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June 29, 2009

VIA USPS EXPRESS MAIL

Hon. Jacklyn Brilling
Secretary
New York State Public Service Commission
3 Empire State Plaza
Albany, NY 12223-1350

**Re: CASE 08-W-1201 -- Proceeding on Motion of the Commission
as to the Rates, Charges, Rules and Regulations
of
Heritage Hills Water Works Corporation**

Dear Secretary Brilling:

Enclosed are an original and five copies of the Response by Heritage Hills Society, LTD.
To Heritage Hills Water-Works Corporation's Reply to the Heritage Hills Society's Motion to
Make Rates Temporary and Subject to Refund. The participating members of Staff are also
receiving both e-mail and hard copy of this filing.

On June 23, 2009, Heritage Hills Society LTD ("the Society") received via e-mail
Heritage Hills Water-Works ("HHWW") Reply to the Society's Motion to Make HHWW's
Rates Temporary and Subject to Refund. While mindful of 16 NYCRR §3.6(d)(3)'s prohibition
on replies to responses to a motion, the Society requests that this response be entertained since
"extraordinary circumstances" exist in connection with HHWW's excessive rates, particularly in

the present economic environment. Those rates are excessive due to a number of factors, not the least of which is the failure to adhere to the Commission's rate base cap established in 1984 which results in a rate base that is over 50% higher than it should be, without considering the fact that this system was substantially over designed to begin with. Excessive operating and maintenance costs, phantom taxes and a fantasy capital structure all contribute to the unjust and unreasonable rates currently being charged.

Furthermore, there is a need to correct a number of errors in HHWW's Reply.

The Society believes that this Response will advance the record in this proceeding and respectfully requests that the Commission consider it.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Daniel P. Duthie", written in a cursive style.

Daniel P. Duthie

cc: Keith J. Sorensen, Vice President
Frank W. Radigan
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Richard Benedict, President, Heritage Hills Society, Ltd.

**BEFORE THE
PUBLIC SERVICE COMMISSION
STATE OF NEW YORK**

Proceeding on Motion)
of the Commission as to the Rates, Charges,)
Rules and Regulations of)
Heritage Hills Water-Works Corporation)

CASE 08-W-1201

RESPONSE

BY HERITAGE HILLS SOCIETY, LTD.

**TO HERITAGE HILLS WATER-WORKS CORPORATION'S REPLY TO THE
HERITAGE HILLS SOCIETY'S MOTION TO MAKE RATES TEMPORARY AND
SUBJECT TO REFUND**

June 29, 2009

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**BEFORE THE
PUBLIC SERVICE COMMISSION
STATE OF NEW YORK**

Proceeding on Motion)
of the Commission as to the Rates, Charges,)
Rules and Regulations of)
Heritage Hills Water-Works Corporation)

CASE 08-W-1201

**RESPONSE
BY HERITAGE HILLS SOCIETY, LTD.
TO HERITAGE HILLS WATER-WORKS CORPORATION'S REPLY TO THE
HERITAGE HILLS SOCIETY'S MOTION TO MAKE RATES TEMPORARY AND
SUBJECT TO REFUND**

Introduction

On June 23, 2009, Heritage Hills Society LTD ("the Society") received via e-mail Heritage Hills Water-Works ("HHWW") Reply to the Society's Motion to make HHWW's rates temporary and subject to refund. While mindful of 16 NYCRR §3.6(d)(3)'s prohibition on replies to responses to a motion, the Society requests that this response be entertained since "extraordinary circumstances" exist in connection with HHWW's excessive rates, particularly in the present economic environment. Furthermore, there is a need to correct a number of errors in HHWW's Reply. The Society believes that this Response will advance the record in this proceeding¹ and respectfully requests that the Commission consider it.

¹ The Commission, on occasion, has accepted responses in other cases where such were found to advance the record. See, for example, CASE 02-E-0939 – Orion Power New York, L.P., Declaratory Ruling on Review of Corporate Reorganization and Order Clarifying Prior Order (Issued and Effective September 24, 2002) and more recently, CASE 09-M-0311 – Implementation of Chapter 59 of the Laws of 2009 Establishing a Temporary Annual Assessment Pursuant to Public Service Law §18-a(6) (Issued June 19, 2009).

The Society represents the 2,606 homeowners of Heritage Hills of Westchester, located in the Town of Somers, New York. The majority of homeowners are on a fixed income making a rate increase particularly onerous since the current rates are many times higher than comparable water utilities. See the chart, produced by the Staff of the PSC inserted on page 2 of the Society's Motion. Part of the reason for the excessive water rates is derived from a departure from Commission precedent as well as uncontrolled costs, fantasy capital structure and phantom federal and state income taxes as has been described in the Society's Motion and as further addressed herein. Thus, an immediate rate decrease is warranted. Surely, these facts constitute extraordinary circumstances.

This is a Major Rate Case and Should be Treated as Such

HHWW's Reply to the Society's statement that this is a major rate case says absolutely nothing about the substance of this claim. Effective April 1, 2009, all utilities in New York State subject to the jurisdiction of the PSC were hit with a minimum² six fold increase in the PSC assessment to 2% from 1/3 of 1% of gross revenues. Chapter 59 of the Laws of 2009 Establishing a Temporary Annual Assessment Pursuant to Public Service Law §18-a(6). As result of this additional element of cost, the \$300,000 limitation has been exceeded causing this case to become a major rate filing. This fact then triggers a hearing requirement under Public Service Law §89(c)(10)(f). There is nothing in the Public Service Law that limits or conditions the origins or timing of the cost increase. Since HHWW has not said it will waive rate recovery for this new "tax", then the case is clearly one that must be considered "major".

² The electric and gas utilities experienced an even higher increase as a result of the inclusion in the PSC assessment calculation of revenues due to ESCO or third party sales of the commodity portion of the service.

Rate Base Cap

Putting aside for the moment whether the Commission intended to inflate the rate base cap established in 1984, HHWW's arithmetic is wrong. If one uses the rate base cap found in the Recommended Decision, dated May 10, 2004, and applies it to the full build out of customers, i.e., 2,606 residential and 37 commercial for a total of 2,643, one arrives at a rate base of \$4,300,161 using the inflated cap of \$1,627 per customer. If the rate base cap was inflated still further by 15% as HHWW argues, the rate base would be \$4,945,185, not the \$5.1 million claimed.

In any event, if HHWW is allowed a rate base cap based on inflation, then that cap should be adjusted by depreciation. Given that the development is now in its 35th year (1974 to 2009) and assuming an average vintage for the system of 17.5 years, then the rate base should be adjusted downward to \$3,214,370 which assumes an average service life for all assets of 50 years. [$\$4,945,185 \times (50 - 17.5)/50 = \$3,214,370$]. This compares favorably with the Society's rate base cap calculation without inflation of \$3,118,740 and the rate base design calculation of \$3,502,346. For purposes of the Society's recommendation an average of those two calculations was used which places the rate base at \$3,310,543. See Society's Motion on pages 6 and 7.

More importantly, the use of inflation with the rate base cap defeats the intent of the rate base cap and the Commission's explicit finding in the 1984 Order which is to place the risk on the developer instead of shifting that inflation risk to the ratepayers. After discussing the initial rate concept, the cost of completing the system, etc., the Commission stated:

As for the future, we share Staff's concern that present ratepayers, for whom the existing system is adequate, be protected from increased costs occasioned by delays in completing the system and adding the full complement of customers. Accordingly, we shall cap the company's projected rate base per customer at its present level of \$1180, [footnote omitted] subject only to increases on account of additional back-bone plant, i.e., plant used to serve all customers, including those now on the system.' If the capital costs

incurred to serve new customers exceed the cap, the excess will be recovered by means that do not burden existing customers. These could include connection charges imposed on new customers or, if the real estate developer chooses, an addition to the price of new homes. (Emphasis added).

1. / Capping rate base per customer at its current projected level makes particularly good sense inasmuch as the original plan called for the system, begun in 1973, to be completed in 1983.

CASE 28453 – Heritage Hills Water Works Corporation – Water Rates, Opinion and Order Determining Revenue Requirement (Issued: January 4, 1984) at pages 14-15.

Thus, it is clear that the Commission expressly left the risk of inflation on the developer, not the ratepayers. The fact that the last case may have incorrectly placed that risk on the ratepayers does not mean such an error should be continued. The Recommended Decision in the last case addressed this issue. The Commission, however, did not address this issue in the last rate case decision for HHWW. The faster that error can be corrected the better. This alone supports the Society's request to make the current rates temporary and subject to refund.

Compliance with Policy Statement on Major Rate Proceedings

HHWW virtually admits that it has not complied with the Commission's Statement of Policy on Test Periods in Major Rate Proceedings, Case 26821 (Issued: November 23, 1977). Specifically, HHWW did not present in its October 2008 rate filing operating results, with normalizing adjustments, for a twelve-month period expiring at the end of a calendar quarter no earlier in time than 150 days before the date of filing. HHWW states in response:

"Given that Heritage Hills like many small company [sic] only reports data on an annual basis it is almost impossible to report data on a quarterly basis." Thus, it is clear that HHWW did not comply with the Policy Statement.

HHWW also states that the Policy Statement does not apply to "mini" filings. HHWW is incorrect. In an Order issued on December 12, 1979, the Commission explicitly addressed how

its Policy Statement would apply to “mini” filings stating that “...we expect filings based on a forecast test year to comply fully with the requirements of our Statement of Policy On Test Periods In Major Rate Proceedings issued November 23, 1977.” This was cited in the Society’s Motion at page 4.

Meter Testing Refund

HHWW disingenuously states that “... it should be noted that there is no expense for meter testing included in this rate case.” HHWW Reply at 6. HHWW’s current level of rates includes \$17,000 a year for meter testing. HHWW could not credibly ask to double dip on an element of expense it has not yet incurred. But the failure to have spent any of this rate allowance for five years means that the ratepayers should be credited with \$85,000 over the next three years and the Society’s adjustment does just that.

Outside Services, Management Fee

While attempting to show that the low volume of consumption causes HHWW’s rates to be much higher, HHWW has made the Society’s point that the system is oversized by a significant margin. For example, HHWW points out that the average water usage per customer of United Water Westchester is 165,170 gallons per year or 4.4 times the average customer of Heritage Hills at 37,640 gallons per year. Even greater is the comparison with United Water Owego where the average customer uses 320,320 gallons per year which is 8.5 times more than Heritage Hills average customer consumption. Sea Cliff customers use 113,000 gallons on average per year. This is three times more usage than HHWW customers.

The developer’s design error, on average, is approximately 5 times that actually required if one uses the annual consumption of the companies cited. This overdesign and the attendant costs should not be visited on the ratepayers. The rate base adjustment proposed by the Society

and contemplated by the Commission's 1984 Order limiting the per capita investment will mitigate, to some degree, this error. Undoubtedly, if the Commission was aware of the huge overdesign then, the rate base would have been subject to a smaller cap that reflects the water consumption for town houses inhabited primarily by seniors.

Finally, the simple truth is that the \$50,000 increase in management fees from approximately \$33,000 allowed in the last case is not justified on the record of management to date. The Society would not oppose an inflationary increase in the \$33,000 allowance from the last case. But simply because HHWW decides to unilaterally increase its management fee by \$50,000 is no grounds for allowing that expense in rates.

Productivity and Austerity Adjustment

Times are tough for all. This Commission has ordered electric and gas utilities to put into place austerity measures. In the Notice Requiring the Filing of Utility Austerity Plans (Issued May 15, 2009), the Commission stated:

The services provided by the State's major electric and gas utilities operating in monopoly markets are essential services to their customers. When utility customers are experiencing the extraordinary economic realities we see today, these customers look to their utility service providers to demonstrate the same frugality as the customers themselves experience daily so that the ultimate costs that customers must bear are minimized.

.....Nevertheless, these utilities, like other New York businesses, should be implementing austerity measures aimed at eliminating or deferring spending whenever such actions can be taken without compromising the provision of safe and reliable service.

While this Notice was directed at the major gas and electric utilities, there is no reason HHWW, as a provider of essential water service should escape from this requirement.

Property Taxes

Management needs an incentive to contest the unusually high property taxes. The Society's proposal, by allowing only 90% of the current property taxes in rates, will do just that.

FIT and SIT

To add insult to injury, HHWW wants the ratepayers to provide it with revenues on tax liabilities it will not incur. To provide revenues for a non-existent tax liability on an overbuilt system is an outrage and such rates cannot be said to be just and reasonable.

Remaining O&M Adjustments

The Society's O&M Adjustments are simply an effort to reflect the reality that not all costs go up every year. Hence the adjustments primarily reflect the most recent information for 2008, updating the three year average. These are not punitive adjustments but simply reflect the actual costs incurred by HHWW. And that is all that should be reflected in rates. "Punitive", however, is the correct characterization for the current level of water rates.

Conclusion

While the Commission must have a rational legal basis for reaching its conclusions, at some point it must go beyond the myopic task of setting rates solely based solely on the information provided by the utility in the filing and ask:

Are the water rates in issue comparable to other similar communities? The answer is clearly that HHWW rates charged to the residents of Heritage Hills exceed by far the rates in other similar communities (see Chart in the Society's Motion). This condition has been known for quite some time. But that does not make it correct. Is the Commission not responsible to carefully reexamine HHWW's rates to determine why?

By far and away the most significant source of the high rates is HHWW's rate base. The Commission's rate base cap Order in 1984 was ignored and inflation was tacked on when it should not have been. That is crystal clear from a review of that 1984 Order wherein the Commission expressly stated that inflation was the developer's risk. The current rates have made the ratepayers the risk takers and that should be stopped.

The Society also posits that another reason for the unjust and unreasonable rates is because the water system that was built exceeds the needs of the community? HHWW, while trying to make another point -- other water systems have significantly higher per capita usage and thus the rates are lower -- has agreed. Who should be responsible for such a significant over design? Obviously, the developer should be on the hook for design errors that result in an overbuilt system.

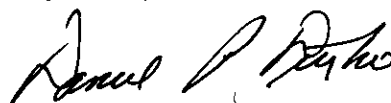
The Society posits further reasons. HHWW has made no attempt to reduce costs. The rate making numbers are skewed because of the capital structure is one that is conjured (45% equity) and not real (100% debt). Income taxes are proposed to be included that will never be paid. Excessive costs are incurred for management fees paid to related companies. The Society has reviewed these costs updated all for 2008 actual costs and made a recommendation that will provide compensatory rates to HHWW.

Often the numbers only tell part of the story and the broader picture must be looked at as well. If the numbers point to rates that exceed by an extreme margin the rates in comparable communities, the Commission has a moral and legal duty to the residents of Heritage Hills to go beyond a rigid adherence to ratemaking policies and to identify the anomalies and/or outright errors that "justify" an inordinately high water rate. The fact that HHWW has chosen to outsource all of its work and not even consider whether having full time direct employees is less

expensive should not be automatically accepted by the Commission which has general supervisory power over HHWW. Certainly, those potentially higher costs should not be passed on to the residents of Heritage Hills without making a determination in comparison to other utilities that manage to operate with much lower overheads.

The Society also requests the appointment of an Administrative Law Judge to hold hearings and make a recommendation on permanent rates to the Commission. It should be possible to set a hearing on permanent rates and conclude with a recommendation to the Commission so that this case can be decided at the November, 2009 Session within the statutory suspension period.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Daniel P. Duthie".

Daniel P. Duthie, Esq.
On behalf of the Heritage Hills Society, Ltd.

June 29, 2009