BEFORE THE TENNESSEE REGULATORY AUTHORITY

NASHVILLE, TENNESEE

November 27, 2007

IN RE:	)	
	)	**DOCKET NO.**
PETITION OF AQUA UTILITIES	)	**06-00187**
COMPANY FOR APPROVAL OF	)	
ADJUSTMENT OF ITS RATES AND	)	
CHARGES AND REVISED TARIFF	)	

OPINION OF DIRECTOR RON JONES
CONCURRING IN PART WITH AND DISSENTING IN PART FROM THE
FINAL ORDER APPROVING RATE INCREASE AND RATE DESIGN

This docket came before a panel of the Tennessee Regulatory Authority ("Authority") at an Authority Conference held on February 5, 2007 for consideration of the *Petition* filed by Aqua Utilities Company ("Aqua") to increase its rates. The numerous decisions made that day are memorialized in the *Final Order Approving Rate Increase and Rate Design* ("*Final Order*") filed on November 27, 2007. In several instances, I either agreed with the conclusion of the majority, but disagreed with the majority's analysis or disagreed with both the conclusions and analysis of the majority. Therefore, I file this separate opinion concurring in part and dissenting in part with regard to the decisions on the purchased water expense, purchased power expense, administrative and general expense, maintenance and repair expense, construction work in progress, taxes other than income, excise tax, total operation and maintenance expense, net operating income, rate base, capital structure, rate of return, revenue deficiency, and rate design.

I. PURCHASED WATER EXPENSE

I concur in the determination that the unaccounted for water rate should be 15 percent,[1] but disagree with the majority's analysis underlying the determination in two respects. First, the majority concluded that the lost and unaccounted for water rate of 49.94 percent reported by Aqua is imprudent and should not be included in the rates.[2] It is my determination that the rate of 49.94 percent is not imprudent, but rather it is abnormal and, as such, is unacceptable. Therefore, I dissent from the majority's finding in this regard.

Second, I dissent from the determination that 10 percent is the proper percentage that should be deemed prudent.[3] This conclusion fails to take into consideration all of the relevant evidence in the record. Instead, my agreement with the 15 percent rate is based on the fact that evidence in the record suggests that it is reasonable for water utilities to have a lost and unaccounted for water rate in the range of 10 to 20 percent. As the percentage contained in the prevailing motion, 15 percent, falls within this range of reasonableness, I concur with that result.

II. PURCHASED POWER EXPENSE

I dissent from the decision to accept Aqua's proposed purchased power expense. The panel unanimously voted to adopt 12 water-only meters as the customer growth for water-only customers during the attrition period.[4] This decision increases the customer growth rate proposed by Aqua, which was only 27 water/wastewater meters per year. Aqua's calculation of its purchased power expense for the attrition period factored in its proposed customer growth rate.[5] Given this calculation methodology, it is my opinion that it is necessary to adjust Aqua's calculation of the purchased power expense for the attrition period to reflect the customer growth

---

[1] *Final Order Approving Rate Increase and Rate Design*, 9 (Nov. 27, 2007).
[2] *Id.*
[3] *Id.*
[4] *Id.* at 7.
[5] Direct Testimony of William H. Novak, p. 6 (July 15, 2007) (attached to *Petition*).

adopted by the panel. Because the majority failed to make the necessary adjustment, I must dissent from the majority's decision to accept Aqua's proposed expense amount.

Moreover, because there is insufficient information in the record to determine the marginal costs associated with adding additional water-only meters, I was unable to calculate the precise amount of purchased power expense for the attrition period. Therefore, it is my position that the Authority request further information from Aqua as to whether purchased power expense would be impacted on a marginal basis by adding additional water-only meters. Only after reviewing such information should the panel render a decision as to the amount of purchased power expense.

III. ADMINISTRATIVE AND GENERAL EXPENSES

I dissent from the determination that the administrative and general expenses, which equal the salary of Mr. Clausel, should be $6,000 a year.[6] Although it is my opinion that there is insufficient evidence in the record to support Aqua's contention that Mr. Clausel is entitled to $30,000 a year, it is also my opinion that the testimony establishes that $6,000 per year is inadequate. According to the testimony, Mr. Clausel will be responsible for "oversight of the day-to-day operations, monitoring the daily work provided by subcontractors, preparation and review of all regulatory reports and filings, and providing the utility with an emergency contact person on a 24 hour basis."[7]

The majority's position results in a total annualized salary that dangerously undervalues the experience and resources that Mr. Clausel provides in managing the utility. His compensation is tragically inadequate and unreasonable for someone who owns and manages multiple businesses and greatly contributes to the management of Aqua. To explain, the record

[6] *Final Order Approving Rate Increase and Rate Design*, 11 (Nov. 27, 2007).
[7] Direct Testimony of William H. Novak, pp. 6-7 (July 15, 2007) (attached to *Petition*).

indicates that approximately 15 percent[8] of Mr. Clausel's time is devoted to utility matters. Given this percentage and the $6,000 yearly salary in the prevailing motion, Mr. Clausel's full time annualized salary would equal $40,000 for managing the utility.[9] As I previously stated, this compensation level, in my opinion, woefully undervalues the management asset contracted with to run the day-to-day operations of the company and is inherently confiscatory. Accordingly, I dissent from the majority's decision to adopt as the annual salary of Mr. Clausel $6,000.

IV. MAINTENANCE AND REPAIR EXPENSE - GRINDER PUMPS

I concur with the conclusions in the *Final Order* regarding the accounting treatment of the cost of grinder pumps and the cost of grinder pump installation, maintenance and repair.[10] However, I dissent from the conclusion that the "maintenance costs are minimal and the on-call utility service included in contractual services should cover these minor repairs."[11] The evidentiary record in its current state is insufficient to allow quantification of these expenses. It is, therefore, my opinion that further information from Aqua is required before attrition period grinder pump maintenance and repair expenses can be calculated. Currently, there is no information in the record forecasting attrition period maintenance and repair expense. Given this absence of evidence, I dissent from the majority's determination.

V. CONSTRUCTION WORK IN PROGRESS ("CWIP")

A. The Majority's Decision

I concur in part and dissent in part with regard to the majority's decision that the Construction Work in Progress ("CWIP") balance should be $0. I understand the majority's

---

[8] Response to Data Request #38 (Sept. 22, 2006).
[9] ($6,000/.15=$40,000). Compare with the requested, but unsupported, annualized compensation level of $200,000 ($30,000/.15=$200,000).
[10] *Final Order Approving Rate Increase and Rate Design*, 15 (Nov. 27, 2007).
[11] *Id.*

position to be as follows. First, the majority relies on *Smyth v. Ames* for the proposition that "forecasted plant" is not used and useful; therefore, the value of the "forecasted plant" should not be included in the calculation of the fair value of property used and useful in providing utility service on which the company is entitled to a reasonable rate of compensation, that is, the rate base. Second, the majority categorizes the CWIP value proposed by Aqua to be for "forecasted plant," because Aqua did not adequately support its forecasted penetration level of 150 subscribers by year end 2007, the end of the proposed attrition period.[12] I concur with the determination that Aqua failed to support the requested attrition year CWIP balance of $2,454,968. I dissent from the strict reliance on *Smyth v. Ames*, and the conclusion that Aqua failed to establish that the plant would not be used during the attrition period, and the determination that the attrition year CWIP balance should be $0.

B. LACK OF JUSTIFICATION FOR THE REQUESTED $2,454,968 CWIP RECOVERY

I find that Aqua failed to support its proposed CWIP attrition year balance of $2,454,968. According to Aqua, these funds are needed to complete The Preserve, which will produce an estimated 550 to 650 new customers[13] and take 5 to 7 years to build-out.[14]

The record indicates the following with regard to Aqua's proposal. The balance of $2,454,968 represents the "average amount of CWIP that will eventually be transferred to Utility Plant in Service when the construction is completed" and is the amount estimated at the attrition year midpoint, June 2007.[15] The total estimated cost of the expansion is approximately $2,950,000.[16] The approximate difference of $500,000 is the amount that appears on the books from the attrition year midpoint, June 2007, through the end of the attrition year, December

[12] *Id.* at 15-16.
[13] The customer count includes 400 to 500 single-home lots and 150 condominium units. Company's Workpapers, RB 11.21 (Aug. 8, 2006).
[14] Response to Data Request #2 (Aug. 31, 2006); *see* Response to Data Request #30 (Sept. 22, 2006).
[15] Direct Testimony of William H. Novak, p. 3 (July 15, 2007) (attached to *Petition*).
[16] Response to Data Request #2 (Aug. 31, 2006).

2007.[17] The total estimated cost of $2,950,000 includes both amounts already expended and amounts estimated to be paid in the future. The chart below details the calculation:

2005	$1,179,756 (spent)
2006	$275,262 (spent)
2006	$500,000 (estimated)
2007	$1,000,000 (estimated)
Total	$2,955,018[18]

Critical here, however, is what the evidence does not reveal. There is no explanation in the record of how Aqua estimated the expected 2006 and 2007 costs.[19] Because Aqua failed to provide sufficient justification for the total amount requested, $2,454,968, I am unable to include that amount in my attrition year rate base calculation. This conclusion merely leads to the question of whether the Authority should permit Aqua to recover some lesser amount. I address this question next.

C. RATE BASE CALCULATION CASE LAW

In the *Final Order*, the majority cites the United States Supreme Court case of *Smyth v. Ames*,[20] for the proposition that forecasted plant is not used and useful. As I believe this to be as good a starting point as any, I too will begin with a discussion of *Smyth v. Ames*. In 1898 in *Smyth v. Ames*, the Court reviewed and affirmed a circuit court decision finding that a Nebraska statute that set the maximum rates for intrastate railroad services violated the Fourteenth Amendment to the United States Constitution. The Court determined that in order for a rate to comply with the due process and equal protection provisions of the Fourteenth Amendment, such rate must result in compensation to the railroad company that is just, both to it and to the

[17] Company's Workpapers, RB-11.00 (Aug. 8, 2006).
[18] *Id.* RB 11.00, 11.01, 11.20 & 11.21. Later filed evidence suggested that the amount spent on construction of The Preserve through August 31, 2006 totaled $1,530,840. Response to Data Request #36, Aqua Utilities Company, Inc. General Ledger 01/01/06 – 09/30/06, p. 3 (Sept. 22, 2006).
[19] *See* Response to Data Request #11 (Aug. 31, 2006); Response to Data Request #36 (Sept. 22, 2006) (stating in reference to the 2007 $1,000,000 estimate that "there are no specific plans and forecasts to support the estimate").
[20] 169 U.S. 466, 526 (1898).

public.[21] Given this criterion, the Court accepted for consideration the question of whether the application of the rates to be set would compel the utility to use its property "for the public substantially without reward, or without the just compensation to which it was entitled."[22] In the course of evaluating the answer to this question, the Court addressed numerous arguments.[23] Of relevance here, however, are the holdings regarding the phrase "fair value of property used for the public."[24]

The Court began its analysis by examining the evidence of revenues and expenses and comparing the railroad companies' expenses to the revenues received pursuant to their existing rates and the revenues they would have received had the statutory maximum rates been in effect. The Court concluded that in most instances the companies' expenses would have exceeded their revenues had the statutory maximum rates been in effect.[25]

Later in the opinion, the Court addressed those few instances in which the calculations revealed that revenues generated by the application of the statutory maximum rates would have exceeded the companies' expenses. In this regard, the railroad companies argued that they are entitled to a rate that covers not only operating expenses, but that also allows them to "meet the

---

[21] *See Smyth v. Ames*, 169 U.S. 466, 526 & 541 (1898); *see also* Tenn. Code Ann. §65-5-101(a) (Supp. 2006) (requiring rates to be just and reasonable).

[22] *Smyth v. Ames*, 169 U.S. 466, 528 (1898).

[23] In addition to addressing the phrase "fair value of property used for the public," the Court rendered decisions of general importance to any rate case. First, the Court considered the contention that the Nebraska maximum rates are reasonable given that they are higher than the rates charged in the neighboring State of Iowa. The court quickly dismissed this reasoning recognizing that comparisons "between the rates of two states, are of little value, unless all the elements that enter into the problem are presented." *Smyth v. Ames,* 169 U.S. 466, 540 (1898). Second, the Court addressed the contention that it should take into consideration the whole of the business, that is, interstate and intrastate revenues and expenses and the value of railroad property. Without hesitation, the Court rejected this argument and unequivocally held that "the reasonableness or unreasonableness of rates prescribed by a state for the transportation of persons and property wholly within its limits must be determined without reference to the interstate business done by the carrier, or the profits derived from it." *Id.* at 541.

[24] The majority also referred to the "fair value of property used." *Final Order Approving Rate Increase and Rate Design*, 16 (Nov. 27, 2007).

[25] *Smyth v. Ames*, 169 U.S. 466, 534-38 (1898).

interest regularly accruing upon all its outstanding obligations, and justify a dividend upon all its stock."[26] Essentially characterizing this standard as selfish, the Court rejected the argument. It specifically noted:

> But the rights of the public would be ignored if rates for the transportation of persons or property on a railroad are exacted without reference to the **fair value of the property used for the public**, or the fair value of the services rendered, but, in order simply that the corporation may meet operating expenses, pay the interest on its obligations, and declare a dividend to stockholders.[27]

The Court explained the meaning of the phrase "fair value of the property used for the public" as follows:

> And, in order to ascertain that value, the original cost of construction, the amount expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by the statute, and the sum required to meet operating expenses, are all matters for consideration, and are to be given such weight as may be just and right in each case. We do not say that there may not be other matters to be regarded in estimating the value of the property. What the company is entitled to ask is a fair return upon the value of that which it employs for the public convenience.[28]

In the end, the Court concluded that even in those instances where revenues would have exceeded costs, the margin achieved was too small to overcome the general conclusion that the maximum rates, if enforced, would have deprived the companies of the "just compensation secured to them by the constitution."[29]

In the 1940's the Court issued two opinions that provided ratemakers relief from the fair value constraints of *Smyth v. Ames* by greatly expanding the underlying theory of ratemaking utilized by state and federal agencies. In *Federal Power Commission v. Natural Gas Pipeline Co. of America*, the Court held that the United States Constitution does not require the use of a

---

[26] *Smyth v. Ames*, 169 U.S. 466, 543 (1898).
[27] *Id.* at 544 (emphasis supplied).
[28] *Id.* at 546-47.
[29] *Id.* at 547.

single formula for rate-making.[30] Although the Court did not explicitly mention *Smyth v. Ames*, three concurring justices in a separate opinion hit the nail squarely on the head. The concurring Justices wrote: "While the opinion of the Court erases much which has been written in rate cases during the last half century, we think this is an appropriate occasion to lay the ghost of *Smyth v. Ames*, . . . which has haunted utility regulation since 1898."[31]

Two years later, the Court resolved any question as to the intended result of *Natural Gas Pipeline Co. of America*. In *Federal Power Commission v. Hope Natural Gas Company*, the Court held that the fair value rule as exemplified in *Smyth v. Ames* is not the only constitutionally acceptable method of calculating rate base and accepted an approach using historical costs.[32] The Court explained: "Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called 'fair value' rate base."[33] The Court also recognized that it is the total effect of the rate order that must be just and reasonable and that ratemaking involves the balancing of the interest of the consumer and utility.[34]

Forty-five years later in 1989, the Court issued its opinion in *Duquesne Light Co. v. Barasch*.[35] In *Duquesne*, the Court noted that it had abandoned as a constitutional requirement

---

[30] *Federal Power Comm'n v. Natural Gas Pipeline Co. of America*, 315 U.S. 575, 586 (1942).
[31] *Id.* at 602 (Black, J., Douglas, J., and Murphy, J. concurring).
[32] *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 604-06 (1944), *see Verizon Commc'ns Inc. v. Federal Commc'ns Comm'n*, 535 U.S. 467, 483-84 (2002) (explaining the holding in *Hope*).
[33] *Federal Power Comm'n v. Hope Natural Gas Company*, 320 U.S. 591, 605 (1944).
[34] *Id.* at 602-03.
[35] 488 U.S. 299 (1989). In *Duquesne*, a number of electric utilities had attempted to recover costs associated with abandoned nuclear generation projects. During the course of the administrative proceedings, the Pennsylvania legislature passed an act that prohibited the recovery of costs associated with the construction of generation facilities until "such time as the facility is used and useful in service to the public." *Id.* at 310 (citing 66 Pa. Const. Stat. § 1315 (Supp. 1988)). Eventually, the Pennsylvania Supreme Court ruled that the act prohibited the recovery of the costs in question. Thereafter, two electric utilities appealed to the United States Supreme Court, which affirmed the lower court and determined that the appellants' contentions, one, that the act impermissibly constrained the Pennsylvania commission and, two, that the used and useful standard contained in the act was inconsistent with historical approach generally used by the Pennsylvania commission were without merit. *Id.* at 313-16.

the fair value rule and offered as the reason for abandonment of the rule the practical difficulties of its application.[36] The Court further recognized that the earlier Court in *Hope* had accepted historical costs as a "valid basis on which to calculate utility compensation."[37] In the opinion, the Court used as a synonym for historical costs the prudent investment rule and defined the rule as follows: "Under the prudent investment rule, the utility is compensated for all prudent investments at their actual cost when made (their "historical" cost), irrespective of whether individual investments are deemed necessary or beneficial in hindsight."[38]

In the course of resolving the issues presented by the facts of *Duquesne*, the Court concluded that a method for calculating a reasonable rate can be internally inconsistent thereby affirming the holding in *Hope* that it is the net effect of the rate that is to be considered.[39] Anticipating future arguments, however, the Court noted that a different outcome may derive from a "State's decision to arbitrarily switch back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at other."[40] Most important to the Authority's treatment of Aqua, is the refusal of the Court to adopt the prudent investment rule as the single constitutional standard. In closing the opinion, the Court noted: "The Constitution within broad limits leaves the States free to decide what ratesetting methodology best meets their needs in balancing the interest of the utility and the public."[41]

---

[36] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 308-09 (1989). Relying on earlier comments by Justice Brandeis dissenting in *Missouri ex rel. Southwestern Bell Tel. Co. v. Public Service Comm'n*, 262 U.S. 276, 292-94 (1923), the *Duquesne* Court noted that "the *Smyth v. Ames* test usually degenerated to proofs about how much it would cost to reconstruct the asset in question, a hopelessly hypothetical, complex, and inexact process." *Id.* at 309 n5.

[37] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989).

[38] *Id.* at 309, *see Verizon Commc'ns Inc. v. Federal Commc'ns Comm'n*, 535 U.S. 467, 486 (2002) (explaining that the prudent investment rule was "intended to give utilities an incentive to make smart investments deserving a 'fair' return, and thus to mimic natural incentives in competitive markets").

[39] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 314 (1989).

[40] *Id.* at 315, *see Verizon Commc'ns Inc. v. Federal Commc'ns Comm'n*, 535 U.S. 467, 527-28 (2002) (discussing the potential caveat carved out by *Duquesne*).

[41] *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 316 (1989).

These cases reveal the following three ratemaking principles. First, there is no single methodology upon which rates must be set. In fact, absent arbitrary action, rates may be set using differing methodologies within a single rate case. Second and somewhat related, it is the net effect of the rate that must be just and reasonable. Third, ratemaking must take into consideration the interest of both the ratepayer and the utility.

Tennessee law recognizes too the validity of these three principles. In *CF Industries v. Tennessee Public Service Commission*, the Tennessee Supreme Court squarely addresses the first two principles described in the preceding paragraph. As to the first principle, the Tennessee Supreme Court notes that there "is no statutory or decisional law that specifies any particular approach that must be followed" and describes the ratemaking process as a "value judgment."[42] Speaking to the second principle, the Court explains: "Thus focusing upon the issues, the Commission decides that which is just and reasonable. This is the litmus test **nothing more, nothing less.**"[43] Finally, with regard to both the first and second principles, the Tennessee Supreme Court quotes the following passage from a Georgia Supreme Court decision: "The process of setting rates is not required to follow any particular course, so long as the end result does not violate the 'just and reasonable requirement.'"[44] As to third principle, the Tennessee Supreme Court in the earlier case of *Southern Bell Telephone and Telegraph Company v. Tennessee Public Service Commission* commented that it has long been established that rates must be fair to both the utility and the consumer.[45]

---

[42] *CF Indus. v. Tennessee Pub. Serv. Comm'n*, 599 S.W.2d 536, 542 (Tenn. 1980), *see Tennessee Cable Television Ass'n v. Tennessee Pub. Serv. Comm'n*, 844 S.W.2d 151, 159 (Tenn. Ct. App. 1992).
[43] *CF Indus. v. Tennessee Pub. Serv. Comm'n*, 599 S.W.2d 536, 543 (Tenn. 1980) (emphasis supplied).
[44] *Id.* (quoting *Allied Chem. Corp. v. Georgia Power Co.*, 224 S.E.2d 396, 399 (Ga. 1976)).
[45] *Southern Bell Tel. & Tel. Co. v. Tennessee Pub. Serv. Comm'n*, 304 S.W.2d. 640, 643 (Tenn. 1957), *see Tennessee Cable Television Ass'n v. Tennessee Pub. Serv. Comm'n*, 844 S.W.2d 151, 159 (Tenn. Ct. App. 1992).

D. DISSENTING ANALYSIS

I cannot in this separate opinion conclude that the majority has inaccurately recited the standard set forth in *Smyth v. Ames* or the validity of the used and useful standard.[46] I must, however, disagree with the majority's result. First, I cannot agree in this instance with the rigid application of the used and useful standard. As the history as recited herein demonstrates, setting rates that are fair to both the consumers and the utility sometimes requires that additional factors be taken into consideration. Second, I do not agree with the conclusion that the plant is not used and useful.

1. STRICT RELIANCE ON USED AND USEFUL

The majority concludes as a matter of law that forecasted plant cannot be included in rate base and as a matter of fact that The Preserve plant is forecasted plant. Strict reliance on this rule of law is neither merited in this case nor is it required by law. As the three principles teach us - no single methodology rules the day, the final rate must be just and reasonable, and the rate must be fair to the interests of both the ratepayer and the utility. While I have determined that The Preserve plant is in fact used and useful,[47] I am of the opinion that even absent such a finding, Aqua is entitled to a portion of its CWIP investment and that such a conclusion is compliant with the three principles.

In rate cases, the Authority must exercise its discretion when deciding whether to include a company's investment in CWIP in the rate base. As a starting point, the Authority may set out to determine whether the CWIP investment is expected to be used and useful in providing utility service during the attrition period. However, in the end, a weightier consideration is whether the

---

[46] To the extent that the fair value rule enunciated in *Smyth v. Ames* applied only to used and useful plant, that standard still can be considered as part of the prudent investment rule. *See Verizon Commc'ns, Inc. v. Federal Commc'ns Comm'n*, 535 U.S. 467, 484 n.6 (2002) (stating: "The fair-value concept survived to some degree in the 'used and useful' qualification to the prudent-investment rule, that a utility can only recover prudently invested capital that is being 'used and useful' in providing the public a good or service.")

[47] *See infra* part V.D.2.

allowance of the recovery in rate base is necessary to the financial integrity of the utility. In other words, the Authority should ask whether inclusion is necessary to maintain sufficient financial liquidity so as to permit the utility to meet all capital obligations and to allow the utility to raise needed capital to prevent the impairment of the utility service. In this case, Aqua demonstrated at the hearing that the integrity of its service may be impaired absent allowing a return on those facilities that it has already deployed.[48]

Additionally, when exercising our discretion, the Authority should recognize that utilities can achieve certain efficiencies when constructing a utility system in a development and that ratepayers and the utility benefit from those efficiencies. For example, it is likely more efficient to build-out utility plant in advance of other development construction, such as roadways. Certainly the Authority would frown upon and perhaps deem imprudent a decision to dig up roads and yards to install plant that the utility could have installed with ease at the start of development construction. Similarly, a utility may lay multiple miles of pipe in year one of multi-year construction project knowing there will be no service subscribers in that first year as an alternative to laying smaller runs of pipe on multiple occasions at greater expense in the future. It is considerations such as these relating to economies and scope that the Authority must evaluate when setting rates.

I note in summation that allowing the recovery of CWIP that is thought not to be immediately used and useful is not as a matter of fact unfair to ratepayers and may very well be unfair to the utility. To explain, ratepayers benefit from the economies of scale produced by a larger rate base and greater number of ratepayers. These two factors increase primarily through development and expansion, both of which require investment. A utility of such a small size as Aqua, should not be expected, or as the majority as done, mandated to shoulder the full risk of an

[48] Transcript of Hearing, pp. 33-36, 38-39 (Dec. 4, 2006).

investment that is expected ultimately to benefit ratepayers as well as the utility. Because the majority's determination fails to recognize that disallowing CWIP in this instance serves only to thwart investment, development and expansion, I must dissent.

2. IS THE PRESERVE PLANT USED AND USEFUL?

Despite my determination that Aqua should be permitted to recover a portion of the requested CWIP even if the plant is determined not to be used and useful, I am compelled to explain my conclusion that, in fact, the plant is used and useful. The record is not wholly clear on the number of customer or meters Aqua expects to add during the attrition period. As part of its rate case, Aqua proposed as its system-wide growth rate 27 water/wastewater meters a year.[49] Aqua based its calculation of the 27 water/wastewater customer growth rate on its historical growth between 2004 and 2005.[50] Aqua also projected that there would be 50 lots built-out in The Preserve in 2006 and another 100 lots built-out in 2007.[51] While it is not wholly clear from the record whether the 50/100 estimate includes the 27 customers per year growth rate, it is without question that Aqua anticipates customers to come on-line during the attrition period. In fact, one customer is already on-line.

Mr. James E. Clausel, owner of Aqua, testified that Aqua is constructing the water/wastewater system for The Preserve, but is not building the homes.[52] He explained that Aqua currently serves a sales trailer using The Preserve's plant, that plans for 2 homes have been approved, and that plans for 2 additional homes are awaiting approval.[53] Additionally, Mr. Clausel noted that builders who generally purchase 5 to 10 lots at a time are interested in The Preserve.[54] Also of significance is Mr. Clausel's testimony that a similar development, The

[49] *See* Response to Data Request #34 (Sept. 22, 2006); Company's Workpapers, RB 1.02 (Aug. 8, 2006).
[50] Company's Workpapers, RB 1.02 (Aug. 8, 2006).
[51] *See* Response to Data Request #13 (Aug. 31, 2006).
[52] Transcript of Hearing, p. 16 (Dec. 4, 2006).
[53] *Id.* at 18-19.
[54] *Id.* at 19.

Points of Pickwick, is in an economic boom and another development, Northshore, has houses being built everyday.[55]

It is my conclusion based on this testimony that Aqua will serve customers in The Preserve during the attrition period. It matters not in my opinion, whether Aqua accurately predicted the actual number to be served. The fact is customers will be served and the plant is used and useful. Therefore, it is appropriate to allow recovery of at least a portion of the CWIP investment.

E. CONCLUSION AS TO CWIP

Having considered all of the relevant factors, it is my determination that a portion of CWIP investment should be included in rate base. As stated earlier herein, Aqua has failed to justify recovery of the full amount requested. In the alternative, it is my opinion that Aqua should be permitted to include in rate base an amount that is equal to its CWIP expenditures as are reflected on its books for the test year, $1,179,706.[56] This approach recognizes the purpose of the CWIP account while balancing the interest of ratepayers and the interest of the utility.

VI. TAXES OTHER THAN INCOME, EXCISE TAX, TOTAL OPERATION AND MAINTENANCE EXPENSE, NET OPERATING INCOME, AND RATE BASE

Given my disagreement with the prevailing motion as described above, I must disagree as a simple matter of mathematics with the attrition period totals contained in the prevailing motion for taxes other than income, excise tax, total operation and maintenance expense, net operating income, and rate base.

[55] Transcript of Hearing, p. 17-19 (Dec. 4, 2006).
[56] Direct Testimony of William H. Novak, p. 3 (July 15, 2007) (attached to *Petition*).

VII. CAPITAL STRUCTURE, RATE OF RETURN, AND REVENUE DEFICIENCY

I find that Aqua does not currently have debt, does not plan to incur debt before the end of the attrition year, and has a three-year history of having no debt.[57] Based on these findings, I concur with the position set forth in the *Final Order* that the capital structure should consist of 100 percent equity.[58]

As for the rate of return on that equity, Aqua proposes a 15 percent return claiming that such treatment is consistent with the agency's actions in regard to Antioch Water Company ("Antioch") and Lynwood Utility Corporation ("Lynwood").[59] In the case of Antioch, the Authority last ordered in 2001 an overall rate of return of 15 percent on rate base.[60] The Authority did not assign a particular return to debt or equity. Similarly, in the case of Lynwood, the Authority last ordered in 2000 an overall rate of return of 8 percent on rate base and did not assign a particular return to debt or equity.[61] In my opinion, these decisions provide useful comparisons given the similarities of the types of services provided and the corporate structure.

The majority chooses to disregard these past Authority decisions and instead compares Aqua to natural gas companies. The majority's justification for doing so – all the companies are "involved in distributing a regulated product"[62] – is wholly insufficient given the stark differences between the compared utilities. Although the majority does not explicitly list the companies used in its analysis, a defect of the order in and of itself, it is reasonable to assume that the majority used the same or similar companies used in the analysis cited by the majority

---

[57] Direct Testimony of William H. Novak, p. 9 (July 15, 2007) (attached to *Petition*); Response to Data Request Nos. 26 and 27 (Aug. 31, 2006).
[58] *Final Order Approving Rate Increase and Rate Design*, 21 (Nov. 27, 2007).
[59] Direct Testimony of William H. Novak, p. 9 (July 15, 2007) (attached to *Petition*).
[60] *In re: Petition of Antioch Water Company to Increase its Rates*, Docket No. 99-00584, *Order Granting Rate Increase*, 8 & 10 (Jun. 13, 2001).
[61] *In re: Petition of Lynwood Utility Corporation to Change and Increase Rates and Charges*, Docket No. 99-00507, 5 & 6 (May 10, 2000).
[62] *Final Order Approving Rate Increase and Rate Design*, 23 (Nov. 27, 2007).

and performed by the Florida Public Service Commission.[63] The companies used by the Florida Public Utilities Commission are multi-state, publicly-traded, multi-tiered organization with mixed capital structures and capitalization between the hundreds of millions of dollars and billons of dollars.[64] Use of such mismatched comparisons should be avoided whenever possible.

Based on the foregoing, it is my opinion that the Authority should adopt the average of the Antioch and Lynwood returns, which equals 11.5 percent. Moreover, because of my disagreement with the rate of return contained in the *Final Order*, I must dissent as well from the calculation of the revenue deficiency.

VIII. RATE DESIGN

The prevailing motion contains a rate design that differs significantly, both in dollar amounts and classifications, from the rate design proposed by Aqua.[65] Given the substantial modifications to the accounting of revenues, expenses, and rate of return that the panel has adopted, I am of the opinion that rather than adopt a rate design of our own creation at this time, the Authority ought to afford Aqua the opportunity to review the deliberations and propose a rate

---

[63] *Final Order Approving Rate Increase and Rate Design*, 23 & n51 (Nov. 27, 2007). The Florida Public Service Commission methodology is complex, but generally speaking "uses returns on equity from financial models based upon an index of natural gas utilities that derive at least 60% of their revenue from regulated rates, with adjustments made to reflect the risks faced by Florida WAW utilities." *See In re: Water and Wastewater Industry Annual Reestablishment of Authorized range of return on Common Equity for Water and Wastewater Utilities Pursuant to Section 367.081(4)(f), F.S.*, Docket No. 060006-WS, Order No. PSC-06-0476-PAA-WS, *Notice of Proposed Agency Action Order Establishing Authorized Range of Returns on Common Equity for Water and Wastewater Utilities*, p. 1 (June 5, 2006).

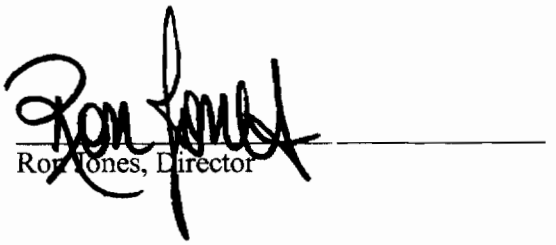
[64] The specific companies used in the Florida study are: AGL Resources, Atmos Energy Corporation, Cascade Natural Gas, KeySpan Corp., Laclede Group, NICOR Inc., Northwest Natural Gas, Peoples Energy, Piedmont Natural Gas, South Jersey Industry, Southwest Gas Corporation, and WGL Holdings, Inc. *See In re: Water and Wastewater Industry Annual Reestablishment of Authorized Range of Return on Common Equity for Water and Wastewater Utilities Pursuant to Section 367.081(4)(f), F.S.*, Docket No. 060006-WS, Order No. PSC-06-0476-PAA-WS, *Notice of Proposed Agency Action Order Establishing Authorized Range of Returns on Common Equity for Water and Wastewater Utilities*, Attachment 1, p. 3 & 6 (June 5, 2006). According to the data in the Florida Notice, KeySpan Corp. has the lowest capitalization at 222.26 million dollars and Cascade Natural Gas has the greatest capitalization at 7,122.65 million dollars. *Id.* at Attachment 1, p. 6.

[65] *Compare Final Order Approving Rate Increase and Rate Design*, 24-26 (Nov. 27, 2007) with *Petition*, Proposed Tariff, Schedule of Rates and Charges, Sheet #1 (July 19, 2006).

design that it believes best suits the characteristics of its ratepayers and its needs. Thus, I dissent from the adoption of the proposed rate design.

IX. CONCLUSION

Based on the foregoing, I respectfully concur in part with and dissent in part from the *Final Order Approving Rate Increase and Rate Design* issued on November 27, 2007.



Ron Jones, Director