

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION)
OF TIDEWATER UTILITIES, INC., FOR AN) PSC DOCKET NO. 06-145
INCREASE IN WATER RATES)
(FILED APRIL 28, 2006))

ORDER NO. 7135

AND NOW, this 27th day of February, 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 agreement reached by all parties, which calls for an additional revenue requirement of \$3,900,000, be approved;

AND WHEREAS, the Commission finds that the proposed rates are just and reasonable and that adoption of the terms of the proposed settlement, as described herein, 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 February 15, 2007 Findings and Recommendations of the Hearing Examiner, appended to the original hereto as "Attachment A".

2. That the Commission approves the agreement reached by Tidewater Utilities Inc., the Division of the Public Advocate, and the Staff of the Commission, which reflects an increase in the test period revenue requirement of \$3,900,000, based on Net Utility Plant in

service as of the end of the test period, or December 31, 2006, of \$97,930,721. The approved rate increase corresponds with a 26.9 percent rate increase over prior approved rates, or 11.2 percent above the temporary rates placed into effect on June 27, 2006. The approved rates will be effective for services rendered after February 27, 2007.

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: FEBRUARY 15, 2007

WILLIAM F. O'BRIEN
SENIOR HEARING EXAMINER

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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. 6922, dated May 23, 2006, reports to the Commission as follows:

I. APPEARANCES

On behalf of the Applicant, Tidewater Utilities, Inc.:

RICHARDS, LAYTON, & FINGER
BY: GLENN C. KENTON, ESQUIRE and KELLY ELIZABETH FARNAN, 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:

G. ARTHUR PADMORE, PUBLIC ADVOCATE.

II. BACKGROUND

1. On April 28, 2006, Tidewater Utilities, Inc. ("Tidewater" or the "Company") filed an application with the Delaware Public Service Commission ("Commission") seeking approval for an increase in its water service revenue of \$5,495,350, which is a 38.58 percent increase over its present revenues. On May 23, 2006, the Commission entered PSC Order No. 6922 suspending the rates proposed in the application

and appointing a Hearing Examiner and Rate Counsel to process the docket. On June 2, 2006, Tidewater filed with the Commission revised tariff leaves designed to increase its water rates by 15 percent or approximately \$2,045,709 annually, as authorized by 26 Del. C. §306(c). On June 20, 2006, the Commission, by PSC Order No. 6946, approved the requested interim increase, with an effective date of June 27, 2006.

2. On the evenings of July 17, 18, and 19, 2006, duly noticed public comment hearings were conducted in Middletown, Dover, and Bethany Beach, Delaware. Public comment, both oral and written, is summarized below.

3. On September 22, 2006, after conducting discovery, Commission Staff and the Division of the Public Advocate ("DPA") filed written direct testimony. On October 20, 2006, Tidewater filed its written rebuttal testimony.

4. A duly-noticed evidentiary hearing was conducted on November 20, 2006, as scheduled.¹ At the onset of the hearing, the parties reported that they had reached a settlement agreement that, if certain conditions were met, would resolve all issues in the case. The parties introduced an original, signed document entitled "Interim Settlement Agreement" (Ex. 3), which identified an award of \$3,900,000 in additional revenues, subject to verification of the Company's projected Net Utility Plant in service as of the end of the test

¹ The affidavits of publication of notice for the evidentiary hearings (as well as the public comment hearings) from the *Delaware State News*, *The News Journal*, and *Delaware Coast Press* are included in the record as Exhibit 1. Hearing exhibits will be cited as "Ex. __" and references to the hearing transcript will be cited as "Tr. __."

period, or December 31, 2006. The parties also presented their pre-filed written testimonies, and called witnesses to testify in support of the settlement agreement.

5. By letter dated February 9, 2007, Rate Counsel indicated that the parties had verified the accuracy of the plant balances reflected in the Interim Settlement Agreement. Ex. 6. After the admission of the February 9, 2007 letter, the record, which then consisted of six exhibits and an 87-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

6. On the evenings of July 17, 18, and 19, 2006, public comment hearings were conducted in Middletown, Dover, and Bethany Beach, Delaware. Notice of the hearings consisted of publication in the legal classified sections of *The News Journal*, *Delaware State News*, and *Delaware Coast Press* (Ex. 1.), and a press release issued by Staff (which led to an article published in the *Delaware State News* on July 17, 2006).

7. No members of the public attended the July 17 hearing in Middletown. One customer attended the July 18 hearing in Dover. She commented that the size of the rate increase was very large, and she asked several questions regarding how rates are developed. Tr. 20-24.

8. Approximately 15 customers attended the July 19 hearing in Bethany Beach. Gary Meredith, Mayor of Ocean View and Eric Magill, a councilman from Ocean View, were in attendance. Public comment

included complaints or concerns regarding the effect of the increase on retired persons (Tr. 33, 34), the frequency of rate increases (Tr. 34), the size of the proposed increase (Tr. 35, 36), the effect of the increase in conjunction with recent hikes in electric rates and gasoline prices (Tr. 35, 36), and whether current ratepayers should pay for new development through higher rates (Tr. 44).

9. Customers submitted written comments consisting of five letters and three e-mails. Several customers objected to the large size of the proposed increase, especially for those on a fixed income and especially when other utility rates are rising. Two customers also complained of poor water quality, which caused them to purchase bottled water for drinking. One customer complained that Tidewater's deadline for bill payment does not allow enough time to submit payment. One other customer complained that his water service stops when there is a power outage, despite Tidewater's pronouncement during the last rate case that it would install back-up generators in his community.

IV. SUMMARY OF THE EVIDENCE

10. **Tidewater Utilities.** In its original application, the Company stated that its need for a rate increase is driven primarily by capital expenditures, with a smaller portion of the increase attributable to increased operating costs.

A significant component of this request includes a net increase in rate base of \$24.4 million since rates were last established. The rate base increase includes utility plant expenditures of \$1.3 million to meet regulatory requirements [relating to water quality], \$12.1 million for replacement of aging infrastructure, \$8.5 million for new infrastructure to meet the needs of new customers and \$1.9 million for improvements in support of the overall operations of the company.

Ex. 2 (Doll) at 1-2. In addition, increases in operating expenses include \$1.3 million for labor and benefits (primarily for additional employees) and \$1.3 million for electric power, chemicals and business insurance.

11. With its original application, submitted April 28, 2006, the Company provided written testimony and documentation in support of an increase in annual revenues of \$5,495,350, or 38.58 percent over then-current rates, based on a test period ending December 31, 2006. Ex. 2. The application included a projected rate base of \$72,283,554, including Net Utility Plant and Equipment of \$99,053,992. The Company calculated its cost of equity to be 11.20 percent with an overall cost of capital (or rate of return) of 8.72 percent. On September 7, 2006, Tidewater filed updated (and corrected) schedules, which increased its revenue request to \$5,679,840, based on a rate base of \$71,288,501, reflecting \$100,167,857 in Net Utility Plant. On October 28, 2006, Tidewater lowered its Net Utility Plant projection to \$97,930,721, having determined that certain capital projects that it had included would not be completed by the end of 2006. Ex. 2. The update resulted in lowering the requested revenue increase to \$5,136,023.

12. **Commission Staff.** In its direct testimony, Staff made adjustments to the Company's test period revenue, claimed expenses, rate base and rate of return. Staff's adjustments resulted in reducing the Company's overall revenue increase proposal to \$2,134,764, based on a rate base of \$61,047,127, an overall cost of capital of 7.32 percent, and a cost of common equity of 9.75 to 10.00 percent. Staff's rate base recommendation included a Net Utility Plant projection of \$90,849,466. Ex. 5.

13. **Division of the Public Advocate.** DPA filed the written testimony of Andrea C. Crane, Vice President of The Columbia Group, Inc., a financial consulting firm that specializes in utility regulation. Ms. Crane recommended additional revenues of \$3,266,999, based on rate base of \$63,009,849 (including roughly \$93 million of net utility plant), a rate of return of 8.13 percent, and a cost of equity of 9.88 percent. Ex. 4. Her two biggest adjustments were to cost of equity and net utility plant, each worth about \$750,000 in revenue requirement. Tr. 67.

14. **The Interim Settlement Agreement.** At the November 20, 2006 hearing, the parties presented an interim settlement agreement ("Interim Settlement"), which was signed by the parties on the morning of the hearing. Ex. 3. In the Interim Settlement, the parties agree that the additional annual revenue requirement awarded the Company will be \$3,900,000. This revenue requirement is based on the Company having in use by December 31, 2006 its most recent projection of \$97,930,721 for Net Utility Plant. The parties also agreed that the Company would provide scheduled, periodic updates of actual balances of Net Utility Plant, followed by a final accounting after December 31, 2006.

15. At the November 20, 2006 hearing, each party presented a witness who testified that adoption of the proposed settlement (once verified) 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. 64, 66, 77. In addition, Company witness Gerard Esposito, President of Tidewater, testified that the Net Utility Plant balance of approximately \$98 million represents a \$22 million increase since the last rate case and

is the largest reason for the requested rate increase. Tr. 62. Staff witness William Schaffer, Regulatory Policy Administrator, noted that Delaware law limits the Commission's ability to disallow rate base recognition of certain plant additions. Tr. 76-77. DPA witness Crane stated that DPA's recommendation, when updated to account for additional net utility plant, reaches \$3.8 million, which is very close to the \$3.9 million settlement figure. Tr. 67-68.

16. As mentioned above, by letter dated February 9, 2007, Rate Counsel advised the Hearing Examiner that Staff and DPA had verified that the projected plant balance identified in the interim settlement agreement (i.e., \$97,930,721) had been placed in service.

V. DISCUSSION

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

18. All parties to this proceeding have agreed to an increase of \$3,900,000 in annual revenue requirement, which is based on actual Net Utility Plant in service as of December 31, 2006, or \$97,930,721.² The contested issues underlying the agreed-upon revenue requirement (including cost of capital issues) are not specifically resolved in the terms of the agreement, other than Net Utility Plant. To this extent, therefore, the agreement constitutes a "black box" settlement. The proposed \$3.9 million rate increase translates to a 26.9 percent increase from prior approved rates, or 11.2 percent above the temporary rates placed into effect as part of this case on June 27, 2006.

² These numbers were identified in the November 20, 2006 Interim Agreement (Ex. 3) and were finalized, after verification, by letter dated February 9, 2007 (Ex. 6).

... (footnote continued to next page.)

19. As seen in the testimony, the primary driver behind Tidewater's need for a rate increase is the infrastructure, or "utility plant," that Tidewater has replaced or constructed since its last rate case, which was based on the net utility plant balance as of September 30, 2004. Tr. 62, PSC Docket No. 04-152. In its original request, the Company identified \$12.1 million of capital expenditures for replacement of aging infrastructure and \$8.5 million for new infrastructure. Ex. 2 (Doll) at 1-2. Before reaching final agreement of the proposed \$3.9 million increase, DPA and Staff verified that the capital additions included in the Company's most recent Net Utility Plant projection of \$97,930,721 had been completed and placed in service by December 31, 2006. Ex. 6.

20. Based upon my review of the entire record, including the testimony adduced at the evidentiary hearing and the oral and written public comment offered by Tidewater customers, I find that the approval of the proposed settlement is in the public interest because it balances the interests of the ratepayers and the Company, and it 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 and that it reflects a mutual balancing of various issues and positions.

21. While the Company is able to collect \$3.9 million of additional revenue under the settlement terms, it will not recover its entire (updated) request of \$5.14 million. Neither, of course, will Staff or DPA achieve all of their proposed adjustments, which had resulted in their original recommendations of \$2.13 million and \$3.27

million in additional revenue, respectively. In addition, it should be noted that the parties did not rely on the Company's test period projections for Net Utility Plant but instead verified that the capital projects included in the plant balance were completed by the end of the test period, or December 31, 2006. In other words, the largest component of the proposed rate increase is based on actual numbers (rather than *pro forma* adjustments) and was verified as accurate by Commission Staff and DPA, which certainly lends credence to the overall rate increase. Finally, I note that settlements are encouraged under Delaware law, particularly when supported by all parties. 26 Del. C. § 512.

VI. RECOMMENDATION

22. In summary, and for the reasons discussed above, I propose and recommend that the Commission adopt as reasonable and in the public interest an award of \$3,900,000 in additional annual revenue requirement, as agreed upon by all parties to this proceeding. 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: February 15, 2007