DR 98-128

CENTRAL WATER COMPANY, INC.

Order Granting Permanent Rate Increase

O R D E R N O. 23,326

October 25, 1999

APPEARANCES: Mary Ellen Goggin, Esq. for Central Water Company Inc.; Joanne V. Heger for Locke Lake Colony Association; and Larry S. Eckhaus, Esq. for the Staff of the New Hampshire Public Utilities Commission.

I. PROCEDURAL HISTORY

On September 25, 1998, Central Water Company (Central or the Company) filed with the New Hampshire Public Utilities Commission (Commission) proposed rate schedules which would increase Central's revenues by 32.15% or a total annual increase of $84,681 for the 625 customers at the Locke Lake Development in Barnstead, New Hampshire. Central stated in its prefiled testimony that it was not seeking temporary rates in this proceeding.

By Order No. 23,045 (October 27, 1998), the Commission suspended Central's proposed rate increase and scheduled a prehearing conference for November 13, 1998. The Commission noted that the filing raised, inter alia, issues related to consumption trends, operation and maintenance expenses, capital structure, rate base additions, management contract allocations and rate case expenses, all of which require a thorough investigation. On the same date as the prehearing conference, Central filed a petition and supporting testimony for temporary rates.

The Commission conducted a hearing to address Central's request for temporary rates on January 21, 1999. By Order No. 23,151 (February 22, 1999), the Commission granted Central's request for temporary rates at the revenue levels stipulated to by Staff and Central, i.e. $50,009, 18.99% over existing rates.

Testimony on permanent rates was filed by Messrs. Richard B. Deres, Mark A. Naylor and Douglas W. Brogan on behalf of the Commission Staff. Mr. Stephen P. St. Cyr and Mr. Raymond Seeley filed testimony on behalf of Central. On August 17, 1999, Central filed a Memorandum Addressing the Rate Recommendations of Douglas W. Brogan and Mark A. Naylor. Hearings on permanent rates were held on August 18 and 19, 1999. Subsequent to the hearings all Parties and Staff filed with the Commission Memoranda with regard to the issues of affordability and management and responded to certain queries from the Commission regarding continued ownership of the system by Central or by a larger water utility.

II. POSITIONS OF THE PARTIES

Though no formal agreement was presented to the Commission at, or prior to, the hearings, in testimony both Staff and Company witnesses agreed that the appropriate calculation of the Company’s revenue requirement, before consideration of the affordability and management issues, was $303,054, an operating income requirement of $59,749, a rate of return of 10.35%, and a rate base of $577,283. (Exhibit 29) This results in a revenue deficiency of $50,877 or 20.2% of pro forma test year revenues.

A. Central Water Company

In its Memorandum and Post-Hearing Memorandum Addressing the Rate recommendations of Douglas W. Brogan and Mark A. Naylor, the Company maintained that Staff’s recommendation to deny the Company’s request for a permanent increase in rates, despite the above calculation, is based upon “erroneous assumptions or implications of mismanagement”, and that the level of rates resulted solely from necessary capital improvements made during the five years since the Company purchased the system from Locke Lake Water Company, Inc. *Re Locke Lake Water Company, Inc. 78 NH PUC 295 (1993)*. The Company maintains that the “affordability” standard expressed by Messrs. Brogan and Naylor would violate traditional ratemaking standards and would be an unconstitutional taking of the Company’s property; and that the Company’s financial condition is a result, in part, of a series of disallowances beginning with the Company’s 1994 rate case. The company recommends that, pursuant to its “agreement between Staff and the Company” regarding the revenue deficiency of the Company, a revenue increase of $50,877 is warranted at this time.

B. Locke Lake Colony Association

The Association maintains that the key issues before the Commission are “affordability in terms of fairness to the consumer and management in terms of whether the revenues have been prudently expended”. The Association avers that, with regard to the question of affordability, consideration of what is a reasonable level of water rates is essential since rapidly escalating water rates in a monopoly situation results in property value declines and customers not being able to make other payments, i.e., an unconstitutional taking of customers’ property. The Association further maintains that management has been imprudently operating the Company, that neither officer has any background or expertise in running a company or a public utility, and that many of Staff’s requests for information remain unanswered. The Association requests that the Commission deny the request for an increase.

C. Staff

Staff witnesses recommended that no rate increase was warranted at this time. Staff believes that the level of Central’s rates, and hence their unaffordability, stem from the inadequate management provided by an affiliate, Integrated Water Company, Inc. (Integrated) through a management service agreement. Although that agreement states that Integrated is “staffed with experienced specialists” in many fields, it is Staff’s opinion, based upon the record, that Integrated has not provided Central with adequate operational, managerial or financial management. Pursuant to RSA 366:5 and RSA 366:7, Staff maintains that the Commission has the authority to disallow payments it finds to be unjust or unreasonable. According to Staff, these unreasonable management costs, and inadequate managerial expertise, have resulted in a high level of rates, inefficiencies and poor management.

III. COMMISSION ANALYSIS

This is not the first time a small water company, and specifically, this small water company has been before this Commission seeking a rate increase. The level of rates to customers of these companies far exceeds the costs of larger well run utilities, and even many small utilities. Indeed the annual rate for 98 gallons per day has risen from $229.54 in 1993, after Central acquired the system, to $497.83 under current temporary rates, among the highest rates in the State. While many improvements were necessary in this system to meet federal and State requirements, we find that management of Central by its affiliate, Integrated, leaves much to be desired.

One of the major costs contributing to these high rates is the existence of two management salaries for a small water utility. This is particularly disturbing considering that only one of those managers has significant business or water utility background or expertise, and the other is related to the sole stockholder, and partial debtholder, of the Company and its affiliates. We have addressed the issue of multiple managers for small water utilities before. In *Re Hillsboro Water Company* 67 NH PUC 785 (1982) we noted that the cost equivalent of one manager was appropriate for a company of this size. In *Integrated*

Water Systems, Inc. 79 NH PUC 541 (1994), we noted that for Central (then known as Integrated) two management-level salaries appear to be unsustainable for a company of this size. Staff recently expressed concerns as to this affiliated group's ability to effectively manage its systems when it sought approval to acquire Indian Mound Water Corporation and Carleton Water Company. *Re Integrated Water Systems, Inc.* 81 NH PUC 475 (1996). Given the problems Central has experienced, it would seem that the severity of the group's operational and service problems have indeed been exacerbated by additional responsibilities from the acquisition.

Central has failed to properly adhere to the Commission's rules and regulations related to financial and accounting reports and records as enumerated in Staff's Audit. As shown in Mr. Brogan's testimony, Central has not adequately met its obligation to provide quality service to its customers. Further, the Company has failed to respond adequately to requests for information needed to evaluate its request for increased rates. In addition, Central's inefficient staffing patterns reflect questionable management judgment. For all these reasons, we will make adjustments to the deficiency calculation presented at the hearing. To reflect the failures of management, we reduce the return on equity to the low end of the discounted cash flow analysis performed by Staff. To eliminate duplicative management expenses, we reduce the hourly rate for the second manager to that of a full time employee. We also find imprudent the Company's practice of using two meter readers together to read the same meters, a practice followed by no other utility. However, as the Company has changed its method of paying for meter reading, we cannot at this time determine the appropriate adjustment which should be made. We make these adjustments pursuant to our plenary ratemaking authority as well as our authority under RSA 366:5 and 366:7. See *Re Southern New Hampshire water Company* 76 NH PUC 52 (1991) and *Carleton Water Company Trust* 77 NH PUC 351 (1992).

The Company has substantial negative retained earnings on its balance sheet. Because the continued financial viability of this water utility is uncertain, the Company is directed to provide a report, within three months, as to how it will meet its service obligations in the future at reasonable rates, and how it will address the many audit recommendations contained in Staff's Audit Report. The Company is also directed to address the issue of selling the system to a larger water utility if it cannot find a way to manage more effectively and efficiently while maintaining reasonable rates to customers.

We also note that the Company has proposed a change in the design of its rates which would have the effect of recovering more of the revenue requirement from seasonal and smaller customers. Because Staff maintained that no increase was appropriate, it did not file testimony on that issue. We note that the Parties and Staff agreed to work together to come up with a permanent rate design, and we order them to do so as noted below. As rates in this proceeding were increased on a temporary basis by increasing rates across the board, the Parties and Staff are directed to also address the issue of temporary rate refunds. The Parties and Staff are also directed to establish the reasonable and prudent rate case expenses which will be offset against temporary rate refunds, and to recommend to the Commission how the net refund or surcharge should be handled.

Based upon the foregoing, we believe that the full amount of the revenue requirement “calculation” should be adjusted. In light of our analysis, we make the following adjustments to the “calculation”:

a. We will calculate the Company’s overall rate of return using a return on equity of 8.49%, the low end of the range of the discounted cash flow analysis (Exhibit 11). This results in a rate of return of 9.176% and reduces the revenue requirement by $6,778.

b. We will adjust the allocation of costs to Central for Mr. Morerod by utilizing the hourly rate for Employee 4 (a full time worker), $17.18, in place of Mr. Morerod's hourly rate of $29.28, which, for 1,100.72 hours, results in a reduction in the revenue requirement of $13,319.

Based upon the foregoing, it is hereby

ORDERED, Central Water Company shall be authorized to file permanent rates designed to provide the Company with an opportunity to earn total revenues of $282,957, an increase of $30,780 above pro forma test year revenues, or an increase of 12.2%; and it is

FURTHER ORDERED, that the effective date for such permanent rates shall be December 1, 1999; and it is

FURTHER ORDERED, that the Parties and Staff shall meet forthwith to develop a permanent rate design consistent with this Order; and it is

FURTHER ORDERED, that the Parties and Staff shall meet forthwith to develop the amount and mechanism for the refund of the difference between permanent rates and temporary rates consistent with this order; and it is

FURTHER ORDERED, that the Company provide Staff with a summary and copies of all invoices for rate case expenses within (10) days of this order; and it is

FURTHER ORDERED, that Central shall submit tariff pages in compliance with this order within 25 days; and it is

FURTHER ORDERED, that the Company shall file, no later than January 31, 2000, a plan setting forth the Company's short-term (one year) and long-term (five year) proposals for necessary capital improvements and retirements, the estimated dates on which the capital improvements are expected to be completed, the Company's best estimate of the potential rate impact of such improvements and retirements, the steps the Company will take to reduce its operating expenses, financing costs, and cost of service, the potential of selling the system to a larger water utility and related impacts thereof, and compliance with the recent Staff Audit of the Company (exhibit 12); and it is

FURTHER ORDERED, that a hearing shall be held, no later than April 30, 2000 to consider the Company's plan and whether the system should continue under the Company's management or be transferred to another, larger utility.

By order of the Public Utilities Commission of New Hampshire this twenty-fifth day of October, 1999.

Douglas L. Patch Chairman	Susan S. Geiger Commissioner	Nancy Brockway Commissioner

Attested by:

Thomas B. Getz
Executive Director and Secretary