

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Ohio- )  
American Water Company to Increase its ) Case No. 07-1112-WS-AIR  
Rates for Water and Sewer Services Provided )  
to its Entire Service Area. )

OPINION AND ORDER

The Commission, coming now to consider the application, testimony, pleadings, stipulation, and public comments of record in this proceeding, 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.

Nancy H. Rogers, Attorney General of the State of Ohio, by Duane W. Luckey, Senior Deputy Attorney General, Thomas G. Lindgren, and Sarah J. Parrot, Assistant Attorneys General, 180 East Broad Street, Columbus, Ohio 43215, on behalf of the staff of the Public Utilities Commission of Ohio.

Janine L. Migden-Ostrander, Ohio Consumers' Counsel, by Ann M. Hotz and Gregory J. Poulos, Assistant Consumers' Counsel, 10 West Broad Street, Suite 1800, Columbus, Ohio 43215, residential customers of Ohio American Water Company.

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

Mark D. Russell, Law Director, 233 West Center Street, Marion, Ohio 43302, on behalf of the city of Marion, Ohio.

I. HISTORY OF THE PROCEEDINGS

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

of the assets of Citizens Utilities Company of Ohio (Citizens) (Co. Ex. 1, Sched. S-4.1, at 2-9; Staff Ex. 1, at 1, 18, 92-93).

Ohio-American is a wholly owned subsidiary of American Water Works Company, Inc. (AWW), headquartered in Voorhees, New Jersey, which controls water company subsidiaries serving almost 17 million people in 29 states. 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 (RWE), a German multinational utility group headquartered in Essen, Germany. In November 2006, RWE announced its intention to divest all of its shares of AWW, subject to market conditions. On April 23, 2008, RWE sold approximately 40 percent of its shares of the common stock of AWW through an initial public offering on the New York Stock Exchange. RWE currently retains a 60 percent share ownership in AWW but has announced plans to divest itself of its majority stake in AWW by the end of 2008, subject to market conditions (*Id.*, Tr. III at 26).

Ohio-American's service territory consists of 17 water systems and three wastewater systems serving approximately 52,000 water and 6,600 wastewater customers throughout Ohio, as of December 31, 2006. The company's service territory is separated over five districts in the state of Ohio: Ashtabula, Lawrence County, Franklin, Marion, and Tiffin. These districts are combined into three divisions for rate-making purposes:

- (1) The "Water A" division includes the Ashtabula, Lawrence County, Marion, and Tiffin districts.
- (2) The "Water C" division includes the former Citizens customers in Portage County and water operations in Franklin County.
- (3) The "Wastewater" division includes only wastewater operations in Franklin County.

(Co. Ex. 1, at 1-2; Direct Testimony of Little at 7; Co. Ex. 1, at Schedule S-4.1, 2-4, 10; Staff Ex. 1, at 1).

The company operates its own water treatment facilities, except in Lawrence County and a portion of Marion County. The Lawrence 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, another AWW subsidiary (Co. Ex. 1, at Schedule S-4.1, 3-5; Staff Ex. 1, at 1).

On October 12, 2007, Ohio-American filed a notice of intent to file an application to increase its water rates in its entire service area, and its sewer service rates in the Franklin County district. In its notice of intent, the company also requested a waiver for certain standard filing requirements relating to financial and informational data and testimony. By entry issued November 7, 2007, the Commission approved the requested waivers, date certain of June 30, 2007, and test-year period of April 1, 2007 through March 31, 2008.

Ohio-American filed its application to increase rates with standard filing requirements on November 13, 2007. The Ohio Consumers' Counsel (OCC), Dragoo & Associates, Inc. aka Dragoo Management, Inc. (Dragoo), and the city of Marion filed motions to intervene in the case on November 20, 2007, December 18, 2007, and January 19, 2008, respectively. On December 13, 2007, OCC filed motions to dismiss or toll the application to increase rates as to the Water C service territory on the grounds that the company was prohibited from filing for such increase under the terms of the stipulation in Case No. 06-433-WS-AIR, Ohio-American's prior rate proceeding. By its entry issued January 9, 2008, the Commission accepted the application for filing as of November 13, 2007, and ordered the applicant to publish a modified notice of the application pursuant to Section 4909.19, Revised Code.

The January 9, 2008 entry also denied a motion filed by OCC to amend Ohio-American's proposed notice and add OCC contact information. On January 23, 2008, OCC filed an application for rehearing regarding the acceptance and publication issues, which were denied by the Commission on February 13, 2008. On May 9, 2008, Ohio-American filed proofs of publication.

Pursuant to Section 4909.19, Revised Code, staff conducted an investigation of the application and filed its report (staff report, Staff Ex. 1) on May 28, 2008. Objections to the staff report were filed by the city of Marion on June 24, 2008, Dragoo on June 26, 2008, and by Ohio-American and OCC on June 27, 2008.

Ohio-American's current rates and charges were established by this Commission's opinion issued on March 7, 2007, in Case No. 06-433-WS-AIR. The following table shows the approximate amount and percentage increase of additional revenue generated using the applicant's proposed rates versus those recommended in the staff report, when applied to the total adjusted test year sales volume.

<u>Service Area</u>	<u>Application</u>	<u>Staff Report</u>
<b>Water A</b>		
Revenue Increase	\$3,158,322	\$877,134 to \$1,191,976
Percentage Increase	11.96%	3.31 - 4.50%
<b>Water C</b>		
Revenue Increase	\$1,204,459	\$1,204,459

Percentage Increase	30.08%	29.97%
<b>Wastewater</b>		
Revenue Increase	\$1,120,227	\$1,120,249
Percentage Increase	36.61%	37.08%
<b>Total Company</b>		
Revenue Increase	\$5,483,008	\$3,516,684
Percentage Increase	16.38%	10.49%

(Co. Ex. Schedule A-1; Staff Report at 1-3, 84.)

By entry issued July 22, 2008, local public hearings were scheduled for August 4, 2008, in both Mansfield and Marion, Ohio; on August 18, 2008, in Galloway, Ohio; and on August 20, 2008, in Westerville, Ohio; and the evidentiary hearing was set for August 14, 2008, at the Commission. Notice of the local public hearings was published in accordance with Section 4903.083, Revised Code, and proof of such publication was filed on September 4, 2008.

## II. SUMMARY OF THE HEARINGS

More than 170 letters, petitions, and other correspondence were filed in this docket by Ohio-American customers and public officials in opposition to the proposed rate increases. Most of the comments relate to the amount or percentage of the proposed increase, and the frequency of Ohio-American rate increases, given that this proceeding marks the company's third rate case in five years, and company representatives have indicated the need to file yet another after this case has been decided.<sup>1</sup>

Each of the four local hearings were well-attended with 17 witnesses testifying at the August 4 afternoon hearing in Mansfield, and more than 20 testifying at the evening hearing in Marion. At the Mansfield hearing, the company distributed information regarding the ten local water systems and the options being considered to replace current flat unmetered service with metered rates (Mansfield Tr. at 6-14). Thereafter, the public witnesses generally voiced opposition to the size and frequency of the company's rate increases, and concerns about the impact of higher rates on property values, low-income customers, and retirees on fixed incomes. The issue of water quality drew mixed responses with some reporting rust, sediment, and pressure problems, while others asserted that their water quality was good and that service has improved since Ohio-American assumed ownership of their system.

The Marion hearing was held in conjunction with a Marion City Council meeting and included testimony from city officials in addition to customer complaints. All voiced

<sup>1</sup> In Ohio-American's previous rate cases, the company's application was filed on March 12, 2004, in Case No. 03-2390-WS-AIR, and on April 17, 2006, in Case No. 06-433-WS-AIR.

opposition to the current proposed increase, particularly in light of the company's history of recent increases, and many reported poor water quality. Other concerns dealt with water leaks and repair problems, and billing or meter issues. In addition, Councilman Ralph Cumston expressed concern that the rates charged to Marion customers by Ohio-American may reflect additional expenses which are not properly attributable to Marion system operations, and he suggested that if Ohio-American continues to hike their rates, the city should consider conversion to a municipal system. He also asserted that the fact that many of the witnesses were testifying at a rate hearing for the first time should be considered by this Commission as an indication of intense opposition to the proposed rate increase (Marion Tr. at 9-12, 56-57).

As in the previous Ohio-American rate case, the hearings in Galloway and Westerville were heavily attended with 21 witnesses testifying in Galloway and more than 40 customers testifying in opposition to the rate increases in Westerville. While these customers also unanimously oppose the proposed rate increase, it appears from their testimony that many of the water quality issues addressed in the previous rate case stipulation have been resolved. These customers, however, are far from satisfied with their service given the history of Ohio-American rate cases, and the relatively high rates compared with municipal service. As noted in the 2006 hearings, customers are concerned about the impact of the frequent rate hikes on their neighborhoods that are populated by moderate and fixed-income families, and their ability to sell their homes given the relatively higher water and sewer rates compared to surrounding areas served by cheaper municipal water and sewer services. Many discussed the level of their rates as compared with wage and inflation levels, and expressed a desire to see justification for the proposed increase and to better understand the factors upon which their rates are determined.

In contrast to the multitude of water samples brought to the 2006 hearing in Westerville, only one witness presented water samples this time. James Welch, president of the Huber Ridge Association, displayed three glasses of water, but not to demonstrate any water quality issue. Rather, he asked why a glass of Ohio-American water costs so much more than two apparently identical glasses from the Columbus and Westerville municipal systems (Westerville Tr. at 88). While some witnesses testified they are still experiencing water quality issues, many others testified that the reverse osmosis system used in the Huber Ridge system has improved the quality. Other issues raised by the witnesses included water tank maintenance, billing, late charge, and shut-off notice problems, many of which will be further explored in considering the company's testimony and responses below.

At the August 14 evidentiary hearing at the Commission, Prairie Township Trustee Steve Kennedy testified regarding hardness testing issues at the Lake Darby plant, and the hearing was then recessed at the request of the parties until August 26, 2008, at which time Mr. Kennedy and Mr. Welch submitted documentation and petitions, and further testified

regarding testing and other issues in their respective service areas. The evidentiary hearing reconvened on September 3, 2008, at which time a proposed stipulation and recommendation (stipulation) was presented and supported by the testimony of three company witnesses: Gary M. VerDouw, Manager of Rates and Regulation, David K Little, President, and Thomas Schwing, Network Operations Superintendent for the Franklin County District. The stipulation was subsequently finalized and joined by Ohio-American, staff, and Dragoo on September 4, 2008; and by OCC and the city of Marion on September 5, 2008. A corrected Exhibit B to the stipulation was filed on September 11, 2008.

In support of the stipulation, Mr. VerDouw testified that this settlement was negotiated by knowledgeable parties, does not violate any regulatory principles, and provides a number of concessions which benefit ratepayers that Ohio-American would not have agreed to in a fully contested case. He noted that the company did not contest the elimination of approximately \$850,000 in certain rate base assets, including a portion of the Marion corporate office; \$120,000 of incentive pay for salaried employees and an additional \$290,000 in management fees relating to incentive pay and certain OCC objections. He also cited the adoption of OCC's recommended rate of return of 8.12 percent, which reduced the overall revenue requirement by approximately \$39,000; and adjustments of \$98,000 made to fuel, power, and chemicals related to unaccounted for water, the elimination of \$142,000 in tank painting and \$17,000 in insurance expenses, and \$189,000 of unamortized rate case expense from the prior rate case, as well as the amortization of the current rate case expense over three, rather than two, years (Tr. III at 7-12, 15-16).

In addition, Mr. VerDouw noted the long list of Ohio-American commitments made in the stipulation, including the obligation to propose a phased-in or "step" increase approach in the company's next application for a base rate increase. The stipulation also includes provisions to limit disconnections for bills under \$75.00, and to conduct a cost-benefit study for customer service functions at three local Ohio offices. The stipulation also provides a cap on unaccounted-for-water expense at a 15 percent level with associated penalty provisions, and improvements in the company's leak detection reporting, and in communications regarding conservation, meter and billing reading, flushing and other topics. The stipulation also contains specific industry standards for the Lake Darby system, including the installation of an on-line analyzer to monitor hardness in the Lake Darby system, and a penalty credit for failure to meet the hardness standards. With respect to the Huber Ridge system, the stipulation calls for at least two unidirectional flushings, and a \$3,000 monthly penalty if iron and manganese exceeds specified standards. Ohio-American also agrees to actively solicit more third-party payment centers in Franklin County, and to implement a customer service function at the Franklin County district office where customers can pay bills, speak face-to-face with an employee about service issues, and set service appointments (*Id.* at 12-14).

The stipulation also continues restoration standards and penalties established in the last rate case, and provides for a contingency emergency plan for the Ashtabula Bunker Hill tank with a permanent upgrade by a date certain. Other provisions include a reduced unmetered rate charge and a survey of Mansfield customers regarding the options for metered service to be proposed in the next case (*Id.* at 14-15).

In his testimony, Ohio-American President David Little explained that despite the increases granted in the company's last rate case, Ohio-American's revenues have not been sufficient to cover increased operating expenses, such as employee payroll and benefits, taxes, depreciation, plus increased maintenance and operating costs, and thereafter to provide for capital costs. He reported that labor, benefits, and support service increased by more than \$590,000; production costs were up more than \$335,000; insurance increased more than \$280,000; regulatory and customer accounting expenses were nearly \$500,000 higher; depreciation increased by more than \$130,000; and general taxes were up approximately \$622,000. During this same period, the company's revenues decreased by more than \$280,000 while net rate base investment increased by approximately \$4.4 million (*Id.* at 17-18).

Mr. Little noted that in response to a staff recommendation in the company's last rate case, Ohio-American added six front-line supervisors to the Ashtabula, Franklin County, Marion, and Tiffin districts to better address customer concerns and communicate with local officials, and to lead operations and maintenance activities. He also testified that the company has spent more than \$2.1 million meeting some 34 commitments agreed to in the last case, as well as other system improvements which are detailed in a report titled DKL Exhibit 2 filed on November 27, 2007, which was inadvertently omitted from Mr. Little's direct testimony in this case. Mr. Little admitted that Ohio-American missed a couple dates and was unable to fully comply with every detail of the commitment provisions, but he asserted that the company has substantially complied with all prior commitments (*Id.* at 18-19).

With respect to the public hearings, Mr. Little explained that he was unable to personally attend the Galloway and Mansfield hearings but local supervisory personnel (Mr. Schwing in Galloway, Roy Craft and Rich Kemple in Mansfield), were available to hear and respond to customer concerns. Mr. Little noted the many misunderstandings about specific issues voiced by customers, and he announced his intention to develop and initiate a new program to improve communications with customers (*Id.* at 19-21).

One example of these misunderstandings is the water line protection service program which was mentioned by several witnesses at the Westerville hearing. Mr. Little explained that the line protection service is not offered directly by Ohio-American, but by American Water Resources, an unregulated branch of the same parent, American Water Works Company. This program offers water line, sewer line, and in-home plumbing

protection for the lines that serve customer homes, typically originating at the curb stop and running under the customer's private property into their homes. This program is voluntary, and customers must sign up directly with American Water Resources for the service. Mr. Little reported that Ohio-American has no role in providing or marketing this service to customers. He explained that American Water Resources pays Ohio-American approximately \$24,000 per year to include the protection service fee on Ohio-American bills, and this payment helps defray some of Ohio-American's operating expenses and thus benefits all customers. He also stated that this protection service fee was involved with a problem reported by a customer at the Westerville hearing, who was charged a late fee for an overpayment; and he asserts this problem has now been corrected (*Id.* at 21-24).

Mr. Little also noted misunderstandings regarding customer service charges, German ownership of Ohio-American's parent company, and testimony regarding substantial company bonuses, and stated that no Ohio-American employee ever received a bonus of \$41,000. He clarified that while some customers had testified that they received as few as three days notice for disconnection, the actual process from billing date to disconnect is a minimum of 43 days. In light of the public testimony, Mr. Little is taking action to modify the company's disconnection notice in order to more readily distinguish these notices from regular customer bills. He also addressed meter reading, water testing, and call center concerns raised by various witnesses, as well as comments regarding the Marion system water quality. In addition, Mr. Little reported on the company's investigation and resolution of a number of customer-specific problems (*Id.* at 24-37).

In his testimony, Franklin County Superintendent Thomas Schwing, addressed issues raised by Huber Ridge customers, and statements made at the Galloway and Westerville hearings. He also reviewed the commitments made by Ohio-American affecting Huber Ridge and Lake Darby customers in the stipulation in this case (*Id.* at 40).

According to Mr. Schwing, the Huber Ridge water treatment system was built around 1962, with aeration and gravity filters for iron removal of groundwater supply, but no water softening treatment. In 1997, a reverse osmosis water treatment system was constructed downstream of the iron removal system which softened the raw groundwater from approximately 440 mg/L to approximately 150 mg/L. Since its acquisition of the Huber Ridge system in January 2002, Ohio-American has invested more than \$1.2 million dollars, and since the last rate case, the company has invested about \$400,000 in improvements that include construction of a new chemical feed building and the implementation of sodium permanganate chemical feed system in order to maintain the iron and manganese concentrations in the finished water below secondary maximum contaminant levels as required by the stipulation in the last rate case. Mr. Schwing asserts that Ohio-American has now solved the discoloration problem in Huber Ridge through these steps as well as three unidirectional flushings and the repair of six water main valves which may have contributed to the discoloration (*Id.* at 40-43).



Mr. Schwing also described the company's attempts to resolve any water quality issues that were reported by customers who filed letters in this docket describing a particular water issue. He believes the company has resolved every legitimate water quality complaint where the customer allowed them to do so. He also addressed many of the issues raised at the local hearings, such as the perception that even when the customers go on vacation, they are charged for water that they do not use. Mr. Schwing described the time line involved in meter reading and the lag that occurs before a meter read appears on the bills, so that a drop in usage may not be reflected on the customer's bill for two periods (*Id.* at 43-46).

Mr. Schwing also discussed the perceptions of some Huber Ridge customers that the reverse osmosis system had fallen in disrepair or that the system costs should be fully paid off. He asserted that these perceptions are not factual, and described the improvements made since Ohio-American purchased the Huber Ridge system in 2003. He also explained that the original surcharge supported by those voting for the reverse osmosis plant covers only the original capital expense of approximately \$1.5 million, depreciation, insurance, property taxes, revenue taxes, uncollectible expense, and the incremental annual operating cost. Mr. Schwing testified that the total softening costs specifically attributable to the reverse osmosis system in this case are approximately \$225,000 and that the surcharge proposed to cover these costs would decrease approximately ten percent to \$1.19 from \$1.32 (*Id.* at 46-47).

The witness also addressed the customer complaints of orange or white residue on their sinks, showers, and appliances by first noting the steps taken to eliminate discolored water under the stipulation in the last rate case. He asserted that since June 2007, samples taken at both the water plant and in the distribution system lines that serve customers have consistently met all the stipulated criteria in tests by Ohio EPA certified laboratories. Mr. Schwing reported that the three system-wide unidirectional flushings accomplished a great deal of scouring the company's distribution lines, removing residue that had accumulated over the years. These flushings were followed by a coating of polyphosphate solution so that any remaining residue does not dissolve into the water (*Id.* at 47-48).

Mr. Schwing contends that Ohio-American is now providing clear water to the curb stop, the point at which the customer-owned lines connect to the company's lines. He believes the customers' water pipes and plumbing have been accumulating deposits from the water for years and are most probably the source of any residue problems. But he also clarified that even though the company is now meeting all clear water standards, the natural calcium in the water can cause deposits which some people may find aesthetically unacceptable. Mr. Schwing said that the company intends to provide information to the customers about clearing their water lines and plumbing of deposits, and the importance of changing filters to prevent the flow of bacteria into their water (*Id.* at 48-50).

While the company may have addressed the water quality issues at the Huber Ridge system, Mr. Schwing noted that Ohio-American does not soften the water in the Blacklick system as those customers voted not to have a centralized water softening treatment plant. He explained that the water is approximately 460 milligrams per liter of hardness which is considered hard, but that the Ohio EPA has no standards for the amount of hardness for unsoftened water (*Id.* at 51-52).

The witness also addressed other customer comments made at the Westerville hearing, and discussed area-specific commitments under the stipulation in this case, including the investment of an additional \$34,500 in the Huber Ridge system, solicitation of additional third-party collection vendors, and the implementation of a pilot program to evaluate providing additional customer service functions in the Franklin County District office (*Id.* at 52-57).

With respect to the Lake Darby water treatment plant, Mr. Schwing testified that the plant, originally built in 1970, has a groundwater supply which draws hard water from the underground aquifer. The treatment plant has one iron removal system, and two water softener treatment units which quit functioning sometime in the 1970s. In 1994, Citizens Utilities restarted the water softening process using the original plant equipment and softening process. At the time Ohio-American acquired the Lake Darby water system in January 2002, there had been no renovation to the 32 year old treatment equipment, electrical controls, instrumentation, or other support systems. Furthermore, the original treatment plant construction did not include equipment redundancy. As the old equipment failed due to age and end of its useful life, there were no backup units to provide ongoing treatment during repairs and/or maintenance periods. Since its acquisition of the Lake Darby water system in January 2002, Ohio-American has invested in excess of \$302,000 dollars in the Lake Darby water system prior to the last rate case and an additional \$28,000 in the past year, which has resulted in a more consistent and reliable treatment of the water hardness to a level of between 120 mg/l and 150 mg/l (*Id.* at 57-60).

Mr. Schwing explained that Ohio-American uses one operator with multiple duties at the Lake Darby plant and the smaller Timber Brook water treatment system. He also discussed the testing processes and issues raised by Prairie Township trustee Steve Kennedy, and noted that Ohio-American has agreed to install a continuous on-line hardness analyzer which will sample every 2 hours and record the measured results, to address the potential variability of the water hardness throughout the day. The witness also noted that Ohio-American has committed to further improve the water at the Lake Darby system under the stipulation filed in this case. He asserted that since the last case the hardness has been consistently within the agreed range of 120 mg/L and 150 mg/L, while under the new commitment in this case, Ohio-American will lower the range to 90 mg/L to soften to a greater degree (*Id.* at 60-65).

With respect to specific issues identified by customers at the local public hearings, Mr. Schwing clarified that testimony regarding Ohio EPA "violations" was not correct. Mr. Schwing explained that the Ohio EPA conducts an annual site visit to sewage treatment plants and that, after the agency visited the Lake Darby sewage treatment plant, he received a letter dated August 8, 2008 from the Ohio EPA referring to past effluent solid exceedances. Ohio-American responded in its letter of August 18, 2008, that the company had already spent approximately \$450,000 on improvements to prevent any further exceedances. No penalties were assessed by the Ohio EPA (*Id.*, at 65-66).

Mr. Schwing also addressed specific issues or concerns raised in the hearings about customers' individual billing problems or misunderstandings, reported leak incidents, the painting of the Lake Darby water tower, and the park and bike trail adjoining the Ohio-American property (*Id.* at 66-81).

### 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 2.85 percent on its proposed rate base (Ohio-American Ex. 1, at 2). 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

The stipulation in this case was initially filed on September 4, 2008, and ultimately joined by each of the parties in this proceeding. A corrected Exhibit B to the stipulation was filed on September 11, 2008. The stipulation purports to resolve all of the issues in this proceeding and is summarized, in part, below (Stipulation at 3-17):

- (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 \$61,491,821.
- (2) The applicant's total adjusted operating revenues for the test year are \$33,300,721, its total adjusted operating expenses are \$31,752,924, and its net operating income is \$1,547,797.
- (3) This net operating income of \$1,547,797 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 \$5,264,697. The stipulation also states that pension expense and other post employment benefits expenses were calculated in accordance with SFAS 87 and SFAS 106, respectively, and with the Commission's prior orders in Case Nos. 87-2153-WW-AIR and 88-379-WW-AAM; and Case Nos. 93-369-WW-AAM and 92-2299-WW-AIR, respectively.
- (5) Ohio-American is entitled to an overall rate of return of 8.12 percent, reflecting a cost of long-term debt of 6.17 percent, a cost of preferred stock of 8.48 percent, and a return on equity of 10.88 percent.
- (6) The rates to be adopted in this proceeding are based upon the settlement of issues raised by Ohio-American's application predicated upon a test year of April 1, 2007 to March 31, 2008, and a date certain of June 30, 2007, and the Staff's investigation; and will become effective with bills rendered after Commission approval and the company's filing of the final compliance tariff pages.
- (7) The following tariff recommendations and changes to be adopted:
 

Nonsufficient funds charge	\$17.25
Account Activation Charge	\$23.10
(unchanged from the current charge)	
Customer Charge (for a 5/8" meter)	\$ 9.51
Third rate block, Water C (unit base cost of providing water)	\$2.1115 ccf
Large quantity user rate, Water A (must use at least 2,000 ccf)	\$1.66/ccf
Mansfield systems' unmetered rate (derived from the average of Water	\$78.77 Bi-monthly

A's metered customers' usage less  
\$2.20 representing the meter  
reading expense)

Proposed final compliance tariff pages are attached as Exhibit  
B of the stipulation. The revenues to be derived are:

<u>Division</u>	<u>Total Revenue</u>	<u>Increase</u>
Water A	\$29,242,234	11.18%
Water C	\$5,170,009	30.37%
Wastewater	\$4,153,175	36.94%

- (8) Water purchased from Portage County will be included in the overall cost of water and thus receive the same treatment as the purchased water from West Virginia American Water Company for the Lawrence County District and from Indiana American Water Company for the Preble County service area.
- (9) In future rate filings, the cost distribution categories in the cost-of-service studies will be reconciled to the different class categories consistent with the Schedule E schedules. If such reconciliation is not contained in the studies and schedules at the time of the initial filing, the Commission may reject the filing.
- (10) In its next application for a base rate increase, Ohio-American will propose a step increase program that will provide for annual increases during the proposed step increase period during which the company will not file for another base rate increase.
- (11) The company will provide its five-year capital plan to the parties within six months of the issuance of the opinion in this case, and updates on an annual basis thereafter.
- (12) In conjunction with its next application for a rate increase, Ohio-American will include specific OCC contact information in its notice of application for newspaper publication.
- (13) Ohio-American makes the following commitments that apply throughout its service areas:
  - (A) Budget Billing and Disconnection Notices: Ohio-American will include budget billing information on bi-monthly customer bills, and medical certification information on disconnection notices.

- (B) Minimum Amount Owed for Disconnection: Ohio-American agrees that it will not physically disconnect a customer's service unless the amount owed is more than \$75.00. The company will, however, continue its collection calls for all amounts owed.
- (C) Cost Benefit Analysis for a Customer Service Function at Local Offices: Ohio-American agrees to conduct a cost benefit analysis based on the Franklin County pilot of providing limited customer service at three additional local offices. The company will provide a report to staff, OCC, and Marion 12 months after the start of the Franklin County pilot on its analysis of the pilot, including the customer utilization rate, and develop a per customer cost.
- (D) Unaccounted-for-Water Reports and Reductions: During the effective period of this opinion, Ohio-American agrees to pursue an unaccounted-for-water (UFW) percentage equal to or less than 15 percent on a rolling 12-month average. The stipulation provides specific quarterly UFW reporting requirements for each system, as well as cost-benefit studies with remedial actions and timelines for the Ashtabula, Marion, Huber Ridge, Blacklick, and Aurora East systems; as well as any other system reporting UFW levels of more than 15 percent for four consecutive quarters. The stipulation also commits the company to hold meetings with the parties and to develop and implement action plans based on the reports and agreements for each system.

In its next rate case, Ohio-American agrees to limit its test-period chemical and power expense using a 15 percent average UFW level for each system. In addition, if Ohio-American is unable to meet the 15 percent UFW level for Marion within 12 months from the date of the order in this proceeding, the company will contribute \$10,000 in the aggregate to Marion Community Action Center for distribution to low-income residential customers in Ohio-American's Marion service area.

- (E) Leak Repair: During the effective period of the opinion in this proceeding, Ohio-American agrees to:

- i. Repair service-affecting leaks within 24 hours of confirmation that a leak exists.
  - ii. Repair non-service-affecting leaks within seven days of confirmation that a leak exists.
  - iii. Repair non-service-affecting minor leaks (estimated one gallon or less per minute) that do not create a water stream on the surface of the ground within 30 days of confirmation that a leak exists.
  - iv. Submit a quarterly leak log report summarizing the status of each district's leak repairs and status of associated restoration work. In the event leaks are not repaired within the specified time period, the report will provide a written explanation.
- (F) Communications with Customers: Ohio-American agrees to provide frequent communications to its customers through quarterly newsletters or bill inserts and to educate customers about the provision of water, conservation, and general issues affecting water that some of the customers at the local public hearings raised. Topics will include budget billing, emergency preparedness, flushing and discoloration issues, conservation, excavation restoration and work sites, plumbing and pipe maintenance, hot water tanks and water quality, meter, and billing issues.
- (14) Lake Darby: During the effective period of this opinion, Ohio-American, at an additional cost of approximately \$38,500, agrees to operate the Lake Darby water treatment plant ion exchange softening process consistent with specified standards; and to install and operate an on-line analyzer to monitor the plant's finished water hardness every two hours while the plant is running. The stipulation provides specific testing, collection, and reporting requirements, including periodic testing by an independent certified laboratory, and an aggregate credit of \$1,000 to Lake Darby customers for each month where the daily average finished water hardness levels are not within a specified range.
- (15) Huber Ridge: During the effective period of this opinion, Ohio-American agrees to operate the Huber Ridge plant's reverse osmosis and treatment processes to maintain the finished water

iron and manganese concentrations consistent with specified standards; and to unidirectionally flush the Huber Ridge distribution system at least twice per calendar year. The stipulation specifies certain testing and reporting requirements, and provides an aggregate credit of \$3,000 to Huber Ridge customers for each month that the plant sample tap concentration for iron or manganese exceeds certain limits.

- (16) Franklin County: Ohio-American agrees to actively solicit additional third-party collection vendors in Franklin County, such as grocery store chains, and to report its progress within 60 days of the order in this proceeding. Ohio-American agrees to implement on a pilot basis at an estimated cost of \$10,000, an ancillary customer service function in the Franklin County district office to permit customers to pay their bills and make service appointments.
- (17) Marion: The stipulation specifies certain reporting and communication commitments with city of Marion officials, and establishes practices relating to property and street restoration projects. In addition, Ohio-American agrees to pay the Marion Community Action Center a penalty of \$200.00 per occurrence up to an aggregate of \$5,000 for each failure to make restorations in with the stipulated provisions.
- (18) Ashtabula Commitment: Within two months of the order in this proceeding, the company will submit for staff approval a contingency emergency plan to be implemented in the event of a catastrophic failure of the Bunker Hill tank while making planned improvements. Within three months from this order, Ohio-American will meet with staff and OCC to report on its plans to upgrade the Ashtabula plant.
- (19) Mansfield Unmetered Systems: By the end of 2008, approximately one-half of the customers in the ten Mansfield systems will have metered service available. Because a number of Mansfield customers have indicated a desire for metered service, Ohio-American will survey those customers who have purchased inside water meters (used by the Richland County Department of Sewers to meter sewage disposal usage) to determine if such meters should be used for water subject to a meter reading surcharge at the rate charged by the county. If a majority of customers desires metered service and are willing to pay the meter reading surcharge, Ohio-



American, in its next rate case, will propose a meter reading surcharge for Mansfield customers.

**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 June 30, 2007 (Stipulation Ex. A, Schedule B-1):

	<u>Water A</u>	<u>Water C</u>	<u>Wastewater</u>	<u>Total</u>
Plant in service	\$88,948,676	\$14,514,170	\$14,934,981	\$118,397,827
Depreciation reserve	<u>(31,926,684)</u>	<u>(5,256,902)</u>	<u>(5,548,020)</u>	<u>(42,731,606)</u>
Net plant in service	\$57,021,992	\$9,257,268	\$9,386,961	\$75,666,221
CWIP	0	0	0	0
Working capital	0	0	0	0
Other rate base items	<u>(9,333,753)</u>	<u>(2,236,128)</u>	<u>(2,604,519)</u>	<u>(14,174,400)</u>
Jurisdictional rate base	\$47,688,239	\$7,021,140	\$6,782,442	\$61,491,821

The Commission finds the jurisdictional rate base, as stipulated by the parties, to be reasonable and supported by the record and, therefore, adopts the valuation of \$61,491,821 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 March 31, 2008 (Stipulation Ex. A, Schedule C-2):

	<u>Water A</u>	<u>Water C</u>	<u>Wastewater</u>	<u>Total</u>
Operating revenues	\$26,302,245	\$3,965,550	\$3,032,926	\$33,300,721
Operating expenses				
Operation & maintenance	\$15,204,750	\$3,039,230	\$1,940,542	\$20,184,522
Depreciation & amortization	2,591,948	327,944	314,509	3,234,401
Taxes, other than income	6,049,743	1,212,299	1,172,496	8,434,538
Federal income taxes	<u>396,629</u>	<u>(286,184)</u>	<u>(210,982)</u>	<u>(100,537)</u>
Total operating expenses	\$24,243,070	\$4,293,289	\$3,216,565	\$31,752,924
Net operating income	\$2,059,175	\$(327,739)	\$(183,639)	\$1,547,797

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 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 \$33,300,721, with allowable adjusted test-year expenses of \$31,752,924, indicates that the applicant, under its present rates, would have realized net operating income of \$1,547,797. Applying this figure to the rate base, the applicant would have earned a rate of return of 2.52 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 7.96 percent to 8.38 percent. The parties have stipulated that a fair and reasonable rate of return in this case is not more than 8.12 percent (Stipulation at 3-4, Ex. A). The Commission believes that the stipulated rate of return is reasonable and will adopt it.

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 \$2,939,989 for Water A (an increase of 11.18 percent), \$1,204,459 for Water C (an increase of 30.37 percent), and \$1,120,249 for Wastewater (an increase of 36.94 percent). The company-wide increase totals \$5,264,697 (an increase of 15.81 percent) in revenues over the current annual operating revenues. Adding the stipulated increase of \$5,264,697 to the current adjusted test year revenues of \$33,300,721 produces a new pro forma revenue total of \$38,565,418. A comparison of the pro forma revenues of \$38,565,418 with the total allowable test-year expenses, adjusted to include taxes and uncollectible expense associated with the increased revenues, of \$33,572,283 indicates that the applicant would realize net operating income of \$4,993,135. The application of the net operating income to the rate base of \$61,491,821 results in a rate of return of 8.12 percent, which is not more than the agreed upon rate of return. (Stipulation at 3-4, Ex. A.)

The Commission finds the stipulated increase of \$5,264,697 to be fair, reasonable, and supported by 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. A corrected Exhibit B to the stipulation was filed by the company on September 11, 2008, reflecting 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. The Commission finds these tariff sheets and proposed customer notices to be reasonable and will be approved as part of the stipulation.

F. Review of the Stipulation

While we note that numerous letters and correspondence have been filed by ratepayers and public officials in opposition to the proposed rate increases, and even the stipulation itself, the agreement submitted by the parties is not opposed by any party of record in this case, and it is endorsed by the Commission's staff and the Consumers' Counsel as the statutory representative of the residential customers of Ohio-American.

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, the stipulation is supported by the statutory customer representative and the Commission's staff, and is not opposed by any party.

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 contains 15 pages of specific commitments, summarized above, which are designed to address the water quality and service issues which have plagued these customers over many years. The Commission notes, however, that while the rate design endorsed by the parties' stipulation serves to benefit the immediate needs of the parties, it may not advance the public's longer term interest in promoting energy efficiency and conservation. The Commission is concerned that declining block rate structures, such as that embodied in the parties' stipulation, do not encourage efficient use. While it is incumbent upon the Commission to balance competing policy interests, energy efficiency and conservation concerns have garnered amplified Commission attention and will increasingly become a foundation for Commission action. In the interest of timely resolution of a matter to which all parties have agreed, however, the Commission is willing to accept this stipulation but will be increasingly reluctant to do so in future instances.

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.

While we are mindful of the history of frequent rate increases subjected upon Ohio-American ratepayers, we are encouraged that the company is moving in the right direction in solving the water quality issues for the Lake Darby and Huber Ridge systems. We are further encouraged by the inclusion of stipulation provisions addressing the proposal of a phase-in plan for future increases and by the various initiatives to improve communications with all Ohio-American customers. While the challenges facing the water industry throughout this state and the nation are drawing greater attention from the media and public, we believe Ohio-American should work to improve its relationships with its customers by providing timely and system-specific information about the costs and operations of their water systems, including the justifications for any future rate increase, and any plans or options for water and sewer service improvements.

As with the company's prior rate case, Ohio-American is directed to file all compliance reports and documentation in a separate compliance docket to facilitate the review of the company's progress in meeting its obligations under the terms of the stipulation.

FINDINGS OF FACT:

- (1) On October 12, 2007, 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 April 1, 2007, through March 31, 2008, and a date certain of June 30, 2007. By Commission entry issued November 7, 2007, 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 November 13, 2007, and supplemented by filings on November 27, 30, and December 4, 2007.
- (2) Local public hearings were held on August 4, 2008, in Mansfield and Marion, Ohio; on August 18, 2008, in Galloway, Ohio; and on August 20, 2008, in Westerville, Ohio. Evidentiary hearings were held at the Commission on August 4 and 26, and on September 3, 2008. The applicant submitted proofs of publication of the local hearings on September 4, 2008.
- (3) A stipulation, which was joined by all of the parties in this proceeding, was filed on September 4, 2008, and updated or corrected by filings on September 5 and 11, 2008.
- (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 with Section 4909.15, Revised Code, is not less than \$61,491,821.
- (6) The current net annual compensation of \$1,547,797 represents a rate of return of 2.52 percent on the jurisdictional rate base of \$61,491,821.
- (7) A rate of return of 2.52 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 \$5,264,697 will result in a return of \$4,993,135 which, when applied to the rate base of \$61,491,821, yields a rate of return of approximately 8.12 percent.

- (9) The allowable gross annual revenue to which the company is entitled for purposes of these proceedings is \$38,565,418.
- (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 8.12 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 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 September 4, 2008, as corrected by filings on September 5 and 11, 2008, be approved by order of the Commission, in accordance with this opinion and order. It is, further,

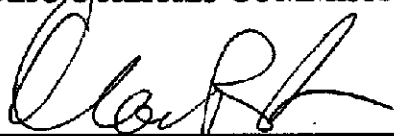
ORDERED, That the application of Ohio-American Water Company for authority to increase its rates and charges for water service is granted to the extent provided in this opinion and order. It is, further,

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 and 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 bills rendered on after such effective date. It is, further,

ORDERED, That a copy of this entry be served upon all parties of record.

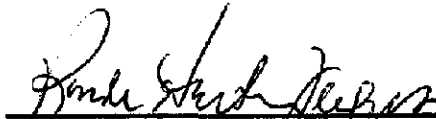
THE PUBLIC UTILITIES COMMISSION OF OHIO



Alan R. Schriber, Chairman



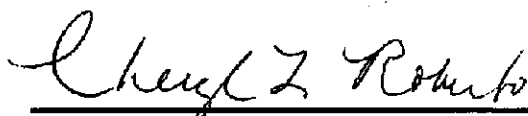
Paul A. Centolella



Ronda Hartman Fergus



Valerie A. Lemmie

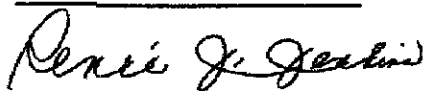


Cheryl L. Roberto

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Renee J. Jenkins  
Secretary