

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION)
OF UNITED WATER DELAWARE INC.)
FOR A GENERAL INCREASE IN RATES) PSC DOCKET NO. 09-60
AND FOR REVISIONS TO ITS TARIFF)
(Filed February 13, 2009))

ORDER NO. 7637

AND NOW, this 9th day of September, 2009:

WHEREAS, the Delaware Public Service Commission (the "Commission") has received and reviewed the Findings and Recommendations of the Hearing Examiner dated September 1, 2009 issued in the above-captioned docket, which Findings and Recommendations were submitted after a duly-noticed evidentiary hearing; and

WHEREAS, the Hearing Examiner recommends that the Settlement Agreement submitted on August 18, 2009, which was executed by all of the parties to the proceeding (Exhibit "A" hereto) be approved; and

WHEREAS, the Commission finds that the proposed rates and tariff changes resulting from the Settlement Agreement are just and reasonable and that approval of the Settlement Agreement is in the public interest.

**NOW, THEREFORE, IT IS HEREBY ORDERED BY THE AFFIRMATIVE VOTE OF
NOT FEWER THAN THREE COMMISSIONERS:**

1. That the Commission adopts the Findings and Recommendations of the Hearing Examiner dated September 1, 2009 and incorporates those Findings and Recommendations herein by reference as though fully set forth in this Order.

2. That the Settlement Agreement attached hereto as Exhibit "B," and the tariff changes and rates contained therein, reflecting a total test period revenue requirement of \$25,170,674, is hereby approved for implementation effective for service provided on and after September 9, 2009.

3. That the Commission reserves jurisdiction and authority to enter such further Orders in this docket 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/ Katie Rochester
Acting Secretary

E X H I B I T "A"

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(FILED FEBRUARY 13, 2009))**

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

**MARK LAWRENCE
HEARING EXAMINER**

Dated: September 1, 2009

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(FILED FEBRUARY 13, 2009))**

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

Mark Lawrence, duly appointed Hearing Examiner in this Docket pursuant to 26 *Del. C.* §502 and 29 *Del. C.* Ch. 29, by Commission Order No. 7537 dated March 3, 2009, reports to the Commission as follows:

I. APPEARANCES

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

Richards, Layton & Finger, P.A.
BY: GLENN C. KENTON, ESQUIRE

James C. Cagle, Director, Regulatory Business
Susan Skomorucha, General Manager

On behalf of the Public Service Commission Staff:

REGINA A. IORII, DEPUTY ATTORNEY GENERAL
JOSEPH C. HANDLON, DEPUTY ATTORNEY GENERAL
Heidi Wagner, Public Utilities Analyst III

On behalf of the Public Advocate:

G. ARTHUR PADMORE, PUBLIC ADVOCATE
MICHAEL D. SHEEHY, DEPUTY DIRECTOR, PUBLIC ADVOCATE
KENT WALKER, ESQUIRE, DEPUTY ATTORNEY GENERAL

II. BACKGROUND

1. On February 13, 2009, United Water Delaware Inc. (“United” or the “Company”) filed an Application with the Delaware Public Service Commission (“the Commission”), pursuant to 26 *Del. C.* §§ 201, 209, 304, and 306. United’s Application sought: 1) a rate increase of \$3,477,637 in additional annual revenue (an approximately 14.75% increase over then existing revenue); and 2) approval to implement a late fee of 1.5% per month for late payments which would apply to all classes of customers whose bills were over thirty (30) days past due.

2. United’s Application also sought to compensate for previously paid surcharges of \$1,184,448 for Distribution System Improvement Charges (“DSIC”) through April 14, 2009 which would be rolled into the new base rates, if approved. (Application at ¶9). If approved, the DSIC surcharge balance would then be re-set to \$0. DSIC eligible improvements are defined in 26 *Del. C.* § 314. The purpose of DSIC surcharges is to reimburse a utility for water system improvements such as replacing water mains and meters, and system improvements to meet water quality standards. *Id.* Utility expansion costs cannot be included in a DSIC surcharge. *Id.*

3. United’s Application included the pre-filed testimony of eight (8) witnesses: Susan Skomorucha, the General Manager of UWD; Caryl D. Jersey and Thomas G. Lippai, Regulatory Specialists for United Water Management & Services, Inc. (“UWM&S”); Elda Gil, an Associate Rate Analyst with UWM&S; Nancy Trushell, UWD’s Director of Engineering; James C. Cagle, the Director, Regulatory Business for UWM&S; Charles E. Loy, a principal of GDS Associates, Inc.; and Pauline M. Ahern, a principal of AUS Consultants.

4. On March 3, 2009, the Commission issued Order No. 7537, suspending the Company’s application for a rate increase pursuant 26 *Del. C.* § 306(a)(1), and appointed this

Hearing Examiner to process the docket and to hold evidentiary hearings concerning the justness and reasonableness of the proposed rates.

5. On March 19, 2009, the Company filed an Application to place interim rates into effect under bond pursuant to 26 *Del. C.* §306(c). On April 7, 2009, the Commission issued Order No. 7548, granting the Company's request to place interim rates into effect under bond, which rates would not exceed 15% of the Company's annual gross intrastate operating revenues. (See 26 *Del. C.* §306(c)) Pursuant to this Order, the Company placed a rate increase of \$1.3 million into effect on April 14, 2009. This amount totaled an approximately 5.6% increase over the Company's then existing base rates.

6. On April 24, 2009, the Division of the Public Advocate (the "Public Advocate") exercised its statutory right of intervention pursuant to 29 *Del. C.* §8716(d)(1). In April, 2009, PSC Staff conducted a field audit at the Company's offices and reviewed the documents supporting the Company's Application.

7. On May 20, 2009, this Hearing Examiner presided over a duly-noticed Public Comment Session at the Carvel State Building in Wilmington. No customers attended.

8. Staff and the Public Advocate submitted their witnesses' pre-filed testimony on June 10, 2009. Staff submitted the pre-filed testimony of Robert J. Henkes, principal of Henkes Consulting; Brian Kalcic, principal of Excel Consulting; and David C. Parcell, President of Technical Associates, Inc.. The Public Advocate submitted the pre-filed testimony of James D. Cotton and Andrea C. Crane, principals of The Columbia Group, Inc.

9. On July 22, 2009, the Company pre-filed rebuttal testimony from witnesses Skomorucha, Jersey, Gil, Ahern, Loy and Cagle, and James I. Warren, Esq., a tax partner in the law firm of Winston & Strawn, LLP.

10. On July 29, 2009, representatives of United, Staff and the Public Advocate met to discuss whether a negotiated resolution of the rate case was possible.

11. On August 18, 2009, the parties submitted a proposed Settlement Agreement to the Hearing Examiner. If the Settlement Agreement is approved, the additional annual revenue awarded to the Company will be \$1,700,000, or an approximately 7.2% increase over the base rates preceding the interim rates, plus the on-going Distribution System Improvement Charge revenue. This increase is approximately \$400,000 above the amount included in interim rates in place under bond as approved by the Commission on April 7, 2009 in Order No. 7548 as described in Paragraph 5 above. This stipulated revenue requirement increase will reflect and produce an overall revenue requirement of \$25,170,674, as detailed on Exhibit "A" to the Settlement Agreement which is attached hereto as Exhibit "A." The parties also agreed to United's proposal to amend its tariff to assess a late fee of 1.5% per month on unpaid balances beginning on the date the new rates become effective.

12. On August 24, 2009, I conducted a duly-noticed, evidentiary hearing at which the parties introduced their pre-filed testimonies and testified about the settlement. At the conclusion of the hearing, the record consisted of twenty-four (24) exhibits and a verbatim transcript. As there were no matters in dispute, post-hearing briefs were deemed unnecessary. I have considered the entire record of this proceeding and, based thereon, I submit these Findings and Recommendations for the Commission's consideration.

III. SUMMARY OF PUBLIC COMMENT

13. On the evening of May 20, 2009, I conducted a duly-noticed Public Comment Session at the Carvel State Office Building in Wilmington, located within United's service territory. No members of the public attended.

14. One United customer wrote to protest the proposed rate increase. This customer challenged the Company's increase in chemical costs, stating that there were already too many chemicals in their food and water.

IV. SUMMARY OF THE EVIDENCE

A. COMPANY'S TESTIMONY

15. For the test period ending June 30, 2009,¹ the Company calculated a revenue deficiency² of \$3,357,283 (Exh. 6 (Jersey-R) at Ex. CDJ-1, p.1), derived from a rate base of \$76,546,712 (Exh. 6 (Jersey-R) at Ex. CDJ-2, page 1 of 7 (MFR 4.2)), an overall rate of return of 9.13%, including a return on equity of 11.7% (Exh. 17 (Ahern-R) at Exh. 11, p.2), and pro-forma operating income of \$5,012,590 (Exh. 6 (Jersey-R) at Exh. 1 (MFR 5.1), p.1). According to the

¹ The Company used a "test year" comprised of the twelve (12) months ending September 30, 2008 and a "test period" comprised of the twelve months ending June 30, 2009. Neither Staff nor the DPA disagreed with the Company's selected test year or test period. However, as discussed herein, Staff and the DPA did not agree with some of the Company's adjustments to the test year and test period, rate base calculation and operating expenses. These differences were eventually settled by the parties by virtue of their Settlement Agreement.

² The proposed increase included \$1,184,448 of existing Distribution System Improvement Charges ("DSIC") to be rolled into base rates. (*See* ¶2, *supra*)

Exhibits introduced at the evidentiary hearings and admitted into the record will be cited as "Exh. __ (witness' name) at __" for direct testimony; ["Exh. __ (witness' name – S) at __" for supplemental testimony]; and "Exh. __ (witness' name – R" at __" for rebuttal testimony. Other exhibits introduced at the evidentiary hearing and admitted into the record will be cited as "Exh. __." The transcript of the evidentiary hearings will be cited as "Tr. at __."

Company, “significant” increases in its energy, chemical, and labor costs, combined with the loss of major industrial and other customers, caused its revenues to substantially decrease. (Exh. 3 (Skomorucha) at 6-14).

16. The Company also proposed to revise its tariff to include a provision authorizing a 1.5% per month late fee on late payments as to all classes of customers. (Exh. 12 (Cagle) at 6; Third Revised Tariff Sheet No. 12). According to Company witness Cagle, the proposed late fee is consistent with other jurisdictions in which the Company operates. The purpose of the late fee is to encourage the Company’s customers to make more timely payments and lower the overall cost to all customers. Mr. Cagle explained that United’s average accounts receivable balance is approximately \$1.9 million each month, which is significantly higher than the \$1.2 million average in its prior base rate case. Implementation of such a fee should reduce the amount of cash working capital required and thus reduce customers’ rates. *Id.*

17. The Commission has approved other Class A water utilities charging interest on delinquent accounts. (*See, e.g.,* Tariffs of Artesian Water Company, Inc. and Tidewater Utilities, Inc.) Also, United’s proposed tariff interest rate of 1.5% per month (18% per annum) complies with Delaware law. (See 6 *Del. C.* 2301.)

18. On April 9, 2009, the Company submitted supplemental testimony from Ms. Elda Gil, wherein she updated information regarding the Company’s various pension and post-employment benefits. As a result of these updates, the Company increased its requested rate increase by \$119,538, to \$3,597,175. (Exh. 9 (Gil-S) at 2-3 and Exh. CDJ-1, p.1 (Supplemental)).

B. PUBLIC SERVICE COMMISSION STAFF'S TESTIMONY

19. For the test period ending June 30, 2009, Staff determined that a rate decrease of \$752,002 was warranted, based on a rate base of \$74,783,927, an overall rate of return of 7.68% (with a return on equity of between 9.5% and 10%), and pro-forma operating income of \$6,185,499. (Exh 21 (Henkes) at 5-6)

20. The most significant areas of dispute between Staff and the Company involved:

a) the proposed return on equity (estimated at approximately \$1.513 million at 9.5% advocated by Staff versus 11.7% sought by the Company); b) the inclusion of short-term debt in the Company's capital structure (estimated at approximately \$431,000); and c) an adjustment to reflect the Company's filing of its taxes on a consolidated basis (estimated at approximately \$1.448 million). (See Exh. 21 (Henkes) at RJH-19).

21. Staff also disputed: a) the Company's exclusion of interest expense from the calculation of its cash working capital requirement (valued at approximately \$25,000); b) the Company's failure to reduce its rate base by the difference between the total cumulative amount of FAS 106/ other post-employment benefits ("OPEB") expenses allowed in rates and the total cumulative amount of cash contributions made to the Company's OPEB trust account (totaling approximately \$86,000); c) the Company's request to include all incentive compensation expense in its operating expenses for ratemaking purposes (totaling approximately \$196,646); d) the amount of expense claimed by the Company for locating other utilities' facilities before excavation (totaling approximately \$95,000); and e) the appropriate level of removal cost included in the Company's depreciation expense for ratemaking purposes (worth approximately \$29,000). (See Exh. 21, Henkes & Henkes at RJH-19).

22. Staff did not object to the Company's proposal to impose a 1.5% per month late fee. (Exh. 23 (Kalcic) at 7). However, Staff recommended a slightly different rate design than the Company in the event that the Commission determined that a rate increase was appropriate. (*Id.*).

C. PUBLIC ADVOCATE

23. For the test period ending June 30, 2009, the Public Advocate determined that a rate decrease of \$288,280 was warranted, based on a rate base of \$73,682,267, an overall rate of return of 8.16% (with a return on equity of 9.84%), and pro-forma operating income of \$6,182,317. (Exh 20/20A (Cotton) at 3-4; Exh. 19 (Crane) at 17, 19) The most significant areas of dispute between the Public Advocate and the Company involved: a) the proposed return on equity (estimated at approximately \$1,230,000 at 9.84% versus 11.7%, *respectively*); b) the appropriate amount of physical plant in service included in the Company's rate base (estimated at approximately \$708,669); and c) an adjustment to reflect the Company's filing of taxes on a consolidated basis (estimated at approximately \$1,225,000). (Exhs. 20 & 20A (Cotton) at 4-9, 38-41 and Schedules JDC-3 and JDC-20). The Public Advocate also disputed: a) the level of employees for test period purposes (estimated at approximately \$229,000); b) the Company's claimed expense for right-of-way clearing (estimated at approximately \$120,000); c) the Company's request to include all incentive compensation expense in its operating expenses for ratemaking purposes (estimated at approximately \$87,212); and d) the appropriate level of costs incurred by the Company for locating other utilities' facilities before excavation (estimated at approximately \$95,000). (Exhs. 20 & 20A (Cotton))

24. The Public Advocate did not take a position on the Company's proposed 1.5% per month late fee.

D. COMPANY'S REBUTTAL TESTIMONY

25. On July 21, 2009, the Company submitted the rebuttal testimony of Ms. Skomorucha, Ms. Jersey, Ms. Gil, Ms. Ahern, Mr. Cagle, Mr. Loy and James I. Warren, a partner with the law firm of Winston & Strawn, LLP. In its rebuttal testimony, the Company reduced its requested total rate increase to \$3,357,283. (Exh. 6 (Jersey-R) p. 2) Although the Company accepted several of Staff's and the Public Advocate's proposed expense adjustments, their respective positions regarding: (a) the proposed cost of equity (Exh. 17 (Ahern-R)); (b) the inclusion of interest expense in the Company's cash working capital calculation (Exh. 13 (Cagle-R)); (c) the proposed consolidated tax adjustment (Exh. 13 (Cagle-R)); (d) the appropriate level of removal cost included in the Company's depreciation expense for ratemaking purposes (Exh. 13 (Cagle - R)); (e) the appropriate level of expense for locating other utilities' facilities prior to excavation (Exh. 8 (Gil-R)); and (f) the level of incentive compensation expense included in rates. (Exh. 4 (Skomorucha-R)) The Company also disputed Staff's proposed capital structure, as well as the Public Advocate's rate base adjustments for plant in service, right-of-way clearing and test period employee level.

E. THE PROPOSED SETTLEMENT AGREEMENT

26. On August 18, 2009, the parties submitted a proposed executed Settlement Agreement which is attached hereto as Exhibit "A." (Exh. 24) In the Settlement Agreement, the parties stipulated that the additional annual revenue increase awarded to the Company is \$1,700,000, for a total revenue requirement of \$25,170,674, representing an approximate 7.2%

increase over the Company's existing base rates and the currently in-place Distribution System Improvement Charge revenues. This increase is, in turn, approximately \$400,000 more than the amount included in interim rates in place under bond as approved by the Commission on April 7, 2009 in Order No. 7548. (Exh. 24 - Settlement Agreement, ¶1) The parties stipulated that the appropriate return on common equity is 10%, applied to a capital structure of 50.87% equity and 49.13% long-term debt. (*Id.* at ¶2.) The parties further stipulated that United would be permitted to amend its tariff to implement its proposed 1.5% per month late fee, beginning on the date new rates resulting from the Settlement Agreement become effective, and United shall file the appropriate modification to its tariff to reflect the new rates and new tariff provision. (*Id.* at ¶3.)

27. At the August 24, 2009 evidentiary hearing, each party presented a witness to testify in support of the Commission approving the proposed Settlement Agreement. Company witness James C. Cagle testified regarding the Company's original revenue increase request, the Staff's and the Public Advocate's positions, and the Company's rebuttal testimony. (Tr. at 27-35). Mr. Cagle testified that he believed that the compromise reached by the parties in the Settlement Agreement was in the public interest and resulted in just and reasonable rates, pointing out that the increase was approximately one-half of the requested increase (Tr. at 31, 34). Mr. Cagle further testified about the Company's request for an amendment to the Company's tariff authorizing the Company to assess a 1.5% per month late fee, pointing out that the Company currently does not impose a late fee and its receivables recently increased, injuring those customers who timely pay their water bills. (Tr. at 32-33.)

28. Deputy Public Advocate Michael D. Sheehy also testified that the Settlement Agreement was in the public interest. He testified that the settling parties represented diverse

interests, and that based on the positions reflected in the extensive record, the result reached in the settlement was within the “range of reasonableness.” (Tr. at 38). In this regard, Mr. Sheehy noted specifically that the additional revenue requirement increase resulting from the settlement was less than one-half of the additional revenue requirement increase which the Company requested in its original filing. (*Id.*) Mr. Sheehy observed that the settlement would conserve the parties’ resources in that it would avoid additional litigation costs. (*Id.*) Furthermore, the settlement would provide more certainty to the utility and its ratepayers faster than if the case continued to be litigated. (*Id.*) Finally, Mr. Sheehy testified that the Public Advocate’s office believed it was unlikely that the Commission would reach a result that was “significantly different” from the result to which the parties agreed in the settlement. (*Id.*)

29. Staff witness Heidi Wagner also testified that the Settlement Agreement was in the public interest. Like Mr. Sheehy, Ms. Wagner observed that the amount of the additional revenue requirement increase was approximately one-half (50%) of the additional revenue requirement increase which the Company had requested in its original filing. (Tr. at 41.) Therefore, the rate increase to customers would be “far less” than that which the Company had originally sought. (*Id.*) Ms. Wagner noted that the Company had agreed to a 10% return on equity, which was seventy (70) basis points less than its currently-authorized return on equity (ROE) and one hundred and seventy (170) basis points lower than the ROE which the Company proposed in its rebuttal testimony. (*Id.*)

30. Ms. Wagner further testified that the settlement avoided the potentially negative precedent which could have been created on various revenue issues which left Staff free to advance its position on those issues in a future rate case. (*Id.*) She noted that, due to plant

closures, the Company had lost some large industrial customers such as Chrysler and Pepsi, which had represented significant revenue. (*Id.*; see also Exhibit 3 (Skomorucha-D), at pp. 13-14 for a complete description of plant closures, etc.) Lastly, Ms. Wagner noted that it was in the public interest for the Company to make some profit “in order to be able to provide safe, adequate and reliable water service to its customers.” (Tr. at 42-43.).

V. **DISCUSSION**

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

32. Section 512 of the Public Utilities Act directs the Commission to “encourage the resolution of matters brought before it through the use of stipulations and settlements,” and provides that the Commission may, upon hearing, approve the resolution of matters through stipulations or settlements when the Commission finds such resolutions to be in the public interest. *26 Del. C.* §512(a), (c).

33. After reviewing the Settlement Agreement and considering the testimony of the Staff, Public Advocate and the Company witnesses regarding its benefits, I conclude that the Settlement Agreement is in the public interest and should be approved. First, all parties involved in the case entered into the Settlement Agreement. As pointed out by Mr. Sheehy and Ms. Wagner, the parties’ unanimity on the benefits of the Settlement Agreement carries great weight given the different constituencies that each party represents.

34. Moreover, the witnesses provided persuasive reasons for concluding that the proposed Settlement Agreement is in the public interest, including that: a) the agreed-upon additional revenue requirement increase is approximately one-half (50%) of that requested by the

Company; b) the cost savings associated with the reduction of the requested return on equity to 10%; c) that it results in just and reasonable rates for both the Company and its ratepayers; and d) that the proposed additional revenue requirement increase is within the range of reasonableness based on the testimony submitted by the parties. In this regard, I note that the cost savings associated with resolving the multiple, complex issues in this case prior to evidentiary hearings and post-hearing briefing is substantial.

35. Most contested issues underlying the proposed Settlement Agreement are not specifically resolved in the Settlement Agreement. In other words, the revenue requirement increase is based on a compromise among 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, then, the parties' agreement constitutes a "black box" settlement; the only specific items addressed are the amount of the annual increase in the revenue requirement, the return on equity as applied to a particular capital structure and the parties' agreement to the proposed amendment to the Company's tariff to permit the Company to assess a 1.5% per month late fee on late payments. The parties have also agreed on rate design and implementation, as reflected in the attachments to the Settlement Agreement.

36. The proposed increase is reasonable particularly because United has not increased its rates since early 2007. (*See* PSC Docket No. 06-174, Commission Order No. 7120, January 23, 2007.) This settlement also provides a fair rate of return for United's shareholders; since United is a public company, by law, it owes a duty to its shareholders, as well as its ratepayers.

37. Regarding service quality, the Company described a number of programs it has undertaken to improve the quality of its customer service. This includes annual customer surveys

(with 96.59% of 2008 customer responses stating that the Company's service was excellent or satisfactory). Also, the Company installed a new website in 2009, has bill payment assistance, conducts conservation education, and has remote payment locations. (Exh. 3, (Skomorucha-D), pp 24-29). Over the past three (3) years, the Company has had no formal complaints filed before the Commission, despite serving over 36, 700 Delaware customers. (*Id.* at pp. 4, 25)

38. Based upon my review of the entire record, I find that approval of the Settlement Agreement is in the public interest because it balances the needs of the ratepayers with the needs of the Company, and obviates the need to fully litigate the complex issues raised by the Company's application and the Staff's and Public Advocate's testimonies. It is clear from the record that the Settlement Agreement is a product of extensive negotiations among the parties, conducted after the completion of thorough investigation and discovery by the Staff and the Public Advocate, and that it reflects a mutual balancing of various issues and positions. It is also evident that the parties all believe that the agreed-upon additional annual revenue requirement will produce just and reasonable rates.

VI. RECOMMENDATION

39. In summary, for the reasons set forth above, I find that the proposed Settlement Agreement will produce just and reasonable rates, and that it is in the public interest. I therefore recommend that the Commission approve the Settlement Agreement which is attached hereto as Exhibit "A." A proposed Order implementing the foregoing Recommendation is attached hereto.

Respectfully submitted,

/s/ Mark Lawrence _____
Mark Lawrence
Hearing Examiner

Dated: September 1, 2009