DECISION

NOVA SCOTIA UTILITY AND REVIEW BOARD

IN THE MATTER OF THE PUBLIC UTILITIES ACT

- and -

IN THE MATTER OF AN APPLICATION of the TOWN OF PICTOU WATER UTILITY for Approval of Amendments to its Schedule of Rates and Charges for Water and Water Services

BEFORE: Murray E. Doehler, CA, P.Eng., Member

APPLICANT: TOWN OF PICTOU WATER UTILITY
Scott Conrod, CMA
Chief Administrative Officer
Kyle Slaunwhite, P.Eng
Chief Operator, Treatment Plant
Eldon MacDonald, CA
Accountant
Mike Chaulk, P.Eng.
Design Engineer
CBCL Limited

INTERVENOR: Ralph Ferguson

HEARING DATE: June 19, 2013

FINAL SUBMISSIONS: July 9, 2013

DECISION DATE: August 19, 2013

DECISION: Schedule of Rates and Charges approved, as amended.
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I SUMMARY

[1] The Town of Pictou ("Town") applied to the Nova Scotia Utility and Review Board ("Board") on behalf of its Water Utility ("Utility") for amendments to its Schedule of Rates and Charges for Water and Water Services ("Application") pursuant to the Public Utilities Act ("Act"), R.S.N.S. 1989, c.380, as amended. The existing Schedule of Rates for Water and Water Services has been in effect since April 1, 2007. The Application does not propose any changes to the Utility’s Schedule of Rules and Regulations, which has been in effect since October 1, 2005.

[2] A Rate Study to support the Application, dated February 25, 2013, was prepared by Town Staff and submitted to the Board on March 11, 2013. Additional information with respect to the Application was filed as a part of the Information Request ("IR") responses.


[4] The Utility’s residential customers are currently unmetered. Although it is expected that all customers will be metered during the 2014/15 test year, the Application requests that the current unmetered rate ("flat billing") continue for residential customers until such time as the Utility’s water discolouration issue is adequately addressed. It is proposed that in the interim period, the meters, although not used for billing purpose, will be read to both provide the residential customers with a "shadow bill", and to provide the Utility with information on actual consumption and suspected leaks.
[5] Based upon the assumption that residential flat billing continues, the proposed amendments to bills for the customer class that will eventually be served by a 5/8" meter size over each of the test years are 48.0%, 0.3%, 0.73% and -0.2%, respectively.

[6] For all other non-residential customers, who are currently metered, based upon the average quarterly consumption of each meter size, the Application proposes amendments between 16.5% to 25.1% in 2013/14, 6.5% to 13.3% in 2014/15, 0.6% to 0.7% in 2015/16 and -0.5 to -0.2% in 2016/17.

[7] The Application further proposes amendments to the annual public fire protection charge to be paid to the Utility by the Town. The annual public fire protection charges are proposed to be increased by 7.8%, 3.9%, 1.6% and 0.9%, resulting in charges of $178,141, $185,126, $188,037, and $189,749, respectively, in each of the test years.

[8] The public hearing was held at the Town's Council Chambers after due public notice. The Utility was represented by Town staff: Scott Conrod, Chief Administrative Officer; Kyle Slaunwhite, Chief Treatment Plant Operator; and Eldon MacDonald, Accountant. Mike Chaulk, Design Engineer, CBCL Limited also represented the Utility. Ralph Ferguson, a Utility customer, applied for formal intervenor status. One letter of comment was filed with the Board. Three members of the public, including the Mayor, spoke during the hearing.

[9] A rate increase is approved, as amended by this Decision.
II INTRODUCTION

[10] The Utility’s source of water supply is from 13 wells in two wellfields, located within and outside of the Town’s boundary. The wells have generally low yield and several are necessary to meet demand. The wells contain naturally elevated levels of iron and manganese. Chlorine is used for disinfection at all of the wells. The additional treatment process at each well head depends upon the quality of water from the individual well. Some of the wells are clustered and pump to a transmission main which supplies the Utility’s water tower. Other wells operate independently and pump directly to the Utility’s distribution system.

[11] Since the Utility’s rate application in 2005, a number of studies dealing with improving the water quality have been undertaken. A series of tests were conducted which determined that a number of the wells can be classified as groundwater under the direct influence of surface water (“GUDI”), requiring additional treatment. The Utility recently commissioned a new non-GUDI well to aid in meeting the demand.

[12] Due to the elevated levels of manganese in the source water, the Utility has experienced water discolouration issues for a long period. In 2009, a water quality evaluation report recommended that a centralized treatment facility, which would receive the blended water from all of the source wells through a common transmission main, would be required to remove the manganese and deal with the discolouration issue at an estimated cost of $4 million.

[13] The Utility has established a two phase plan to complete its necessary infrastructure upgrades. Phase one, totalling approximately $3.3 million, is to be
completed by the end of the test period. Phase one’s primary focus is to bring the Utility, which is currently non-compliant, into compliance with Provincial Drinking Water Regulations ("NSE Regulations"), while ensuring that any upgrades will be compatible with the eventual centralized treatment process. This phase also includes the installation of meters and the rehabilitation of the water tower. The revenue requirements associated with Phase one are included in the Rate Study.

[14] Phase two deals with addressing the water discolouration issue through centralized treatment. The costs associated with resolving this matter are not included in the revenue requirements of the Rate Study, with the exception of approximately $87,000 for piloting potential treatment technologies.

[15] The Applicant currently serves 1,363 customers. It is projected that there will be 13 new residential customers in each of 2015/16 and 2016/17, from new housing developments that are scheduled to be completed.

III REVENUE REQUIREMENTS

1. Operating Revenue and Expenses

[16] The Utility had an excess of revenue over expenditure for the 2011/12 fiscal year of $8,835 and an accumulated operating surplus of $92,628. It is projected that at current rates there will be an accumulated operating deficit of $567,944 at the end of the test period.

[17] The Rate Study includes a section outlining the assumptions used in projecting the various operating expenses during the test years. Using the 2012/13 expenses, the pumping, purification and distribution labour costs, and power and
pumping maintenance costs are projected to increase by 3% over each of the test years. An additional $3,000 has been added to the maintenance of pumping equipment expense in 2014/15 for additional costs related to the proposed SCADA system.

[18] The purification maintenance and supplies and distribution main maintenance expenses in 2013/14 are based upon the average of the prior three years, with inflation of 3% applied during each of the test years.

[19] The source of supply expense is projected to decrease from $10,650 in 2013/14 to $2,500 over each of the three remaining test years. The Applicant explained that the 2013/14 estimate was based upon an average of the previous three years, when extensive repairs were carried out on the wellheads. It is projected that with the completion of wellhead upgrades and new equipment to be completed during the test period, the maintenance costs will decrease.

[20] The transmission and distribution repair expense in 2013/14 is based upon the average of the previous three years. The projected expense decreases slightly in 2014/15 due to an approximately one-time $20,000 increase in repair costs in 2012/13. The Applicant noted that the assumption used in the Rate Study to increase the repair expense annually by 3% was not applied to the calculations; but concluded that this error will not have a material impact on the revenue requirements.

[21] The administration and general expense contains a line item "Uncollectable accounts", which is based upon the percentage calculated through averaging the ratio of the previous three years’ actual bad debt expense to billing revenue, and applying this percentage to the projected years’ billing revenues. The Board noted that the annual amount projected, of approximately $10,000 to $11,000
represents money lost, and questioned what is being done to reduce this amount. The Utility noted that it has recently installed new accounting software which allows for improvements to the collection process through the generation of various reminders and notices related to the billing process.

[22] The Board advised the Utility that in reviewing the financial statements it noted that the administration and general expense includes the expenses associated with interest and principal payments on long term debt, which should be a separate non-operating expense. The Applicant responded that it will make this correction to its 2013 financial statements. The debt payments in the Rate Study are properly classified as a non-operating expense, in accordance with the Water Utility Accounting and Reporting Handbook ("Accounting Handbook").

[23] The depreciation expense in the Rate Study is based upon the proposed capital projects over the test period. The depreciation rates are in accordance with those set out in the Accounting Handbook.

[24] Mr. Conrod confirmed during the hearing that the operating expense item identified as “Grant in lieu” is actually property taxes and should be identified as such.

[25] The Applicant described the allocation of costs from the Town to the Utility for the year ended March 31, 2012:

- Office and office equipment usage - $10,000
- Truck usage - $3,000
- Public works equipment usage - $18,000
- Superintendent – 50% of salary
- CAO – 40%
- Billing Admin Assistant – 50%
- Accounting staff (Accountant, AP, Front Desk) – 30%

[Exhibit P-3, IR-11f]

[26] Mr. Conrod added that the allocation is reviewed with staff annually, based upon actual costs and time.
Findings

[27] The Board has reviewed the Applicant’s explanation of the allocation of common costs between the Utility and the Town and finds the methodology to be reasonable. It appears that the Utility is also following sound business practices in periodically reviewing the cost allocations. The Board accepts the operating expenses as projected over the test period.

[28] The Board further accepts the annual depreciation expense, based upon depreciation rates set out in the *Accounting Handbook*. The Board reminds the Utility that its financial statements should be prepared in accordance with the *Accounting Handbook*, in particular, the classification of debt charges.

2. Capital Budget and Funding

[29] The Rate Study includes the Utility’s proposed capital expenditures over the test period, to meet the two main goals of meeting the *NSE Regulations*, and planning for the eventual construction of the centralized water treatment plant, the capital costs of which are not included in this Application.

[30] The total cost associated with the infrastructure plan indicated in the Rate Study is $3,348,911. Of this total, $1,108,575 was spent in the past to deal, in part, to the clustering of a series of wells. The bulk of the work, costing $1,878,620, associated with meeting *NSE Regulations* is projected to occur in the current year, 2013/14. The current year’s projects further include the rehabilitation of the water tower and the meter installation project. The projects in the remaining test years focus on distribution and hydrant work, with projected annual costs of $157,716, $110,000 and $100,000 over the test period.
The funding for the capital expenditure is as follows:

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<td>$1,878,620</td>
<td>$151,716</td>
<td>$100,000</td>
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[Exhibit P-2, p. 10]

The Utility indicated that the grants have been confirmed. The new debt of $270,000 in 2012/13 and $806,041 in 2013/14 has terms of 25 years and 20 years, respectively. The intent is to match the term of the debt to the useful lives of the funded assets. The Utility noted that there is an error of $88,891 associated with pumping equipment with a 20 year useful life which is included in the 25 year debt; however, a correction of this would have a minimal impact on rates. The projected interest rates for both debentures range from 1.55% to 4.41% which is based upon information from the Municipal Finance Corporation (“MFC”).

Mr. Conrod explained that the annual amount of $100,000 capital from operations relates to the continuation of the Utility’s annual investment in repairing its distribution mains.

In the Rate Study the Utility shows a forecasted increase in the depreciation fund of $330,870 in 2012/13 (to a total of $549,139) while the annual depreciation is only $72,864. The Utility explained that the difference, of $258,006, is the proceeds of a debenture, which was placed into the depreciation fund reserve.
Thus, the Utility has the resources in the depreciation fund to withdraw $653,260 in 2013/14.

[35] The Board noted that although the proposed funding for the test years indicated there are depreciation funds available, based upon the Utility’s explanation, it is difficult to determine the actual depreciation fund balance, as it appears to be a combination of accounts. The Board supports the maintenance of a healthy depreciation fund balance, especially given the Utility’s significant capital expenditures projected for the next few years.

[36] With respect to the financial statements for the year ended March 31, 2012, the Utility confirmed that the annual depreciation expense was not transferred to the depreciation fund for each of the years reported. The Applicant confirmed that although this had not been the case in the past, it is now being transferred. Note (3) to the financial statements refers to the depreciation fund reserve, however, it was confirmed by the Utility that this is actually the accumulated depreciation.

[37] The Rate Study’s projected capital fund balance sheet shows an amount of $270,000 at the end of the test years which is owed by the capital fund to the operating fund. Mr. Conrod explained that the Utility views the information currently before the Board as a “bridging application”, with the expectation that another rate application will be filed in the near future which will consider the inter-fund balances.

**Findings**

[38] Given the significant infrastructure upgrades identified by the Utility over the next few years, the Utility has taken a phased approach in dealing with its capital requirements, which the Board accepts. The Utility’s main priority at this time is to be
compliant with *NSE Regulations*, while beginning to plan for the eventual centralized treatment process.

[39] The Board accepts the Utility’s proposed capital program and funding as set out in the Application. However, the Board reminds the Utility that, as set out in the *Accounting Handbook*, the depreciation expense is to be set aside annually and carried in the depreciation fund. While the Utility may establish other capital reserves, in accordance with the procedures contained in the *Accounting Handbook*, the depreciation reserve should be a separate account and only contain funds associated with the depreciation of the Utility’s assets.

[40] There appears to be some confusion with respect to the depreciation fund reserve asset account and the Utility’s accumulated depreciation account, as presented in the financial statements. This should be reviewed with the Utility’s auditors. As noted by the Board during the hearing, it is imperative that the Utility properly record its depreciation fund balance, given the magnitude of the proposed capital upgrades.

[41] In a letter to the Utility dated May 21, 2013, the Board approved the Utility’s 2013/14 capital projects and funding as projected in the Application. The Board reminds the Utility that the inclusion of the other capital projects in the Rate Study does not constitute Board approval. Separate Board approval is required prior to construction of all capital projects in excess of $250,000, as set out in s. 35 of the *Act*. 
3. Non-Operating Revenue and Expenditures

[42] There are no non-operating revenues projected over the test period. The non-operating expenditures include capital expenditures out of revenue ($100,000) and debt charges, both existing and new.

[43] In its decision to fund some capital from revenue, the Utility noted that while it considered using other funding options, it believed that the additional debt would result in an unfavourably high debt to revenue ratio.

[44] The existing debt was incurred to fund various capital projects including a transmission main and distribution mains, treatment equipment and wells. The new debt charges relate to the financing of a portion of the Utility’s projected capital program.

[45] The Rate Study indicates that the calculated return on rate base for each of the test years is 4.53%, 5.20%, 5.21%, and 5.23%, respectively. (The return on rate base in the final test year was corrected in response to IR-19a). The Utility commented on the magnitude of the projected return on rate base, noting that it does not view the amounts as unreasonable, given the uncertainties associated with the long term interest rates.

[46] The Board questioned the return on rate base calculated in the Rate Study for the 2011/12 fiscal year of 4.68%, as it differs from that indicated in the financial statements of 6.2%. In response to Undertaking U-2, the Utility reconciled the two figures and indicated that the return on rate base is 4.7%.

Findings

[47] The Board notes that the return on rate base is higher than the projected new debt interest rates over the test period. However, the Board accepts and approves
the return on rate base, as it is required for cash sufficiency with no excess earnings are being requested over the test period.

[48] The Board accepts the projected non-operating expenditures.

IV ALLOCATION OF REVENUE REQUIREMENTS

1. Public Fire Protection

[49] The allocation of utility plant in service to fire protection in the test years is generally consistent with the Accounting Handbook as well as the majority of other water utilities in the Province with the exception of the proposed allocations of transmission mains, distribution mains and pumping equipment. The allocation of each of transmission and distribution mains is 60%/40% to general service/fire protection as opposed to the 40%/60%, respectively set out in the Accounting Handbook and used by the Utility in its last rate application. The allocation of pumping equipment is 40%/60% to general service/fire protection, as opposed to the 90%/10%, set out in the Accounting Handbook.

[50] The Board questioned the proposed 40% allocation of the transmission mains to fire protection, which is lower than the 60% used in both the Utility’s previous rate application and in the Accounting Handbook. Mr. MacDonald explained that the transmission main goes directly from the wells to the reservoir, and it is the distribution system which is sized to achieve the necessary fire flows.

[51] In response to Undertaking U-1, the Utility stated that it reviewed its proposed allocations of distribution mains, pumping equipment and transmission mains, in relation to industry standards and its specific use of these assets. As a result, it
proposed that both the pumping equipment and distribution main allocations be revised to reflect the *Accounting Handbook* allocations. With respect to transmission mains, it noted that existing and recent additions to these mains connect or cluster a number of wells which produce water which is delivered directly to the water tower, to enable the eventual connection to a centralized treatment plant. Based upon this, the Applicant concludes that the transmission main does not provide fire flow to the Town, which is provided through the distribution system including the water tower, and has revised the allocation to 90%/10% to general service/fire protection.

**Findings**

[52] The Board notes that with the revisions proposed in response to Undertaking U-1, the methodology used to determine the fire protection charge conforms to the methodology set out in the *Accounting Handbook*, with the exception of the allocation of transmission mains.

[53] The Board understands that the Utility’s system can be described as unique among water utilities in the Province, with numerous wells, requiring various treatment processes, with the ultimate goal of being clustered in order to ultimately have a centralized treatment system. The Board accepts the transmission main allocations, as set out in the response to Undertaking U-1, for this Application.

[54] As a result of the changes to the allocation as set out in the response to Undertaking U-1, the fire protection charges will decrease from that proposed in the Rate Study. The Utility, in its compliance filing, is to recalculate the fire protection charge.
The fire protection charge for the first test year, 2013/14, will be calculated by prorating the current and new charge.

2. Utility Customers

The remaining revenue requirements, after the allocation to fire protection charges, are to be recovered from the rates to the Utility’s customers. The methodology used to allocate the remainder of the expense items to determine the base and consumption charges is consistent with the Accounting Handbook. The Board questioned why taxes are allocated 100% to base, as opposed to using the same 40%/30%/30% allocation to base/delivery/production as depreciation and return on rate base. In response to Undertaking U-2, the Applicant explained that the allocation used is in accordance with the Accounting Handbook and does not want to change it.

The Application estimates the residential consumption volumes over the test years, except for 2014/15, to increase 1% to reflect new customers. In 2014/15, the Utility projects a 15% decrease in total consumption when all customers will be metered. The Utility explained that the 15% figure is based upon the experience of other utilities upon metering. It further noted that it is assumed that the impact from metering on reducing consumption will only be seen in the first year, with consumption patterns normalizing thereafter.

Even when residential customers are metered, the Utility proposes to “flat bill” them. The actual consumption will be disclosed on the bill. The Utility explained its proposed “flat billing” approach:

The Utility’s model, a flat billing approach, is based on an estimated average consumption based on total volumes produced. Estimated consumptions for metered billing at this point is unreliable as more data is needed, i.e., the Utility’s request to
continue flat billing while issuing a shadow bill for public information while allowing the Utility to collect metered data.

[Exhibit P-3, IR-23b]

[59] Of the Utility’s 1,363 customers, 1,230 are 5/8” meter equivalent, residential unmetered customers. Twenty commercial/industrial customers are metered 5/8” customers. The Board commented on the difficulty of calculating an average 5/8” meter size rate, given that both residential and commercial customers are included in this rate class. In particular, the Board noted that the approximately 21,800 gallons per quarter consumption assumed for a typical 5/8” meter size is high in comparison with other utilities who generally use volumes in the 15,000 gallons per quarter range for residential unmetered consumption.

[60] The proposed quarterly base charges vary little over the test period. For example, the 5/8” meter proposed quarterly base rates are $41.26, $42.91, $43.18 and $42.93, respectively over each of the test years. Upon questioning from the Board, the Utility was not opposed to fixing the base charge over the test period.

Findings

[61] The Board approves the methodology used in the allocation of expense items to the base charge, customer charge, delivery and production categories, which is consistent with the Accounting Handbook.

[62] The Board accepts that the total water consumption by residential customers will decrease when they are billed for actual usage. However, this will likely not happen if flat billing is continued until the Phase two capital program is completed, which will be after the 2014/15 test year. The shadow billing may change behaviour to reduce some consumption, but not likely to the level projected.
[63] There is only a one block rate, so the allocation between production and delivery costs is not relevant. The total of these two costs increases by less than 2% per year. With the large dramatic projected reduction in consumption, the volumetric charge increases by about 20% in 2014/15 and is then in line with the total costs thereafter. This means there is an unfair shift of the costs to the metered customers from the residential customers. The Board does not accept the concurrent flat rate billing for residential customers along with a reduction in consumption.

[64] In its compliance filing, the Utility should select one of the two following acceptable alternatives:

a) Continue to flat bill residential customers until Phase two is completed, and do not use a consumption decrease of 15% when calculating the volumetric charge.

b) Bill everyone the calculated volumetric charge once they are metered and use the reduced residential consumption in the calculation.

[65] The Board finds that the minor changes to the base rates proposed over the test years should be replaced with a fixed quarterly amount for the whole test period, rounded to the nearest dollar. The consumption charges are then to be calculated based upon meeting the necessary revenue requirements. Given, the changes to the fire protection charge noted above and the selection described in para. [64], the revenue requirements from customer rates to be used in the calculation will differ from those proposed in the Rate Study.

V SUBMISSIONS

[66] Mr. Ralph Ferguson, a customer of the Utility, was a formal intervenor in the proceeding. His main concern was about the water discolouration issue, and the
impact that it has had on Utility customers (e.g., staining laundry and corroding appliances). He illustrated the issue through a water sample he collected from his washroom tap, which showed the settlement of solids at the bottom of the jar, and further questioned if a settling tank could be installed to eliminate the solids. Mr. Chaulk commented that several feet of sediment were found at the bottom of the water tower and the outlet was subsequently raised. He added that the Utility’s capital plan includes draining, flushing and cleaning the water tower.

[67] During the hearing a letter was received and read from a customer who described her concerns with the discoloured water and the amount of money spent on bottled water. She requested that the Board allow the continuation of flat residential billing as currently, in her opinion, the amount of water that comes from the tap is not reflective of the amount of “usable” water.

[68] Two other customers expressed their concerns with respect to the discoloured water. One customer noted that she must boil the water before use. The other customer commented that the rates could be increased once a solution to the problem has been put in place. She further questioned the rate increase that will be associated with the Phase two capital work.

[69] Mayor Joe Hawes spoke during the hearing, noting that the number one policy of Town Council is to fix the water problem and that the only way that this can be done is through a water rate increase.

[70] Mr. Chaulk explained that the discolouration issue becomes more pronounced when there is a large demand on the system caused by an event such as a main break. He added that although the capital expenditures during the test years does
not directly address discoloration, it builds on the overall plan by centralizing the well controls through pumping to one location, which is needed when phase two construction begins. He added that currently the effort is focused on disinfection and meeting NSE Regulations.

VI CONCLUSION

[71] The Application was prepared based upon rate increases being in effect the entire 2013/14 fiscal year (i.e., effective April 1, 2013), which is not possible given the timing of the filing date and hearing. The Board approves the Schedule of Rates and Charges for Water and Water Services supplied on and after September 1, 2013, April 1, 2014, April 1, 2015, and April 1, 2016.

[72] The Utility is ordered to file a compliance filing that recalculates the rates in accordance with the findings of this Decision. The compliance filing should recalculate the fire protection charge; choose an acceptable method to calculate the consumption charge; determine a base charge for each meter size, for the whole test period; recalculate the consumption charge, and the unmetered ("flat") residential rate. The Utility should further file a copy of its proposed Schedule of Rates and Charges for each of the test years, in the same format as currently exists.

[73] An Order will issue upon receipt and acceptance of the Compliance Filing.

DATED at Halifax, Nova Scotia, this 19th day of August, 2013.

Murray E. Doehler