

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio)
American Water Company to Increase its) Case No. 06-433-WS-AIR
Rates for Water and Sewer Services Provided)
to its Entire Service Area.)

OPINION AND ORDER

The Commission, coming now to consider the above-entitled application, hereby issues its opinion and order.

APPEARANCES

Bricker & Eckler, by Sally W. Bloomfield and Thomas J. O'Brien, 100 South Third Street, Columbus, Ohio 43215, on behalf of Ohio American Water Company.

McNees, Wallace & Nurick, by Lisa McAlister, Samuel C. Randazzo, Gretchen J. Hummel, and Daniel J. Neilsen, 21 East State Street, Columbus, Ohio 43215-4228, on behalf of the cities of Tiffin and Marion

Janine L. Migden-Ostrander, Ohio Consumers' Counsel, by Maureen Grady and Melissa Yost, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215, on behalf of the residential customers of Ohio American Water Company.

Marc Dann, Attorney General of the State of Ohio, by Duane W. Luckey, Senior Deputy Attorney General, Thomas G. Lindgren, and Steven L. Beeler, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of the staff of the Public Utilities Commission of Ohio.

Eckhart Law Offices, by Henry W. Eckhart, 50 West Broad Street, Suite 2117, Columbus, Ohio 43215, on behalf of Dragoo Management Company.

I. History of the Proceedings

Ohio American Water Company (Ohio American, company, or applicant) is an Ohio corporation and a public utility, engaged in the business of supplying water and wastewater service to consumers within the state of Ohio. The applicant was first incorporated in 1923 as the Marion Water Company, and subsequently formed by the merger of the Marion Water Company with Ashtabula Water Works Company, Lawrence County Water Company, and the Ohio Cities Water Company in Tiffin. In 2002, Ohio American added customers in Franklin and Portage counties through the purchase of the

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assets of Citizens Utilities Company of Ohio. The applicant is a subsidiary of the American Water Works Company (AWW), headquartered in Voorhees, New Jersey. Administrative, legal, engineering, and other back-office functions are provided by a related affiliate, American Water Works Service Company, Inc., through its central region office in St. Louis, Missouri. In January 2003, AWW was acquired by RWE AG, one of the world's largest utility groups headquartered in Essen, Germany (Co. Ex. 1, at Schedule S-4.1, 3-5; Staff Ex. 1 at 1, 18, 92-93).

Ohio American's service territory consists of six districts: Ashtabula, Lawrence, Franklin, Marion, Portage, and Tiffin. These districts are broken down into three divisions. The "Water A" division includes the Ashtabula, Lawrence County, Marion, and Tiffin districts. The "Water C" division is comprised of Portage County and the water operations in the Franklin County district. The "wastewater" division includes only wastewater operations in Franklin County. The applicant's operations served approximately 57,917 customers throughout Ohio, as of December 1, 2005 (Co. Ex. 1, at Schedule S-4.1, 3-5, 10; Staff Ex. 1, at 93).

Ohio American owns and operates 17 water systems and three wastewater systems across its districts. The company operates its own water treatment facilities, except in Lawrence County and a portion of Marion County. The Lawrence County district purchases all of its water from the Huntington Water Company, a West Virginia subsidiary of AWW. The Preble County portion of the Marion district purchases all of its water from the Richmond district of Indiana American Water Company, a subsidiary of AWW (Co. Ex. 1, at Schedule S-4.1, 3-5; Staff Ex. 1, at 1, 93).

On March 17, 2006, Ohio American filed a notice of intent to file an application for an increase in rates for water and sewer service to customers in its entire service area. The company also filed a motion to waive the requirement to file certain rate of return data, a supplemental five-year forecast, and testimony relating to rate of return. By entry of April 5, 2006, the Commission granted the company's request for waivers, and approved the requested test period of July 1, 2005 through June 30, 2006, and the date certain of December 31, 2005.

The application to increase rates, along with the standard filing requirements, was filed by Ohio American on April 17, 2006, and supplemented on May 18, 2006. The office of the Ohio Consumers' Counsel (OCC), Dragoo & Associates, Inc. aka Dragoo Management, Inc. (Dragoo), and the cities of Tiffin and Marion filed motions to intervene in the case on April 19, 2006, April 28, 2006, and June 21, 2006, respectively. By its entry issued May 16, 2006, the Commission granted the motions to intervene, accepted the application for filing as of April 17, 2006, and ordered the applicant to publish notice of the application pursuant to Section 4909.19, Revised Code. On June 27, 2006, Ohio American filed proofs of publication.

Pursuant to Section 4909.19, Revised Code, staff conducted an investigation of the application and filed its report of investigation (staff report, Staff Ex. 1) on September 25, 2006. Objections to the staff report were filed by Ohio American, OCC, Dragoo, and the cities of Tiffin and Marion on October 25, 2006.

Ohio American's current rates and charges were established on February 23, 2005, in Case No. 03-2390-WS-AIR. The applicant's proposed rates in this proceeding, when applied to the total adjusted test year sales volume, would generate additional revenue of approximately \$4,214,864 for Water A, \$758,146 for Water C, and \$157,748 for wastewater, an increase of approximately 17.93 percent, 21.53 percent, and 5.05 percent over current revenues, respectively. The staff report recommended revenue increases for Water A of between \$2,583,609 and \$2,912,143 (or 10.93 to 12.32 percent); for Water C of between \$689,075 and \$730,758 (or 19.44 to 20.62 percent); and for wastewater of \$157,748 (or 5.03 percent). (Staff Ex. 1, at 2.)

By entry issued November 7, 2005, local public hearings were scheduled for November 27 in Galloway, Ohio; November 28 in Marion, Ohio; November 29 in Tiffin, Ohio; and December 5, 2006 in Westerville, Ohio; and the evidentiary hearing was set for December 11, 2006, at the Commission. At the request of the OCC and a local official, a fifth local hearing was scheduled for December 6, 2006 in Ravenna, Ohio, but subsequently postponed due to severe weather until January 8, 2007. Proofs of publication of the notices of these hearings were filed on February 22, 2007.

On December 11, 2006, the evidentiary hearing was recessed at the request of the parties and subsequently continued to January 8, 2007, at which time the parties were granted additional time to reach a settlement. On January 10, 2007, the hearing reconvened and the parties presented a stipulation and recommendation (stipulation) signed by Ohio American, OCC, Dragoo, and the staff. The cities of Tiffin and Marion are not signatories to the stipulation but do not oppose its adoption by this Commission. The company presented four witnesses in support of the stipulation.

II. Local Hearings

The local hearings in Galloway and Westerville were particularly well-attended with 21 witnesses testifying in Galloway and an additional 27 in Westerville. Both hearings focused on water quality issues and what Ohio American customers testified were the relatively high rates compared with their rates for municipal services. Customers indicated that they were concerned about additional rate hikes particularly in light of company's increase from its last rate case in 2005, and the impact on these service areas that are populated by low-to-moderate and fixed-income families. They expressed worries that they will not be able to sell their homes because their water and sewer rates were much higher than in surrounding areas.

The major complaint at both hearings was, however, the poor quality of water provided by the company. Virtually all of these witnesses complained about the relatively high rates which they are already paying for their water and that it is of such poor quality, that it can not be used for cooking, cleaning, washing, bathing, or drinking. Many of the attendees to the hearings brought samples of brown water and filters showing discoloration and deposits, and most witnesses testified that the water is undrinkable and expressed skepticism that the company is appropriately softening the water given their need to repeatedly and prematurely replace water heaters, dishwashers, shower heads, faucets, coffee pots, and plumbing. Some testified that when they advised the company about their poor water quality, the company's response to their concerns was to advise the customers to run their water before use to clear it up which just adds to most witnesses indicated that this response only increased the cost of water service.

Other issues raised at the hearings included billing problems and meter inconsistencies with some customers having meters measuring water consumption in gallons and others in cubic feet. Other testimony raised problems regarding fire hydrant maintenance and surface restoration delays after repairs on both public rights of way and private land.

At the November 28 hearing in Marion, 20 people testified regarding a variety of concerns, including the relatively high level of their current rates. Many witnesses were concerned about the impact of even higher water rates on low- and fixed-income residents, and on the ability of the city to attract new businesses to the area. They also testified that the level of proposed rate increases were excessive, as compared with inflation levels, increases in other utility bills, and increases in tuition at educational institutions. Several witnesses also expressed a desire to understand the reason for the proposed increase and the factors upon which an increase might be determined. Many Marion witnesses also testified regarding the quality of the water, including such concerns as bad taste, bad smell, high levels of chemicals, water hardness, and substantial deposits occurring over time. As a result of quality concerns, many local residents stated that they must purchase drinking water from other sources.

At the November 29 hearing in Tiffin, two city officials voiced concerns about the impact of higher water rates on low- and fixed-income residents and local business development. They also cited incidents regarding surface delays in restoration after Ohio American repair work.

Nine witnesses appeared at the Ravenna hearing and voiced concerns about the impact of the proposed increase on customers and their community, as well as maintenance of fire hydrants and other facilities. Several witnesses complained that the bills were not reasonable and were inconsistent with their actual water usage. Some witnesses expressed

concern about Ohio American's foreign ownership and they claimed that the company was not responsive to customers or would not honor its commitments.

III. Commission Review and Discussion

This case comes before the Commission on the application of Ohio American. The application was filed pursuant to Section 4909.18, Revised Code, for authority to increase its rates and charges for water and sewage service. Section 4909.15(A), Revised Code, requires the Commission to determine (1) the valuation as of the date certain of the property of the public utility used and useful in rendering the services for which rates are to be fixed and determined, (2) a fair and reasonable rate of return to the utility on the valuation of the property used and useful in rendering the utility services, (3) the dollar annual return to which the utility is entitled by applying the fair and reasonable rate of return to the valuation of the property, and (4) the cost to the utility of rendering the services for the test period, less the total of any interest on cash or credit refunds paid. It is through this procedure, and based on these factors, that the Commission fixes and determines rates and charges.

According to the applicant, the current rates produce a rate of return of approximately 2.79 percent on its proposed rate base (Ohio American Ex. 1, at 3). The applicant states, in the application, that the present rates do not provide adequate compensation for water service furnished and do not provide a just a reasonable return on its property used and useful in furnishing water service.

A. Summary of the Stipulation

At the evidentiary hearing of January 10, 2007, the company submitted a stipulation which was joined by staff, OCC, and Dragoo. Although the cities of Tiffin and Marion did not join as signatories to the agreement, they do not oppose its adoption by this Commission. The stipulation purports to resolve all of the issues in this proceeding and is summarized, in part, below:

- (1) The agreed-upon value of the applicant's property used and useful in the rendition of water and wastewater services (rate base), on a company-wide basis, is \$58,133,116.
- (2) The applicant's total adjusted operating revenues for the test year are \$30,323,924, its total adjusted operating expenses are \$28,038,617, and its net operating income is \$2,285,307.
- (3) This net operating income of \$2,285,307 is insufficient to provide the applicant with reasonable compensation for service to its customers.

- (4) A just and reasonable increase in the revenue requirement is \$3,430,137.
- (5) Ohio American is entitled to an overall rate of return of 7.65 percent, reflecting a cost of long-term debt of 5.93 percent, a cost of preferred stock of 8.37 percent, and a return on equity of 10 percent.
- (6) Within three months of the issuance of the opinion in this case, the company agrees to correctly reflect plant additions and associated retirements, replacements, and transfers by plant location.

Stipulation at 3-4.

Abeyance Fund

To assure compliance with the agreement, Ohio American is required to establish an abeyance fund in the amount of \$50,000 which will be targeted to the company's performance in five categories: (1) unaccounted-for-water identification, reporting and reduction; (2) meter reading and change-out program; (3) valve maintenance and operation; (4) tank inspections, storage studies and replacements; and (5) hydrant flushing and painting. Categories 2-5 each carry a \$10,000 penalty that will be credited to all customers if the company fails comply with the stipulation. With respect to the unaccounted-for-water limitation of Category 1, the company, staff, and OCC will establish a process within 90 days of the issuance of this opinion for distribution of the penalty on behalf of Ohio American's low-income residential customers in the event the company fails to meet the 15 percent limit (Stipulation at 7-8). More specifically the categories provide:

- (1) The company will maintain no more than 15 percent unaccounted-for-water on a rolling 12-month basis and on a per system basis beginning December 31, 2006. Four districts (Huber Ridge, Blacklick, Madison and Marion) have specific timelines to meet the 15 percent limit or trip the penalty. Ohio American also agrees to adjust the test period chemical and power expense in the next rate case to reflect no more than 15 percent unaccounted-for water. The company will also provide quarterly reports to staff and OCC for each district and a remedial report for each affected district reflecting the action taken to date and the actions contemplated the next quarter.

- (2) Ohio American will complete its encoder meters installation program in the Marion district by January 1, 2007, Ashtabula district by January 1, 2008, and Franklin County district by December 31, 2008. Compliance will be deemed met when all encoder meters are installed except to the extent replacement is not technically feasible or where customers oppose meter replacement. Annual meter reads are required or any back billing of customers will be limited to 12 months. Annual meter and encoder data will be provided to staff by January 31 of the following year.
- (3) Ohio American will comply with valve inspection requirements throughout all service areas.
- (4) The company will complete its distribution and storage study of the Marion storage tank within six months of the issuance of this opinion, and report on alternative methods for maintaining the pressure during inspection of the Ashtabula Bunker Hill storage tank. Ohio American will also complete construction of a new Lake White storage tank by January 31, 2008.
- (5) The company will repaint each fire hydrant in the Ashtabula and Marion districts once every five years, or approximately 20 percent each year, and will flush all hydrants in accordance with Rule 4901:1-15-10(B)(4), O.A.C.

(*Id.* 8-11).

Huber Ridge

The stipulation contains a number of provisions designed to resolve the quality issues in the Huber Ridge system (*Id.* Paragraph 12, at 12-15). Ohio American agrees not to request rate relief for former Citizens Utilities Company customers in the "Water C" district in the form of an application to increase rates until the discoloration issue has been resolved (*Id.* 4).

By January 31, 2007, the company will report to staff, OCC, and the Ohio Environmental Protection Agency (OEPA) on the results of prechlorination efforts undertaken in the Huber Ridge system in late 2006. The company will also submit a plan for both the Huber Ridge Water Treatment Plant and distribution system. Remedial actions taken by Ohio American at the treatment plant will be deemed successful if 95 percent of all

samples evaluated at the tap are at or below the OEPA secondary standards for iron and manganese. The company will submit quarterly reports to staff, OCC, and OEPA until the 95 percent target has been achieved for 12 consecutive months. The plan will also include sampling of water quality in the Huber Ridge distribution system at least once per week at locations where there have been clusters of discolored water complaints. The company will implement the plan with OEPA concurrence by February 28, 2007 (*Id.* 12-13).

By March 31, 2007, Ohio American will complete a distribution model to develop a unidirectional flushing program. Hydrants will be flushed twice during 2007 concurrent with valve operation. Thereafter, the company will continue operating valves and performing unidirectional flushing at a minimum frequency as needed to properly flush out the Huber Ridge distribution system (*Id.* 12-13).

By April 30, 2007, Ohio American will complete and report to staff, OCC, and OEPA its evaluation of the internal status of the Huber Ridge pipes which will include removal and examination of five to six pipe sections. If by May 31, 2007, more than five percent of Huber Ridge Plant water samples analyzed the in previous quarter under the plan do not meet iron and manganese secondary standards, the company will report its evaluation of using chemical additives with the finished water for controlling water quality in the distribution system. If Ohio American provides a recommendation as to the use of a chemical addition, the company will apply for OEPA approval by June 30, 2007, and implement adding the chemical within 60 days of permit approval (*Id.* 14).

The standard for determining that discolored water has been eliminated shall be that each month the turbidity level of at least 95 percent of the samples taken from the distribution system (except the control sample) will be equal to one or less than the average nephelometric turbidity unit (NTU) or equal to or less than the average NTUs at the control site, whichever is greater. If discoloration continues in the Huber Ridge distribution system after June 30, 2007, the company will cease charging the reverse osmosis surcharge each month until the discoloration has been eliminated. The company may reinstate the reverse osmosis surcharge for any month the discoloration has been eliminated, but if discoloration returns within six months thereafter, the company will not collect the surcharge for that month. Once the company has provided water that is not discolored for six consecutive months, the company may continue to charge the reverse osmosis surcharge without reference to the discoloration standard (*Id.* 14-15).

By September 30, 2007, if more than five percent of the samples from the treatment plant do not meet the secondary standards, the company will meet with staff, OCC, and OEPA to evaluate additional remedies, including the use of alternative oxidants such as potassium permanganate, and changing filter media to green sand. When the discoloration has been eliminated in the Huber Ridge system, the company will send a letter to customers informing them of the elimination of the discoloration and suggesting procedures in the

event that they experience discoloration that may be caused by customer service lines or other customer-owned facilities or equipment (*Id.* 15).

Lake Darby

With respect to the Lake Darby Treatment Plant, Ohio American will, by January 15, 2007, install new flow meters to monitor the softening process and activate system recharge prior to hard water break-through, and install new electronic controllers for each water softener to accurately control the softening process based on demand. The company will also install a new system with 24/7 remote reporting and alarms for monitoring the treatment plant performance and mechanical operation systems.

In addition, Ohio American will implement control testing and process monitoring to consistently produce finished water softness with a daily average between 120 mg/l and 150 mg/l for 95 percent of the reported test results. Beginning May 1, 2007, if the company fails to meet this 95 percent target for finished water softness, the company will provide an aggregate credit of \$1,000 per month to be spread among the Lake Darby customers (*Id.* 15).

Other Service Area Commitments

In the Mansfield district, Ohio American will complete replacement of approximately 3,000 feet of main in the Harprest system, Apple Lane and McElroy projects by December 31, 2007. In the Marion district, Ohio American will replace the two slakers (2 gravimetric feeders, the lime bin hopper and grit elevators) by December 31, 2007. The company will also implement process control testing and monitoring to operate the water softening process within a control band of 120mg/l to 150 mg/l for at least 95 percent of the monthly softening reports. In the Ashtabula district, Ohio American will analyze the least cost options to renovate or construct a new Ashtabula treatment plant, and will meet with staff and OCC to discuss the reasons for selecting renovation or new construction and its financing plan (*Id.* 15-16).

Throughout its service territories, Ohio American has committed to repair service-affecting leaks within 24 hours of detection and non-service-affecting leaks within seven days of detection, unless it is beyond the control of the company to do so. The company will report to staff on leaks which can't be repaired within these parameters (*Id.* 17).

With respect to property restoration issues, Ohio American has committed to semi-annual meetings with the cities to review street repair project plans and identify opportunities for coordination with the cities' other activities. The company will provide detailed records of projects upon request of cities, and reasonably restore public and private property to its condition prior to repair. For repairs made between May 1 and September 30, the repair process will be completed within 45 days. For repairs made from October 1

through April 30, lawn restoration shall be completed by June 30. Road openings between May 1 and September 30 shall receive repair within 60 days. Following repair and until final road opening repair is completed, all road openings shall be completely filled and compacted with suitable material. If openings are found to be unsuitable, a city may give the company a 10-day notice that it will make repairs and require Ohio American to reimburse them (*Id.* 18-19).

The stipulation also contains specific provisions requiring the company to keep detailed records of all service and non-service affecting leaks, and to provide staff with access to monitor Ohio-specific customer calls. Within four months of the issuance of the opinion in this case, a working group of staff, OCC, OEPA, and the company shall convene to analyze and discuss the efficacy and cost efficiency of Ohio American's application for either the Ohio Water Supply Revolving Loan or the Disadvantaged Community Loan Program (*Id.* 20).

B. Rate Base

The following schedules present, in summary form for each division of the applicant, the stipulated determination of the value of the applicant's property used and useful in the rendition of water service, as of the date certain December 31, 2005 (Staff Ex. 1 at Schs. A-1, B-1):

	<u>Water A</u>	<u>Water C</u>	<u>Wastewater</u>	<u>Total</u>
Plant in service	\$82,981,854	\$13,016,061	\$13,473,575	\$109,471,490
Less: Depreciation reserve	<u>(28,783,951)</u>	<u>(4,866,899)</u>	<u>(4,899,007)</u>	<u>(38,549,857)</u>
Net plant in service	\$54,197,903	\$8,149,162	\$8,574,568	\$70,921,633
Plus: CWIP	0	0	0	0
Working capital	0	0	0	0
Less: Other rate base items	<u>(6,838,278)</u>	<u>(2,667,778)</u>	<u>(3,282,461)</u>	<u>(12,788,517)</u>
Jurisdictional rate base	\$47,359,625	\$5,481,384	\$5,292,107	\$58,133,116

The Commission finds the jurisdictional rate base, as stipulated by the parties, to be reasonable and supported by the law and the record and, therefore, adopts the valuation of \$58,133,116 for the jurisdictional rate base for the total company, for purposes of these proceedings.

C. Operating Income

The following table reflects the stipulated adjusted operating income for each division for the 12 months ending June 30, 2006 (Staff Ex. 1, Sch. C-1):

	<u>Water A</u>	<u>Water C</u>	<u>Wastewater</u>	<u>Total</u>
Operating revenues	\$23,643,884	\$3,544,192	\$3,135,848	\$30,323,924
Operating expenses				

Operation & maintenance	\$13,845,910	\$2,254,247	\$1,582,167	\$17,682,324
Depreciation & amortization	2,798,091	280,729	277,605	3,356,425
Taxes, other than inc.	4,727,850	944,900	959,365	6,632,115
Federal income taxes	<u>361,253</u>	<u>(40,662)</u>	<u>47,164</u>	<u>367,755</u>
Total operating expenses	\$21,733,103	\$3,439,214	\$2,866,300	\$28,038,617
Net operating income	\$1,910,781	\$104,978	\$269,548	\$2,285,307

The Commission finds the determination of the applicant's revenues, allowable expenses, and net operating income, as stipulated by the parties, to be reasonable, proper and supported by the law and the record. Therefore, the Commission will adopt these figures for purposes of these proceedings.

D. Rate of Return and Authorized Increase

A comparison of adjusted test year operating revenue for the company as a whole, of \$30,323,924, with allowable adjusted test year expenses of \$28,038,617, indicates that the applicant, under its present rates, would have realized net operating income of \$2,285,307. Applying this figure to the rate base, the applicant would have earned a rate of return of 3.93 percent during the test year. Such a rate of return is insufficient to provide the applicant with reasonable compensation for its water and wastewater services and is below the rate of return recommended by staff in the staff report, of 7.41 percent to 7.84 percent. The parties have stipulated that a fair and reasonable rate of return in this case is not more than 7.65 percent (Stipulation at Ex. 3). The Commission believes that the stipulated rate of return is reasonable and will adopt it. However, the Commission also recognizes the substantial body of service quality testimony from customers of the applicant. The Commission is therefore putting the applicant on notice that if water quality and service issues do not improve by the time of the next rate case, we will take this into account in determining the appropriate rate of return.

The parties have agreed that the applicant should be authorized to increase its company-wide revenues. The agreed-upon increase is comprised of increases of \$2,765,398 for Water A (which is an increase of 11.7 percent), \$506,991 for Water C (which is an increase of 14.3 percent), and \$157,748 for wastewater (which is an increase of 5.03 percent). The company-wide increase totals \$3,430,137, for an increase of 11.31 percent in revenues over the current annual operating revenues. Adding the stipulated increase of \$3,430,137 to the current adjusted test year revenues of \$30,323,924 produces a new pro forma revenue total of \$33,754,061. A comparison of the pro forma revenues of \$33,754,061 with the total allowable test year expenses, adjusted to include taxes and uncollectible expense associated with the increased revenues, of \$29,344,067 indicates that the applicant would realize net operating income of \$4,409,994. The application of the net operating income to the rate base of \$58,133,116 results in a rate of return of 7.59 percent, which is not more than the agreed upon rate of return. (Staff Exhibit 1, at updated Schs. A-1, B-1, C-2.)

The Commission finds the stipulated increase of \$3,430,137 to be fair, reasonable, and supported by the law and the record and will, therefore, adopt it for purposes of these proceedings.

E. Rates and Tariffs

As part of its investigation in this matter, the staff reviewed the applicant's various rates and charges, and the provisions governing terms and conditions of service. Attached to the stipulation are proposed tariffs that would produce revenues authorized by this order and proposed customer notices which are in conformance with the changes agreed to by staff and the parties to the stipulation (Stipulation para. 21 at 20-21). The Commission finds the tariff sheets and proposed customer notices attached to the stipulation to be reasonable and they will be approved as part of the stipulation.

F. Review of the Stipulation

The stipulation submitted on January 10, 2007 is unopposed. Rule 4901-1-30, Ohio Administrative Code, authorizes parties to Commission proceedings to enter into stipulations. Although not binding on the Commission, the terms of such an agreement are accorded substantial weight. See *Consumers Counsel v. Pub. Util. Comm.*, 64 Ohio St.3d 123, 125 (1992), citing *Akron v. Pub. Util. Comm.*, 55 Ohio St.2d 155 (1978). Such weight is particularly compelling where, as in the case at hand all parties either supported or agreed not to oppose the stipulation.

The ultimate issue for our consideration is whether the agreement embodies considerable time and effort by the signatory parties, is reasonable, and should be adopted. In considering the reasonableness of a stipulation, the Commission has used the following criteria:

- (1) Is the settlement a product of serious bargaining among capable, knowledgeable parties?
- (2) Does the settlement, as a package, benefit ratepayers and the public interest?
- (3) Does the settlement package violate any important regulatory principle or practice?

The Ohio Supreme Court has endorsed the Commission's analysis using these criteria to resolve issues in a manner economical to ratepayers and public utilities. *Indus. Energy Consumers of Ohio Power Co. v. Pub. Util. Comm.*, 68 Ohio St.3d 547 (1994) (citing *Consumers' Counsel, supra*, at 126). The court stated in that case that the Commission may

place substantial weight on the terms of a stipulation, even though the stipulation does not bind the Commission (*Id.*).

Based on our three-pronged standard of review, we find that the first criterion, that the process involved serious bargaining by knowledgeable, capable parties, is met. Counsel for the applicant and the staff, as well as the intervenors, have been involved in many cases before the Commission, including a number of prior cases involving rate issues. Further, a review of the terms of the stipulation, and the schedules and tariffs attached thereto, shows that the parties engaged in comprehensive negotiations prior to signing the stipulation.

The stipulation also meets the second criterion. As a package, it advances the public interest by resolving all issues raised in these proceedings without incurring the time and expense of extensive litigation. Although the stipulation includes a rate increase for all customers, the increase should allow the company an opportunity to recover expenses while improving water quality. Indeed, the stipulation addresses a number of problems raised at the public hearings and specifically provides many initiatives that might not otherwise be targeted to address ratepayer and public concerns:

- (1) a meter reading, change-out program,
- (2) deadlines for valve maintenance, and operation,
- (3) tank inspection, storage studies and replacements,
- (4) a discoloration program for the Huber Ridge service area,
- (5) a Lake Darby Softening program,
- (6) main replacement for the Mansfield service area,
- (7) replacement of two slakers in the Marion service area,
- (8) cost options for the renovation or construction of a new Ashtabula treatment plant,
- (9) the limitation on the maximum billable amount of unaccounted-for-water,
- (10) requirements for restoration of public and private property following repair activities by Ohio American,
- (11) specific deadlines for leak repairs,
- (12) installation of encoder meters in certain districts,
- (13) specific deadlines for the flushing, painting, and continued maintenance on fire hydrants in two districts, and
- (14) the filing of a report regarding recarbonation tank and slaker operations in one district.

Finally, with respect to the third prong of our analysis, no evidence or argument has been advanced that the stipulation violates any important regulatory principle or practice.

Of all the issues raised by Ohio American customers at the public hearings, the Commission was struck by the intensity of testimony from the public hearing in Galloway,

Ohio in the Lake Darby service area involving the level of hardness of the water and the public hearing in Westerville, Ohio in the Huber Ridge service area involving the discoloration of water. Ohio American customers testified that, when water is too hard, an excessive amount of water must be used for washing, cleaning and bathing and that this causes rust to develop in plumbing fixtures and causes water filters to wear out prematurely. Many Lake Darby customers apparently believe that Ohio American is not consistently softening the water at the treatment plant and that, as a result, they must use in-home softeners. Many were also unsure of the level of softness that the company had used or how much customers should use. The stipulation contains several provisions intended to remedy the overall water softness issue. Ohio American will install new flow meters to monitor the softening process, install new electronic controllers for each water softener, install an instrumentation system for monitoring treatment plant performance, and implement a process control testing and monitoring to consistently and reliably produce softened water within an industry accepted range. Also, the stipulation provides a financial incentive for the company to remedy the softness issue before May 1, 2007, or credit \$1,000 per month to the Lake Darby district.

While we believe that the terms of the stipulation should assist in remedying the softening issue, there are many customers who believe that the company is not softening the water and as a result, they are using in-home water softeners at considerable expense. In order to resolve this issue, the Commission believes that a public education campaign should immediately be started to provide information to customers on the softening issue. Accordingly, Ohio American should work with staff to develop and institute such a program within 30 days.

The second major issue to be addressed by Ohio American is the discoloration of water in the Huber Ridge district. These customers presented samples of cloudy, rust-colored water that contained particulate matter. It is especially disturbing to the Commission that any customer of a public utility should be receiving water of such quality. The stipulation provides specific actions to address the discoloration issue. First, the company, staff, OCC and OEPA will begin a plant and distribution system monitoring and sampling program to determine if the source is distribution-related, plant-related, or both. The sampling will be done throughout this system and the company will provide reports to the parties as to the analysis of the samples. In addition, several pipe sections will be removed for analysis and a unidirectional flushing program will be initiated to effectively remove sediment from the system. At various intervals the parties will meet and discuss the findings and results of these initiatives, and jointly decide the courses of action until the discoloration issue is resolved. Moreover, the stipulation provides a financial penalty to the company in the event it is unable to correct this problem. If Ohio American is unable to eliminate the discoloration from the water by June 30, 2007, its ability to collect the reverse osmosis surcharge from Huber Ridge customers will be impacted.

The Commission believes that the terms of the stipulation should assist in correcting the problems faced by Ohio American customers. However, to facilitate our review of the company's progress in meeting its obligations under the terms of the stipulation, we will open a separate compliance docket and direct that all future company reports or other materials relating to stipulated actions be filed therein. This docket will also enable Ohio American customers to follow the progress of the company toward meeting the terms of the stipulation as well as identify for the company, the staff, and the Commission if the problems with water quality persist.

The provisions set forth in this stipulation, are designed to eliminate the service and water quality issues raised by Ohio American's customers. Furthermore, while the stipulation provides certain specific penalty provisions for failure to correct these problems, we do not interpret such provisions as in any way limiting the Commission's enforcement powers under Section 4905.54, Revised Code. The Commission will closely monitor the company's performance and we are hereby putting Ohio American on notice that if the company fails to meet its obligations in accordance with the terms of this stipulation and this Commission order, we will take appropriate action consistent with such powers.

FINDINGS OF FACT:

- (1) On March 17, 2006, Ohio American filed a notice of intent to file an application for an increase in rates. In that application, the company requested a test year of July 1, 2005, through June 30, 2006, and a date certain of December 31, 2005. By Commission entry issued April 5, 2006, the test year and date certain were approved and certain waivers from the standard filing requirements were granted. Ohio American's application was filed on April 17, 2006, and supplemented on May 18, 2006.
- (2) Local public hearings were held on November 27, 2006 in Galloway, Ohio, November 28, 2006 in Marion, Ohio, November 29, 2006 in Tiffin, Ohio, December 5, 2006 in Westerville, Ohio, and January 4, 2007 in Ravenna, Ohio. The applicant submitted proofs of publication at the evidentiary hearing on January 10, 2007.
- (3) At the evidentiary hearing held at the Commission on January 10, 2007, Ohio American, staff, OCC, and Dragoo submitted a stipulation which purports to resolve all of the issues in this proceeding. The intervening cities of Marion and Tiffin were not signatories but do not oppose our adoption of the stipulation.

- (4) The stipulation is the product of serious bargaining between knowledgeable parties, benefits ratepayers, advances the public interest, and does not violate any important regulatory principles or practices.
- (5) The value of all of the company's property used and useful for the rendition of water and wastewater services to customers affected by these applications, determined in accordance under Section 4909.15, Revised Code, is not less than \$58,133,116.
- (6) The current net annual compensation of \$2,285,307 represents a rate of return of 3.93 percent on the jurisdictional rate base of \$58,133,116.
- (7) A rate of return of 3.93 percent is insufficient to provide the applicant with reasonable compensation for the water and wastewater services rendered to its customers.
- (8) The stipulated revenue increase of \$3,430,137 will result in a return of \$4,409,994 which, when applied to the rate base of \$58,133,116, yields a rate of return of approximately 7.59 percent. This 7.59 percent rate reflects returns of 7.65 percent for Water A and Water C operations, but 6.95 percent for wastewater because the rate is limited to the amount requested by the company. Therefore, the combined total company return is 7.59 percent.
- (9) The allowable gross annual revenue to which the company is entitled for purposes of these proceedings is \$33,754,061.
- (10) The applicant's proposed tariffs and notice to customers are consistent with the discussion and findings set forth in this opinion and order and shall be approved. The company's present tariffs governing water service to its customers should be withdrawn and canceled.

CONCLUSIONS OF LAW:

- (1) The company's application was filed pursuant to, and this Commission has jurisdiction of the application under, the provisions of Sections 4909.17, 4909.18, and 4909.19, Revised Code, and the application complies with the requirements of these statutes.

- (2) A staff investigation was conducted and a report duly filed and mailed, and public hearings held herein, the written notice of which complied with the requirements of Section 4909.19 and 4903.083, Revised Code.
- (3) The stipulation submitted by the parties is reasonable and shall be adopted.
- (4) The existing rates and charges for water service are insufficient to provide the applicant with adequate net annual compensation and return on its property used and useful in the provision of water and wastewater services.
- (5) A rate of return of not more than 7.65 percent is fair and reasonable under the circumstances of these cases and is sufficient to provide the applicant just compensation and return on its property used and useful in the provision of water and wastewater services to its customers.
- (6) The company is authorized, as of no earlier than two business days after the date of this opinion and order, to withdraw its current tariffs and to file, in final form, tariffs which the Commission has approved herein.

It is, therefore,

ORDERED, That the stipulation filed on January 10, 2007 be approved by order of the Commission, in accordance with this opinion and order. It is, further,

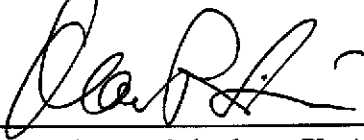
ORDERED, That the application of Ohio American Water Company for authority to increase its rates and charges for water service is granted to the extent provided in this opinion and order. It is, further,

ORDERED, That Ohio American is authorized to file, in final form, four complete copies of tariffs consistent with this opinion and order. The company shall file one copy in this case docket and one copy in its TRF docket (or may make such filing electronically, as directed in Case No. 06-900-AU-WVR). The remaining two copies shall be designated for distribution to the Rates & Tariffs, Energy and Water Division of the Commission's Utilities Department. It is, further,

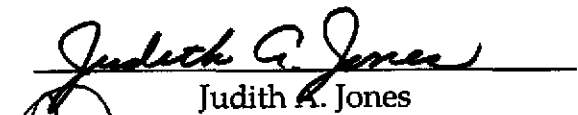
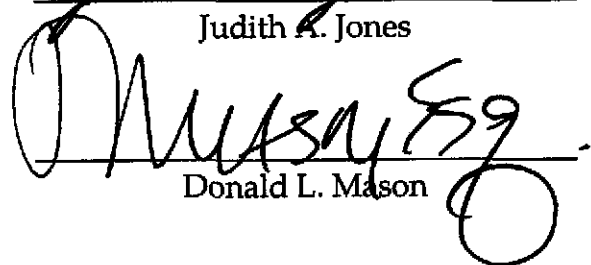
ORDERED, That the new tariffs shall not become effective until the company has filed four complete, printed copies of final tariffs with the Commission. The new tariffs shall be effective for services rendered on after such effective date. It is, further,

ORDERED, That a copy of this Opinion and Order be served upon all parties of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO




Alan R. Schriber, Chairman


Ronda Hartman Fergus
Judith A. Jones
Valerie A. Lemmie
Donald L. Mason

SEF/RMB;geb

Entered in the Journal

MAR 07 2007


Renee J. Jenkins
Secretary