DECISION **2017 NSUARB 103**
M07898

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE PUBLIC UTILITIES ACT

- and -

IN THE MATTER OF AN APPLICATION of the **CAPE BRETON REGIONAL MUNICIPALITY** on behalf of its **WATER UTILITY** for Approval of Amendments to its Schedule of Rates and Charges for Water and Water Services and its Schedule of Rules and Regulations

BEFORE:	Richard J. Melanson, LL.B., Member
APPEARING:	**CAPE BRETON REGIONAL MUNICIPALITY** Gerry Isenor, P.Eng. G.A. Isenor Consulting Limited Blaine Rooney, CPA, CA Blaine S. Rooney Consulting Limited Greg Penney Water Operations Manager Mike MacKeigan, C.E.T. Water Utilities Manager Jennifer Campbell, CPA, CA Manager of Finance
HEARING DATE:	May 30, 2017
UNDERTAKINGS:	June 13, 2017
DECISION DATE:	**June 27, 2017**
DECISION:	**Schedule of Rates and Charges approved, as amended. Schedule of Rules and Regulations approved, as amended.**

Document: 256576

I SUMMARY

[1] The Cape Breton Regional Municipality ("Municipality"), applied to the Nova Scotia Utility and Review Board ("Board") on behalf of its Water Utility ("Utility" or "Applicant") for amendments to its Schedule of Rates and Charges for Water and Water Services and its Schedule of Rules and Regulations pursuant to the *Public Utilities Act*, R.S.N.S. 1989, c. 380, as amended ("*Act*"). The existing Schedule of Rates for Water and Water Services and Schedule of Rules and Regulations have been in effect since April 1, 2013, and August 1, 2011, respectively.

[2] A rate study to support the Application ("Rate Study"), dated January 5, 2017, was prepared by G.A. Isenor Consulting Limited, in association with Blaine S. Rooney Consulting Limited, and was submitted to the Board on February 28, 2017. Information Requests ("IRs") were issued by Board staff on April 3, 2017, and responses were filed on April 13, 2017.

[3] During the hearing, the Applicant noted an error in the depreciation rate applied to one category of capital additions in the rate study filed with the Application. As Undertaking U-1, the Applicant submitted a revised rate study, correcting this error. It is the revised rate study ("Rate Study") provided as Undertaking U-1 that is referenced in this Decision, unless otherwise noted.

[4] The Rate Study proposed rate increases for the fiscal years 2017/18, 2018/19, and 2019/20 ("Test Years"). For unmetered customers, the proposed increases in each of the Test Years are 15.9%, 2.9%, and 3.4%, respectively. For 5/8" meter residential customers, based upon average quarterly consumption, the proposed increases in each of the Test Years are 14.8%, 2.6% and 2.9%, respectively. For all other

metered customers, based upon the average quarterly consumption of each meter size, the proposed rate increases are between 16.5% to 21.9% in 2017/18, 2.6% to 4.7% in 2018/19, and 3.3% to 5.8% in 2019/20.

[5] As the hearing took place after the April 1, 2017 effective date used for the first year included in the original schedules, the Schedules of Rates for Water and Water Services provided for approval by the Board in response to Undertaking U-1 included an updated effective date of July 1, 2017.

[6] The Application also proposes amendments to the annual public fire protection charge to be paid to the Utility by the Municipality for the provision of water for fire protection service. In the original rate study, the total annual public fire protection charge, currently $6,965,758, was proposed to increase to $7,183,675 in 2017/18, and then decrease to $7,131,023 in 2018/19, and $7,076,384 in 2019/20.

[7] The public hearing was held at the Sydney Municipal Council Chambers on May 30, 2017, after due public notice. Gerry Isenor of G.A. Isenor Consulting Limited and Blaine Rooney of Blaine S. Rooney Consulting Limited, represented the Utility. The Utility was also represented by Greg Penney, Water Operations Manager; Mike MacKeigan, C.E.T., Water Utilities Manager; and Jennifer Campbell, CPA, CA, Manager of Finance. There were no formal intervenors in the proceeding. No members of the public requested to speak during the hearing. One letter of comment was received by the Board.

[8] As set out in this Decision, the Schedule of Rates and Charges and the Schedule of Rules and Regulations are approved, as amended and requested by the Utility.

II INTRODUCTION

[9] The Water Utility is comprised of seven distinct areas, each with its own water supply and distribution system. The seven areas are: Sydney, Glace Bay, Northside, New Waterford, Louisbourg, Floral Heights, and Gardiner Mines. The water supply for each of these areas, respectively, is: Middle Lake Wellfield, MacAskill's Brook Reservoir, Pottle Lake, Waterford and Kilkenny Lakes, Kelly Lake, and two non-GUDI drilled wells. Each area has its own water treatment process.

[10] The Utility currently serves approximately 27,773 customers, including 126 unmetered customers. The Utility also provides partially treated water to several commercial customers. The Application predicts a slight decline in customer base over each of the Test Years, consistent with the recent history of the Utility.

[11] As the Utility services a wide area with a diverse water system, emergency planning and response procedures must play an important role in the Utility's management. In response to various IR's, the Utility advised it has a comprehensive risk assessment process. It is noted the Municipality has an Emergency Preparedness Plan which is administered by the CBRM Emergency Measures Coordinator, incorporating all components of CBRM, including the Utility. The plan is revised annually. Manuals with up-to-date emergency plans are in place and made available to key personnel.

[12] The Utility has a comprehensive source water protection plan and Boil Order advisory program. The Utility is also actively engaged in assessing lead line issues. Given research conducted in association with the Dalhousie NRC Industrial Research Chair, the Utility does not complete partial lead line replacements, due to the potential for adverse health effects. The experience of the Utility, to date, indicates where a lead

service line is found to exist on the private property side of the line, the homeowner will replace the same.

[13] The Application was presented to the Board based upon the need to adjust the rates as a result of increased operating costs, to fund the projected capital program, and to adjust for the loss of several large commercial customers.

III REVENUE REQUIREMENTS

a) Operating Expenditures

[14] For the year ended March 31, 2016, the Utility had an excess of expenditures over revenues of $1,446,687 and an accumulated deficit of $4,908,426. If current rates are left in place, the Utility is projecting the accumulated deficit balance to increase to $15,070,036 by the end of 2019/20.

[15] The revised Rate Study corrected an error in the depreciation rate applied to the distribution reservoirs and standpipes additions. As a result of this correction, there are slightly lower rates proposed for customers in 2018/19 and 2019/20 than had been in the original submission (decreased to a range of 2.7% to 4.7% from 2.9% to 4.9% in 2018/19 and decreased to a range of 2.9% to 5.8% from 3.3% to 6.0% in 2019/20).

[16] The Utility has seen an increasing accumulated deficit balance in the last few years. The Utility has experienced a reduction in customers, most significantly large commercial customers, which has contributed to the growing deficit. In response to IR-16, the Utility explained the reason for the variance to budget in metered sales revenue:

> Metered sales continues to be an issue as our customer base is shrinking, water usage is declining and large customers are closing up, a number of larger commercial operations have closed (Scotsburn Dairy, Hopkins Fisheries, Clearwater) over the last three (3) years and this has had a dramatic impact on our metered sales. No real growth prospects exist into the future.
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> [Exhibit C-5, p. 14]

[17] During his presentation at the hearing, Mr. Isenor noted that the deficit has been considered in the requested rates:

> We are also asking the Board for earnings in the final two test years, in the amount of 550,000 and 650,000 dollars, to start addressing the deficit of the Utility. Those amounts were chosen basically looking at the impact on rates in the final two years, and so we've tried to pick numbers that we felt were suitable but didn't impact the customer base too dramatically.
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> [Transcript, p. 3]

[18] The Board asked the Utility during the hearing why it had not applied for a rate increase sooner, given the length of time the deficit has been present. The Utility responded that it had not received the political direction to pursue a rate increase. The Utility had instead been asked to find cost savings.

[19] In the previous rate application, the Board noted that water loss was a significant issue for the Utility. In response to IR's, the Utility provided an update on this issue, stating that there has been a significant level of activity to address this problem since the previous application. The Utility noted that a high level of success was achieved after a leak detection program was undertaken in 2011, but that the Utility was unable to maintain that success after the consultant had completed its work. More recently, the Utility has engaged a new consultant and partnered with EfficiencyOne to undertake a water loss reduction project aimed at developing the management systems required in order to sustain long-term results. During the hearing, the Utility pointed out that the water-loss reduction should help the Utility to reduce its deficit.

[20] The operating budget is drafted by senior management of the Utility, reviewed by the Director, and then submitted to Municipal Council for review and approval. Expenses shared between the Municipality and the Utility include general office expenses and staff costs. Staff costs for four full-time staff members, partial customer service clerks and partial administrative staff are allocated to the Utility from the Municipality. Expenses are allocated based upon a percentage of operating costs.

[21] The response to Board IR-18 explained why two of the budgeted 2016/17 operating expenses vary significantly from the previous year's actual expenses: source of supply expense increased by $111,600 (or 32%), due to an anticipated well rehabilitation for three of the production wells at the Sydney Wellfield (also described as the Middle Lake Wellfield); and power and pumping expense increased by $215,010 (or 12%), mainly due to the anticipated replacement of variable speed drives for the electric motors at the Glace Bay pumping station.

[22] Much of the work noted above was not actually performed, resulting in a projection that the related expense areas will be under-budget for the most recent fiscal year. The Board noted that the budgeted magnitude of these expense items (as well as several other areas projected to be under-budget) were used to project the expenses over the Test Years, and questioned the Utility regarding the accuracy of these expenses over the Test Years. The Utility responded that it focused on future projections more than previously incurred expense levels in developing its projections for the Test Years.

[23] The projected operating expenses for the Test Years are generally based upon the Utility's budget for 2016/17 plus an annual increase sufficient to cover inflation. Exceptions to this are the source of supply expense and the water treatment expense.

The source of supply expense has a significant increase in 2017/18 ($107,000 or 23%). In its response to IR-25, the Utility explained the reasoning behind this increase. The Utility anticipates additional well rehabilitation at the primary Sydney Well Field in 2017/18, as well as at the Gardiner and Floral Heights locations. Conversely, the water treatment expense was projected to remain fairly stable over the Test Years. The Utility explained this is due to the long-term impact of the water loss strategy.

[24] The projected depreciation expense in each of the Test Years is based upon the planned infrastructure additions included in the Utility's capital budget. The expected depreciation is based on rates as set out in the Water Utility Accounting and Reporting Handbook ("*Accounting Handbook*"), or, in several cases where they differ or no specific guidance is given, the rates are based upon the asset's expected useful life.

Findings

[25] The Board finds the projected operating expenses over the Test Years to be reasonable. The Board accepts the allocation of costs between the Municipality and the Utility. The Board reminds the Utility to review these allocations on a periodic basis to ensure accuracy.

[26] The Board accepts the revenue requirement in the Rate Study which resulted in a minor decrease from that used in the original Application.

b) Capital Budget and Funding

[27] The Rate Study included the Utility's capital budgets in each of the three Test Years, totaling $12,000,000, $4,000,000, and $4,200,000, respectively. The Utility has budgeted $12,000,000 in the first Test year and $800,000 in the third Test Year for

distribution mains. The second Test Year has budgeted $2,700,000 for distribution reservoirs and standpipes, $1,000,000 for transmission mains, and $300,000 for meters. The third Test Year also has budgeted $2,200,000 for distribution reservoirs and standpipes, $1,000,000 for transmission mains, and $200,000 for meters.

[28] The proposed funding for the capital budget is as follows:

	2017/18	2018/19	2019/20
Infrastructure Program	$ 9,000,000	-	-
Depreciation Fund	$ 2,850,000	$ 3,850,000	$, 4,050,000
Long Term Debt	-	-	-
Capital out of revenue	$ 150,000	$ 150,000	$ 150,000
Total	**$ 12,000,000**	**$ 4,000,000**	**$ 4,200,000**

[29] The Rate Study projects that, with the proposed funding as set out above, the depreciation fund balance will be $2,145,940 at the end of the Test Years.

[30] In response to IR-2, the Utility noted it had activated a boil water advisory four times since the last rate application in 2011. When questioned about the cause of these boil water advisories, the Utility responded that it is currently working with Dalhousie University to analyze the last boil water advisory and determine the source of the issue.

[31] Mr. MacKeigan advised the Board that the period of significant capital spending seen in recent history has now stabilized, with the focus of the capital program shifting to maintenance of current infrastructure versus expansion.

Findings

[32] The Utility is primarily focusing on repairing and replacing current infrastructure over the Test Years. The intended capital program should help to address the water quality issues the Utility has been experiencing as well as the non-revenue water.

[33] The Board finds the proposed capital budget and funding for each of the three Test Years to be reasonable. However, the Utility is reminded that the inclusion of the proposed capital projects in the Rate Study does not constitute Board approval of these projects. Separate Board approval is required for projects in excess of $250,000 as set out in s. 35 of the *Act*.

c) Non-Operating/Other Revenues and Expenditures

[34] The total annual amount for other operating revenues in each of the Test Years is $343,125, $351,453, and $360,000, respectively. The only non-operating revenue is amortization of deferred capital contributions, which the Utility proposes to phase out over the Test Years. The Board notes that including amortization of deferred capital contributions in non-operating revenue results in under-recovery of the full depreciation expense. In the Board's view, this is not in accordance with sound utility financial principles in that it creates a substantial risk of generating the need for more debt when capital assets have to be replaced. The Board is pleased the Utility is discontinuing this practice and will continue to monitor the issue.

[35] The non-operating expenses include debt payments, and the corresponding interest expense, short-term interest charges, and amortization of debt discounts.

[36] Also included is capital out of revenue of $150,000 in each Test Year as well as earnings in the second and third Test Years ($550,000 and $650,000, respectively). As discussed previously, the Utility has budgeted for earnings in order to bring down the deficit.

[37] The rates of return calculated in the Rate Study provided in response to Undertaking U-1, which are calculated using the total non-operating expense revenue requirement, are 5.27%, 5.40% and 5.40%, respectively, in each of the Test Years.

Findings

[38] The Board finds the Utility's other and non-operating revenues and expenditures to be reasonable and accepts them as presented.

[39] The Board notes that at least a portion of the need for the requested rate of return relates to the need to reduce the accumulated deficit, which has been incurred because a rate application was not brought forward earlier.

[40] Failure to bring applications for required rate relief does cause some intergenerational concerns. It is also important for the ongoing financial health of the Utility that the accumulated deficit be addressed in a reasonable period of time. Therefore, in the circumstances of this case, the Board finds the calculated rates of return are reasonable.

d) Allocations of Revenue Requirement

1. Public Fire Protection

[41] The methodology used in the Rate Study for the calculation of the public fire protection charge is in accordance with the *Accounting Handbook.* This methodology is the same as what was used in the previous rate application.

[42] The percentage allocation of utility plant in service to public fire protection is calculated in the Rate Study to be within a range of 34.7% to 35.7% over the Test Years. The fire protection charges calculated in the Rate Study produced a reduction in

the fire protection charge. For rate design purposes, the Utility is requesting to reduce the fire protection charge to match the calculated amount over the next six years. Therefore, the fire protection charge requested as part of the Application, as set out in the Rate Study, is $7,183,675, $7,131,029, and $7,076,391 in each of the Test Years, respectively.

Findings

[43] The Board accepts the Utility's determination of the fire protection charges as presented in the Rate Study, with the gradual reduction to match the calculated amount requested, and approves them.

2. Utility Customers

[44] The remaining revenue requirement, after the allocation to the fire protection charges, is to be recovered from the customers of the Utility.

[45] The Utility currently has approximately 27,773 customers, which is projected to decrease by 250 customers/annum throughout the Test Years. The Utility based this estimate on trends seen in recent history. The Utility has projected a corresponding slight reduction in consumption. The Utility also has several commercial customers which purchase partially treated water for industrial purposes.

[46] The allocations of costs used in the Rate Study are consistent with the methodology as set out in the *Accounting Handbook*. However, as noted above, the calculated reduction to the allocation to fire protection is being phased in over time.

[47] The Utility is requesting a change to its current block structure. The two-block consumption rate structure is currently based on 14,000 cubic meters per year per

customer for the first block. The Utility is proposing to change the first block to 16,000 cubic meters per year per customer in 2017/18, 18,000 cubic meters per year per customer in 2018/19, and 20,000 cubic meters per year per customer in 2019/20.

Findings

[48] The Board accepts the methodology used by the Utility in the calculation of base and consumption rates for each of the Test Years as proposed.

[49] The Board further accepts the amendment to the consumption volume used to determine the first block, and the calculation of the rates for partially treated water sales. The proposed rates are approved as calculated in the revised Rate Study.

e) Schedule of Rates and Charges

[50] In addition to the rates for water supply to its customers, the Application included two proposed changes to its Schedule of Rates and Charges. These changes, as outlined in IR-33, are for: the special service charge, which was updated to remove the after-hours charge; and the charge for non-negotiable cheques, which was updated to included any additional bank fees.

[51] Mr. Isenor stated that the effective date in the first Schedule of Rates and Charges should be updated, given the timing of the hearing.

Findings

[52] The Board has reviewed the proposed amendments included in the Schedule of Rates and Charges, and finds them to be reasonable.

[53] The Schedule of Rates and Charges for the Test Years are approved as calculated in the Rate Study.

f) Schedule of Rules and Regulations

[54] There were also some changes proposed to the Schedule of Rules and Regulations. The Utility outlined the changes and reasons for them in the response to IR-34. The amendments make property owners liable for the water bill where the premises are leased; clarify billing procedures where contracts are terminated at other than a regular billing date; and, correct a reference to pressure relief valves.

Findings

[55] The proposed Schedule of Rules and Regulations is consistent with most other water utilities in the Province which have had recent rate applications.

[56] The Board approves the Schedule of Rules and Regulations, as presented in Undertaking U-1, as requested.

IV SUBMISSIONS

[57] There were no formal intervenors to the Application. There was one letter of comment, and no requests to speak. The letter of comment expressed concern over the increasing water rates, and, in particular, the level of costs given the reduced consumption of water by Utility customers.

[58] During the hearing, the Board questioned the Utility with respect to the level of costs in relation to the level of consumption. Mr. MacKeigan responded that the only direct costs of the Utility are water treatment chemicals, and power. The remaining costs

are costs that are fixed and need to be recovered from customers regardless of how much water is consumed. Mr. Rooney noted:

> …you still need treatment plant operators, and you still have the same infrastructure, and it's a year older every year, and all that stuff, so it's, you know – and thus, tell me what happens if you lose a lot of revenue. Sometimes rates have to go up to cover that, some of those fixed costs.
>
> [Transcript, p. 23]

Findings

[59] The Board understands the difficulty the Utility faces in recovering its fixed costs due, in part, to the loss of some of its commercial customer revenue. The Board expects the Utility to proceed with its plan to reduce the non-revenue water, which should help to reduce the current deficit and in turn put less upward pressure on rates in the future.

V CONCLUSION

[60] In response to Undertaking U-1, the Utility refiled the Schedule of Rates and Charges for Water and Water Services and amended the effective date to July 1, 2017. Accordingly, the Board approves the Schedule of Rates and Charges for Water and Water Services, effective July 1, 2017, April 1, 2018, and April 1, 2019, as amended in the Undertaking. The public fire protection charge in 2017/18 is prorated, based upon the effective date.

[61] The Board approves the Schedule of Rules and Regulations as proposed, effective July 1, 2017.

[62] An Order will issue accordingly.

DATED at Halifax, Nova Scotia, this 27th day of June, 2017.

Richard J. Melanson