DEPARTMENT OF STATE
PUBLIC SERVICE COMMISSION
Statutory Authority: 26 Delaware Code, Section 209(a) (26 Del.C. §209(a))

PROPOSED

PUBLIC NOTICE

Reg. Docket No. 15; Concerning the Terms and Conditions Under Which Water Utilities Require Advances and/or Contributions In-Aid-Of Construction from Customers or Developers, and the Proper Ratemaking Treatment for such Contributions and Advances

ORDER NO. 6814

AND NOW, this 10th day of January, 2006, the Commission having considered: (a) the record before Senior Hearing Examiner William F. O'Brien in this matter, including the evidence and post-hearing briefs; (b) the Report of the Senior Hearing Examiner dated November 18, 2005; (c) the written exceptions submitted by the parties to the Commission; and (d) the arguments of the parties at the public hearing held before the Commission on December 20, 2005; now, therefore,

IT IS ORDERED:

1. As and for its summary of the evidence pursuant to 29 **Del.C**. §10118(b)(1), the Commission incorporates by reference the "Appearances," "Procedural Background," "The Proposed Amendment," and "Summary of Evidence" sections (sections I, II, III, IV, and V) of the Report of the Senior Hearing Examiner dated November 18, 2005.

2. The Commission adopts the "Findings and Recommendations" (section VI) set forth in the Report of the Hearing Examiner dated November 18, 2005, however, the Commission finds that the proposed rules may reflect substantive changes from the earlier published rules (Jan. 2005), and may constitute a new proposal within the meaning of 29 **Del.C.** §10118(c). Staff represents that these proposed rules are as set forth in Attachment "A" to the Report. A copy of the Report of the Hearing Examiner with Attachment "A" is attached hereto as Exhibit "A".

3. The Secretary of the Commission shall transmit to the Registrar of Regulations for publication in the *Delaware Register* the notice attached hereto as Exhibit "B" and the proposed regulations attached to the Hearing Examiner's Report as Attachment "A".

4. The Secretary of the Commission shall cause the notice attached hereto as Exhibit "B" to be published in *The News Journal* and the *Delaware State News* newspapers on or before February 1, 2006.

5. The Secretary of the Commission shall cause the notice attached hereto as Exhibit "B" and the proposed regulations attached to the Hearing Examiner's Report as Attachment "A" to be sent by United States mail to all persons who have made timely written requests for advance notice of the Commission's regulation-making proceedings.

6. All written comments, suggestions, and compilations of data, briefs, or other written materials concerning the proposed regulations shall be submitted to the Commission on or before March 3, 2006.

7. The Commission will hold a public hearing on March 14, 2006 at 1:00 PM to consider adoption of the proposed regulations attached to the Hearing Examiner's Report as Attachment "A".

8. The public utilities regulated by the Commission are notified that they may be charged for the cost of this proceeding under 26 **Del.C.** §114.

9. The Commission retains the jurisdiction and authority to enter such further Orders in this matter as may be deemed necessary or proper.

BY ORDER OF THE COMMISSION:

Arnetta McRae, Chair
Joann T. Conaway, Commissioner
Dallas Winslow, Commissioner
Jaymes B. Lester, Commissioner
Jeffrey J. Clark, Commissioner

ATTEST:

Karen J. Nickerson, Secretary

Public Notice of Comment Period and Public Hearing and Soliciting Comments Concerning Revisions to Regulations

On May 14, 2003, the Division of the Public Advocate ("DPA") filed a petition with the Public Service Commission ("PSC" or "Commission") asking the Commission to make revisions and amendments to its regulations concerning the *Terms and Conditions Under Which Water Utilities Require Advances and/or Contributions In-Aid-Of Construction From Customers or Developers and the Proper Ratemaking Treatment for Such Contributions and Advances* ("the Regulations"). These Regulations were originally adopted in PSC Order No. 2928 (Mar. 15, 1988) and revised in PSC Order No. 4310 (Sept. 24, 1996).

In PSC Order No. 6198 (June 16, 2003), the Commission accepted the DPA's petition to reopen those earlier regulations. In PSC Order No. 6538 (December 7, 2004), the Commission issued a revised set of regulations for public comment and designated a Hearing Examiner to conduct further proceedings. On November 18, 2005, the Hearing Examiner issued a written report with revised regulations that were proposed for adoption by the Commission. On December 20, 2005, the Commission voted to adopt the Hearing Examiner's Report and publish the revised regulations for further public comment.

The revised regulations address the following: (a) the definitions of Contributions In-Aid-Of Construction ("CIAC"), Advances, Facilities Extension, and New Services; (b) the computation of CIAC, including costs categories; (c) the nature of advances; (d) refunds of advances; (e) the ratemaking treatment of advances; (f) the gross-up of CIAC; (g) the ratemaking treatment of CIAC; (h) the true-up of CIAC and advances; (i) that the regulations apply only to Class A water utilities; (j) that the regulations will only have prospective application; and (k) matters necessarily related to the foregoing. The Commission proposes that its Order promulgating the final version of the new regulations will provide that the regulations (and the related docket) will be reopened two years from the effective date of the new regulations to review the new rate-making methodology, and to assess its effectiveness, the CIAC computation, and related costs categories. After such review and assessment, the Commission may, if deemed appropriate, consider further modifications of the regulations.

Copies of the present Regulations, the proposed regulations, and the DPA's petition to reopen are available for public inspection at the Commission's address set out below during normal business hours.

The Commission has authority to promulgate the regulations pursuant to 26 **Del.C.** §209(a) and 29 **Del.C.** §10111 et seq.

The Commission hereby solicits written comments, suggestions, and compilations of data, briefs, or other written materials concerning the proposed regulations. Ten (10) copies of such materials shall be filed with the Commission at its office located at 861 Silver Lake Boulevard, Cannon Building, Suite 100, Dover, Delaware, 19904. All such materials shall be filed with the Commission on or before March 3, 2006. Persons who wish to participate in the proceedings, but who do not wish to file written materials, are asked to send a letter informing the Commission of their intention to participate on or before March 3, 2006. The Commission will hold a public hearing to consider the proposed regulations on March 14, 2006 at 1:00 PM at its Dover office identified above.

The proposed regulations and the materials submitted in connection therewith will be available for public inspection and copying at the Commission's Dover office during normal business hours. The fee for copying is $0.25 per page. The regulations may also be reviewed, by appointment during normal business hours, at the office of the Division of the Public Advocate located at the Carvel State Office Building, 4th Floor, 820 North French Street, Wilmington, Delaware 19801, and will also be available for review on the Commission's website: www.state.de.us/delpsc.

Any individual with disabilities who wishes to participate in these proceedings should contact the Commission to discuss any auxiliary aids or services needed to facilitate such review or participation. Such contact may be in person, by writing, by telephone, or otherwise. The Commission's toll-free telephone number (in Delaware) is (800) 282-8574. Any person with questions may also contact the Commission Staff at (302) 739-4247 or by Text Telephone at (302) 739-4333. Inquiries can also be sent by Internet e-mail to karen.nickerson@state.de.us.

FINDINGS AND RECOMMENDATIONS OF THE HEARING EXAMINER

DATED: November 18, 2005 William F. O'Brien

Senior Hearing Examiner

William F. O'Brien, duly appointed Hearing Examiner in this Docket pursuant to 26 **Del.C.** §502 and 29 **Del.C.** Ch. 101, by Commission Order No. 6538, dated December 7, 2004, reports to the Commission as follows:

I. APPEARANCES

On behalf of Commission Staff:
MURPHY SPADARO & LANDON
BY: FRANCIS J. MURPHY, ESQUIRE

On behalf of the Division of the Public Advocate:
G. ARTHUR PADMORE, Public Advocate

On behalf of Homebuilders Association of Delaware, Inc.:
THE BAYARD FIRM
BY: WILLIAM D. BAILEY, JR., ESQUIRE

On behalf of United Water Delaware Inc.:
MORRIS, JAMES, HITCHENS & WILLIAMS, LLP
BY: NICHOLAS J. CAGGIANO, JR., ESQUIRE

On behalf of Artesian Water Company, Inc. ("Artesian"):
JOHN J. SCHREPPLER, II, ESQUIRE

II. PROCEDURAL BACKGROUND

1. PSC Regulation Docket No. 15 governs the terms and conditions under which regulated water utilities require advances or Contributions In-Aid-Of Construction ("CIAC") from customers or developers who request water service. On May 14, 2003, the Division of the Public Advocate ("DPA") filed a petition to reopen Regulation Docket No. 15 seeking to amend the current regulation to require water utilities to collect CIAC in amounts sufficient to protect existing customers from bearing the costs of system expansion. By memorandum dated May 16, 2003, Commission Staff supported DPA's petition to reopen the regulation docket. Then, by Order No. 6198 (June 17, 2003), the Commission reopened Regulation Docket No. 15 to address DPA's and Staff's concerns.

2. In order to gain assistance in drafting a proposed regulation, Staff met on numerous occasions over the course of many months with representatives of regulated water utilities, developers, and DPA, and received written and oral comments from these participants, as well as from other interested parties. Although Staff was unable to gain a full consensus from the participants, Staff completed a draft of proposed regulations, which it presented to the Commission in December of 2004. By Order No. 6538 (Dec. 7, 2004), the Commission directed Staff to publish notice of the proposed regulation in the *Delaware Register* (and in *The News Journal* and *Delaware State News* newspapers) and to mail it to all certificated water utilities. The Commission set a deadline of February 4, 2005, for interested parties to file comments on the proposed regulation.

3. In response to the notice, United Water Delaware Inc. ("United Water"), Artesian Water Company, Inc. ("Artesian"), Tidewater Utilities Inc. ("Tidewater"), Home Builders Association of Delaware, Inc. ("HBA/DE"), The Reybold Group ("Reybold"), and Knollwood Development Corporation ("Knollwood") moved for leave to intervene. In addition, United Water filed substantive comments and HBA/DE filed a Motion to Dismiss the case. Reybold joined HBA/DE in its Motion to Dismiss, which alleged various procedural and substantive defects regarding the proposed regulation. After receiving responses to the Motion, I denied the Motion, in a letter dated March 22, 2005. In the same letter, I granted all of the petitions for intervention.

4. After a period of discovery, Staff, DPA, United Water and Artesian submitted pre-filed direct testimony on May 3, 2005; HBA/DE filed direct testimony on May 24, 2005; and Staff, DPA and United Water filed rebuttal testimony on June 14, 2005. On June 21, 2005, Blenheim Bayberry LLC ("Blenheim") submitted written comments objecting to the proposed regulation. On June 22, 2005, I conducted a duly-noticed evidentiary hearing, at which representatives from Staff, DPA, United Water, Artesian, and HBA/DE moved their prefiled testimony into the record and made themselves available for cross-examination. Representatives of Tidewater and Blenheim also attended the hearing but did not participate.

5. On June 28, 2005, consistent with the post-hearing schedule, United Water submitted an amended proposed

regulation, which Staff, DPA and Artesian endorsed. On or about July 25, 2005, DPA and Staff submitted opening briefs, and Artesian submitted a letter indicating its support for the United Water amendment. With its brief, Staff included its final proposed regulation ("Proposed Regulation"), which included minor revisions to the draft submitted by United Water on June 28, and which United Water supported by e-mail dated September 2, 2005. HBA/DE and Reybold filed answering briefs on August 22, 2005, opposing the Proposed Regulation. On September 16, and September 26, 2005, DPA and staff, respectively, filed their reply briefs.[1]

6. On September 16, 2005, HBA/DE requested oral argument on the post-hearing revisions to the proposed regulation. Staff, DPA, and Artesian opposed the request. By letter dated November 14, 2005, I denied the request for oral argument and entered into evidence Staff's July 25, 2005 final draft of the proposed regulation (Ex. 12). I then closed the record, which now consists of twelve exhibits and a 198-page *verbatim* transcript of the proceedings.[2] I have considered all of the record evidence of this docket and, based thereon, I submit for the Commission's consideration these Findings and Recommendations.

III. THE PROPOSED AMENDMENT

7. Staff's final proposed regulation, which it submitted as an attachment to its opening brief, is attached hereto as Attachment "A." In addition, Staff provided the following outline of the Proposed Regulation, which identifies the changes made to the existing regulation:

Section 1.3.14. This section is new and contains the definition of the term "Facilities Extension". "Facilities Extension" is defined as "the extension of the water utility's Mains and appurtenances ("Facilities") for the provision of water service." The term "appurtenances" includes "valves, hydrants, pumps, sampling equipment and other miscellaneous items appurtenant to a Main extension."

Section 1.3.15. This section is new and defines the term "New Services" as "the extension of pipe from the water utility's Mains to the customer's premises.

Section 3.8. This section has been revised in three respects. First, it requires the water utility to collect CIAC for a "Facilities Extension" to the extent provided in sections 3.8.1 and 3.8.2. Second, it a) incorporates the term "New Services" and b) permits, but does not compel, the water utility to collect CIAC or Advances for "New Services". Third, it permits the water utility to pay for the costs of "New Services" and to include the costs in its rate base.

Section 3.8.1. This section has been revised to require a CIAC when a request for a "Facilities Extension" will require the installation of pipe and/or associated utility plant. The CIAC shall be paid to the water utility as Category 1A, 1B and Category 2 costs, as computed under sections 3.8.2 and 3.8.6, subject to true-up under section 3.8.8. The references to Advances in this section have been eliminated, and the heading of the section has been modified to reflect its new content.

Section 3.8.2. The existing section has been deleted in favor of a new section which delineates how CIAC is to be computed. CIAC is broken down into three cost categories in section 3.8.2. The first, Category 1A costs, are primarily on-site costs directly assignable to a project. The second, Category 1B costs, are off-site costs directly assignable to a project. The third, Category 2 costs, refer to transmission, supply, treatment and/or other plant costs not directly assignable to the new project, where the Category 1 costs are not sufficient to supply water to the project.

Category 1A costs are CIAC and include "all on-site Facilities costs that are directly assignable to a specific project…." Category 1A costs include the costs of such items as "Mains, hydrants, treatment plants, wells,

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1. Staff's and DPA's opening briefs will be cited as "Staff OB at __" and "DPA OB at __." HBA/DE's and Reybold's answering briefs will be cited as "HBA/DE Br. at __" and "Reybold Br. at __." Staff's and DPA's reply briefs will be cited as "Staff RB at ___" and "DPA RB at ___."

2. References to the Exhibits entered into the evidentiary record of this proceeding will be cited as "(Ex. ___)" or "(Ex. ___ at ___)." References to the transcript of the proceedings will be cited as "(Tr. ___)."

pump stations, storage facilities, and shall include any other items that are necessary for the provision of water utility service." In addition, Category 1A costs include the cost of “Facilities Extension” from the furthest point of the project site up to a point 100 feet beyond the boundary of the project (in the direction of the utility’s existing Main)….”

Category 1B costs are CIAC. Category 1B costs are intended to capture off-site Facilities costs that are directly assignable to a specific project beyond the 100 feet boundary covered by Category 1A costs. The section specifically exempts Facilities costs that the utility elects to incur for company betterment, that are not needed to supply water service to the project. In computing Category 1B costs, CIAC shall be calculated using a minimum of 8 inch diameter pipe, unless a larger diameter is required by “applicable laws, building or fire codes, or engineering standards to provide water service to the project on a stand-alone basis….”

“Category 2 Costs” are CIAC and the term refers to “transmission, supply, treatment and/or other utility plant costs to supply water to the project” that are not “directly assignable” to that specific project. Under Category 2, the sponsor of a project, such as a developer, “shall pay $1,500 per single family residential water meter service” to defray their portion of Category 2 costs. The $1,500 charge is a set amount that is required for each single family residential water meter service.

The provision dedicated to “Category 2 Costs” requires each water utility to file tariff pages, within 120 days from the effective date of the regulations, containing the charges it will impose for Category 2 Costs for types of metered water service, other than single family residential service. The regulation requires that “[s]uch charges shall be determined based on water meter size or another objective factor.”

The provision about “Category 2 Costs” allows utilities to hold such amounts and defer accounting for them as CIAC until such amounts are actually used to fund capital improvements. At that time, the utility is “entitled to account for the Category 2 Costs as CIAC to the extent it is able to make offsetting entries to the utility’s plant accounts.”

Section 3.8.3. This section describes the nature of Advances. In paragraph (1), the words “constructing the extension” have been changed to “construction”. In paragraph (2), the word “applicable” has been added before the words “Federal income taxes” for consistency with the immediately following passage, which refers to “applicable State taxes”.

Section 3.8.4. This section relates to “Refunds of Advances” and has been modified in several respects. First, a provision describing how the refund of an Advance is calculated has been deleted. Second, the words “if any” have been inserted in the first sentence after the words “plus the tax savings” to clarify that there may not be any tax savings.

The final sentence of the section has been changed in two respects. First, the words “prospective new customer” have been deleted and the words “person(s) making the advance” have been substituted in their place, to clarify that persons other than a new customer may be making an advance. Second, the minimum twenty-year period for the refund of advances has been changed to a maximum five-year period.

Section 3.8.5. This section deals with the ratemaking treatment of advances. It has been changed to add the words “if required” after the words “since the income taxes”. In addition, the word “customer” has been deleted and the words “person(s) making the advance” substituted in its place. These changes are made for purposes of clarification and consistency.

Section 3.8.6. This section has been rewritten largely to address the gross up of CIAC to account for tax liabilities. In the first sentence, the term “reasonable overhead” has been changed to “the utility’s standard overhead”. In addition, the sentence has been changed to incorporate the defined term “Facilities Extension”.

A new second sentence has been added that allows a utility to gross up the amount of CIAC charged to a project sponsor, if any portion of contributed property is deemed taxable income.

Section 3.8.7. This section deals with “Ratemaking Treatment of CIAC” and allows the utility to add to rate base the Federal and State income taxes associated with CIAC and paid by the utility. A change has been made by adding the words “if required” after the introductory words “The Federal and State income taxes….”

Section 3.8.8. This section has been revised to create a mutual obligation on the part of utilities and persons paying CIAC and Advances to engage in a “true-up” process, in circumstances where there has been an overpayment or underpayment.

Section 3.8.9. This is a new miscellaneous provision. It provides that the regulations shall apply only to Class A Water Utilities, and shall be given prospective effect only. It also requires that the docket be reopened within two years from the effective date of the regulations to review the methodology and assess the effectiveness of the CIAC computation and costs categories.

(Staff OB at 7-11.)

IV. SUMMARY OF PUBLIC COMMENT

8. No individual members of the public offered oral or written comments in this proceeding. Blenheim Bayberry LLC, a real estate developer, however, submitted written comments on June 21, 2005, which was the deadline for written comments from the public. Blenheim objected to the proposed $1,500 CIAC for residential units (and the unspecified amount for commercial units), alleging that it will "provide free capital with which a water utility may expand its system outside the project in question."

9. Blenheim stated that it currently has a project underway that: (1) includes properties within the service territories of both Artesian and Tidewater and (2) has an adequate supply of water on-site. Blenheim recommends that the regulations be amended to allow Blenheim to modify the service territories within its project area to best serve the interests of future homebuyers, based on competing proposals from Artesian and Tidewater. In addition, Blenheim recommends that the regulations permit developers to require water utilities to use on-site supply and to charge the developer only the cost of the on-site system. This requirement would apply to those projects where adequate on-site supply is present and when the cost of the on-site system, per unit, is materially less than the CIAC required by the proposed regulations.

10. Blenheim also recommends that higher-cost utilities, such as Artesian, be held to an established industry standard for CIAC charges, in order to protect consumers from paying arbitrarily high costs for expansion. Finally, Blenheim urged the Commission to apply the new regulation, if approved, only to properties not already subject to water service agreements.

V. SUMMARY OF EVIDENCE

A. Prefiled Direct Testimony

11. **Commission Staff.** Connie S. McDowell, the Commission's Chief of Technical Services, submitted pre-filed direct testimony on behalf of Staff. (Ex. 3.) Ms. McDowell testified that in the last five years two large water utilities, Artesian and Tidewater, have each filed for two substantial rate increases as a result of the rapid expansion of their service territories during that time. Both Staff and DPA believe that the companies were not collecting enough CIAC or advances from developers to cover the source of supply, pumping equipment and water treatment equipment necessitated by the system expansion. Consequently, existing ratepayers are paying these costs in the form of higher rates. In one of Artesian's rate cases (PSC Docket No. 02-109), the parties agreed that it would be more appropriate to address the CIAC issue by reopening Regulation Docket No. 15 than to address the issue solely with Artesian in that case.

12. Ms. McDowell described the proposed revisions to the CIAC regulations. (*Id.* at 4-5.) If a developer or customer requests a "main extension," which is defined as an expansion of the system into a location not previously served, then the utility collects a CIAC for both "Category 1" costs and "Category 2" costs. Category 1 refers to all the plant costs directly assignable to the project, including the mains, services, and hydrants, as well as any supply, pumping and treatment plant built specifically for the project. Category 2 refers to supply and treatment plant built that may be used for more than one project. The utility must collect a $1,500 CIAC for Category 2 costs for residential water meter service and must calculate, on a case-by-case basis, the amount charged for non-residential service. Both CIAC amounts are subject to challenge by the customer or developer. The utility may collect a refundable advance, rather than CIAC, for a "new service," which is the connection from a customer's premises to an existing main. 13.Ms. McDowell testified that she calculated the actual cost, per new customer, to Artesian, Tidewater, and United Water for Category 2 costs for the years 2001 through 2004, and concluded that the proposed $1,500 CIAC is less than the cost per new customer for each of these utilities for the last two years. (*Id.* at 5-6.) Ms. McDowell asserted that new customers should bear the cost of expansion because they are the "cost causers." In addition, if new customers do not bear the cost of expansion, then water utilities will continue to file frequent rate cases and water rates will continue to escalate.

14. **DPA.** James D. Cotton, a financial consultant with The Columbia Group, testified on behalf of DPA. In his prefiled direct testimony (Ex. 6), Mr. Cotton testified that developers should pay for the cost of constructing water

facilities, just as they pay for other necessary components of homebuilding. (*Id.* at 10.) In most new subdivisions, developers either install the facilities themselves and "contribute" the facilities to the utility, or they contribute cash to the utility to fund the utility's construction of the facilities, or they contribute some combination of cash and construction. Under any arrangement, however, the objective should be for the developers to pay their own costs of construction.

15. Mr. Cotton testified that the proposed regulations require developers to pay for on-site facilities and off-site facilities. (*Id.* at 11-12.) Mr. Cotton explained that, currently, it is more typical for a developer to tie its subdivision into a larger water supply system, than to construct a stand-alone, on-site system with its own well and treatment plant. When a subdivision is tied into a larger system, however, expansion of the supply source and associated treatment plant may be very costly. The proposed regulation, therefore, provides for a second CIAC charge, for off-site facilities (*i.e.*, Category 2), in the amount of $1,500 per residential customer. This fee helps to offset the costs of building water supply and treatment facilities that serve many new developments. Mr. Cotton asserted that a flat fee is appropriate because it would be nearly impossible to compute the actual cost per customer in any one development for the investment in common water supply and treatment plant required to serve future customers. The flat fee correlates, therefore, with system needs rather than subdivision needs and provides a more efficient CIAC process. As such, utilizing a flat fee significantly reduces the administrative costs of utility companies, developers and Commission Staff. (*Id.* at 12.)

16. Mr. Cotton testified that another major benefit of the proposal is that it relies on CIAC, rather than refundable advances. (*Id.* at 13.) The amount of an advance is not known up-front because a utility pays back the advance to the developer over a number of years as new customers are added to the system. The amount of a CIAC, on the other hand, is known by all parties because the transaction is completed up-front, without any refunds. The numerous costs associated with advances, including the additional personnel required to track payments and the litigation expenses incurred when disputes arise, are absorbed by ratepayers. Mr. Cotton also provided a proposed scale for CIAC charges for commercial customers, based on meter size, because Staff's initial proposal did not include specific CIAC charges for commercial customers. (*Id.* at 15.)

17. **Artesian.** David B. Spacht, Vice President, Treasurer and Chief Financial Officer of Artesian Resources Corporation, submitted prefiled direct testimony on behalf of Artesian. (Ex. 2.) Mr. Spacht testified that Artesian participated in all the workshops conducted in this proceeding and he concluded that the proposed revisions to the CIAC regulations strike a proper balance among the needs of the utility, its customers and the development community. (*Id.* at 3.) He asserted that the $1,500 fixed contribution was developed to provide consistency among different geographic locations for a water utility and consistency between water utilities for the same geographic location. He asserted that the $1,500 charge is based on an equal sharing between utilities and developers (so that the utility can maintain an investment in rate base) for construction costs, based on a small facility design. Small facility design costs less per customer then a large facility design. In addition, Mr. Spacht recommended that the regulation include an "equivalent meter table" to establish increasing per-customer contribution amounts for off-site facilities based on the relative size of the services to be installed within a development. (*Id.* at 7.)

18. **United Water.** Nancy J. Trushell, Engineering Manager, submitted prefiled direct testimony on behalf of United Water. (Ex. 8.) Ms. Trushell testified that United Water provides water service to approximately 35,650 customers in northern New Castle County, operating two surface water treatment plants. While its service territory consists primarily of three non-contiguous geographical areas, its entire system is physically interconnected with transmission lines. Because United Water has treatment capacity available from its two existing plants, new sources of supply are not normally part of new facilities projects. New customers are simply connected to the existing plants, which are already included in rate base. (Ex. 8 at 3.) From 2001 to 2004, United Water completed 48 developer projects, adding 1,229 residential, 54 commercial, and 0 industrial customers. United Water requires developers to provide the funds for 100 percent of the cost of the project prior to beginning any phase of a project. As such, United Water does not track revenue from new main extensions, or make refunds to developers, which would be administratively burdensome. (*Id.* at 7.)

19. **HBA/DE.** Francis Julian, Vice President of Benchmark Builders, Inc. and President of HBA/DE, submitted prefiled direct testimony on behalf of HBA/DE. (Ex. 11.) The HBA/DE consists of approximately 95 homebuilders and 320 "associated" members, whom are involved in service to the industry. HBA/DE members employ approximately 10,752 people.

20. Mr. Julian testified that HBA/DE members typically purchase unimproved land for home construction. In most cases, the utility has already obtained the issuance of a Certificate of Public Convenience and Necessity ("CPCN") to serve the site. As a result, the certified utility holds a monopoly to serve that site even though it may not even have a water source located on that property to use as supply. (*Id.* at 2.) The interested developer, therefore, is barred from exploring an alternative that would be less costly than obtaining service by the certificated utility. Mr. Julian emphasized that the proposed regulation, while purporting to strike a balance between new and old customers

for the financing of new plant, ignores the fact that all customers have the burden of paying for the replacement of worn out plant for any particular development. (*Id*. at 7-8.)

21. Mr. Julian noted that before obtaining a CPCN, utility management must have concluded that it could make a profit in the proposed service territory and, before granting the CPCN, the Commission must have concluded that the utility had the means to serve the site. (*Id*. at 2-3.) In fact, the utility may have even paid the original landowner for the right to serve the site. He asserted, therefore, that the utility has voluntarily put itself in the situation about which it now complains.

22. Mr. Julian also objected to the apparent elimination of advances, which are an alternative to CIAC, and which are refunded to the developer over time. (*Id.* at 3.) The denial of any refunds would eliminate the balance struck between a utility, who benefits from cost-free capital, and the homebuilder, who provides the capital and the future income stream. Mr. Julian also questioned the meaning of the language of the proposed rule that recognizes the practice of using refundable advances, while other provisions seem to eliminate advances and refunds.

23. Mr. Julian disagreed with the other parties' claims that tracking refunds is administratively burdensome. (*Id.* at 4.) He stated that developers should be required to notify the utility that service to a new customer is subject to a rebate and should also notify the utility of any changes to the payee's address. He asserted, however, that the Class A utilities have MIS equipment capable of handling this simple procedure without hiring new employees. If a developer fails to keep its contact information up to date, then the refund should be retained by the utility until it is turned over to the state escheator, as required by law.

24. Mr. Julian testified that the cost of extending the main 100 feet beyond the project area is more properly included in Category 2 rather than Category 1. (*Id*. at 5.) Or, if boring is necessary to extend the main, then the cost should be financed with a refundable advance, in order to recognize that the utility benefits by the extension because of the revenues it will receive from its certificated area. Mr. Julian also objected to inclusion in Category 1 of "other costs necessary for the provision of utility water service" because these costs are not defined and because there is no defined procedure for identifying these costs, which should include input from the developer. (*Id.* at 5-6.)

25. Mr. Julian also opposed the inclusion in CIAC of utility overhead costs, because there is no provision for how overhead will be calculated and because there is no justification for marking up every item at the same rate. (*Id.* at 6.) In addition, the proposal does not include a procedure to allow a developer to challenge an overhead rate charged by a utility. Finally, Mr. Julian urged the exclusion from CIAC of those costs from state-mandated drought relief efforts or from the replacement of existing systems because both types of costs should be borne by all customers, whether they are new customers or existing customers. (Id at 8-9.)

B. Prefiled Rebuttal Testimony

26. **Staff.** In response to Mr. Julian's testimony, Ms. McDowell submitted prefiled rebuttal testimony on behalf of Staff. (Ex. 4.) Ms. McDowell testified that builders benefit from a central water system because county regulations allow for smaller lots with a central system, which means that builders can build more homes per acre. Furthermore, builders can pass the cost of water service on to the homebuyer in the price of the home just as they do for the costs of providing streets, street lights, sidewalks, and wastewater systems. (*Id*. at 2.) In addition, if a builder believes that a utility is charging it for unreasonable overhead costs, the builder can contact Commission Staff to mediate the dispute or it can file a formal complaint with the Commission. Regarding Mr. Julian's concerns about a utility's statutory, drought-related investments or its replacement costs for worn out extensions, Ms. McDowell testified that such costs are not included as CIAC-recovered costs. (*Id.* at 3.)

27. **DPA.** In his prefiled rebuttal testimony, Mr. Cotton responded to many of Mr. Julian's assertions. (Ex. 7.) Mr. Cotton testified that, by arguing that a utility should pay part of the cost of new facilities because a utility expects profits from the associated project, Mr. Julian ignores the impact of the project on ratepayers, who are forced to bear the cost of serving the new development. In addition, Mr. Cotton disagreed with Mr. Julian's assertion that builders generate an "income stream" for the utility, noting that it is the ratepayers who generate the income. He objected to any sharing of costs attributable to a new development because of the adverse impact on current ratepayers. In addition, Mr. Cotton noted that advances must be addressed in the regulations, even if advances are no longer permitted, because utilities still carry advances on their books. Mr. Cotton also asserted that no inequity results from requiring new customers to pay for their own facilities while requiring all customers to pay for facilities replacement because new customers eventually gain the same benefit once the facilities for their system are replaced or repaired. (*Id.* at 2-3.)

28. **United Water.** In her prefiled rebuttal testimony, Ms. Trushell responded to Mr. Julian's testimony as well as to certain statements from Ms. McDowell and Mr. Cotton. (Ex. 9.) Ms. Trushell testified that United Water already requires all costs associated with connecting a new development to the United Water system to be paid up front in a

non-refundable CIAC. In this way, new development costs are borne by the cost causer, administrative expenses are limited (*i.e.*, no tracking of refunds is necessary), and all developers are treated equally. (*Id*. at 2-3.). Ms. Trushell noted that by consistently obtaining CIAC to fully fund extensions for new developments, United Water has avoided the need to increase its rates since 1998. (*Id.* at 13.)

29. In addition, Ms. Trushell objected to the provision in the proposal that limits CIAC Category 1 costs for main extensions to 100 feet beyond the project area. (*Id.* at 7.) Ms. Trushell recommended establishing a "Category 1B," under which the utility will recover off-site costs beyond the 100-foot mark. Otherwise, the utility and its ratepayers will be asked to absorb the business risk associated with the proposed development. Ms. Trushell noted that, ironically, the new regulation could force United Water to collect less CIAC then it currently collects, if United Water must bear the construction cost of extensions beyond the 100-foot mark. (*Id.* at 13-14.) As a compromise position, Ms. Trushell recommended allowing developers to pay for these costs with advances, refundable over a 5-year period, as new customers begin to take service.

30. Ms. Trushell disagreed, however, with Mr. Julian's assertion that developers have a "right" to use refundable advances simply because advances are recognized in the current regulation. (*Id.* at 10-11.) According to Ms. Trushell, the distinction between CIAC and advances in the current regulation originated because of differences in federal tax treatment; differences that no longer exist. Ms. Trushell also made several drafting recommendations in order to clarify the proposed regulations.

C. Live Testimony From the June 22, 2005 Hearing

31. **Staff.** At the hearing, Ms. McDowell testified that Staff has accepted certain changes to the proposed regulations as recommended by United Water and she submitted a copy of the revised proposed regulation. (Tr. 452; Ex. 5.) Under the revised proposal, Category 1 costs now include, under "Category 1B," all off-site costs directly assignable to the project, which occur beyond 100 feet from the boundary of the project. "Category 1A" consists of the former Category 1 costs, which are all on-site facility costs directly assignable to the project (occurring within 100 feet from the boundary of the project). Both sub-categories will be financed by the builder via non-refundable CIAC. Ms. McDowell asserted, however, that she would add a provision stating that Category 1B costs, which occur when the utility has to extend a main more than 100 feet from its system, are determined as if the main installed were an 8-inch main. Therefore, if the utility decides to install a 12-inch or a 14-inch main to accommodate future growth, the builder will only pay the cost of an 8-inch main, which is the minimum size main that a utility would extend to a new development. (Tr. 494.)

32. Under the revised proposal, Category 2 still consists of those costs not directly assignable to a project, such as common supply or treatment facilities utilized by the new customers, and are funded via the $1,500 fee for residential services. (Tr. 445.) Ms. McDowell also agreed with United Water's recommendation that the proposal include a provision that builders will pay Category 2 costs for non-residential services at a rate to be determined by the utility and included in its tariff. Ms. McDowell would strike from United Water's proposal, however, the last statement under "Category 2" costs that provides for an offset to the $1,500 fee for direct costs for treatment and supply contributed by the builder under Category 1. (Tr. 456.)

33. On cross-examination, Ms. McDowell explained that Staff decided to use a flat fee for Category 2 costs because it would be difficult to calculate an actual cost for each project and because there is a benefit to all parties in knowing the amount up-front. (Tr. 462-463.) In addition, if the cost were calculated on a project-by-project basis, then the developers again would be in a position to negotiate lower charges, which is what the new regulation was designed to prevent. Taking an average cost for all utilities and requiring all utilities to charge the same flat fee, therefore, was the most equitable solution.

34. Ms. McDowell testified that, based on her compilation of historical Category 2 costs for utilities in Delaware (attached as "Exhibit 1" to her prefiled direct testimony), there is little chance that $1,500 exceeds the actual Category 2 costs. (Tr. 464.) She noted, however, that even if a builder had a particular project where the fee exceeded actual costs, that builder would likely make up for it with another project where the $1,500 fee under-compensated the utility for its actual Category 2 costs. (Tr. 465.)

35. When asked if the utilities' under-collection of CIAC charges, under the current regulation, is a result of poor negotiations, Ms. McDowell answered that "it certainly looks that way." (Tr. 547.) She added, however, that under rate base, rate of return regulation, utilities are motivated to under-collect CIAC because whatever capital costs the utility contributes can be added to rate base. By building rate base, a utility can earn more profit. (Tr. 547-548.)

36. Regarding her statement in prefiled testimony that builders can pass CIAC charges along to the homebuyer in the price of the home, Ms. McDowell agreed that she undertook no elasticity of demand studies to support her contention. (Tr. 471.) She simply relied on common business sense. Her point, however, was that by knowing its costs up-front, a builder can price its homes to more accurately reflect its costs. Under the current regulation, the fees are not set out, and so developers "continue to negotiate back and forth with either utility on what the costs would be." (Tr. 473.)

37. On re-direct examination, Ms. McDowell testified that the proposed regulation will reduce the number of rate cases, which are very costly and which add nothing to the quality of water service. (Tr. 485-487.) Artesian's last rate case cost about $600,000, which is passed on to the customers. She also noted that the regulations only apply to Class A water utilities, which includes only those utilities with more then $ 4 million in annual operating revenues.

38. Ms. McDowell also testified that the figures that she calculated for the historical cost, per new customer, of the three Class A utilities that she studied do not include transmission or distribution costs. (Tr. 596.) She also noted that the fact that Artesian's per-customer cost has been substantially higher than the other two utilities' per-customer costs, does not mean that Artesian has been inefficient. Artesian's costs have been higher because they utilize more expensive sources of supply, such as wells, and because they have had to address water sufficiency supply issues. (*Id*.)

39. **DPA.** At the hearing, Mr. Cotton testified that he supports the changes to the proposed regulations, as provided by Staff at the hearing in Exhibit No. 5. (Tr. 511.) On cross-examination, Mr. Cotton asserted that under the proposal utilities will be remain motivated to accept new service territories in order to collect additional rates in between rate cases. (Tr. 514.) In addition, it is the nature of a monopolist to add service territory because, even if it does not add revenues immediately, there will be profit opportunities in the future from facility replacements. Mr. Cotton noted that, historically, those utilities that have expanded the quickest have been the most successful and have made the greatest profits. (Tr. 515.)

40. Mr. Cotton testified that the $1,500 is a fair number, even though it is very conservative and likely below the actual cost to the utility. (Tr. 529, 540.) Historic costs have averaged $3,000 per new customer, not including transmission rates, and the trend is upward. He also emphasized that existing customers are currently subsidizing the builder, not the new utility customers. (Tr. 532.)

41. **United Water.** On cross-examination, Ms. Trushell testified that she was satisfied that the most recent changes to the proposal remove the risk to the utility of paying for main extensions beyond 100 feet rather than collecting such costs in CIAC. (Tr. 555.) She noted, however, that she is uncertain where to apply the $1,500 fee, from an accounting perspective.

42. Ms. Trushell also testified that United Water's practice of requiring CIAC for all direct costs of a project, rather than permitting refundable advances, has not prevented developers from entering into water service agreements. (Tr. 571-572.) She also noted that she knows that there is a significant administrative burden associated with tracking advances because she was personally involved with administering the refunds with United Water Pennsylvania. (Tr. 576.) Ms. Trushell also asserted that while United Water continues to add customers in new subdivisions, it is not seeking additional certificated areas, and has not for at least three years. (Tr. 559, 561, 572.)

43. **Artesian**. On cross-examination, Mr. Spacht testified that Artesian currently uses refundable contracts to finance on-site water mains and hydrants. (Tr. 424.) Under the proposed regulations, Artesian would no longer be able to offer a refundable contract.

44. Mr. Spacht testified that under the proposed regulations, Artesian's rate base would continue to increase over time, for several reasons. (Tr. 426.) First, the $1,500 contribution for off-site costs was designed as a minimum, and Artesian's capital costs above the $1,500 would be added to rate base. In addition, Artesian's rate base increases for reasons other than serving new customers, such as relocations, rehabilitation of older systems, and replacement of treatment facilities. (Tr. 442.) For instance, Artesian recently constructed two transmission lines under the Chesapeake and Delaware Canal, in order to better integrate its system and enhance reliability. (Tr. 444-445.)

45. Mr. Spacht also testified that a water utility is motivated to serve new areas, irrespective of rate base growth, if the expansion promotes regionalization. (Tr. 432-433.) There is not a lot of motivation, however, to serve a customer in a remote location that is not in a growth area. However, if the utility already has a CPCN for that area, then it must serve that customer. (Tr. 440.)

46. **HBA/DE.** At the hearing, Mr. Julian testified that he holds a B.S. degree in finance from the University of Delaware. (Tr. 584.) On cross-examination, Mr. Julian reiterated that when the Commission grants a CPCN, it must expect that the utility can make a profit by serving the territory that is the subject of the CPCN application. (Tr. 586.) In addition, he noted that the long-standing practices followed by utilities and developers regarding CIAC and advances are lawful and he asserted that any new regulations should also follow the applicable statutes. (Tr. 594.)

VI. FINDINGS AND RECOMMENDATIONS

A. Background

47. The Commission reopened this docket to consider amending its CIAC rules to require Class A water utilities to collect CIAC from builders or developers in amounts designed to better protect existing customers from paying for

system expansion. PSC Order No. 6538 (Dec. 7, 2004.) According to DPA and Staff, the two large, high-growth water utilities in Delaware (*i.e.*, Artesian and Tidewater) have been collecting insufficient CIAC from developers, relative to their actual costs of system expansion. Because of this under-collection of expansion costs, both utilities have obtained large rate increases in the last five years, which were warranted by the companies' inclusion in rate base of the un-reimbursed portion of the cost of new facilities. As a result, existing ratepayers are, in large part, bearing the cost of system expansion and are therefore subsidizing the builders and developers who cause the costs to be incurred by building the new homes.

48. The current CIAC regulations do not define the amount of CIAC that utilities must charge and, in practice, developers have successfully negotiated CIAC charges with Artesian and Tidewater that are well below actual costs. Possible reasons for the below-cost charges include: (1) poor negotiations (Tr. (McDowell) 547); (2) lower CIAC collected translates into higher rate base, which means more return on rate base to the utility (*Id*.); and (3) competition between Artesian and Tidewater for new service territories, with respect to those parcels that have yet to be certificated.[1]

49. United Water, on the other hand, has not experienced the rapid growth seen by Artesian and Tidewater, has not competed with other water utilities for service territory, and, consequently, has consistently charged non-refundable CIAC in amounts sufficient to cover its actual cost of system expansion. As a result, United Water has not filed for a rate increase since 1998. (Ex. 9 (Trushell) at 13.)

50. In order to curb the utilities' ability to under-charge for CIAC, Staff drafted amendments to the current regulation that standardize the determination of CIAC for Class A utilities and that require cost-based contributions from builders or developers. Staff's Proposed Regulation, therefore, limits a utility's flexibility to negotiate lower CIAC amounts with developers and ensures collection of CIAC that more closely tracks actual incremental costs.

51. In general, the Proposed Regulation requires Class A water utilities to collect nonrefundable CIAC from builders or developers in two parts. First, the utility must collect CIAC in an amount equal to all of its construction costs directly assignable to the project in question, both on-site and off-site (*i.e.*, Category IA and IB costs). Second, it must collect $1,500 per residential service[2] to help cover its indirect costs, which relate to common plant utilized for supply, treatment, and transmission (*i.e.*, Category 2 costs). Staff selected the $1,500 figure by reviewing the actual increases in supply and treatment plant, per additional customer, for Artesian, United Water, and Tidewater for the years 2000 through 2004. (Ex. 3 at 5-6.) For the years 2003 and 2004, these per-customer costs exceeded $1,500 for each of the three utilities.

52. In addition, the Proposed Regulation eliminates the practice of refunding contributions for a "facilities extension," which generally refers to a water main extension to a new subdivision. Refundable advances are still permitted, however, for a "new service," which refers to the extension of pipe from a main to an individual customer. Utilities may also elect to pay for a new service itself, rather than charging a CIAC or advance. (Section 3.8.)

53. Participating in this case, in varying degrees, were Staff, DPA, three Class A water utilities (*i.e.*, Artesian, Tidewater, and United Water); HBA/DE, Reybold, and Knollwood Development. Staff, DPA, and the water utilities support (or do not object to) the final Proposed Regulation and HBA/DE and Reybold object to the Proposed Regulation. For the following reasons, I recommend that the Commission deny HBA/DE's and Reybold's objections, find that the Proposed Regulation is just and reasonable, and therefore adopt the Proposed Regulation.

B. Statutory Authority for the Proposed Regulation

54. Under 26 **Del.C.** §209(a), the Commission may, after a hearing, fix "just and reasonable" standards, regulations, or practices to be followed by any public utility. By requiring water utilities to collect certain levels of CIAC, the Proposed Regulation is fixing a standard or practice to be followed by a public utility. In general, therefore, the Commission is authorized to adopt the Proposed Regulation, as long as it is "just and reasonable." HBA/DE and Reybold argue, however, that the Commission does not have the authority to adopt the Proposed Regulation because

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1. Competition for service territory, and the resulting lower cost of water service to the landowner (in the form of lower, negotiated CIAC), was the subject of an August 21, 2005 *News Journal* article that HBA/DE attached to its brief. In addition, Ms. McDowell touched on this dynamic when she referenced a developer's ability to negotiate CIAC with two utilities at once. (TR. 473.) Also, see Blenheim's recommendation, in its June 21, 2005 letter, that it be permitted to receive proposals for water service agreements from both Artesian and Tidewater in order to lower its cost for water service infrastructure.

2. For non residential services, the utilities must file, within 120 days, proposed tariff pages containing the charges it will impose for Category 2 costs. Such charges shall be determined based on meter size or another objective factor. Section 3.8.2.

it contradicts other statutory provisions governing Commission regulation of public utilities. (HBA/DE Br. at 12-19; Reybold Br. at 8-9.)

55. 26 **Del.C.** §§102(3)(c) and (e)**.** HBA/DE argues that because the Proposed Regulation eliminates refundable advances, it improperly alters §102(3), which references refunded and non-refunded customer advances in its definition of "rate base." (HBA/DE at 13-14.)[1] That section, however, creates no developer entitlement to refunds of CIAC; it only acknowledges the existence of refunded and unrefunded contributions and provides the appropriate ratemaking treatment thereof. By simply providing the ratemaking treatment for different types of contributions, the statute reflects no policy favoring allowance of refunds, and any limitation on such refunds therefore violates no statutory requirement.

56. To support its argument, HBA/DE cites *In re* DNREC, 401 A.2d 93, 95 (Del. Super. 1978) for the proposition that an agency cannot eliminate something that is permitted by its enabling statute. (HBA/DE Br. at 12.) In that case, however, the applicable statute obligated DNREC to consider permit applications for activities affecting wetlands, and the statute provided specific criteria for approval of such applications. DNREC then adopted a regulation that prohibited all wetlands activities, refusing to even consider permit applications. The Court struck down the regulation because, by denying all wetlands uses without applying the statutory criteria to each proposed use, such denials were "arbitrary and capricious." (*In re DNREC*, at 95-96.) In this case, the Commission is under no specific statutory obligation to consider requests to use refundable advances instead of CIAC to finance new construction, and no such obligation can be inferred generally from the statute's delineation of the ratemaking treatment for refundable advances versus CIAC, under §102(3). The *DNREC* case, therefore, does not apply in this instance.

57. Furthermore, the proposed regulation in this case does not eliminate advances and the §102(3) definitions, therefore, continue to have effect. First, as noted by DPA, Class A water utilities in Delaware carry millions of dollars of advances on their books, and §102(3) will continue to apply to the ratemaking treatment of such advances. (DPA RB at 5.) Second, the Proposed Regulation allows for the use of refundable advances to finance new services (as opposed to facilities extensions), which will continue to receive ratemaking treatment in accordance with §102(3). Third, those non-Class A water utilities that are not governed by the Proposed Regulation may continue to refund advances, even for facilities extensions, if they so choose. Section 102(3), therefore, continues to have effect in numerous instances and, as such, HBA/DE's contention that the Proposed Regulation runs contrary to §102(3) should be rejected.

58. 26 **Del.C.** §§203C(e)(3) and 403(b)**.** Next, HBA/DE argues that the Proposed Regulation is "out of harmony with the new CPCN statute, §§[203C(e)(3)] and 403(b), which together require the water company to establish and certify their ability to supply new customers with water at the house and at the pressure of at least 25 pounds." (HBA/DE Br. at 16.) According to HBA/DE, this provision is inconsistent with "transferring all costs away from the utility that has by its own volition obtained a monopoly over the site." I agree with DPA and Staff, however, that these sections have no bearing whatsoever on the Commission's authority to adopt the Proposed Regulation. (Staff RB at 7-8; DPA RB at 6-7.)

59. First, the requirement that a utility be able to supply water to new customers at a certain pressure says nothing about how the utility funds the incremental infrastructure required to serve the customers. After all, no one argues that the current CIAC regulation, under which utilities have been requiring some level of contribution, violates the CPCN statute. In fact, United Water already requires 100 percent of its direct costs, up-front and nonrefundable, for its projects. (Ex. 9 (Trushell) at 2-3.) The Proposed Regulation simply standardizes, across utilities, the CIAC calculation and ensures that adequate amounts are collected. As noted by Staff, if HBA/DE's reading of the CPCN statute were correct, then builders could simply demand installation of water service infrastructure at the sole expense of the utility. (Staff RB at 7.) Second, the Proposed Regulation does not transfer "all costs away from the utility." It is undisputed in the record that the $1,500 charge will not cover the actual Category 2 costs expended, over time, for each new customer. (Staff RB at 8.)

60. 26 **Del.C.** §§314 and 1307**.** Next, HBA/DE argues that the "attempt in the [Proposed Regulation] to bar rate base growth is 'out of harmony' with" §314 (creating the DSIC rate)[2] and §1307 (relating to Water Supply Coordinating Council ("WSSC") projects).[3] (HBA/DE Br. at 16-17; see also Reybold Br. at 8-9.) According to HBA/DE, because these statutory provisions authorize rate increases (by way of rate base growth) for certain types of

1. HBA/DE made this argument, and the argument relating to §302 below, in its February 4, 2005 Motion to Dismiss, which I addressed in my March 22, 2005 denial of the Motion.

capital improvements, any Commission action intended limit rate increases (by limiting rate base growth), must violate public policy. The Proposed Regulation, however, is not intended to limit rate increases, although that likely will be one of the positive consequences. It is intended to effect a more equitable allocation of expansion costs between existing ratepayers and the developers that are causing expansion to occur. The public policy invoked in this proceeding, therefore, is not "low rates." It is "just and reasonable" rates, which *is* the stated policy of the legislature. (26 **Del.C.** §§303, 309, 311.)

61. 26 **Del.C.** §302. Next, HBA/DE argues that §302, "presents legislative policies and principles contrary to the principles that underlie" the Proposed Regulation. (HBA/DE Br. at 17; see also, Reybold Br. at 8.) Section 302 requires that the Commission include as rate base, in a rate case, all utility facilities that serve existing customers or customers "reasonably anticipated to be added" within three years, without imputation of revenues. According to HBA/DE, by permitting rate base inclusion of unused infrastructure, the legislature established a policy of rate base treatment of new facilities, which the Proposed Regulation thwarts. HBA/DE argues that the Proposed Regulation "makes impossible the operation of §302 because of its requirement of CIAC treatment in every instance," which is an improper interference with the utility/developer relationship. (HBA/DE Br. at 18.)

62. I agree with Staff and DPA, however, that the determination of rate base and imputation of revenues in a rate case, under §302, in no way affects whether the Commission can require a water utility to charge a CIAC for new construction. (Staff RB at 4-5; DPA RB at 7-8.) While §302 may have the effect of burdening ratepayers, rather than shareholders, with a portion of the cost of new construction, it does not prevent the Commission from reasonably allocating a portion of the cost of new construction to developers rather than existing customers. The Proposed Regulation and §302 involve, therefore, two different sets of competing interests.

63. In other ords, that Class A utilities will no longer need to invoke §302 in rate cases, under the Proposed Regulation, does not mean that the Proposed Regulation contradicts the policy behind §302. In enacting §302, the legislature was protecting utility shareholders from losing their return on new infrastructure that the Commission might have excluded from rate base because it was not yet being used for utility service. Under the Proposed Regulation, however, utility shareholders remain protected. The Proposed Regulation merely adds protection for existing ratepayers from subsidizing system expansion. Furthermore, §302 will remain effective in rate cases involving non-Class A water utilities. For these reasons, § 302 has no impact on the Commission's authority to adopt the Proposed Regulation.

64. 26 **Del.C.** §512**.** Next, HBA/DE argues that the Commission's "attempt to eliminate negotiations between the utility and the developer, is plainly inconsistent and out of harmony with the encouragement of negotiations to resolve [Commission] matters found in 26 **Del.C.** §512." (HBA/DE Br. at 19.) Section 512 directs the Commission to encourage the resolution of matters brought before it through the use of settlements and authorizes the Commission to adopt such settlements, as long as they are found to be in the public interest. Section 512, however, relates to matters brought before the Commission, not to the private negotiations between developers and water utilities. (Staff RB at 9; DPA RB at 9.) Section 512, therefore, has no bearing on the Commission's authority to adopt the Proposed Regulation.

65. In fact, the policy underlying §512 actually supports the Commission's adoption of the Proposed Regulation. As noted by DPA, §512 allows the Commission to avoid expensive and lengthy litigation, by permitting resolutions by settlement. (DPA RB at 8-9.) Similarly, § 314, which permits rate increases for DSIC improvements without going through a rate case, serves to avoid expensive and lengthy litigation. The Proposed Regulation, which is expected to reduce the number of rate cases filed by the high-growth Class A water utilities, follows this principle.

C. The $1,500 Flat Fee for Indirect Costs

66. HBA/DE argues that the $1,500 fee in the Proposed Regulation for recovery of Category 2 costs is improper. (HBA/DE Br. at 20-23.) According to HBA/DE, by paying for costs not directly assignable to a specific project, the developer is subsidizing all other customers, in addition to the utility stockholders. HBA/DE also argues that the provision in the Proposed Regulation that allows for deferred accounting of the $1,500 fee, to be used for *any* capital improvements, shows that the $1,500 will be over-compensate the utility for actual Category 2 costs attributable to the developer. (*Id* at 21-22.) As possible solutions, HBA/DE recommends, among other things, that: (1) the $1,500

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2. The DSIC ("distribution system improvement charge") statute allows water utilities to recover DSIC costs without incurring the expense of a rate case. DSIC costs relate to improvements to the utility's distribution system that do not increase revenues but which are eligible for rate base treatment. (Staff RB at 5, *citing* § 314(4)a and b.)

3. Section 1307, which relates to drought relief, allows water utilities to recover the cost of twater supply enhancement projects identified by the WSCC as being necessary to assure adequate water supplies for Delawareans. (Staff RB at 6.)

fee not be imposed by a utility that does not have Category 2 costs against which to record the fee and (2) the accounting deferral period be limited to some set period (e.g., three years), after which the fee is returned to the developer.

67. First, just because a cost is not directly assignable to a specific project, does not mean that the cost was not caused by the project. If a utility employs transmission, supply and treatment plant that serves numerous subdivisions, and additions or upgrades to that plant are required, in part, to serve additional subdivisions, then it is appropriate to allocate a portion of those costs to the developers, just as costs directly assignable to a specific project are allocated to the developers.[1] After all, not all common capital costs will be recovered by the $1,500 fee and those that are not recovered will be funded by the utility and added to rate base. (Tr. (Spacht) at 426, 442, 444.) In other words, the $1,500 fee was not sized to recover all common capital costs, only those attributable to system expansion. As specified in Section 3.8.2, the fee recovers from developers "*their portion* of transmission, supply, treatment and/ or other utility plant costs made available by the water utility." (Emphasis added.)

68. Second, the deferral of accounting of the $1,500, until the funds are actually used, was added in response to United Water's concerns that it may not incur Category 2 costs contemporaneous with the construction of new facilities, and it did not want to be faced with decreasing its rate base. (Tr. (Trushell) 564; Tr. (McDowell) 496, on cross-examination by counsel for United Water.) Even if the accounting is deferred, however, the fees will eventually be used for Category 2 costs, which are driven largely by system expansion. Moreover, it is unknown whether, in practice, deferred accounting will be used to any significant degree. After all, since 2003, none of the Class A utilities studied has incurred less than $1,500 per new customer, on an annual basis, for Category 2 costs.[2] And since the Proposed Regulation includes a mandatory reopening of this docket after two years, the amount of the fee can be modified in the unlikely event that actual Category 2 costs fall below $1,500 per new customer.

69. HBA/DE also warns that the provision under which the utility, rather than the developer, will pay for Category 1B costs (off-site direct costs) that constitute "company betterment" "promises to be a battlefield." (HBA/ DE Br. at 20.) No other party, however, expressed any concern that the "company betterment" clause would lead to a significant number of disputes. Even if it does, however, the "company betterment" provision, like any other, will be subject to clarification or revision upon the mandatory reopening of the docket in two years. In the meantime, parties may contact Commission Staff for prompt assistance in resolving a dispute or a party may file a complaint with the Commission for formal adjudication. (Ex. 4 (McDowell) at 2-3.)

70. HBA/DE also notes that while Section 3.8.8 of the Proposed Regulation calls for true-up of the Category 1 CIAC charge, Section 3.8.2 defines Category 2 CIAC to include those Category 1 costs that have not been collected under the Category 1 charge. (HBA/DE Br. at 20.) If the costs are trued-up, however, then there should be no need to include any un-collected costs in another category. The Section 3.8.2 clause including un-collected Category 1 costs, therefore, appears to be unnecessary. I do not, however, find this minor discrepancy, if it is one, to warrant rejection the Proposed Regulation. In practice, as long as the Section 3.8.2 true-up takes place, Category 2 costs will exclude all Category 1 costs anyway.

71. In its brief, Reybold argues that the proposed $1,500 fee is unjustly discriminatory, because it applies to customers who purchase a new home and it does not apply to customers who purchase an existing home. (Reybold Br. at 6, 7.) As argued by DPA, however, the fee is charged to developers, not homebuyers, and it is applied equally to all developers. (DPA RB at 14-15.) The fee, therefore, is not discriminatory. Whether or not the builder raises the price of the home in an amount equal to the fee does not alter this conclusion. Even if the fee is considered a charge to new water service customers, however, the utility does not charge buyers of existing homes the $1,500 because the costs that the fee are designed to recover are the costs associated with adding new infrastructure, and no new infrastructure is added for an existing home. Under either perspective, therefore, the charge is not unjustly discriminatory.

72. Moreover, it would be impossible to determine the "perfect" allocation of common capital costs between new and existing customers. As such, while the $1,500 fee is not perfect, it more accurately (and therefore more fairly) allocates the cost of system expansion to those who cause system expansion in comparison to the current

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1. As Mr. Cotton put it, the $1,500 flat fee "looks at system needs rather than subdivision needs." (Ex. 6 at 12.)

2. For 2003 and 3004, Artesian has paid $3,241 and $6,082 per customer, United Water has paid $1,574 and $1,637 per customer, and Tidewater has paid $1,861 and $1,836 per customer. (Ex. 3 at "Exhibit 1.") These figures do not include transmission costs, so total Category 2 costs would be higher.

regulation. In so doing, the fee simply lessens the substantial burden placed on Artesian's and Tidewater's existing ratepayers who, under the current CIAC regulation, have been subsidizing new development for years. According to Staff, DPA, and Artesian, $1,500 is a conservative figure, in that a higher amount would be justifiable based on the actual incremental costs of system expansion. (Staff RB at 8; DPA RB at 13; Tr. (Spacht) 426.)

D. Conclusion

73. Under 26 **Del.C.** §209(a), the Commission has the authority and jurisdiction to fix "just and reasonable" regulations governing any public utility. The Proposed Regulation is "just" because it lessens the subsidy that flows from existing ratepayers to developers under the current regulation and because it promotes equal treatment by all Class A utilities for all builders and developers. The Proposed Regulation is "reasonable" because for Category 1 costs, it requires collection of only the actual, direct costs of a specific project (subject to true-up) and, for Category 2 costs, it requires a flat $1,500 fee, which reflects the low end of the range of Category 2 costs historically incurred by the Class A utilities per new customer added. The Proposed Regulation is also reasonable in that it likely will reduce the number of rate cases, thereby avoiding substantial litigation costs, which are borne by the ratepayers and which do not add value to the water service provided.

74. For all of the above reasons, I recommend that the Commission adopt, as just and reasonable, Staff's proposed regulation, as seen in Attachment "A" hereto.

Respectfully submitted,
William F. O'Brien, Senior Hearing Examiner
Dated: November 18, 2005

STAFF'S OPENING BRIEF – EXHIBIT C
STAFF'S 7/25/2005 PROPOSAL

"CLEAN" VERSION OF PROPOSED REGULATIONS

1.3.12 CONTRIBUTION IN-AID-OF CONSTRUCTION ("CIAC")

Cash, services, funds, property or other value received from State, municipal, or other governmental agencies, individuals, contractors, or others for the purpose of constructing or aiding in the construction of utility plant and which represent a permanent infusion of capital from sources other than utility bondholders or stockholders.

1.3.13 ADVANCES FOR CONSTRUCTION OF SERVICES ("ADVANCES")

Cash, services, funds, property or other value received by the utility which would be CIAC but for an agreement by the utility to refund in whole or in part the amount received so that the Advances initially represent a temporary infusion of capital from sources other than utility bondholders or stockholders.

1.3.14 FACILITIES EXTENSION

"Facilities Extension" means the extension of the water utility's Mains and appurtenances ("Facilities") for the provision of water service. As used in this definition, "appurtenances" include valves, hydrants, pumps, sampling equipment and other miscellaneous items appurtenant to a Main extension.

1.3.15 NEW SERVICES

"New Services" means the extension of pipe from the water utility's Mains to the customer's premises.

3.8 CONTRIBUTIONS IN-AID-OF CONSTRUCTION AND ADVANCES

A utility shall require CIAC for Facilities Extensions to the extent provided in §§3.8.1 and 3.8.2 herein below. Nothing contained herein shall prevent a utility from requiring CIAC, or Advances, or neither, for the provision of New Services. Nothing herein shall prevent any utility from paying for, and including in its rate base, the costs of New Services.

3.8.1 CIAC REQUIREMENT FOR FACILITIES EXTENSIONS

A utility shall require a CIAC when the request for a Facilities Extension will require the installation of pipe and/or associated utility plant. All charges henceforth to contractors, builders, developers, municipalities, homeowners, or other project sponsors, seeking the construction of water Facilities from a water utility company shall be in the form of a CIAC to be paid to the water utility as Category 1A, 1B and Category 2 costs, as computed under §§3.8.2 and 3.8.6, subject to true-up under §3.8.8.

3.8.2 COMPUTATION OF CIAC

Category 1A Costs.

All on-site Facilities costs that are directly assignable to a specific project are Category 1A costs and shall be designated by the utility and paid for by the contractor, builder, developer, municipality, homeowner, or other project sponsor, as CIAC, with no refunds. These costs include such items as Mains, hydrants, treatment plants, wells, pump stations, storage facilities, and shall include any other items that are necessary for the provision of utility water service. The cost of a Facilities Extension from the furthest point of the project site up to a point 100 feet beyond the boundary of the project (in the direction of the utility's existing Main) shall be considered a Category 1A Cost.

Category 1B Costs.

All off-site Facilities costs that are directly assignable to a specific project from such point 100 feet beyond the boundary of the project and continuing to the utility's existing Main are Category 1B Costs and shall be designated by the utility and funded by the contractor, builder, developer, municipality, homeowner, or other project sponsor, as a CIAC not subject to refund. These costs include such items as Mains, hydrants, treatment plants, wells, pump stations, storage facilities, and shall include any other items that are necessary for the provision of utility water service. Notwithstanding the foregoing, Category 1B Costs shall not include, and the utility shall be entitled to pay for and include in its rate base, any additional Facilities costs elected to be incurred by the utility in connection with the Facilities Extension for company betterment. In determining whether Category 1B Costs are directly assignable to a project, or elected as company betterment, the CIAC shall be calculated based on the cost of installing Mains using a minimum of 8 inch diameter pipe, *provided, however,* that where Mains of a larger diameter are required by applicable laws, building or fire codes, or engineering standards to provide water service to the project on a stand-alone basis, the CIAC shall be calculated based on the cost of installing Mains using such larger diameter pipe.

Category 2 Costs.

Category 2 Costs refer to transmission, supply, treatment and/or other utility, plant costs that are not directly assignable to a specific project or where the Category 1 costs have not included sufficient direct costs for transmission, supply, treatment, and/or other utility plant costs to supply water to the project. The contractor, builder, developer, municipality, homeowner or other project sponsor shall pay $1,500 per single family residential water meter service for their portion of transmission, supply, treatment and/or other utility plant costs made available by the water utility. These costs will be contributed by the contractor, builder, developer, municipality, homeowner, or other project sponsor, as CIAC, with no refunds. Within one hundred and twenty (120) days following the effective date of these regulations, each water utility shall file with the Commission proposed tariff pages containing the charges it will impose for Category 2 costs for single family residential and other types of metered water service. Such charges shall be determined based on meter size or another objective factor. The utility may account for such amounts by applying such amounts to pay for or offset any capital costs, including new and/or replacement plant, whether incurred in connection with the project or otherwise. The utility shall be entitled to hold amounts received as Category 2 Costs, and defer accounting for them as CIAC, until such amounts are actually used to fund capital improvements, at which time the utility shall be entitled to account for the Category 2 Costs as CIAC to the extent it is able to make offsetting entries to the utility's plant accounts.

3.8.3 ADVANCES

An Advance may consist of the following components:

1. An amount equal to the entire estimated cost (including reasonable overhead costs) of construction; plus
2. Any applicable Federal income taxes, and applicable State taxes, that may be generated to the account of the utility as a result of the Advance.

3.8.4 REFUNDS OF ADVANCES

By April 30th of each year, the utility will refund a portion of the Advance representing each additional customer connected during the previous calendar year based on a standard formula developed by the utility (the "net refund amount") plus the tax savings, if any, which the utility receives from deducting the Advance refund payment (the sum of which is referred to as the "gross refund amount"). In no event shall the total amount refunded by a utility (the sum of the gross refund amounts) exceed the amount received by such utility as an Advance (as finally determined by the utility after compliance with Rule 3.8.8). At the end of the negotiated refund period, no further refunds or payments will be made. If, at the end of such refund period, an Advance has not been fully refunded, the remaining un-refunded Advance will be considered a CIAC and will be treated for accounting and ratemaking purposes as a CIAC. The utility and the person(s) making the Advance shall determine the period in which the refund of the Advance may occur, but such period shall not exceed five (5) years.

3.8.5 RATEMAKING TREATMENT OF ADVANCES

An Advance will be considered as a non-taxable transaction for ratemaking purposes since the income taxes, if required, will be provided by the person(s) making the Advance.

3.8.6 GROSS UP OF CIAC

A CIAC will consist of an amount equal to the entire estimated cost, including the utility's standard overhead costs, of constructing the Facilities Extension. If any portion of property contributed by the contractor, builder, developer, municipality, homeowner, or other project sponsor is deemed taxable income to the utility, the utility shall be permitted to gross up the amount of the CIAC to include such tax liability.

3.8.7 RATEMAKING TREATMENT OF CIAC

The Federal and State income taxes, if required, associated with the CIAC and paid by the utility receiving the CIAC, may be added to rate base, at which time the utility will have an opportunity to earn a fair return on this amount.

3.88 TRUE-UP OF CONTRIBUTIONS AND ADVANCES

Where the estimated amount of the CIAC or Advance exceeds the finally determined cost of the Facilities Extension or New Services, that excess amount shall be returned to the person making the CIAC or Advance.

Where the estimated amount of the CIAC or Advance falls short of the finally determined cost of the Facilities Extension or New Services, that shortage amount shall be paid to the utility by the person making the CIAC or Advance.

3.8.9 MISCELLANEOUS; CLASS A WATER UTILITIES AFFECTED; PROSPECTIVE APPLICATION; REOPENING OF DOCKET

The regulations governing CIAC and Advances shall:

1. apply only to Class A Water Utilities, and
2. apply prospectively and therefore shall not affect or apply to circumstances where the water utility has already entered into a water service agreement with the contractor, builder, developer, municipality, homeowner, or other person, regarding the construction of water facilities.

PSC Regulation Docket 15 shall be reopened two years from the effective date of the revised regulations governing CIAC and Advances to review the extension methodology and to assess its effectiveness, and the CIAC computation and costs categories. After such review and assessment, the Commission may, if deemed appropriate, consider further modifications.