

Testimony

GUASTELLA ASSOCIATES, INC.

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UTILITY MANAGEMENT • VALUATION • RATE CONSULTANTS

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May 3, 2004

EXPRESS MAIL

Hon. Jaclyn A. Brillling, Secretary
New York State Department of
Public Service
3 Empire State Plaza
Albany, New York 12223-1350

*Orig-Files
C 03-W-0952
Copies:
Mr. A. Gordon
Mr. D. Vanort (extra's)*

Re: Case No. 03-W-0952 – Application of Reagans Mill Water Company for
Approval of an Increase in Rates and Charges.

Dear Secretary Brillling:

I am enclosing four copies of an affidavit on behalf of Reagans Mill Water
Company in support of its rate increase filing and in opposition to the PSC Staff's
preliminary report in this case.

I am also enclosing the same affidavit in separate envelopes to Chairman Flynn
and Commissioners Weiss, Dunleavy and Gavin, and to Messrs. Thomas Dvorsky and
Jack Agansky. I am taking the liberty of asking you to have these delivered to them.

Thank you for your assistance. Please call me at (561) 747-9867 if you have any
questions.

Respectfully submitted,

GUASTELLA ASSOCIATES, INC.
Consultant for Reagans Mill Water Co.



John F. Guastella
President

Encl.

THE STATE OF NEW YORK
DEPARTMENT OF PUBLIC SERVICE

PSC Case No. 03-W-0952

In the Matter of the Application of
Reagans Mill Water Company for
Approval of an Increase in Rates and
Charges.

AFFIDAVIT IN SUPPORT
OF APPLICATION

STATE OF FLORIDA)
) ss.:
COUNTY OF PALM BEACH)

John F. Guastella, being duly sworn, desposes and says:

1. I am President of Guastella Associates, Inc., a utility consulting firm, and a licensed professional engineer in the States of New York, New Jersey and Florida. I have been actively engaged in matters involving utility rates and service for forty-one (41) years. A copy of my resume is annexed hereto as Exhibit "1".

2. I make and submit this affidavit in support of the application in the above captioned proceeding by Reagans Mill Water Company ("Reagans Mill" or "Company").

3. I make this affidavit upon personal knowledge.

PROFESSIONAL BACKGROUND

4. I have been President of Guastella Associates, Inc. since its formation in 1978. Guastella Associates, Inc. provides management, valuation and rate consulting services to numerous public and private utilities and specializes in rate analysis and

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calculation for water and sewer utilities. Guastella Associates, Inc. has provided rate consulting services for numerous private, investor-owned utilities, such as Reagans Mill.

5. Prior to establishing Guastella Associates, Inc., I was employed by the New York State Public Service Commission ("PSC" or "Commission") for sixteen (16) years, from 1962 to 1978. During my tenure at PSC, I held the positions of Chief of Rates and Finance in the Commission's Water Division (1970 to 1972) and Assistant Director (1972 to 1974) and Director of the Water Division (1974 to 1978). While employed at the PSC, I was directly involved in developing the Commission's initial rate policy for new developer related water utilities. I also drafted laws that were enacted with respect to the Commission's jurisdiction over small and developer related water utilities.

6. As a principal of Guastella Associates, Inc. and as a former PSC employee, I have had extensive experience in utility valuation and rate-setting, including rate consulting services for water and/or sewer utilities located in Alaska, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nevada, New Jersey, New Mexico, New York, North Dakota, Ohio, Pennsylvania, South Carolina, Texas, Rhode Island, and Virginia.

7. In 1974, while still employed by the PSC and serving as Co-Chairman of the Staff Subcommittee of the NARUC Water Committee, I developed the case study material and helped establish the Water Rate Seminar on behalf of the NARUC. I have served as an instructor at that seminar each year since 1974, which has been held in Florida for the last 31 years. In 1980, at the request of the then NARUC Water Committee Chairman, I assisted in establishing a similar seminar to be held in the

western side of the country, and I have served as an instructor at that seminar each year for the last 24 years.

REAGANS MILL'S 2003 RATE INCREASE APPLICATION

A. Preparation of the Rate Application

7. In 2003, Guastella Associates, Inc. was retained by Reagans Mill to perform a rate analysis and prepare a rate application to be submitted to the PSC.

8. As a result, I reviewed relevant portions of the Company's books and records for the period 2000 to 2002, as well as appropriate financial and other operating data.

9. I prepared schedules summarizing my rate analysis, which are similar, but likely more comprehensive, in content and scope to those typically submitted to the PSC for small water utilities seeking rate increases. These "Schedules in Support of the Rate Filing, along with a revised tariff schedule and work papers, were submitted to the PSC on behalf of Reagans Mill. A copy of these schedules and revised tariff, together with the transmittal letter signed by myself, and Mr. Gary C. White of my firm, who assisted me in the preparation of the filing, are annexed hereto as Exhibit "2". These materials constitute Reagans Mill's rate increase application.

10. The rate analysis contains a detailed summary of the Company's cost of providing water service, and the resultant rates necessary to cover that cost.

11. The rate-setting principles and methodologies employed in the rate analysis are accepted throughout the utility industry as a proper means of calculating rate relief and reflect a fair and rational basis for establishing water rates.

12. The rate-setting principles and methodologies utilized in the rate analysis were consistent with those previously employed by Reagans Mill in seeking and obtaining approval of its initial rates from PSC in 1988. In 1988, I personally prepared Reagans Mill's initial rate analysis, founded upon the appropriate rate setting principles and methodologies that are applicable to newly formed utilities created by affiliated real estate developers in order to serve their new real estate projects. A copy of that initial rate analysis is annexed hereto as Exhibit "3".

13. Significantly, the PSC adjudicated the Company's 1988 initial rate filing and allowed, in full, the rates requested by the Company, effectively approving the methodology and initial rate concept reflected in the calculation of the initial rates.

B. Rate Calculation

14. In preparing Reagans Mills rate application to the PSC, I again used the rate-setting methodologies that are consistent with those used in the initial rates that were approved by the PSC in 1988. This methodology is designed to establish rates that produce revenues sufficient to cover the cost of providing service – known as the revenue requirement. The revenue requirement is comprised of two principle components: (a) operation costs; and (b) capital costs related to the investment in plant, including a return on investment to enable the utility to maintain its financial integrity and attract capital.

15. Thus, the proposed rate increase was designed to (a) recover Reagans Mill's cost of operations (operation and maintenance expenses, depreciation and taxes); and (b) provide a return (net operating income) on investment in plant and facilities used and useful in providing service to the Company's customers.

(1) **Cost of Operations**

16. Projected Reagans Mill's cost of operations for a complete system as set forth in its rate increase petition (Exh. B, Schedule C) follows:

Operation & Maintenance	\$ 71,275
Depreciation and Amortization	40,099
Taxes-other (i.e. Real Estate and Revenue Taxes)	35,250
Income Taxes	<u>91,134</u>
Total Operating Expenses	\$237,758

(2) **Return on Investment**

17. In addition to operating expenses, rates must be established which also provide a return on investment. In establishing a reasonable return, it is first necessary to determine the rate base. It is the original cost of the investment made in utility plant in service that is used and useful and necessary to serve the customers, less accumulated depreciation, plus working capital and unamortized balances. The utility plant in service amount is net of contributions in aid of construction that, in accordance with the 1988 initial rate analysis approved by the PSC, were imputed at 35% of the original cost of the utility plant in service. The rate base for the complete system of the Company was calculated to be \$1,216,856. (Exh. B, Schedule B).

18. Once the rate base is determined, the rate of return on the net investment (i.e., on the rate base) must be determined. Because the Company's source of funds is only from equity investment, the rate of return used in the Company's rate petition is 12.5%, representing a return on the Company's equity capital. (Exh. B, Schedule D).

19. The return (net operating income) is then calculated by taking the rate of return (12.5%) and multiplying it by the rate base (\$1,216,856), yielding the sum of \$152,107. (Exh. B, Schedule C).

(3) **The Revenue Requirement**

20. The total revenues required by the Company are, therefore, \$389,865 (\$237,758 for expenses (see paragraph 16) and \$152,107 for net operating income (see paragraph 19).

C. **Rate Setting Methodology**

21. In computing rates for Reagans Mill's rate application, I utilized, as has always been the case with Reagans Mill, the policy applied by the PSC to growing utility systems of determining revenues and costs for a fully developed or "complete system." The "complete system" analysis ensures that during the growth years of a developing utility (such as Reagans Mill), the customers pay only their proportionate share of the cost of the utility system. In this instance, the Company was expected to be fully developed at year-end 2003. This method is consistent with the PSC's initial rate policy as set forth in its Statement of Policy on Rates For Water Service, issued September 21, 1978, a copy of which is annexed hereto as Exhibit "4".

22. The result of adopting the PSC policy of a "complete system" in establishing its initial rates in 1988, and now, has been that Reagans Mill's investors, rather than its customers, have borne the costs (carrying costs) of supporting a utility system that was not fully developed until 2003. The customers have paid only their proportionate share of the cost of providing water service; the Reagans Mill's investors have borne the carrying costs of remainder of full cost of operating and funding the water utility during its growth years.

23. The "complete system" rate structure has been in place since the inception of Reagans Mill. This arrangement was specifically expressed in the initial rate analysis submitted to and approved by the PSC in 1998. The magnitude of the carrying costs absorbed by the stockholders is in excess of \$4,000,000, comprised of cumulative operating deficits, unearned return and the related time value of money.

24. Reagans Mill's affiliated developers had the same individual stockholders as Reagans Mill. The need for the affiliated developer to fund the construction cost of the Company's water system and subsidize its operations during the growth years is not only typical but also inescapable for a newly formed utility. A new developer-related utility has no revenues initially and insufficient revenues during the growth years because, under the initial rates that are based on a complete system, the customers pay for only their proportionate share of the total operating and capital costs of the system.

25. I prepared a schedule of water rates and charges, which includes a service charge for the Company's residential customers of \$211.68 per quarter and a usage rate of \$4.95 per thousand gallons. The Company serves only one small industrial customer that has a water meter that is the same size as the meters for the residential customers. That customer would also pay a separate private fire service charge of \$4,000 annually, in addition to a share of the public fire service costs incorporated into the general metered rates.

26. Under the proposed rate structure, I projected that the 324 residential customers would generate \$382,106 of annual revenues and the small industrial customer would generate \$7,753 of annual revenues. This level of revenues is slightly less than the revenue requirement because of rounding in the specific rates.

27. The rate analysis and proposed rate increase as submitted to the PSC are based on proper regulatory rate-setting methodologies and principles, and consistent with

the initial rates approved by the PSC in 1988. It is important to note that the initial rate analysis that was submitted to and approved in 1988 specifically advised the PSC that “Each revenue requirement component has been calculated in current, uninflated dollars so that today’s customers do not pay rates for service based on future price levels. It is therefore anticipated that any increase in operating expenses and construction costs in the future (due to inflation, operational expenses and construction changes, delays, variance in system characteristics or other unanticipated changes) would require compensatory rate revisions.” I have examined the Company’s costs of operations and found them to be reasonable. All appropriate rate-setting principles pertaining to developer-related utilities have been considered and appropriately utilized in preparing the rate increase application to the PSC.

28. Although the proposed overall revenue increase was 198.3 %, it spans 15 years and reflects the need to compensate for a significantly reduced level of anticipated revenues because the annual consumption per customer is now about 67,200 gallons compared with the initial estimate of 92,000 gallons, a 27% reduction.

29. The major cost components have generally increased due to inflation or for circumstances beyond the control of the Company. Operation and Maintenance expenses have experienced an annual average increase of some 3.5%. Taxes (other than income taxes), essentially property taxes that are of course entirely beyond the control of the Company, have increased by an annual average of 7.2%.

30. The net plant investment (original cost less contributions and depreciation) is now \$1,158,744 or an increase over the initial estimate of \$891,439 or 30% in total (an average annual increase of less than 2%), due to construction cost changes and because significantly more rock excavation for water main installations was necessary than originally anticipated, and due to additional customers. It is also noted

that the net investment reflects the imputation of contributions in the amount of \$656,801 as compared to the initial level of \$488,309, a 35% increase.

31. The return requirement and related income taxes are more than originally estimated because of the higher net plant investment and a capital structure consisting of all equity investment (due to the inability of the company to obtain debt financing on the strength of its own financial condition).

PSC STAFF'S PRELIMINARY ANALYSIS

32. By facsimile dated December 18, 2003 Staff submitted its preliminary analysis to the Company, annexed hereto as Exhibit "5". Upon review of Staff's preliminary analysis, the Company and I strongly objected to certain of Staff's adjustments, particularly the rate base adjustment. In a telephone conversation with Staff I express those concerns and was informed that Staff would not likely revise its position. I requested a hearing on behalf of Reagans Mill. After consulting with its attorneys, Staff denied my request for a hearing.

33. In addition to the rate setting issues, Reagans Mill was also faced with a Staff imposed procedure that would deny any opportunity for the Company to present expert testimony and to cross-examine and rebut any testimony that would be presented by Staff. It was not only impossible for the Company to anticipate the adjustments that Staff would propose, Staff's preliminary report also contains only minimal conclusory comments but no substantive discussion of any rate setting principles or utility economics in support of its adjustments to which the Company takes exception.

RATE BASE ADJUSTMENT

34. Staff's preliminary report shows a rate base adjustment in the amount of \$462,226 stating, "the majority of the adjustment relates to non-arms length transactions

and the Commission's policy on initial rates." Staff provides no explanation as to why a non-arms length transaction, per se, or the Commission's initial rate policy would warrant any rate base adjustment.

Initial Rate Policy

35. It is important to recognize at the outset that the Commission's initial rate policy does not require affiliated real estate developers to contribute any portion of the cost of a water system to its newly created water utility. If the initial rates of a newly formed water utility were calculated to cover all operating expenses and a return on the entire cost of the water system, then the rate base would not reflect any deduction for contributions, either per books or imputed. Only if the initial rates were calculated to be significantly less than fully compensatory would the imputation of a level of contributions be considered - - and only to the extent that the initial rates had an apparent impact on the prices paid or to be paid by the customers for the related real estate.

36. In 1988, I prepared Reagans Mill's initial rates. The calculation of rate base and annual depreciation reflected an imputation of contributions equal to 35% of the original cost of the water system as originally contemplated for a complete system. My initial rate report was submitted in support of Reagans Mill's initial rate filing. The Commission approved those initial rates as filed. My initial rate report stated,

" Each revenue requirement component has been calculated in current, uninflated dollars so that today's customers do not pay rates based on future price levels. It is therefore anticipated that any increases in operating expenses and construction costs in the future (due to inflation, operational and construction changes, delays variances in system characteristics or other unanticipated changes) will require compensatory rate revisions. The possible occurrence of such future events, however, does not alter the compensatory nature of the revenue requirement and resultant rates established in this analysis."

37. Thus, in accordance with the initial rate policy, the initial rates were established on a compensatory basis using an imputation of contributions at 35% of the original cost of the water system.

38. In the current rate filing the rate base reflects an additional imputation of contributions equal to 35% of the additional cost of plant over and above the original imputation of contributions. The rates as now filed by the Company maintain the imputation of contributions at 35% of the cost of plant. This rate base (and depreciation) treatment is entirely consistent with the Commission's initial rate policy, as well as the initial rate analysis and rates as originally filed and approved by the Commission.

39. Accordingly, Staff's adjustment that eliminates a major portion of the actual original cost of the utility system is not supported by the initial rate policy, nor any other economic or rate setting principle.

Non-Arms Length Transaction

40. While Staff refers to "non-arms length transactions" without explanation, it must be assumed that Staff believes that under an arms length scenario, an additional \$462,000 would have been contributed. Staff's assumption cannot be supported by any rate setting or economic principle. If a third party developer had applied for an extension of mains to serve its development, the Company could not have simply required a contribution at 100% of the cost of the extension. The Company would have had to ask for an advance subject to refund on the basis of the Commission's governing rules, Part 501, Extension of Mains, a copy of which is annexed hereto as Exhibit "5". The refund would have been made for the portion of the total length of the main extension that was

in excess of 75 feet for each connection and 20 feet per hydrant, or subject to a refund based upon an economic test.

41. Under the "75 foot" test, the Company would have had to refund - - or essentially pay for - - the cost of 75 feet of main for each customer added to the extension and the cost of 20 feet for each hydrant. Under this scenario, there would have been little if any contributions, because 75 feet times the number of connections plus 20 feet per hydrant equals some 25,435 feet of main in relation to some 30,055 total feet of main in the system, or about 85 %.

42. Under an "economic test," the Company would have had to refund - - or pay for - - an amount approximately equivalent to the investment it had made as reflected in the initial rate calculation - - or some 65% of the original cost (contributions of 35% of the original cost were imputed). Accordingly, under the economic test, the contributions would not have exceeded 35% of the original cost.

43. Thus, the "non-arms length transaction" reason given by Staff also provides no justification for Staff's adjustment. In any event, an arms length scenario is not appropriate to use in evaluating this issue. Unaffiliated developers did not and would not automatically bear the carrying costs incurred to create this utility and would not automatically protect the customers from bearing any of the risk or cost of creating the utility, as did the Company's affiliated developers.

44. The Company's proposed rate base reflecting contributions equal to 35% of the original cost is consistent with its approved initial rates and the initial rate concept. There is no rate setting or economic principle that would support the imputation of additional contributions or the disallowance of the investment as set forth in the Company's filing.

RATE OF RETURN ADJUSTMENT

45. Staff's preliminary report reflects an allowance of a pretax rate of return of 9.8%. While there is no discussion in Staff's preliminary report as to why it reduced the proposed rate of return from 12.5% on equity, I was informed by Staff in a telephone discussion that the 9.8% is the level Staff is currently using. On the basis of my experience with other water rate filings before the Commission, I am aware that Staff currently uses a pretax rate of return on the basis of proxy group of electric utilities, and that the pretax rate of return includes a combination of debt and equity capital.

46. Reagans Mill has no debt; it cannot attract debt on the strength of its own financial condition. All of its funding has come from stockholder advances and direct equity infusions, typical of virtually all new small water utilities. Its sensitivity to earnings erosion is dramatically greater than for any of the proxy companies Staff typically uses in its rate of return calculations, as well as for any large water utility in New York or anywhere.

47. I have prepared a comparison, set forth in Exhibit "7" annexed hereto, showing for four of the largest investor-owned water utilities in New York and Reagans Mill, the impact of a hypothetical \$50,000 shortfall in earnings for each utility. Data for the year 2000 were used because of availability. The four large water utilities would hardly notice the difference; their equity returns would be reduced from an assumed 10% to 9.8% or 9.9%. On the other hand, the impact on Reagans Mill's equity return would be dramatic, from 10% to 6.5%, a 35% reduction.

48. Staff's proposed rate of return for this small water utility is simply not consistent with the Supreme Court's guidepost decision that the return on investment must be sufficient for the utility to maintain financial viability and attract capital, and in line with investments in other enterprises having comparable risks, Federal Power

Commission v. Hope Natural Gas Co., 320, US 591, (1944). By this standard, and given the same rate of return as resulting from Staff's proxy group analysis, would any prudent investor invest in Reagans Mill instead of the electric utilities in the proxy group or the large water utilities in New York? The answer, of course, is no.

49. Staff's proposed pretax rate of return assumes a level of income taxes based on a proxy capital structure consisting of both debt and equity. Because Reagans Mill has no debt, and cannot attract any on its own, it will pay income taxes on its entire earnings. Thus, under Staff's proposed rates, the actual equity return for Reagans Mill would be less than the level indicated in Staff's proxy group analysis, because Reagans Mill's actual tax liability would be more than the relative tax liability assumed in the pretax rate of return.

50. Reagans Mill's proposed tariff revision was issued on June 11, 2003 with an effective date of July 11, 2003. It is based on a complete system test year ended December 31, 2003. The statutory suspension period has created a regulatory lag of some 11 months from the filed dated. Staff's proposed revenue increase is \$63,897 and its total allowed return is \$73,708. Accordingly, the delay in obtaining rate relief due to regulatory lag, under Staff's preliminary figures, would cost Reagans Mill nearly its entire return allowance. None of the proxy group electric utilities or the large water utilities in New York faces such extreme financial risks as the loss of a year's return on investment simply due to regulatory lag.

51. Staff's rate of return proposal does not reflect the realities of the risks and financial condition of such small utilities as Reagans Mill. The need for higher rates of return for small water utilities has been recognized in numerous Commission decisions over the years. Staff's rate of return allowance should be rejected. The 12.5% post tax rate of return proposed by the Company is reasonable and conservative.

AMORTIZATION ADJUSTMENT

52. The Company's filing includes \$37,472 of rate case expenses that were proposed to be amortized over 4 years, and \$8,000 of the \$16,000 cost of a system valuation study that were proposed to be amortized over 5 years. Staff's amortization adjustment reduces the Company's rates case expenses from \$37,472 to \$10,000, and entirely eliminates the portion of the valuation cost that was included for recovery through the rates.

53. To support its adjustment, Staff's preliminary report makes a one word conclusory comment about the rate case expenses, that they are "exorbitant." The Company has not filed for a rate increase in 15 years, and the customers have never paid anything for rate case expense. Like all small water utilities, Reagans Mill does not have a full time staff, and certainly no one qualified to prepare a rate filing. All of the time and work performed to analyze the Company's books, establish a base year and proforma complete system analysis consistent with the initial rate concept, prepare summary schedules of each revenue requirement component, rate of return and rate design, was absolutely necessary. Significant time and expense was also needed to respond to Staff's data requests, and to attend the customer meeting conducted by Staff and answer customer questions about the rate filing and rate setting process. In order to mitigate the impact on rates, the rate case expenses were amortized over a 4-year instead of a more typical 2-year period.

54. Staff's out-of hand reduction of the rate case expense is not supported with any analysis at all, let alone a fair analysis. Moreover, the rate base and rate of return adjustments made by Staff required rebuttal by qualified experts, especially when the Staff's conclusory reasons for those adjustments are not consistent with applicable rate setting principles. The work performed by my firm was essential for the preparation of

Reagan Mill's rate filing. It was essential for the Company to establish the cost of providing safe and adequate service to its customers and to maintain financial viability and earn a reasonable return on its investment. Staff's allowance of \$10,000 is not adequate for those purposes.

55. Staff gives no reason for the elimination of the cost of the valuation study. The Company's proposed 50/50 sharing of the cost between the stockholders and customers, and amortization over a 5-year period is reasonable. Reagan Mill has provided safe and adequate service to its customers and has managed the operations as cost effectively as reasonable possible for a small part-time operation. It is, of course, a small company with relatively few customers over which to spread the costs of service. The Commission's 1994 Statement of Policy on the Acquisition Incentive Mechanisms for Small Water Companies in Case 93-W-0962, a copy of which is annexed hereto as Exhibit "8", encourages acquisitions of small water companies. It is also general knowledge that the Commission Staff at least looks into possible acquisition opportunities at times of rate filings. It was therefore anticipated that the significant rate increase would prompt consideration of an acquisition by a municipal type entity, in particular the Dutchess County Water Authority. To be prepared for that possibility, the Company had a valuation study performed in order to establish Reagan Mill's market value. Both the stockholders and customers would benefit by such an acquisition; the stockholders if they could obtain a fair price, and the customers because they would realize the benefit of lower water rates due to low cost financing, economies of scale and the tax-exempt posture of Dutchess County Water Authority.

RATE DESIGN ADJUSTMENT

56. Staff proposes to increase the charges to the one commercial customer in order to reflect additional costs of providing fire protection service to that customer in relation to total cost of providing fire protection service. Staff's allocation of fire protection costs is based on a total fire demand of 2,750 gallons per minute ("gpm") for two coincidental fire demands: 2,000 gpm for the commercial customer and 750 gpm demand for the residential customers. Accordingly, for the most part, Staff allocated the total fire service costs at 73% to the one commercial customer and 27% to all 324 residential customers combined, the ratios of each respective fire demand to the total fire demand. There are two theoretical errors in this calculation. Reagans Mill's system is too small to assume coincidental fire demands. The total fire demand should be 2,000 gpm, not 2,750 gpm. Also, the 750 gpm is a potential fire demand for each residential unit and, therefore, should not be treated as a combined fire demand. In other words, the system is capable of meeting a fire demand at any one of the residential units, not just one. Allocating fire service costs to the one commercial customer in relation to only one potential residential fire demand results in an excessive allocation to the commercial customer. Once the total fire service costs are determined, the typical allocation to public fire service (residential in this case) and private fire service (the one commercial customer) is on the basis of the relative number of equivalent public hydrants and private connections. In this case, there is one private fire service connection and 53 public hydrants; the commercial customer should be assigned only 2% of the fire service costs (1 divided by 54), not 27%.

PHASE IN PROPOSAL

57. Staff's preliminary report proposes a 3-year phase in of its proposed \$63,897 revenue increase. According to Staff's preliminary determination, the

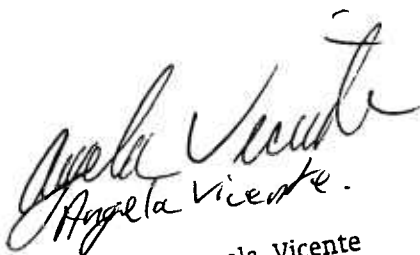
Company's cost of providing service is \$63,987 higher than would be generated under the existing rates. If that full cost is not allowed on a current basis, Reagans Mill and its stockholders would be subsidizing the cost of providing water service to its customers. Staff's phase in recommendation would result in the loss of about a year's worth of return on investment, as determined by Staff, which in my opinion would clearly constitute a confiscation of property.

CONCLUSION

58. Reagans Mill has not been provided with a copy of Staff's final report. Staff's preliminary recommendations with respect to the issues identified and for the reasons set forth above, are unreasonable, unsupported and contrary to acceptable and applicable rate setting principles.



JOHN F. GUASTELLA



Angela Vicente



Angela Vicente
Commission # DD 038641
Expires August 27, 2005
Bonded Thru
Atlantic Bonding Co., Inc.

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CONCLUSION

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JOHN F. GUASTELLA



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PROFESSIONAL QUALIFICATIONS AND EXPERIENCE
of
JOHN F. GUASTELLA

B.S., Mechanical Engineering, Stevens Institute of Technology, 1962

Registered Professional Engineer in: Florida, New York and New Jersey

Member:

American Water Works Association
National Association of Water Companies
American Society of Appraisers

Committees:

AWWA, Water Rates Committee (Manual M-1, 1983 Edition)
National Association of Regulatory Utility Commissioners (NARUC) and
NAWC, Joint-Committee on Rate Design
NAWC, Rates and Revenues Committee
NAWC, Small Water Company Committee

Currently, Mr. Guastella is President of Guastella Associates, Inc., which provides management, valuation and rate consulting services for municipal and investor-owned utilities. His clients include utilities in the states of Alaska, Arkansas, California, Connecticut, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Maine, Maryland, Massachusetts, Missouri, Michigan, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, North Dakota, Ohio, Pennsylvania, South Carolina, Texas, Rhode Island and Virginia. He has provided consulting services that include all aspects of utility regulation and rate setting, encompassing revenue requirements, revenues, operation and maintenance expenses, depreciation, taxes, return on investment, cost allocation and rate design. He has performed depreciation studies for the establishment of average service lives of utility property. He has performed appraisals of utility companies for management purposes and in connection with condemnation proceedings. He has also negotiated the sale of utility companies.

Mr. Guastella also served for more than four years as President of Country Knolls Water Works, Inc., a water utility that served some 5,500 customers in Saratoga County, New York. He also served as a member of the Board of Directors of the National Association of Water Companies.

Mr. Guastella has qualified and testified as an expert witness before regulatory agencies and municipal jurisdictions in the states of Alaska, California, Connecticut, Delaware, Florida, Illinois, Indiana, Maryland, Massachusetts, Missouri, Montana, Nevada, New Mexico, New

Jersey, New York, North Dakota, Ohio, Pennsylvania, Rhode Island, South Carolina, Texas and Virginia.

Prior to establishing his own firm, Mr. Guastella was employed by the New York State Public Service Commission for sixteen years. For two years he was involved in the regulation of electric and gas utilities, with the remaining years devoted to the regulation of water utilities. In 1970, he was promoted to Chief of Rates and Finance in the Commission's Water Division. In 1972, he was made Assistant Director of the Water Division. In 1974, he was appointed by Alfred E. Kahn, then Chairman of the Commission, to be Director of the Water Division, a position he held until he resigned from the Commission in August 1978.

At the Commission, his duties included the performance and supervision of engineering and economic studies concerning rates and service of many public utilities. As Director of the Water Division, he was responsible for the regulation of more than 450 water companies in New York State and headed a professional staff of 32 engineers and three technicians. A primary duty was to attend Commission sessions and advise the Commission during its decision making process. In the course of that process, an average of about fifty applications per year would be reviewed and analyzed. The applications included testimony, exhibits and briefs involving all aspects of utility valuation and rate setting. He also made legislative proposals and participated in drafting Bills that were enacted into law: one expanded the N.Y. Public Service Commission's jurisdiction over small water companies and another dealt specifically with rate regulation and financing of developer-related water systems.

In addition to his employment and client experience, Mr. Guastella served as Vice-Chairman of the Staff-Committee on Water of the National Association of Regulatory Utility Commissioners (NARUC). This activity included the preparation of the "Model Record-Keeping Manual for Small Water Companies," which was published by the NARUC. This manual provides detailed instruction on the kinds of operation and accounting records that should be kept by small water utilities, and on how to use those records.

Each year since 1974 he has prepared study material, assisted in program coordination and served as an instructor at the Eastern Annual Seminar on Water Rate Regulation sponsored by the NARUC in conjunction with the University of South Florida, Florida Atlantic University, the University of Utah, Florida State University and the University of Florida. This course is recognized as one of the best available for teaching rate-setting principles and methodology. It is attended by regulatory staff, utility personnel and accounting, engineering, legal and consulting firms throughout the country. In 1980 he was instrumental in the establishment of the Western NARUC Rate Seminar and has annually served as an instructor since that time. He has also served as an instructor and panelist in a water and sewer utility rates and regulations seminar conducted by the Independent Water and Sewer Companies of Texas. In 1998, he prepared and conducted a seminar on basic rate regulation on behalf of the New England Chapter of the National Association of Water Companies.

In 2000 and 2001, Mr. Guastella developed and conducted a special seminar for developer related water and sewer utilities in conjunction with Florida State University, and again in 2003 in conjunction with the University of Florida. It provided essential training for the financial structuring of small water and sewer utilities, rate setting, financing and the establishment of their market value in the event of a negotiated sale or condemnation.

Mr. Guastella has presented papers at meetings of the National Association of Regulatory Utility Commissioners, the American Water Works Association, the National Association of Water Companies, the New England Conference of Public Utilities Commissioners, the Florida, New England, New Jersey and New York Chapters of NAWC, the Mid-America Regulatory Conference, the Southeastern Association of Regulatory Utility Commissioners, the Pennsylvania Environmental Conference, and the Public Utility Law Section of the New Jersey Bar Association.



RECYCLED PAPER MADE FROM 20% POST CONSUMER CONTENT

GUASTELLA ASSOCIATES, INC.

Utility Management - Valuation - Rate Consultants

3 SLEEPY HOLLOW DRIVE
CLIFTON PARK, N.Y. 12065
TEL : (518) 373-1232
FAX : (518) 373-1626

06/04/2003

Ms. Janet Hand Deixler, Secretary
State of New York, Public Service Commission
Three Empire State Plaza
Albany, New York 12223-1350

Re: Reagans Mill Water Co., Inc.

Dear Ms. Hand Deixler:

On behalf of Reagans Mill Water Company, Inc. ("Company"), we are submitting for filing five copies of the following tariff leaves to become effective on July 11, 2003, as revisions to P.S.C. No. 1-Water:

Second Revised Leaf No. 8, superseding the Original Leaf No. 8
Second Revised Leaf No. 9, superseding the Original Leaf No. 9

The proposed revisions would increase rates to all customers. The revisions to Leaf No. 8 would increase the existing service charge for a 5/8 x 3/4" meter customer from \$45.00 to \$211.68 per quarter and increase the usage rate from \$3.10 to \$4.95 per thousand gallons. The revisions to Leaf No. 9 would increase the quarterly public fire service charge from \$90.00 to \$125.00 per hydrant and private fire service for an 8 inch service from \$180.00 to \$250.00 per quarter. We have also included a monthly interest charge for unpaid water billings and a \$25.00 charge for dishonored checks.

On the basis of the 2003 operations, using a year-end rate base, the proposed rates would produce \$259,173 of additional revenues over existing rates, or a 198% increase. The basis for the projected 2003 operations is the 2002 actual historical data adjusted for known and measurable changes. The Company is, therefore, asking that the 2003 data be accepted as representative of the Company's cost of providing service.

The Company has not revised its rates since the initial rates were established in 1988. The purpose of this increase is to meet the increased operating expenses and provide a reasonable return on the existing investment in utility plant. The operating expenses have increased from \$76,620 (used for developing initial rates) to \$237,758. These are the primary factors driving the need for the proposed rate increase. The Company is requesting an opportunity to earn an overall rate of return of 12.5%.

Publication of a notice of the proposed revisions will appear once a week for four consecutive weeks in a newspaper having general circulation in the Company's service area. Please advise if anything further is required at this time.

Respectfully Submitted,
GUASTELLA ASSOCIATES, Inc.


John F. Guastella


Gary C. White

cc: Reagans Mill Water Company, Inc.

SERVICE CLASSIFICATION NO. 1

Applicable to Use of Service for:

Residential, small commercial, and general use.

Character of Service:

Continuous

Usage Rate:

Per 1,000 gallons \$4.95

Quarterly Service Charge (No Water Allowance):

5/8-3/4" meter	\$211.68
3/4" meter	234.98
1" meter	296.37
1 1/2" meter	376.33
2" meter	611.50
3" meter	2,351.78
4" meter	2,963.52
6" meter	4,468.58

Terms of Payment:

Service charge bills shall be rendered QUARTERLY in ADVANCE with Usage bills rendered QUARTERLY in ARREARS. All billings are due and payable when rendered. Bills not paid within 30 days of rendition are delinquent and service may be discontinued after proper notice as required by law, and bills will be subject to an additional charge of 1 1/2% per month levied on the unpaid balance of the water bill.

Bills paid with a negotiable instrument which is subsequently dishonored will be subject to a \$25 charge.

Term:

Terminable by the customer upon 10 days' written notice to the Company.

Date of Issue: 11-Jun-2003

Effective Date: 11-Jul-2003

Issued by: Thomas F. Flood, III (President)

SERVICE CLASSIFICATION NO. 1

Applicable to Use of Service for:

Residential, small commercial, and general use.

Character of Service:

Continuous

Rate:

Quarterly charge per hydrant \$125.00

Private Fire Service Connection:

<u>Connection Size</u>	<u>Quarterly Charge</u>
6" Service & Smaller	\$125.00
8" Service	250.00
10" Service	375.00

Terms of Payment:

Bills shall be rendered QUARTERLY in ARREARS and are due and payable when rendered. Bills not paid within 30 days of rendition are delinquent and service may be discontinued after proper notice as required by law, and bills will be subject to an additional charge of 1 1/2% per month levied on the unpaid balance of the water bill.

Bills paid with a negotiable instrument which is subsequently dishonored will be subject to a \$25 charge.

Term:

Terminable by the customer upon 10 days' written notice to the Company.

Date of Issue: 11-Jun-2003

Effective Date: 11-Jul-2003

Issued by: Thomas F. Flood, III (President)

REAGANS MILL WATER CO., INC.

Schedules in Support
of the
Rate Filing

Historical Test Period 12/31/02
Projected through 12/31/03

GUASTELLA ASSOCIATES, INC.

JUNE 2003

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REAGANS MILL WATER CO., INC.
COMPARATIVE BALANCE SHEET

ASSETS	12/31/99	12/31/00	12/31/01	12/31/02
Cash	\$10,340	\$63,223	\$19,502	\$18,999
Accounts Receivable	25,933	27,836	30,298	32,318
Prepaid Property Taxes	7,298	7,619	10,795	11,457
Fixed Assets	1,565,839	1,569,020	1,572,902	1,580,156
Accumulated Depreciation	(196,787)	(219,269)	(243,539)	(268,675)
Accumulated Amortization	0	(5,411)	(9,740)	(14,069)
Total Assets	<u>\$1,412,623</u>	<u>\$1,443,018</u>	<u>\$1,380,218</u>	<u>\$1,360,186</u>
LIABILITIES AND EQUITY				
Accounts Payable	\$3,450	\$911	\$2,630	\$1,577
Customer Deposits	0	200	400	500
Accrued Expenses	0	2,600	11,900	4,405
Advances from Stockholders	1,976,159	1,976,159	1,891,159	1,891,159
Common Stock	488,309	488,309	488,309	488,309
Retained Earnings	(1,055,295)	(1,025,160)	(1,014,180)	(1,025,763)
Total Liabilities & Equity	<u>\$1,412,623</u>	<u>\$1,443,018</u>	<u>\$1,380,218</u>	<u>\$1,360,186</u>

REAGANS MILL WATER CO., INC.
COMPARATIVE INCOME STATEMENTS
Year Ended 12/31

	2000	2001	2002
Operating Income	\$112,555	\$124,358	\$131,622
O & M Expenses	30,798	59,613	83,390
Depreciation	23,564	24,270	25,136
Amortization	4,329	4,329	4,329
Taxes Other than Income Tax	20,465	24,034	30,466
Income Tax	4,475	3,061	0
Operating Expenses	<u>83,631</u>	<u>115,307</u>	<u>143,321</u>
Net Operating Income	28,924	9,051	(11,699)
Interest Income	<u>1,211</u>	<u>1,928</u>	<u>116</u>
Net Income	<u>\$30,134</u>	<u>\$10,980</u>	<u>(\$11,583)</u>

REAGANS MILL WATER CO., INC.
RATE BASE

RATE BASE	BALANCE PER BOOK 12/31/2002	(Sch. B-3) PER BOOK ADJ'S	BALANCE ADJUSTED TEST YEAR	(Sch. B-4) PRO FORMA ADJ'S	BALANCE ADJUSTED 12/31/2003
Utility Plant in Service	\$1,549,856	(\$175,392)	\$1,374,464	\$80,550	\$1,455,014
Less: Accumulated Depreciation	(268,675)	(37,243)	(305,918)	9,648	(296,270)
Net Plant	1,281,181	(212,635)	1,068,546	90,198	1,158,744
Plus: Working Capital (1/5 O & M)	3,889		3,889	171	4,060
Plus: Unamortized Tank Painting Costs	18,395		18,395	(4,329)	14,066
Plus: Unamortized Balances	0		0	39,986	39,986
Total Rate Base	<u>\$1,303,465</u>	<u>(\$212,635)</u>	<u>\$1,090,830</u>	<u>\$126,026</u>	<u>\$1,216,856</u>

REAGANS MILL WATER CO., INC.
UTILITY PLANT IN SERVICE
RATE YEAR ENDING DECEMBER 31, 2003

WATER PLANT	BALANCE PER BOOK 12/31/2002	(Sch. B-3) COST ADJ.	(Sch. B-3) CIAC ADJ.	ADJUSTED TEST YEAR	(Sch. B-4) PRO FORMA ADJUSTMTS	YEAR END 12/31/2003
Land	127,000	0	(44,450)	82,550	0	82,550
Intangibles	28,500	0	(9,975)	18,525	0	18,525
Wells	41,932	15,200	(18,550)	38,582	80,550	119,132
Structures	174,210	86,440	(47,007)	213,643	0	213,643
Pumping Equipment	83,850	0	(29,348)	54,503	0	54,503
Treatment Equipment	7,800	0	(2,730)	5,070	0	5,070
Reservoirs and Standpipes	209,850	75,150	(99,750)	185,250	0	185,250
Mains	575,000	330,184	(316,814)	588,370	0	588,370
Services	124,000	(52,900)	(24,885)	46,215	0	46,215
Meters and Installation	70,300	(0)	(16,275)	54,025	0	54,025
Hydrants	84,000	27,335	(38,967)	72,368	0	72,368
General Plant:						
Furniture & Fixtures	5,413	0	(1,750)	3,663	0	3,663
Transportation Equipment	15,000	0	(5,250)	9,750	0	9,750
General Plant Equipment	3,000	0	(1,050)	1,950	0	1,950
Total	<u>\$1,549,856</u>	<u>\$481,409</u>	<u>(\$656,801)</u>	<u>\$1,374,464</u>	<u>\$80,550</u>	<u>\$1,455,014</u>

REAGANS MILL WATER CO., INC.
ACCUMULATED DEPRECIATION
RATE YEAR ENDING DECEMBER 31, 2003

WATER PLANT	BALANCE PER BOOK 12/31/2002	(Sch. B-3) MISC. ADJ.	(Sch. B-3) ADJUSTED TEST YEAR	(Sch. B-4) Y.E. 12/31/03 ACCRUAL	(Sch. B-4) Y.E. 12/31/03 RETIREMENT	YEAR END 12/31/2003
Land			0	0		0
Intangibles			0	0		0
Wells			12,540	1,971	(34,450)	(19,939)
Structures			47,742	5,341		53,083
Pumping Equipment			26,343	1,817		28,160
Treatment Equipment			4,410	304		4,714
Reservoirs and Standpipes			53,723	3,705		57,428
Mains			85,314	5,884		91,198
Services			13,402	924		14,326
Meters and Installation			15,956	1,622		17,578
Hydrants			16,144	1,113		17,257
General Plant:						
Furniture & Fixtures			4,898	366		5,264
Tools and Equipment			22,620	1,560		24,180
Communication Equipment			2,828	195		3,023
Total	<u>\$268,675</u>	<u>\$37,243</u>	<u>\$305,918</u>	<u>\$24,802</u>	<u>(\$34,450)</u>	<u>\$296,270</u>

REAGANS MILL WATER CO., INC.
RATE YEAR ENDING DECEMBER 31, 2003
NOTES TO RATE BASE ADJUSTMENTS

ADJUSTMENTS TO TEST YEAR RATE BASE

A. Adjust Plant in Service to true-up the original cost plant for asset costs not initially booked to utility plant.	481,409
B. Adjust Plant in Service to reflect the Contributed Plant (CIAC) balances established in the initial rate filing at 35% of 1988 plant investments.	<u>(656,801)</u>

ADJUSTMENTS TO TEST YEAR UTILITY PLANT IN SERVICE

(175,392)

C. Adjust Accumulated Depreciation to reflect PSC regulatory lives applied to net plant (Plant in Service less CIAC).

	Y.E. Plant Balance	Deprec Rate	Accrual	Accumulated Depreciation
Land	82,550	0.00%	0	0
Intangibles	18,525	0.00%	0	0
Wells	38,582	2.50%	965	12,540
Structures	213,643	2.50%	5,341	47,742
Pumping Equipment	54,503	3.33%	1,817	26,343
Treatment Equipment	5,070	6.00%	304	4,410
Reservoirs and Standpipes	185,250	2.00%	3,705	53,723
Mains	588,370	1.00%	5,884	85,314
Services	46,215	2.00%	924	13,402
Meters and Installation	54,025	3.00%	1,622	15,956
Hydrants	72,368	1.54%	1,113	16,144
General Plant:			0	
Furniture & Fixtures	3,663	10.00%	366	4,898
Tools and Equipment	9,750	16.00%	1,560	22,620
Communication Equipment	1,950	10.00%	195	2,828
	1,374,464		23,797	305,918
Accumulated Depreciation per Books				268,675

ADJUSTMENTS TO YEAR END 12/31/02 ACCUMULATED DEPRECIATION

37,243

REAGANS MILL WATER CO., INC.
RATE YEAR ENDING DECEMBER 31, 2003
NOTES TO RATE BASE ADJUSTMENTS

ADJUSTMENTS TO YEAR END 12/31/03 RATE BASE

D. Adjust balance of 2003 UPIS to include two (2) new wells and retire two (2) wells.

	Cost
Well A	60,000
Well B	55,000
Retire 2 Existing Wells (original cost, net of CIAC)	<u>(34,450)</u>

ADJUSTMENTS TO YEAR END 12/31/03 UTILITY PLANT IN SERVICE

80,550

E1. Adjust Accumulated Depreciation for average balance of 2003 UPIS, including added plant.

	Avg Plant Balance	Deprec Rate	Deprec Expense
Land	82,550	0.00%	0
Intangibles	18,525	0.00%	0
Wells	78,857	2.50%	1,971
Structures	213,643	2.50%	5,341
Pumping Equipment	54,503	3.33%	1,817
Treatment-Equipment	5,070	6.00%	304
Reservoirs and Standpipes	185,250	2.00%	3,705
Mains	588,370	1.00%	5,884
Services	46,215	2.00%	924
Meters and Installation	54,025	3.00%	1,622
Hydrants	72,368	1.54%	1,113
General Plant:			
Furniture & Fixtures	3,663	10.00%	366
Tools and Equipment	9,750	16.00%	1,560
Communication Equipment	<u>1,950</u>	10.00%	<u>195</u>
	1,414,739		24,802

E2. Adjust accumulated depreciation for the retirement of two wells.

(34,450)

ADJUSTMENTS TO YEAR END 12/31/03 ACCUMULATED DEPRECIATION

(9,648)

REAGANS MILL WATER CO., INC.
RATE YEAR ENDING DECEMBER 31, 2003
NOTES TO RATE BASE ADJUSTMENTS

ADJUSTMENTS TO YEAR END 12/31/03 RATE BASE

F. Adjustment to Working Capital related to O & M expenses for the 12 months ending 12/31/03.

Pro Forma O & M Expenses	71,275.44
Less: 2002 O & M Expenses	<u>68,277.44</u>
	2,998.00
Usage Revenue Percent	28.48%
Working Capital Percent	<u>20.00%</u>
	170.77

ADJUSTMENT TO WORKING CAPITAL ALLOWANCE

\$171

G. Average unamortized balance of 10/99 Tank Painting Costs.

Tank Painting	\$30,300	Oct-99
Amort Period (yrs & amt)	7	\$4,329

	<u>2002</u>	<u>2003</u>
Years in Service	3.25	4.25
Year-End Amortized Amount	14,069	18,398
Year-End Unamortized Balance	16,231	11,902
Average Unamortized Balance	18,395	14,066

ADJUSTMENT TO TANK PAINTING AMORTIZATION

(\$4,329)

H. Average unamortized balance of PSC Rate Case Expenses
(over 4 years) for 12/31/03 base year.

	Cost	Years	Rate Year Avg Balance
Average unamortized bal. of System Valuation Costs (50% x \$16,000)	\$37,470	4	
	\$8,000	5	

AVERAGE UNAMORTIZED BALANCE

\$39,986

REAGANS MILL WATER CO., INC.
CONSTRUCTED STATEMENT OF OPERATIONS

	TEST YEAR ENDING 12/31/02	ADJUSTMENTS		RATE YEAR ENDING 12/31/03	CONSTRUCTED STATEMENT	
		REFERENCE	PROFORMA		ADJUSTMENTS	TOTALS
Operating Revenues	<u>\$131,622</u>	Sch C-3	<u>(\$930)</u>	<u>\$130,692</u>	<u>\$259,173</u>	<u>\$389,865</u>
Operating Expenses:						
Operation & Maintenance	68,277	Sch C-3	2,998	71,275	0	71,275
Amortization	4,329	Sch C-4	10,968	15,297	0	15,297
Depreciation	25,136	Sch C-4	(334)	24,802	0	24,802
Taxes Other Than Income Taxes	31,266	Sch C-5	1,407	32,673	2,577	35,250
Provision For Income Taxes	<u>(800)</u>	Sch C-5	<u>(1,203)</u>	<u>(2,003)</u>	<u>93,137</u>	<u>91,134</u>
	<u>128,209</u>		<u>13,836</u>	<u>142,044</u>	<u>95,714</u>	<u>237,758</u>
Net Operating Income	<u>\$3,413</u>		<u>(\$14,765)</u>	<u>(\$11,352)</u>	<u>\$163,459</u>	<u>\$152,107</u>
Other Income (Expense):						
Interest	<u>116</u>	Sch C-5	<u>(116)</u>	<u>0</u>	<u>0</u>	<u>0</u>
Net Income	<u>\$3,529</u>		<u>(\$14,881)</u>	<u>(\$11,352)</u>	<u>\$163,459</u>	<u>\$152,107</u>
Rate Base	\$1,090,830			\$1,216,856		\$1,216,856
Rate of Return	0.31%			-0.93%		12.50%
				Overall Revenue Requirement Increase		<u>198.3%</u>

REAGANS MILL WATER CO., INC.
OPERATION AND MAINTENANCE EXPENSES

DESCRIPTION	<i>INITIAL AMOUNT</i>	AMOUNT	ADJUSTMENTS	INFLATION	ANNUAL EXPENSE
Chemicals	<i>2500</i>	\$591	\$2	12	\$605
Purchased Power	<i>12,920</i>	11,818	36	0	11,854
Fuel Expense		151	0	3	154
Other Maint & Repair	<i>1700</i>	5,966	0	119	6,085
System Operator Expense	<i>9000</i>	17,814	0	0	17,814
Monitoring Expense		593	0	12	605
Rent		3,000	0	0	3,000
Officers Salaries	<i>9700</i>	12,000	0	0	12,000
Directors Fees		3,000	0	0	3,000
Salaries & Wages		8,000	0	0	8,000
Office Expense	<i>2100</i>	53	0	1	54
Outside Services-Legal		0	0	0	0
Outside Services-Engr & Other (a)	<i>9484100 500 1000</i>	1,951	0	0	1,951
Outside Services-Acctg		1,800	0	0	1,800
Insurance	<i>3000</i>	618	185	0	803
Regulatory Assessment		212	0	0	212
Telephone		539	0	11	550
Bad Debt Expense		0	2,614	0	2,614
Misc Expense		171	0	3	174
Total		<u>\$68,277</u>	<u>\$2,837</u>	<u>\$161</u>	<u>\$71,275</u>

Note (a): Removed \$15,112 of system valuation costs expensed in 2002.

REAGANS MILL WATER CO., INC.
DEPRECIATION EXPENSE

	ANNUAL RATE	ORIGINAL COST	ANNUAL ACCRUAL (a)
Land	0.00%	\$82,550	\$0
Intangibles	0.00%	18,525	0
Wells	2.50%	78,857	1,971
Structures	2.50%	213,643	5,341
Pumping Equipment	3.33%	54,503	1,817
Treatment Equipment	6.00%	5,070	304
Reservoirs and Standpipes	2.00%	185,250	3,705
Mains	1.00%	588,370	5,884
Services	2.00%	46,215	924
Meters and Installation	3.00%	54,025	1,622
Hydrants	1.54%	72,368	1,113
General Plant:			
Furniture & Fixtures	10.00%	3,663	366
Tools and Equipment	16.00%	9,750	1,560
Communication Equipment	10.00%	1,950	195
		0	0
Total		<u><u>\$1,414,739</u></u>	<u><u>\$24,802</u></u>

Note: (a) Accrual is based on original cost of plant in service, times depreciation rate.

REAGANS MILL WATER CO., INC.
NOTES TO CONSTRUCTED STATEMENT OF OPERATIONS ADJUSTMENTS

PROFORMA

OPERATING REVENUES

A. Adjustments to per book revenue

	<u>Per Book</u>	<u>Billing @ Pro Forma</u>	
Metered Sales	\$131,621.82	\$130,692.00	
Service Charges	0.00	0.00	
Misc. Operating Income	<u>0.00</u>	<u>0.00</u>	
Total Revenue	\$131,621.82	\$130,692.00	<u><u>(\$930)</u></u>

B. Adjustment to increase Operating Revenues to the total level required to provide a fair return on rate base.

\$259,173

OPERATION & MAINTENANCE EXPENSE

C. Known changes to per book 2002 O & M Expenses:

1) Adjustment to increase chemical costs for demand increases.

Water Production (2002)	24,646.842	
% Demand Increase	100.301%	
Water Production (2003)	24,721.113	
Increase (1,000 gals.)	74.271	
Test Year cost per 1,000 gals.	<u>\$0.0240</u>	
	\$1.78	2

2) Adjustment to increase purchased power for demand increases.

Water Production (2002)	24,646.842	
% Demand Increase	100.301%	
Water Production (2003)	24,721.113	
Increase (1,000 gals.)	74.271	
Test Year cost per 1,000 gals.	<u>\$0.4795</u>	
	\$35.61	36

3) Adjustment to insurance which is projected to increase by 30% (based on 2002 increase).

Insurance Costs (2002)	\$618	
Projected Costs	<u>803</u>	
	\$185	185

4) Adjustment to reflect for uncollectible accounts at 2% of billed revenue.

2,614

TOTAL O & M ADJUSTMENT TO PER BOOK EXPENSES

\$2,837

REAGANS MILL WATER CO., INC.
NOTES TO CONSTRUCTED STATEMENT OF OPERATIONS ADJUSTMENTS

PROFORMA

OPERATION & MAINTENANCE EXPENSE

D. Adjustment to reflect changes in O & M Expense computed as follows:

1) General O & M Expense Inflation Adjustment:	
O & M Expense - As Adjusted Test Year	<u>\$71,114.44</u>
Less amounts not subject:	
a) Rent Expense	3,000.00
b) Mgmt, Wages, Operations & Outside Service	44,565.00
c) Uncollectible Accounts	2,614.00
d) Regulatory Assessment	212.00
e) Electric Costs	11,854.00
f) Insurance	<u>803.00</u>
Amount Subject to Inflation Adjustment	8,066.44
Inflation Adjustment Factor	<u>2.00%</u>
Operation Expense Inflation Adjustment	161.33
TOTAL O & M ADJUSTMENT FOR INFLATION	<u><u>\$161</u></u>
TOTAL OF ADJUSTMENTS TO OPERATION & MAINTENANCE EXPENSE	<u><u>\$2,998</u></u>

REAGANS MILL WATER CO., INC.
NOTES TO CONSTRUCTED STATEMENT OF OPERATIONS ADJUSTMENTS

PROFORMA

AMORTIZATION

E. Adjustment to amortize Rate Case Expense over 4 years.		9,368
Adjustment to amortize 50% of System Valuation Costs over 5 years.		<u>1,600</u>
TOTAL AMORTIZATION ADJUSTMENTS		<u><u>\$10,968</u></u>

DEPRECIATION

F. Adjustment to annual depreciation for year-end 12/31/02 UPIS.			
Depreciation Accrual (Sch. C-3)	\$23,797		
Per Book Depreciation Expense	<u>(25,136)</u>		(1,339)
G. Adjustment to annual depreciation for year-end 12/31/03 UPIS.			
Depreciation Accrual (Sch. C-2)	\$24,802		
As Adjusted 2002 Depreciation Expense	<u>(23,797)</u>		1,005
TOTAL DEPRECIATION ADJUSTMENTS			<u><u>(\$334)</u></u>

REAGANS MILL WATER CO., INC.
NOTES TO CONSTRUCTED STATEMENT OF OPERATIONS ADJUSTMENTS

PROFORMA

TAXES OTHER THAN INCOME TAXES

H. Adjustment to property taxes for the plant additions.

	Per Books	Per Tax Bills
Property Tax Expense	29,760	29,867
Utility Plant - Prior Year	2,024,011	2,031,264
Property Tax Rate	1.47%	1.47%

Adjustment to Property Taxes 107

	Revenue	Tax Amount
I. Adjust per book Revenue Tax to reflect a rate of 0.995%		
Pro Forma	\$131,622	1,308.98
Revenue Tax per Books		0.00
		1,308.98

1,309

J. Revenue Tax related to revenue adjustments on Schedule C-3 page 1.
(\$929.82) 0.995%

(9)

TOTAL ADJUSTMENT TO TAXES OTHER

\$1,407

PROVISION FOR INCOME TAXES

K. Adjustment to Provision for Income Taxes:

Adjusted Net Income		(\$11,352)
Provision for Income Taxes		(2,003)
Total Taxable Income		(13,355)
Taxes @	15.00%	(2,003)

Total Income Taxes		(2,003)
Previous Total		(800)

PROFORMA INCOME TAX ADJUSTMENT

(\$1,203)

REAGANS MILL WATER CO., INC.
NOTES TO CONSTRUCTED STATEMENT OF OPERATIONS ADJUSTMENTS

PROFORMA

INTEREST EXPENSE

L. Adjustment to increase expense, based on the Capital Structure as reflected on Schedule D.

Total Long-Term Debt	\$0	
Cost of Debt	<u>9.00%</u>	
Proforma Interest Expense	0.00	
Interest Expense Per Books	<u>(116.00)</u>	
Interest Expense Adjustment	\$116.00	<u>\$116</u>

TAXES OTHER THAN INCOME TAXES

M. Adjustment to increase gross receipts tax due to additional Operating Revenue requirement. \$2,577

PROVISION FOR INCOME TAX

N. Adjustment to Provision for Income Taxes:

Rate Base		\$1,216,856
Rate of Return		<u>12.50%</u>
Net Operating Income Requirement		152,106.99
Interest Expense		<u>0.00</u>
Adjusted Net Income		152,106.99
Provision for Income Taxes		<u>91,134.11</u>
Total Taxable Income		<u>\$243,241.10</u>
State Income Tax	8.78%	21,344.41
Federal Taxable Income		\$221,896.69
Taxable Income x Income Taxes @	15.00% First 50000	7,500.00
	25.00% 50-75 K	6,250.00
	34.00% 75-100 K	8,500.00
	39.00% 100-335 K	<u>47,539.71</u>
Total Income Taxes		69,789.71
Previous Total		<u>(2,003.00)</u>
INCOME TAX ADJUSTMENT		<u>\$93,137</u>

REAGANS MILL WATER CO., INC.
COST OF CAPITAL COMPUTATION
RATE YEAR ENDING DECEMBER 31, 2003

<u>CLASS OF CAPITAL</u>	<u>AMOUNT</u>	<u>RATIO</u>	<u>COST</u>	<u>WEIGHTED COST OF CAPITAL</u>
Long Term Debt	\$0	0.00%	9.00%	0.00%
Common Equity	1,216,856	100.00%	12.50%	12.50%
Total Capital	<u>\$1,216,856</u>	<u>100.00%</u>		<u>12.50%</u>

REAGANS MILL WATER CO., INC.
PRO FORMA BILLING ANALYSIS
AT PROPOSED RATES

WATER	NUMBER OF BILLS Test Year	CONSUMED GALLONS (000)	BASE RATE (PER QTR)	BASE CHARGE REVENUE	USAGE RATE/1000	USAGE CHARGE REVENUE	USAGE GENERATED REVENUE
RESIDENTIAL:							
5/8-3/4" meter	1,296	21,771.5	\$211.68	\$274,337	\$4.95	\$107,769	\$382,106
3/4" meter	0	0.0	234.98	0	4.95	0	0
1" meter	0	0.0	296.37	0	4.95	0	0
1 1/2" meter	0	0.0	376.33	0	4.95	0	0
2" meter	0	0.0	611.50	0	4.95	0	0
3" meter	0	0.0	2,351.78	0	4.95	0	0
4" meter	0	0.0	2,963.52	0	4.95	0	0
6" meter	0	0.0	4,468.58	0	4.95	0	0
TOTAL RESIDENTIAL	<u>1,296</u>	<u>21,771.5</u>		<u>\$274,337</u>		<u>\$107,769</u>	<u>\$382,106</u>
GENERAL SERVICE:							
5/8-3/4" meter	4	587.0	\$211.68	\$847	\$4.95	\$2,906	\$3,753
3/4" meter	0	0.0	234.98	0	4.95	0	0
1" meter	0	0.0	296.37	0	4.95	0	0
1 1/2" meter	0	0.0	376.33	0	4.95	0	0
2" meter	0	0.0	611.50	0	4.95	0	0
3" meter	0	0.0	2,351.78	0	4.95	0	0
4" meter	0	0.0	2,963.52	0	4.95	0	0
6" meter	0	0.0	4,468.58	0	4.95	0	0
TOTAL GENERAL SERVICE	<u>4</u>	<u>587.0</u>		<u>\$847</u>		<u>\$2,906</u>	<u>\$3,753</u>
FIRE PROTECTION CHARGE:							
6" Service	0	0	\$125.00	\$0		\$0	\$0
8" Service	16	0	250.00	4,000		0	4,000
10" Service	0	0	375.00	0		0	0
	<u>16</u>	<u>0</u>		<u>\$4,000</u>		<u>\$0</u>	<u>\$4,000</u>
BILLED REVENUE	<u>1,316</u>	<u>22,358.5</u>		<u>\$279,184</u>		<u>\$110,675</u>	<u>\$389,859</u>
MISC OPERATING REVENUE							<u>0</u>
TOTAL WATER OPERATIONS							<u>\$389,859</u>

REAGANS MILL WATER CO., INC.
COMPARISON OF PRESENT AND PROPOSED BILLS

	Use (000 gal.)	PRESENT BILL	PROPOSED		TOTAL	INCREASE
			SERV. CH	USAGE		
RESIDENTIAL CUSTOMERS	9	\$72.90	\$211.68	\$44.55	\$256.23	251.48%
	12	\$82.20	211.68	\$59.40	271.08	229.78%
	15	\$91.50	211.68	\$74.25	285.93	212.49%
	16	\$94.60	211.68	\$79.20	290.88	207.48%
	18	\$100.80	211.68	\$89.10	300.78	198.39%
	21	\$110.10	211.68	\$103.95	315.63	186.68%
	24	\$119.40	211.68	\$118.80	330.48	176.78%
	27	\$128.70	211.68	\$133.65	345.33	168.32%
	30	\$138.00	211.68	\$148.50	360.18	161.00%
	33	\$147.30	211.68	\$163.35	375.03	154.60%
	36	\$156.60	211.68	\$178.20	389.88	148.97%
	40	\$169.00	211.68	\$198.00	409.68	142.41%
	45	\$184.50	211.68	\$222.75	434.43	135.46%
	50	\$200.00	211.68	\$247.50	459.18	129.59%
	55	\$215.50	211.68	\$272.25	483.93	124.56%
	60	\$231.00	211.68	\$297.00	508.68	120.21%

WORK PAPERS

REAGANS MILL WATER CO., INC.
REVENUE REQUIREMENT

Work Paper

Description	Amount
Operation & Maintenance Expense	\$71,275
Depreciation Expense	24,802
Amortizations	15,297
Taxes, Other than Income Tax	35,250
Income Taxes	91,134
Return on Investment	<u>152,107</u>
	\$389,865

REAGANS MILL WATER CO., INC.
 Revised Y.E 2002 Original Plant Costs by Year of Installation

Work Paper

Year Installed	Description	Per Book Cost	Cost Correction	Total Cost	Life	Accum Deprec	CIAC	CIAC Amort.	Net Depr Expense	In Service Years
1988	Land	127,000	0	127,000			(44,450)			
1988	Franchise & Consent	12,500	0	12,500			(4,375)			
1988	Organization Costs	16,000	0	16,000			(5,600)			
1988	Wells	37,800	53,000	53,000	40	(19,213)	(18,550)	6,724	861	14.5
2002	Wells	4,132	0	4,132	40	(52)			103	0.5
1988	Pumping Structures	47,865	134,304	134,304	40	(48,685)	(47,007)	17,040	2,182	14.5
1996	Pumping Structures	62,820	62,820	62,820	40	(10,208)			1,571	6.5
1998	Pump House	13,191	13,191	13,191	40	(1,484)			330	4.5
1999	Pump House Improvements	50,335	50,335	50,335	40	(4,404)			1,258	3.5
1988	Pumping Equipment	83,850	83,850	83,850	30	(40,528)	(29,348)	14,185	1,817	14.5
1988	Purification Equipment	7,800	7,800	7,800	16.67	(6,785)	(2,730)	2,375	304	14.5
1988	300 gal. Distribution Reserv	209,850	285,000	285,000	50	(82,650)	(99,750)	28,928	3,705	14.5
1999	Improvmnts-Tower Painting	0	0	0	Amort.					3.5
1988	Distribution Mains	575,000	905,184	905,184	100	(131,252)	(316,814)	45,938	5,884	14.5
1988	Service Laterals	124,000	71,100	71,100	50	(20,619)	(24,885)	7,217	924	14.5
1988	293 - 5/8" x 3/4" Meters	46,500	0	46,500	33.3	(20,248)	(16,275)	7,087	908	14.5
1996	Woodwinds Meter	8,665	0	8,665	33.3	(1,691)			260	6.5
1997	Woodwinds Meter	1,638	0	1,638	33.3	(271)			49	5.5
1998	Meters	726	0	726	33.3	(98)			22	4.5
1998	Woodwinds Meter	70	0	70	33.3	(10)			2	4.5
1999	Woodwinds Meter	2517	0	2,517	33.3	(265)			76	3.5
2000	Woodwinds Meter	3,181	0	3,181	33.3	(239)			96	2.5
2001	Woodwinds Meter	3,882	0	3,882	33.3	(175)			117	1.5
2002	Woodwinds Meter	3,121	0	3,121	33.3	(47)			94	0.5
1988	Hydrants	84,000	111,335	111,335	65	(24,836)	(38,967)	8,693	1,113	14.5
1988	Office Furniture	5,000	0	5,000	10	(7,250)	(1,750)	2,538	325	14.5
1998	Office Furniture	413	0	413	10	(186)			41	4.5
1988	Transportation Equipment	15,000	0	15,000	6.25	(34,800)	(5,250)	12,180	1,560	14.5
1988	Other General Equipment	3,000	0	3,000	10	(4,350)	(1,050)	1,523	195	14.5
	TOTAL UTILITY PLANT	1,549,856	1,777,919	2,031,264		(460,343)	(656,801)	154,425	23,797	

Net Plant @ 12/31/02:

Plant in Service	2,031,264
Accum Depreciation	(460,343)
Contrib. in Aid of Construction	(656,801)
CIAC Amortization	154,425
	<u>1,068,546</u>

REAGANS MILL WATER CO., INC.
 Revised Y.E 2002 Accumulated Depreciation

Work Paper

Year Installed	Description	Total Cost	CIAC	Net UPIS	Life	Accum Deprec
1988	Land	127,000	(44,450)	82,550		
1988	Franchise & Consent	12,500	(4,375)	8,125		
1988	Organization Costs	16,000	(5,600)	10,400		
1988	Wells	53,000	(18,550)	34,450	40	(12,488)
2002	Wells	4,132	0	4,132	40	(52)
1988	Pumping Structures	134,304	(47,007)	87,298	40	(31,645)
1996	Pumping Structures	62,820	0	62,820	40	(10,208)
1998	Pump House	13,191	0	13,191	40	(1,484)
1999	Pump House Improvements	50,335	0	50,335	40	(4,404)
1988	Pumping Equipment	83,850	(29,348)	54,503	30	(26,343)
1988	Purification Equipment	7,800	(2,730)	5,070	16.67	(4,410)
1988	300 gal. Distribution Reserv	285,000	(99,750)	185,250	50	(53,723)
1999	Improvemts-Tower Painting	0	0	0	50	0
1988	Distribution Mains	905,184	(316,814)	588,370	100	(85,314)
1988	Service Laterals	71,100	(24,885)	46,215	50	(13,402)
1988	293 - 5/8" x 3/4" Meters	46,500	(16,275)	30,225	33.3	(13,161)
1996	Woodwinds Meter	8,665	0	8,665	33.3	(1,691)
1997	Woodwinds Meter	1,638	0	1,638	33.3	(271)
1998	Meters	726	0	726	33.3	(98)
1998	Woodwinds Meter	70	0	70	33.3	(10)
1999	Woodwinds Meter	2,517	0	2,517	33.3	(265)
2000	Woodwinds Meter	3,181	0	3,181	33.3	(239)
2001	Woodwinds Meter	3,882	0	3,882	33.3	(175)
2002	Woodwinds Meter	3,121	0	3,121	33.3	(47)
1988	Hydrants	111,335	(38,967)	72,368	65	(16,144)
1988	Office Furniture	5,000	(1,750)	3,250	10	(4,713)
1998	Office Furniture	413	0	413	10	(186)
1988	Transportation Equipment	15,000	(5,250)	9,750	6.25	(22,620)
1988	Other General Equipment	3,000	(1,050)	1,950	10	(2,828)
	TOTAL UTILITY PLANT	2,031,264	(656,801)	1,374,464		(305,918)



RECYCLED PAPER MADE FROM 20% POST-CONSUMER CONTENT

Reagan Mill
Water W. Inc
30 Reagan Mill Rd
Wingdale, NY 12594

John GUESTELLA

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914-832-9400
945

RATE-SETTING METHODOLOGY

The initial rates for water service have been predicated on the basis that the Company will be a water utility capable of providing safe and adequate service on the strength of its own financial condition. The revenue requirement has been calculated to include an estimate of all operation and maintenance expenses, depreciation, taxes and a reasonable return on investment (excluding imputed contributions of capital in an amount equal to thirty-five percent of the construction cost of the system). Consistent with establishing fully compensatory rates, the revenue requirement--or total cost of service--has been based on a fully developed system. It has been recognized that since the system will not be fully developed in the first years of growth, the revenues generated during the earlier years will not be adequate to cover all operating costs. Accordingly, unrecovered operating expenses in the interim will be covered by advances from affiliated companies.

This method of developing initial rates and structuring a new water utility has the following advantages:

1. The risk of the investment in utility plant, which is dependent on the success of the development, is borne by the developers, not the utility or its customers, since the customers actually added will, in effect, pay through the rates only a pro rata share of the costs.

2. Since the developers will provide advances to cover any operating costs in excess of revenues during the growth years, except for possible periodic rate increases due to inflation or unanticipated costs, the utility will have the necessary cash flow. Disposition of advances in the future (by forgiveness of a respective portion of debt) will enable the utility to avoid dilution of its equity.

3. With fully compensatory initial rates, the potential customers' decisions to pay the market value of the real estate will not be tempered by the water rates.

4. The water utility will be better able to attract capital for future plant replacements or additions and, therefore, to provide safe and adequate service on a long-range basis.

REVENUE REQUIREMENT

Because projections are made for the complete system, the cost of operations must be estimated in order to determine the revenue requirement and resultant rates. Schedule A sets forth the computation of revenue requirement which is estimated at \$171,972. The revenue requirement components are identified as: Operation and Maintenance Expenses, Depreciation, Taxes-Other, Federal Income Taxes and Return, each of which is developed later in this report.

Each revenue requirement component has been calculated in current, uninflated dollars so that today's customers do not pay rates for service based on future price levels. It is therefore anticipated that any increases in operating expenses and construction costs in the future (due to inflation, operational and construction changes, delays, variances in system characteristics or other unanticipated changes) will require compensatory rate revisions. The possible occurrence of such future events, however, does not alter the compensatory nature of the revenue requirement and resultant rates established in this analysis. Moreover, since contributed capital has been imputed in the development of the initial rates, no further adjustment will be necessary in the future-- because the investment in utility plant has been adjusted to recognize any effect the water rates may otherwise have had on real estate purchases.

RATE BASE

Schedule B, page 1, sets forth the computation of the Company's rate base which amounts to \$899,539. The original cost of plant in service in the amount of \$906,856 is based on the estimated cost of facilities for a fully developed system. The construction cost of plant, imputed contributions and original cost, by primary plant account is set forth on page 2 of Schedule B, along with the accumulated depreciation amount.

The accumulated depreciation recognizes that the total water system will be completed prior to the time when the development is at full occupancy. At that time, there will, of course, be an accumulation of depreciation on all plant, and it is reasonable to estimate an amount of \$15,417 based on depreciation accruals on all plant consistent with the growth in customers over the years. This approach is appropriate because the recovery of the cost of plant through depreciation is limited to the actual number of rate-paying customers, and the depreciation accruals should follow a similar course. Moreover, the utility will not be left with large amounts of unrecovered depreciation on its books when the system is fully developed, and therefore will not be in a position of having to secure outside financing for replacements or additions which could not be financed through unrealized internally generated sources of capital.

Consistent with regulatory accounting procedures in New York, imputed contributions in the amount of \$488,309 are netted against construction costs in order to establish the "original" cost of \$906,856.

RATE OF RETURN

The return on rate base is predicated on an overall rate of return of 10.6%, as set forth on Schedule E. For the purpose of this analysis, the capital structure is estimated at 60% debt and 40% equity, with cost rates of 9.0% for debt and 13.0% for equity. Because of the size of this Company, a detailed "cost of money" analysis is impractical and unnecessary. The current impact of a variance in the overall rate of return necessary for the Company to attract capital in the future is insignificant (even if measurable) with respect to the compensatory nature of the initial rates.

RATE STRUCTURE

In addition to general metered rates, fire service charges have been established. The general metered rates are designed on the basis of a "Service Charge" and "Usage Rate" for all customers. Schedule F, page 1, contains an estimated billing analysis which, under the initial rates, would produce \$56,840 through service charges and \$90,652 through the usage rate, as well as \$24,480 in fire service charges. These amounts are calculated by applying rates (rounded) to billing units, and are consistent with cost allocations as set forth on Schedule F, pages 2, 3 and 4.

The fire service percentage allocations as shown on each page of Schedule F are based on judgment, taking into account the fact that for a small water company potential fire demands could produce disproportionately large fire allocations.

With respect to general metered service, costs which would not fluctuate with usage or demand are allocated to the service charge category, and costs which do fluctuate with usage or demand are allocated to the usage rate category. In addition to being cost justified, the service charge type of rate structure has a number of advantages. Customers only pay for the water they actually use. Not only would large use customers save money by conserving water, low use customers would also save money even if they conserve water below what would otherwise be a minimum water allowance. This type of structure is particularly beneficial for a small utility because it simplifies billing as well as maintaining billing records and preparing billing analyses. It is also easier for customers to understand.

A copy of the filed tariff schedule is attached as Appendix A.

Reagans Mill Water Company

Revenue Requirement

<u>Description</u>	<u>Amount</u>
Operation & Maintenance Expense	\$40,500
Depreciation Expense	15,417
Taxes - Other	12,449
Federal Income Taxes	8,255
Return on Investment	<u>95,351</u>
Revenue Requirement	<u><u>\$171,972</u></u>

Reagans Mill Water Company

Rate Base

<u>Description</u>	<u>Amount</u>
Utility Plant in Service	\$906,856
Accumulated Depreciation	15,417
Net Plant	\$891,439
Working Capital	8,100
Rate Base	\$899,539

Reagans Mill Water Company

Utility Plant in Service
and
Accumulated Depreciation

Description	Estimated Construction Cost	Impufed Contributions	Original Cost	Accumulated Depreciation
Organization	\$16,000	\$5,600	\$10,400	\$
Franchises & Consents	12,500	4,375	8,125	
Land	127,000	44,450	82,550	
Wells	37,800	13,230	24,570	614
Pumping - Structures	47,865	16,753	31,112	778
- Equipment	83,850	29,348	54,502	1,815
Purification Equip.	7,800	2,730	5,070	304
Distr. Reservoirs	209,850	73,448	136,402	2,728
Mains	575,000	201,250	373,750	3,738
Services	124,000	43,400	80,600	1,612
Meters	46,500	16,275	30,225	907
Hydrants	84,000	29,400	54,600	841
Office Furn. & Equip.	5,000	1,750	3,250	325
Transportation Equip.	15,000	5,250	9,750	1,560
Other General Equip.	3,000	1,050	1,950	195
Total	\$1,395,165	\$488,309	\$906,856	\$15,417

Base

Reagans Mill Water Company

Operation and Maintenance Expense

<u>Description</u>	<u>Amount</u>
Labor	\$9,000
Purchased Power	10,000
Chemicals	2,500
Repairs and Supplies	1,700
Administrative Salaries & Exp.	9,700
Office Expense	2,100
Insurance	3,000
Transportation	1,000
Outside Services & Regulatory Exp.	1,000
Miscellaneous	500
Total	<u>\$40,500</u> =====

Reagans Mill Water Company

Annual Depreciation Expense

Description	Original Cost	Annual Depreciation	
		Rate	Amount
Organization	\$10,400		\$
Franchises & Consents	8,125		
Land	32,550		
Wells	24,570	2.50%	614
Pumping - Structures	31,112	2.50%	778
- Equipment	54,502	3.33%	1,815
Purification Equip.	5,070	6.00%	304
Distr. Reservoirs	136,402	2.00%	2,728
Mains	373,750	1.00%	3,738
Services	80,600	2.00%	1,612
Meters	30,225	3.00%	907
Hydrants	54,600	1.54%	841
Office Furn. & Equip.	3,250	10.00%	325
Transportation Equip.	9,750	16.00%	1,560
Other General Equip.	1,950	10.00%	195
Total	\$906,856		\$15,417

Reagans Mill Water Company

Capital Structure & Rate of Return

Capital	Amount	Ratio	Cost Rate	Weighted Cost
Debt	\$534,863	60%	9.0%	5.40%
Equity	356,576	40	13.0%	5.20%
Total	\$891,439	100%		10.60%

Reagans Mill Water Company

Billing Analysis

	Meter Size	Annual Billing Units	Quarterly Rate	Annual Revenue
<hr style="border-top: 1px dashed black;"/>				
GENERAL METERED SERVICE				
<hr style="border-top: 1px dashed black;"/>				
Service Charge:	5/8"	1,240	\$45	\$55,800
	3/4"	0	50	0
	1"	0	63	0
	1-1/2"	0	80	0
	2"	8	130	1,040
				<hr style="border-top: 1px dashed black;"/>
				\$56,840
Usage Rate:	All	29,214	3.10	90,652
				<hr style="border-top: 1px dashed black;"/>
Total General Metered Revenue				\$147,492
FIRE PROTECTION SERVICE				
<hr style="border-top: 1px dashed black;"/>				
Hydrants		256	\$90	23,040
Private Fire Connections (2 - 8")		8	180	1,440
				<hr style="border-top: 1px dashed black;"/>
				\$24,480
				<hr style="border-top: 1px dashed black;"/>
Total Revenues				\$171,972
				=====

Reagans Mill Water Company

Cost Allocation
Fire Service, Service Charge and Usage Rate

Description	Fire Service			General Metered Service			
	Total	Percent	Amount	Total	Allocation Symbol	Service Charge	Usage Rate
Operation & Maintenance:							
Labor	\$9,000	5.00%	\$450	\$8,550	A	\$4,500	\$4,050
Power	10,000	1.00%	100	9,900	B		9,900
Chemicals	2,500	1.00%	25	2,475	B		2,475
Repairs and Supplies	1,700	1.00%	17	1,683	C	1,000	683
Admin. Salaries & Exp.	9,700	2.00%	194	9,506	D	8,505	900
Office Expense	2,100	2.00%	42	2,058	E	2,058	
Insurance	3,000	2.00%	60	2,940	E	2,940	
Transportation	1,000	2.00%	20	980	F	504	476
Outside Services	1,000	5.00%	50	950	F	489	461
Miscellaneous	500	2.00%	10	490	F	252	238
Total	\$40,500		\$968	\$39,532		\$20,349	\$19,183
Depreciation	15,417	Table 3	3,299	12,118		4,214	7,904
Taxes - other	12,449	G	1,818	10,631		3,929	6,702
Federal Income Tax	8,255	Table 2	1,516	6,739		2,055	4,684
Return	95,351	Table 2	17,516	77,835		23,733	54,102
Revenue Requirement	\$171,972		\$25,117	\$146,855		\$54,280	\$92,575

Explanation of Allocation Symbols

- A - Labor for meter reading, billing and customer services is estimated at \$4,500.
- B - Direct to Usage Rate since these costs are usage or demand related.
- C - Repairs related to services and non-usage costs are estimated at \$1,000.
- D - These costs primarily relate to accounting, billing and management which will not fluctuate with usage; however, \$900 is allocated to Usage Rate based on judgment.
- E - Direct to Service Charge since these are "customer" costs.
- F - Weighted according to other Operation & Maintenance Expenses (about 51.4% and 48.6%).
- G - Weighted according all other allocations.

Reagans Mill Water Company

Allocation of Rate Base

Description	Net Plant	Fire Service		General Metered Service			
		Percent	Amount	Total	Allocation Symbol	Service Charge	Usage Rate
Organization	\$10,400		\$	\$10,400	A	\$10,400	\$
Franchises & Consents	8,125			8,125	A	8,125	
Land	82,550			82,550	A	82,550	
Wells	23,956	1.00%	240	23,716	B		23,716
Pumping - Structures	30,334	2.00%	607	29,727	B		29,727
- Equipment	52,687	5.00%	2,634	50,053	B		50,053
Purification Equip.	4,766			4,766	B		4,766
Distr. Reservoirs	133,674	65.00%	86,888	46,786	B		46,786
Mains	370,012	5.00%	18,501	351,511	B		351,511
Services	78,988			78,988	A	78,988	
Meters	29,318			29,318	A	29,318	
Hydrants	53,759	100.00%	53,759	0			
Office Furn. & Equip.	2,925	18.51%	541	2,384	A	2,384	
Transportation Equip.	8,190	18.51%	1,516	6,674	A	6,674	
Other General Equip.	1,755	18.51%	325	1,430	A	1,430	
Net Plant	\$891,439		\$165,011	\$726,428		\$219,869	\$506,559
Working Capital	8,100	2.39%	194	7,906		4,070	3,836
Rate Base	\$899,539		\$165,205	\$734,334		\$223,939	\$510,395
Percentage Allocation	100.00%		18.37%			24.89%	56.74%

Explanation of Allocation Symbols

- A - Direct to Service Charge since these costs will not fluctuate with usage or demand, or are "customer" costs.
- B - Direct to Usage Rate since these costs fluctuate with usage or demand.
- C - Allocated according to Operation and Maintenance allocations.

Reagans Mill Water Company

Allocation of Depreciation Expense

Description	Depreciation Expense	Fire Service		Total	General Metered Service		
		Percent	Amount		Allocation Symbol	Service Charge	Usage Rate
Wells	\$514	1.00%	\$6	\$608	B	\$	\$608
Pumping - Structures	778	2.00%	16	762	B		762
- Equipment	1,815	5.00%	91	1,724	B		1,724
Purification Equip.	304			304	B		304
Distr. Reservoirs	2,728	65.00%	1,773	955	B		955
Mains	3,738	5.00%	187	3,551	B		3,551
Services	1,612			1,612	A	1,612	
Meters	907			907	A	907	
Hydrants	841	100.00%	841	0			
Office Furn. & Equip.	325	18.51%	60	265	A	265	
Transportation Equip.	1,560	18.51%	289	1,271	A	1,271	
Other General Equip.	195	18.51%	36	159	A	159	
Total	\$15,417		\$3,299	\$12,118		\$4,214	\$7,904



RECYCLED PAPER MADE FROM 20% POST CONSUMER CONTENT

copy

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

STATEMENT OF POLICY ON RATES
FOR WATER SERVICE

Issued: September 21, 1978

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

COMMISSIONERS:

Charles A. Zielinski, Chairman
Edward P. Larkin
Carmel Carrington Marr
Harold A. Jerry, Jr.
Anne F. Mead
Karen S. Burstein

STATEMENT OF POLICY ON RATES
FOR WATER SERVICE

(Issued September 21, 1978)

When we authorize rates to be charged by a water company, or by a water supplier operating as a legal or functional adjunct to a land development company, one of the factors we must evaluate is the company's investment in plant.^{1/} For ratemaking purposes in New York, the company's plant investment generally is understood to equal the total plant investment, minus "customer contributions" to plant. The policy we set forth here^{2/} concerns the manner in which customer contributions should be recognized, in evaluating the rate base for water companies that have been established in the course of real estate development ventures. Such companies pose special analytic problems.

^{1/}"Plant investment," for purposes of this Statement of Policy, has the same meaning as for purposes of rate base computations: it denotes net investment, i.e., original cost of plant minus depreciation.

^{2/}We have discussed this policy also in Case 27178, Dennis Land Development Co., Inc. (Order Adopting. . . Recommended Decision, issued April 11, 1978, mimeo at pp. 2-3); Case 26865, Sterling Forest Water Corp., 16 NY PSC 464, 471, n. 5 and text accompanying (1976); Case 26861, Wild Oaks Water Co., Inc., 16 NY PSC 446, 449-50 (1976); and Case 26861, Wild Oaks Water Co., Inc. (Order Denying Petition for Rehearing, issued June 24, 1976, mimeo at pp. 3-4).

I

In examining rate proposals by water companies operated in a legal or functional relationship to land development companies, we find frequently that a water plant has been installed as a necessary part of a broader development program involving the sale of lots to builders or purchasers of houses. Typically, the company seeks our approval of a new rate only after the lapse of a period during which it has been charging consumers some rate for water service, or giving them ostensibly "free" service, without our approval.

In many cases, the initial rate submitted for our approval is two or three times the sum of the previous, unregulated rate (if any) plus increments attributable to changes, in expenses and in capital costs, that have occurred since the water service was established. At the same time, however, the proposed initial rate may seem reasonable when we evaluate all current expenses and capital costs (rather than considering only changes that have occurred among these items since service began, which typically would justify only an increase approximately parallel to the rate of inflation). In such cases, obviously, the company originally was providing service without charging a rate that sufficed to cover the expenses and capital costs of the water system.

This practice has two undesirable features. First, it is inconsistent with the consumer's reasonable expectation (in the absence of a clear warning to the contrary) that the rate charged for water service will not increase substantially faster than increases in the cost of providing the service. When they begin receiving water service, consumers are likely to realize that the rate may change in proportion to inflation-related changes in the company's operating expenses and changes in the company's capital costs, but not that the rate may be doubled or trebled

because it was insufficient to cover expenses and capital costs originally.

Second, if we approve a proposed regulated rate merely because it reflects the cost of providing service during the period when the new rate will be in effect, and we do not also examine whether such approval will result in a rate increase greater than any increase in the cost of providing service, we may effectively be annulling a customer contribution that was reflected in the previous, unregulated rate. This is because companies normally do not provide water service on a noncompensatory basis; if the unregulated rate failed to cover the operating expenses and the apparent capital costs of the water system, we can infer that the company was compensated for such costs and expenses by means of the proceeds it realized from real estate sales instead of through water rates. In such circumstances, the sale price of the real estate reflects a customer contribution to the water plant, which we might improperly fail to recognize if we authorized a rate increase greater than any increase in the company's operating expenses and capital costs.

As a matter of economic logic, a developer normally will not provide water service free of charge or at a low rate unless the combined revenues, from realty sales and water service, provide the maximum return on the combined realty and water investments that the developer thinks the local realty market will permit. Based on this judgment about the market, the developer will set a first, unregulated rate that may or may not be the sole source of return on the investment in water plant; and will demand the maximum obtainable price for the realty, whose marketability will of course be affected by the availability and price of water (as well as by numerous other variables). Therefore, if the consumer enjoys ostensibly "free" water service or service

at a rate that does not cover the operating expenses and capital costs of the water system, what makes this bargain possible is that the consumer has made a capital contribution to the water system (either directly to the developer or through some intermediate vendee) in the guise of a payment for realty.

It is quite reasonable that parties apportion revenues between water charges and realty prices in this fashion as a result of marketing decisions by sellers who are attempting to make their property as attractive as possible to buyers. These decisions create difficulty only if the developer, having already obtained a customer contribution of capital to the water system partly or wholly by means of real estate sale proceeds rather than water rates, is then allowed to charge a regulated rate that fails to recognize the customer contribution and therefore effectively "recovers" the contribution a second time. Fairness to the developer does not require such a double recovery, and fairness to the ratepayer precludes it.

II

In recognition of the problems that may result from the disparity between an unregulated rate (or "free" service) and the initial regulated rate subsequently authorized by the Commission, the Legislature effectively has abolished the unregulated rate in future land developments: Public Service Law § 89-e(2) provides that 120 days before initiating water service, the operator must submit a rate schedule for our approval.^{1/} Thus, in water systems that begin operating

^{1/}L. 1977, c. 370, § 1; eff. July 6, 1977. We note that the Federal government also has recognized the significance of this problem, by requiring that the "statement of record," to be filed with the Department of Housing and Urban Development by land developers in interstate commerce, contain information about probable terms and conditions of utility services at the development site.

after the effective date of the statute, the first rate that consumers experience will be a previously published, regulated rate. Regardless of whether we must diminish the proposed regulated rate in any particular case because there have been customer contributions to the system, the problems of violated expectations and double recovery will be eliminated in systems controlled by the statute because the initial rate will be ascertainable in advance. Purchasers will be able to develop sound expectations and pricing decisions, secure in the knowledge that rate changes thereafter will be limited to the extent of changes in operating expenses and capital costs.

But the statute does not solve the problem posed by companies that began water operations before its effective date but have not yet proposed initial regulated rates, and companies now charging regulated rates that fail to reflect customer contributions collected in the form of realty sale proceeds. On several occasions, we have declared our reluctance to disregard the possibility that some return on water plant investment was realized through realty prices rather than through water rates;^{1/} but applicants have continued to present cases in a manner that fails to address this concern. We therefore find it necessary to announce the following policy on this subject, which will be applied in evaluating all proposed water rates filed after September 31, 1978.

We shall presume that a regulated rate will afford the company reasonable opportunity to earn a fair return on its investment in water plant if the rate reflects all new developments, in operating expenses, capital costs, and value of plant, since the time when service began free of charge or at an unregulated rate. The company will bear the

1/Cases cited at p. 1, n. 2, above.

burden of overcoming this presumption.^{1/} The reason for the presumption (in summary of what has been explained previously at greater length) is that water service, from its inception, will have been provided on terms that create a full opportunity to earn a reasonable return on investment in plant either through water rates or through realty sales proceeds.

Obviously, however, a rate is not reasonable if it implies that foreseeable cost increases, during the period for which the rate is expected to be in effect, will result in an operating loss. We therefore shall recognize not only current data, but also a reasonable, additional allowance for the dual purpose of (a) encouraging efficiency, by assuring the operator that expenses will be reimbursed as

1/Although we have said that our policy will be applied to "all proposed water rates," consideration of the principles involved will show that the policy will have a practical effect only on water companies whose rates reflect some concurrent or past transactions in non-utility activity such as realty development. The policy itself effectively sorts companies or operating entities according to whether non-utility transactions have affected the rates they charge for utility service; thus it becomes unnecessary to prescribe special rules of analysis according to criteria such as whether the water company is a subsidiary of a land development company, or has appropriated some land development company assets in the process of becoming an independent water company, or always has made independent decisions about rates despite its affiliation with a land development company, or exemplifies any of the other myriad possibilities that might emerge. All that is needed is an inquiry whether water revenues, segregated from all other types of revenue, cover the operating expenses and capital costs of the water plant. (Where working capital is held for more than one corporate purpose, a reasonable portion can be attributed to the requirements of the diversified company's water operation.) If a company is exclusively a water utility, it always will attempt to have revenues equal utility-related expenses and capital costs. If it is involved in some other activity, it may pursue a different objective. In either case, the main issue is not the corporate structure, but whether customer contributions are recognized consistently when service begins and when a regulated rate is authorized.

they accrue and by assuring lenders that repayment schedules can be maintained; and (b) offsetting reasonably foreseeable rate base attrition and earnings erosion, attributable to various phenomena such as inflationary changes and increased maintenance costs as plant deteriorates.

Depending on its persuasiveness, several types of evidence might tend to refute the presumption that a rate is adequate if it reflects changes since service began. For example, a company might attempt to show that the property was sold with actual knowledge on the buyer's part that water rates would lack the comparative stability one associates with rates that change only in response to changes in operating expenses and capital costs (as contrasted with the instability associated with drastic rate base changes resulting from disregard of customer contributions). If the buyer did not expect comparative stability, the bargain between buyer and seller may not have included a customer contribution to the water system.

We also would consider relevant an express warning that water rates would accelerate substantially faster than the cost of service, if the warning were included in the contract of sale (or in a publicly filed subdivision plan if the buyer had actual rather than constructive notice of the plan). Similarly, if a buyer experienced a low unregulated rate or service free of charge, and the company can show that it was unreasonable for the buyer to assume that water would be provided on such terms indefinitely (as, for example, if service were offered free of charge, but meters were being installed, at the time of sale), we might deem the buyer to have been warned constructively that rates would increase faster than changes in operating expenses and capital costs.

In summary, the company will bear the burden of showing that it based its realty sale price on the expectation of realizing an adequate return on water plant investment through the medium of water rates rather than through realty sale proceeds. This may be demonstrated by showing that the unregulated rate was designed to cover the operating expenses and capital costs attributable to water service. If the company can make such a demonstration persuasively, we shall conclude that no part of the realty sale proceeds represents a customer contribution to water plant.^{1/}

1/If the facts of a particular case preclude the use of comparatively reliable and convenient modes of proof such as we have suggested, we may be willing to consider more questionable indicia, such as contractual recitals that some specified part of the purchase price represents a contribution to water plant, or such as entries in the company's tax records.

With regard to contractual terms, however, the very problem that prompts this statement of policy is that when a buyer and seller agree upon a total price for realty supplied with water, neither of them has any motive for ensuring that there be an actual "meeting of the minds" as to what percentage of the mutually accepted price represents a payment for water service. Thus, although experience may prove otherwise, it seems to us that an express but casual contractual allocation of a certain amount for water plant is no more illuminating than the allocation implied by the establishment of an overall sales price in a contract that says nothing about water plant.

As for tax records, it seems regrettable but perhaps inevitable that small water companies, lacking the resources to prepare records based on generally accepted accounting principles (and the Uniform System of Accounts) in addition to records prepared for tax purposes, will continue to offer only the latter in rate proceedings despite our general view that records used for ratemaking purposes should reflect the concepts and items expressly relied on in setting rates. Since tax records are prepared for wholly different purposes, we seriously doubt (without foreclosing the attempt) that they could be used as conclusive evidence regarding the value of rate base adjusted for customer contributions. They might have some value, however, as supplementary proof of outlays and receipts.

Finally, in the absence of enough comparatively convenient and reliable evidence, a company might attempt to show that its proposed rate is similar to, or dissimilar from, rates charged by other, comparable water companies; or to show that among comparable items of realty, traded under comparable conditions, there are price differentials that can be isolated and attributed specifically to the differing terms on which water is provided to these various properties.



RECYCLED PAPER MADE FROM 20% POST-CONSUMER CONTENT

CASE 03-W-0952

REAGANS MILL WATER COMPANY

CONFIDENTIAL ANALYSIS BY V. OREIFEJ AND J. AGANSKY

	<u>Company</u> <u>Pro Forma</u>	<u>Staff</u> <u>Adj. Pro</u>	<u>Staff</u> <u>Pro Forma</u>
Operating Revenues	\$389,865	(194,958) (a)	\$194,907*
Operating Revenues Deductions:			
Operation & Maintenance			
Chemicals	\$ 605		\$ 605
Purchased Power	11,854	(720) (b)	11,134
Fuel Expenses	154		154
Maintenance & Repairs	6,085	(2,161) (c)	3,924
System Operator	17,814		17,814
Monitoring Expenses	605		605
Rent	3,000		3,000
Officer Salary	12,000		12,000
Directors Fees	3,000		3,000
Salary & Wages	8,000		8,000
Office Expenses	54		54
Outside Service Engineer	1,951	(1,951) (d)	0
Outside Service Accountant	1,800		1,800
Insurance	803		803
Regulatory Assessments	212	304 (e)	516
Bad Debt Expenses	2,614	(1,584) (f)	1,030
Telephone	550		550
Misc. Expenses	174		174
Total O & M	<u>\$ 71,275</u>	<u>(6,112)</u>	<u>\$ 65,163</u>
Depreciation	\$ 24,802	(7,602) (g)	17,200
Amortization	15,297	(8,468) (h)	\$ 6,829
Operating taxes	35,250	(4,243) (i)	31,007
Income taxes	\$ 91,134	(91,134) (j)	\$ 0
Total Oper.Rev.Ded.	<u>\$237,758</u>	<u>(117,559)</u>	<u>\$120,199</u>
Net Oper.Income	<u>\$152,107</u>	<u>(78,399)</u>	<u>\$ 73,708</u>
Rate Base	<u>\$1,216,856</u>	<u>(462,226) (k)</u>	<u>\$754,708</u>
Rate of Return	<u>12.5%</u>		<u>9.8%**</u>

* Approx 7.6% from Private Fire Protection Service

** Pratax return

CASE 03-W-0952

REAGANS MILL WATER COMPANY

CONFIDENTIAL ANALYSIS BY V. OREIFEJ AND J. AGANSKY

EXPLANATION OF STAFF ADJUSTMENTS

- (a) - Adjustment to operating revenues to reflect Staff's projected revenue requirement. This adjustment also takes into account the proper service charge for the Modular Home Factory's 2-inch meter. (Rate increase \$63,897 or 48.8% to be implemented over three years) \$ (194,958)
- (b) - Adjustment to the purchased power bill to reflect the elimination of sales tax. The company should seek an exemption. (720)
- (c) - Adjustment to maintenance and repairs to reflect the use of a 3 year average. Staff's prior years' amount were updated for inflation. (2,161)
- (d) - Adjustment to outside service engineer to reflect unsubstantiated expenses. (1,951)
- (e) - Adjustment to P.S.C. assessment based upon Staff's pro forma revenues. 304
- (f) - Adjustment to the cost of bad debt expenses. Lacking actual historical data, Staff used .5% of revenues. (1,584)
- (g) - Adjustment to depreciation expense, to reflect the use of Staff's Water Plant in Service. (7,602)
- (h) - Adjustment to amortizations to reflect the elimination of System Valuation costs and exorbitant rates case expenses. (Rate Case allowance of \$10,000) (8,468)
- (i) - Adjustment to operating taxes, to reflect the 2003-2004 school taxes and 2003 town and county taxes and the elimination of property taxes for a 64 acres parcel of land of 64 acres. (4,243)
- (j) - The elimination of income taxes. Staff is recommending a pre-tax return. (91,134)

CONFIDENTIAL ANALYSIS OF V. OREIFEJ AND J. AGANSKY

(Continued)

- (k) - Adjustment to the rate base to reflect the use of Staff's water plant in service, accumulated depreciation, working capital and unamortized balances. The majority of the adjustment relates to non-arms-length transactions and the Commission's policy on initial rates.

(462,226)



RECYCLED PAPER MADE FROM 25% POST CONSUMER CONTENT

PART 501**EXTENSION OF MAINS**

(Statutory authority: Public Service Law, §§89-b, 89-c)

Sec.	
501.1	Definitions
501.2	Construction of facilities
501.3	Applicant within specified distance
501.4	Applicant beyond specified distance
501.5	Maintenance of service line beyond highway limits
501.6	Cost of installation before service required
501.7	Responsibility for maintenance and replacement
501.8	Applicants who cannot qualify as reasonably permanent customers
501.9	Filing of main extension agreements
501.10	Petition for waiver

Historical Note

Part (§§501.1-501.6) repealed, new (§§ 501.1-501.10) filed May 21, 1991 eff. June 12, 1991.

§ 501.1 Definitions.

- (a) *Water main* - a pipe carrying water which is generally available to more than one service line.
- (b) *Extension* - the extension of water main including the pipe, elbows, tees, valves, reducers, service taps, and other appurtenances which may be part of the facilities extended to provide water service.
- (c) *Service line or lateral* - the pipe and valves which are used to deliver the water from the main into the customer premises; the company portion being that between the main and the customer property line, and the customer portion being that from the property line into the premises.
- (d) *Service connection* - the facilities necessary to provide the customer service, including the service line, the main tap, meter, and other related facilities.
- (e) *Extension costs* - as used in this Part shall include the costs of labor, equipment and materials used in the extension installation, all paving charges for the repair or replacement of street or sidewalk which may be disturbed in the course of such installation, the costs of inspection, amounts paid to governmental authorities for permits to do the work required, and other costs or taxes that are legally imposed by any governmental authority.
- (f) *Applicant* - a person, developer, builder, partnership, association, corporation, or governmental agency requesting service to a specific location.
- (g) *Developer* - a business or person who will subdivide or prepare real estate for residential or commercial occupancy, who requires the installation of utility plant in advance of occupancy, and whose success resulting in utility customers can be considered speculative since it is dependent upon the success of the real estate venture.
- (h) *Residential service* - water service for sanitary and potable domestic use.
- (i) *Surcharge* - a charge billed to the customer in addition to the regular bill for service.
- (j) *Gross annual utility revenue* - the total of customer charges for utility service billed in one year.
- (k) *Advance or deposit* - money advanced by the applicant to the utility subject to refund.
- (l) *Contribution* - money paid by the applicant to the utility, usually to pay for the cost of installing plant, which will not be refunded.

§ 501.1

TITLE 16 PUBLIC SERVICE

(m) *Water-works tariff* - the schedule of rules and charges for water service, filed with and approved by the Commission, under which the utility is required to provide service.

(n) *Service area* - the area in which the utility has required government authorization to provide utility service.

Historical Note

Sec. repealed, new filed May 21, 1991 eff. June 12, 1991.

§ 501.2 Construction of facilities.

(a) *Facilities within highway*. All water-works corporations subject to the jurisdiction of this commission shall hereafter furnish, place, construct, operate, maintain and when necessary replace at their own cost and expense all mains, service pipes, service connections and other facilities within the territorial limits of any street, avenue, road or way that is for any highway purpose under the jurisdiction of the legislative body of any city, town, village, county or the State of New York, or other public place open to the general public for highway purposes, provided all necessary easements are furnished without cost to such corporation.

(b) *Facilities outside highway*. Where such facilities will be constructed without the territorial limits of any street, avenue, road or way, or other public place open for highway purposes, the applicant shall be allowed to construct the facilities, where such diligence results in lower cost or better time performance, using contractors and materials acceptable to the water-works corporation, pursuant to its water system specifications, based on safety and compatibility and, as to contractors, reputable past performance, and subject to inspection and approval by the water-works corporation based on such specifications. The additional cost of said inspections is to be paid by the applicant.

Historical Note

Sec. repealed, new filed May 21, 1991 eff. June 12, 1991.

§ 501.3 Applicant within specified distance.

Upon written application of the owner or occupant of any property abutting on any such street, avenue, road or way or other public place within the distance specified in section 501.4(d) of this Part of any main of a water-works corporation, appropriate to the service requested, such water-works corporation shall furnish, place and construct at its own cost and expense such mains, service pipes, service connections and facilities as are necessary to render the service requested.

Historical Note

Sec. repealed, new filed May 21, 1991 eff. June 12, 1991.

§ 501.4 Applicant beyond specified distance.

Whenever an owner or occupant of any property abutting on any street, avenue, road or way or other public place as hereinbefore defined in which there is no water main within the distance specified in subdivision (d) of this section from said property makes a written application for service to the water-works corporation having authority to render service to said applicant, such corporation shall extend its system so as to serve said property, provided:

(a) Said applicant shall first have assured said corporation that he will be a reasonably permanent customer by meeting the following conditions:

- (1) the applicant will own or occupy a premises in a permanent structure and on a building lot which both comply with governmental building codes and requirements;
- (2) the applicant will take service for at least one year continually on an annual or seasonal basis; and
- (3) the applicant will take service within 60 days of completion of the main extension.

(b) The applicant shall first have executed an agreement, the terms of which shall provide substantially as follows:

CHAPTER V WATERWORKS CORPORATIONS

§ 501.6

(1) applicant shall agree to pay to said corporation the rates charged to customers served under section 501.3 of this Part and in addition a surcharge of 19 percent (return, depreciation, taxes and maintenance) per year of the actual, reasonable cost of such portion of said main extension (excluding the cost of any service pipe, hydrants, and their accessories) that is in excess of the distance specified in subdivision (d) of this section from the end of the nearest water main appropriate to the service requested if the size of said extension be six inches or less in nominal diameter or if the service requested requires a main larger than six inches in diameter or 19 percent of the estimated cost of a six-inch main if said corporation lays a main greater than six inches in diameter when not necessary for the service requested; provided, however, that said surcharge shall begin at the date when water service is first available to the applicant and shall cease 10 years from that date;

(2) whenever more than one customer shall be connected to said extension, said surcharge shall be so adjusted as to yield to said corporation not more than said 19 percent in any one year from all customers served from said extension and said surcharge shall be reasonably allocated to the several customers served from said extension, taking into account that the distance of main hereinafter specified and a service are to be allowed without surcharge for each customer connected thereto;

(3) whenever the number of customers on a main extension multiplied by the distance specified hereinafter shall equal or exceed the length of the main extension, all surcharges shall cease; and

(4) in lieu of the above surcharge, the applicant may at his option pay the cost of the main extension in excess of the distance hereinafter specified subject to annual refunds without interest related to the number of new customers added to the extension each year multiplied by the distance hereinafter specified; however, refunds shall cease after 10 years or when the total of all refunds equals the amount of the original payment made by the applicant.

(c) The applicant shall first have furnished reasonable security as to performance of his agreement if so required by said water-works corporation; said reasonable security as to performance shall be by advance payment of the surcharge for a period not to exceed one year, or where an applicant's premises does not yet exist, by completion of the foundation and construction of a substantial portion of the premises framing before main extension construction is commenced, or by deposit by the applicant of the entire estimated cost of the extension until said premises construction is complete.

(d) The specified distance allowed for each applicant taking service from the main extension shall be 75 feet for "Class A" water-works corporations as defined in the Uniform System of Accounts and section 561.1 of this Title. For corporations that do not qualify as "Class A" corporations, the Commission staff may allow a main extension of less than 75 feet, at the corporation's request, based on the corporation's financial ability and existing investment in main.

Historical Note

Sec. repealed, new filed May 21, 1991 eff. June 12, 1991.

§ 501.5 Maintenance of service line beyond highway limits.

That portion of the service pipe without the limits of a street, avenue, road or way as hereinbefore defined or easement area shall be provided, placed, constructed and maintained by the property owner or the customer but in accordance with such reasonable specification for the construction and maintenance thereof as may be filed in the tariff schedules of said water-works corporation.

Historical Note

Sec. repealed, new filed May 21, 1991 eff. June 12, 1991.

§ 501.6 Cost of installation before service required.

Whenever, at the request of an owner or occupant, a service pipe is provided through which service is not immediately desired, said property owner or occupant shall bear the entire reason-

§ 501.6

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the expense of providing, placing and constructing the service pipe and accessories, but he shall be entitled to a refund whenever water service is begun for such part of the expense as the water-works corporation is hereinbefore required to assume. Such refund shall be the cost of said service pipe and accessories, less depreciation at the rate of three percent per annum for the period which said pipe has been in the ground.

Historical Note

Sec. repealed, new filed May 21, 1991 eff. June 12, 1991.

§ 501.7 Responsibility for maintenance and replacement.

All water-works corporations shall hereafter be solely responsible for the maintenance and replacement of all mains, service pipes and facilities placed within a street, avenue, road or way as hereinbefore defined or easement area used by said water-works corporations for supplying water to its customers; and if adequate maintenance requires the reconstruction or replacement of such mains, service pipes and facilities, said mains, service pipes and facilities shall be reconstructed or replaced by the water-works corporation responsible for maintenance as hereinbefore provided. However, replacement or reconstruction of mains and service pipes less than two inches in diameter in excess of 75 feet in length heretofore installed and privately owned, shall be governed by the provisions of section 501.4 of this Part.

Historical Note

Sec. filed May 21, 1991 eff. June 12, 1991.

§ 501.8 Applicants who cannot qualify as reasonably permanent customers.

An applicant who cannot qualify as a reasonably permanent customer may be required to deposit the entire cost of the main extension and installed services with the water-works corporation. The portion of the deposit related to the length of main extension within the specified distance, as set forth in section 501.4(d) of this Part, and the cost of the service, hydrants and accessories shall be refunded without interest within 30 days of the applicant taking service and demonstrating reasonable permanency. For developers who are subdividing or preparing real estate for residential or commercial occupancy, who require the installation of utility plant in advance of occupancy, the waterworks corporation may retain as a deposit the cost of the entire extension, subject to annual refunds without interest determined as the proportion of the number of customers connected to the extension that year multiplied by the distance specified in section 501.4(d) of this Part, related to the total extension length. No further refunds will be made after five years after the date construction of the extension is completed and approved or after the total of all refunds equals the amount of the deposit.

Historical Note

Sec. filed May 21, 1991 eff. June 12, 1991.

§ 501.9 Filing of main extension agreements.

All line extensions shall require a line extension agreement setting forth the terms and conditions under which the extension will be made, duly signed by the water-works and applicant. No charges or conditions shall be obtained from or imposed upon the applicant for the provision and extension of water service, other than those contained in the line extension agreement in compliance with the water-works tariff or as approved by the Commission. One copy of each main extension agreement shall be filed with the commission within 30 days of execution; or where such agreements may exceed ten in number in any calendar year, the utility may instead maintain a file at company offices of such agreements and file a summary of such agreements by January 31 of the following year.

Historical Note

Sec. filed May 21, 1991 eff. June 12, 1991.

CHAPTER V WATERWORKS CORPORATIONS

§ 501.10

§ 501.10 Petition for waiver.

As provided in Part 5 of this Title, petition may be made in writing in a specific case for waiver, modification or relief from any of the provisions of these rules by stating the supporting facts and reasons for waiver. However, such petition shall not be made for waiver of Part 501 until the water-works has first obtained approval by the Department of Environmental Conservation and the town of service area modification which may be necessary to include the applicant within the water-works' service area or franchised service territory. Nor shall the petition for waiver contain provisions which would not reasonably apply to any other similar applicant, or in any way be discriminatory.

Historical Note

Sec. filed May 21, 1991 eff. June 12, 1991.

PART 502**CONSTRUCTION AND MAINTENANCE OF SERVICE PIPES**

Sec.	
502.1	Standards
502.2	Maintenance of utility-owned service pipe
502.3	Rules to be printed on application form
502.4	Exceptions

§ 502.1 Standards.

Every water-works corporation shall on or before November 15, 1935, submit for the approval of this commission proposed amendments to its tariff schedules setting forth rules and regulations covering the construction and maintenance of service pipes, such rules and regulations, among other things, to provide:

- (a) The minimum depth at which all service pipes shall be laid. The depth so fixed to be sufficient to prevent freezing.
- (b) The size and kind of pipe and apparatus to be installed, service pipes to be at least three-quarters inch in diameter except under unusual circumstances which shall be clearly defined.
- (c) All connections of service pipes with the transmission mains where the covering over the main is less than five foot shall be made on the side of the main and the service pipe shall in no case have less covering than the main.

§ 502.2 Maintenance of utility-owned service pipe.

Such rules and regulations shall in no event require the consumer to maintain any service pipe owned by the water-works corporation.

§ 502.3 Rules to be printed on application form.

Such rules and regulations shall either be printed on the service application form or shall be printed on a folder which shall be delivered to every applicant for service.

§ 502.4 Exceptions.

Water-works corporations having now on file with this commission rules and regulations in connection with the construction and maintenance of service pipe need not submit such rules except when amendments are necessary to comply with the requirements of this Part.



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Exhibit 7

Comparison of Sensitivity to Earnings Erosion
2000 Statistics (A)

	Proprietary Capital	Assumed 10% Equity Return	Impact of \$50,000 Shortfall	Resultant Rate of Return on Equity
Long Island Water	\$ 28,018,076	\$ 2,801,808	1.8%	9.8%
NY Water Service	42,562,925	4,256,292	1.2%	9.9%
United Water	60,376,142	6,037,614	0.8%	9.9%
United Water NY	49,280,358	4,928,036	1.0%	9.9%
Reagans Mill	1,439,308 B)	143,931	34.5%	6.5%

(A) Source: PSC Report

(B) Includes Advances From Assoc. Cos.



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**STATE OF NEW YORK
PUBLIC SERVICE COMMISSION**

**CASE 93-W-0962 - Proceeding on Motion of the Commission to
Establish a Policy to Provide Incentives for the
Acquisition and Merger of Small Water Utilities.**

**STATEMENT OF POLICY ON
ACQUISITION INCENTIVE MECHANISMS
FOR SMALL WATER COMPANIES**

Issued and Effective: August 8, 1994

Case 93-W-0962

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

COMMISSIONERS:

Peter Bradford, Chairman
Lisa Rosenblum
Harold A. Jerry, Jr.
William D. Cotter

CASE 93-W-0962 - Proceeding on Motion of the Commission to
Establish a Policy to Provide Incentives for the
Acquisition and Merger of Small Water Utilities.

STATEMENT OF POLICY ON ACQUISITION INCENTIVE
MECHANISMS FOR SMALL WATER COMPANIES

(Issued and Effective August 8, 1994)

BY THE COMMISSION:

GUIDELINES FOR WATER COMPANY ACQUISITIONS

PREAMBLE

On October 20, 1993, we instituted Case 93-W-0962 to consider the provision of incentives for the acquisition of small water companies by, and therein merger into, larger entities. Public comment was invited, and on the basis of that comment and the recommendations of Department staff, we are establishing goals and guidelines that will apply to proposals to consolidate small water companies through acquisitions and mergers.

Small water companies typically cannot attract capital and often have small cash reserves, or none at all. Frequently, these companies are run by part-time managers possessing little technical training. In addition, their small customer base

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limits their ability to incur significant expenditures for regulatory compliance and other purposes. As a result, these small companies frequently fail to comply with new, or even existing, health and safety regulations. In particular, the requirements of the Safe Drinking Water Act are expected to impose requirements that many systems will be unable to meet. Consolidation of water companies through acquisition or merger may serve as a solution in these situations.

GOALS

This policy is intended to foster acquisitions and mergers that will: (1) improve the ability of small water companies to provide service; (2) improve customer service; (3) make it easier to comply with current and future regulations; (4) avoid drastic rate increases; (5) bring the rates of merged systems into parity; (6) improve and consolidate management and operation; and (7) promote conservation.

GUIDELINES

The guiding principal in granting acquisition incentives will be to increase customer benefit. An acquirer must be able to show that it can continue to exist in the long term and will be able to provide its customers with safe and adequate service at just and reasonable rates. To foster a

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transformation of small non-viable water companies into entities better able to serve, acquisition incentives may be provided in certain cases, where the following factors so suggest:

1. Whether the acquiring company has the ability to adequately manage the business, serve customers, comply with regulations, and finance capital improvements.
2. Whether the impact on customers resulting from the acquisition is at least as beneficial as the impact of realistic alternatives.
3. Whether the terms of the acquisition will permit future beneficial solutions, such as municipalization.
4. Whether benefits to customers are expected to be commensurate with the cost of the incentives for the acquisition or merger.
5. Whether meaningful customer participation has been obtained through effective public involvement.

We will also consider additional incentives where proposals are made to consolidate several water systems at once.

INCENTIVES

Because each small water company will present unique circumstances, incentive plans will have to be tailored case-by-case. The following incentive mechanisms are provided as examples of those that may be considered. They will not be appropriate in each instance, nor do they constitute an

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exhaustive list of measures that can be entertained. As a general matter, however, any significant rate increases that may be needed should be phased in, in order to avoid unduly harsh effects on customers.

1. Rate Base

- a. Where the purchase price is less than the rate base of the company being acquired, rates may nevertheless reflect the full rate base of the acquired company.
- b. Where the purchase price is greater than rate base, rates may reflect the purchase price premium if warranted. For example, a premium might be justified by improved service, realized cost efficiencies, or economies of scale.
- c. Where capital expenditures are required for service improvements or to comply with health and safety regulations, projected improvement costs may be reflected in rates immediately, subject to verification that the expenditures are made.
- d. Where the company being acquired has little or no rate base, a proxy rate base may be allowed, equivalent to the rate base per customer of the acquiring company.

2. Depreciation

Where circumstances warrant, depreciation may be allowed at accelerated rates, or depreciation on projected improvement costs may be allowed subject to subsequent adjustment.

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3. Amortization

The reasonable costs of acquisition may be recovered by amortization. Under certain conditions, amortization may also be considered for recovery of a purchase price premium. The term of an amortization should be chosen to minimize adverse effects on customers.

The four incentives described below will be considered only in special cases for good cause shown. They represent a departure from traditional rate-making practice and are meant to facilitate consolidation that may otherwise not be possible.

4. Operating Ratio

Where rate base incentive mechanisms are less practicable, a ratio of revenues to operation and maintenance costs may be used to determine revenue requirement.

5. Rate of Return

Where it can be shown to benefit customers, a premium on the overall rate of return may be allowed.

6. Delayed Recovery

Where the costs of acquisition or improvements, or the effects of rate equalization, would cause unduly harsh effects on customers, proposals to delay or phase in

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recovery of costs, rather than lose the opportunity for consolidation, may be considered.

7. Lease/Buyout

Where there is uncertainty regarding the overall benefit of an acquisition, and it would appear beneficial for ownership, management, and operation to occur for a trial period, operation of the company under a lease with an option to buy may be considered as a mechanism for providing incentives.

REQUIRED INFORMATION

The following information should be submitted with any request for our approval of an acquisition or merger.

- o With respect to both companies involved in the merger or acquisition:
 - The current extent of compliance with regulatory agency requirements and directives (Departments of Health, Environmental Conservation, and Public Service, and local authorities).
 - The prospects for future compliance with regulatory requirements.
 - The number of customers.
 - Comparative income statements for the three most recent years.
 - A current balance sheet.
 - Estimate of rates needed to comply with SDWA or other service requirements.

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- Evaluation of customer benefits and economies of scale.
 - Information and data on the rate impact on all customers (acquiring and acquired companies), and the rate plan to achieve parity.
 - A report on the public involvement effort and customer input.^{1/}
- o With respect to the acquired company:
- Identification of ownership of all transferred water plant.
 - Inventory of plant being transferred.
 - The location of the acquired company relative to the acquiring company and to nearby systems, both municipal and private.
- o With respect to the acquiring company:
- A copy of the proposed purchase contract.
 - Identification of municipal approvals, if required.
 - The proposal for financing the acquisition, if appropriate, including applicable information in compliance with 16 NYCRR Part 37.

By the Commission,

(Signed)

JOHN J. KELLIHER
Secretary

^{1/}In reviewing any acquisitions, we will focus on the results of the company's public involvement and information efforts.

PSC Case No. 03-W-0952

THE STATE OF NEW YORK PUBLIC SERVICE COMMISSION

In the Matter of the Application of
REAGANS MILL WATER COMPANY
For an Increase in its Rates and Charges

AFFIRMATION IN RESPONSE TO THE PSC STAFF PRELIMINARY REPORT

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