECOMMENDATION

20. In summary, and for the reasons discussed above, I propose and recommend that the Commission adopt as reasonable and in the public interest the January 3, 2007 Proposed Settlement Agreement ("Attachment B" to the proposed Order). A proposed Order, which will implement the foregoing recommendation, is attached hereto.

Respectfully submitted,

/S/ William F. O'Brien
William F. O'Brien
Senior Hearing Examiner

Dated: January 11, 2007

“ATTACHMENT B”

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE**

IN THE MATTER OF THE APPLICATION OF)	
UNITED WATER DELAWARE INC. FOR AN)	PSC Docket No.
INCREASE IN WATER RATES)	06-174
(Filed May 26, 2006))	

PROPOSED SETTLEMENT AGREEMENT

This SETTLEMENT AGREEMENT (“Settlement”), is entered into as of the 3rd day of January, 2007, by and among UNITED WATER DELAWARE INC., a Delaware corporation (“UWDE” or the “Company”), the STAFF OF THE DELAWARE PUBLIC SERVICE COMMISSION (“Staff”) and the DIVISION OF THE PUBLIC ADVOCATE (“DPA”) (each, a “Party” and, collectively, the “Parties”).

WHEREAS, on May 26, 2006, UWDE filed an application (the “Application”) with the Public Service Commission of the State of Delaware (the “Commission”), pursuant to 26 *Del.C.* §§ 201, 209, 304 and 306 and other sections of the Public Utilities Act of 1974, 26 *Del.C.* §§ 101 et seq. (the “Act”) as applicable, seeking an overall increase of \$5,866,240 over base rates previously authorized by the Commission in 1999 in PSC Docket No. 98-98. This increase includes existing surcharges of approximately \$787,000 for the Distribution System Improvement Charge, and approximately \$19,000 for the PSC Assessment Charge, both of which would be rolled into the new base rates. On a net basis, the Company’s overall revenue would increase approximately 24% over test year book revenues;⁴ and

... (footnote continued to next page.)

WHEREAS, the Application also included a complete set of new tariff sheets (the “Proposed Tariff”), which incorporated proposed changes to UWDE’s Rules and Regulations concerning, among other things (1) providing that property owners will be liable for water service and account balances at properties they own; (2) addressing cross connection and giving UWDE the ability to require cross connection controls to eliminate or minimize backflow or contamination of UWDE’s water system; (3) updating miscellaneous fees and charges to present day costs; and (4) adding a new charge for reimbursement when meters have been damaged due to negligence; and

WHEREAS, certain of the tariff sheets attached to the Application were intentionally left blank as a place saver for provisions pending the Commission’s approval of UWDE’s tariff filing in compliance with the Commission’s *Regulations That Will Govern the Terms and Conditions Under which Utilities Require Advances and/or Contributions from Customers or Developers, and the Proper Ratemaking Treatment for such Contributions and Advances* adopted in Order No. 6873 in the Commission’s Regulation Docket No. 15 (the “Docket 15 Regulations”); and

WHEREAS, on July 11, 2006 the Commission entered Order No. 6966 pursuant to which UWDE’s petition, filed June 23, 2006, to put interim rates into effect under bond was approved thereby permitting UWDE to place into effect, on July 25, 2006, an interim rate increase of \$2,500,000 under bond, and subject to refund as permitted under 26 *Del. C.* § 306(c); and

WHEREAS, on August 29, 2006, a duly noticed public comment session was conducted at the Minquas Fire Hall, 21 N. James Street, in Newport, Delaware; and

⁴ Excluding the revenues from the DSIC and PSC assessment charges, the net increase over the Company’s normalized test period revenues agreed to as part of this settlement is 27%.

WHEREAS, on October 9, 2006, UWDE filed a Supplement to the Application to substitute, for the blank sheets in the Proposed Tariff Sheets, UWDE's tariff sheets filed in Docket 15 on August 3, 2006, in compliance with the Docket 15 Regulations, which tariff sheets have been approved by the Commission by Order No. 7092, effective December 5, 2006; and

WHEREAS, on October 25, 2006, Staff filed direct testimony in which it took the position that UWDE should be allowed an additional revenue requirement of \$2,487,571; and

WHEREAS, pursuant to 29 *Del C.* § 8716, the DPA intervened in this proceeding, and on October 25, 2006, filed direct testimony in which it took the position that UWDE should be allowed an additional revenue requirement \$2,673,110; and

WHEREAS, the Parties have conducted substantial discovery; and

WHEREAS, on November 21, 2006, UWDE filed rebuttal testimony revising its original rate increase request to \$5,207,942; and

WHEREAS, the Parties desire to avoid the substantial cost which would be involved if this case were to proceed to evidentiary hearing; and

WHEREAS, the Parties have conferred in an effort to resolve the issues raised in this proceeding; and

WHEREAS, it is acknowledged that the Parties differ as to the proper resolution of many of the underlying issues in the rate proceeding and are preserving their rights to raise those issues in future proceedings, but believe that settlement of the pending rate proceeding on the terms and conditions contained herein, will serve the interest of the public and the Company, while meeting the statutory requirement that rates be both just and reasonable;

NOW, THEREFORE, IT IS HEREBY STIPULATED AND AGREED by the undersigned that the Parties shall, and do hereby, submit to the Commission for its approval the following terms and conditions for resolution of this rate proceeding:

1. The Parties acknowledge that this Settlement, and the amounts set forth herein, have been agreed to as a compromise of the Parties' positions, and the Parties hereby acknowledge, agree and set forth their collective belief that these proposed awards are within the bounds of the statutory requirement of a fair rate of return, based on circumstances specifically unique to UWDE.

2. The additional annual revenue increase awarded the Company will be \$3,800,000, representing a total revenue requirement of \$22,569,384.⁵ This revenue requirement is based on a compromise between the Parties on all issues toward the end of achieving an overall resolution of the case and does not reflect any particular position on any issue except as may otherwise be expressly set forth herein. The Parties agree that the proposed revenue requirement reflects a normal level of operating and maintenance expense, and a base level of cost for purchased power and water of \$1,684,179 and \$659,180, respectively.

3. The Parties pledge to use their respective best efforts to work diligently towards securing the Commission's approval of this Settlement (including the rates and tariff provisions herein contained), so that the new rates may become effective on or before February 1, 2007.

4. The Parties have agreed to a cost of service analysis and rate design, as reflected in the attached Exhibit A. The Company's rates shall be those that result from the application of the agreed-upon additional revenue requirement to this cost of service analysis and rate design.

5. In addition to the changes in rates, the Parties have agreed to certain changes to UWDE's Rules and Regulations, all as set forth in UWDE's revised Tariff, which is attached hereto as Exhibit B. The changes in Rules and Regulations include those provisions relating to cross connection, miscellaneous fees and charges, and reimbursement for negligent damage to meters, as proposed by the Company, but do not include the proposed provision relating to property owners' liability for water service charges. The Parties agree that the Tariff set forth in Exhibit B hereto shall replace in its entirety, and supersede in all respects UWDE's Tariff as in effect prior to this Settlement.

6. This Settlement is the product of extensive negotiation, and reflects a mutual balancing of various issues and positions. It is therefore a condition of the Settlement that it be approved by the Commission in its entirety without modification or condition. If this Settlement is not approved in its entirety, this Settlement shall become null and void.

7. This Settlement shall not set a precedent, shall not have any precedential effect in any future proceeding, and no Party shall be prohibited from arguing any policy or position before the Commission in any future proceeding as a result of this Settlement. The purpose of this Settlement is to provide just and reasonable rates for the customers of UWDE. In addition, the Parties believe that the Settlement is in the public interest because, among other things, it avoids the additional cost of litigation.

8. The terms of this Settlement will remain in effect until changed by an order of the Commission or until mutually agreed to in writing by the Parties. The Parties acknowledge and agree that the Commission retains jurisdiction over this Settlement and all statutory procedures

⁵ Excluding the revenues from the DSIC and PSC assessment charges that already were being collected in customer bills before this Application, the increase in revenues allowed by the settlement represents a 16% increase over the . . . (footnote continued to next page.)

and remedies otherwise available to the Parties to ensure that UWDE's rates are just and reasonable, while providing a fair rate of return to UWDE's shareholders, including without limitation 26 Del. C. §§ 304 and 309-311.

9. This Proposed Settlement Agreement may be executed in multiple counterparts by any of the signatories hereto and transmission of an original signature by facsimile or email shall constitute valid execution of this Agreement. Copies of this Proposed Settlement Agreement executed in counterpart shall constitute one agreement. Each signatory executing this Proposed Settlement Agreement warrants and represents that he or she has been duly authorized and empowered to execute this Proposed Settlement Agreement on behalf of their respective party.

*[THE REMAINDER OF THIS PAGE IS BLANK INTENTIONALLY;
THE SIGNATURE PAGES IMMEDIATELY FOLLOW]*

Company's normalized test period revenues.

IN WITNESS WHEREOF, the undersigned Parties have executed this Settlement with intent to be legally bound hereby as of the day and date set forth in the first paragraph hereof.

DELAWARE PUBLIC SERVICE COMMISSION – STAFF

Date Signed: 1/3/07 By: /s/ Bruce Burcat
Name: Bruce Burcat
Title: Executive Director,
Delaware Public Service Commission

DIVISION OF THE PUBLIC ADVOCATE

Date Signed: Jan. 3, 2007 By: /s/ G. Arthur Padmore
Name: G. Arthur Padmore
Title: Public Advocate

UNITED WATER DELAWARE INC.

Date Signed: 1/3/07 By: /s/ Robert J. Iacullo
Name: Robert J. Iacullo
Title: President

EXHIBIT A: COST OF SERVICE ANALYSIS AND RATE DESIGN

EXHIBIT B: TARIFF SHEETS