


City of Alexandria, Virginia

MEMORANDUM

DATE: MAY 18, 2010

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: JAMES K. HARTMANN, CITY MANAGER 

SUBJECT: PROPOSED VIRGINIA-AMERICAN WATER COMPANY RATE INCREASE

ISSUE: Virginia-American Water Company's proposed rate increase

RECOMMENDATION: That City Council authorize staff to provide formal comments and concerns as outlined in this report to the State Corporation Commission (SCC) in regard to the proposed 16.0 percent increase in the Virginia-American Water Company's (Water Company) Alexandria customer rates, as well as encourage City residents and businesses to provide comments and input to the SCC.

DISCUSSION: On March 8, 2010, the Virginia-American Water Company (Water Company), a privately-owned for-profit entity, filed with the State Corporation Commission (SCC) an application for a 22.4 percent increase for the Alexandria District (Case No. PUE-2010-00001), which encompasses the City of Alexandria. Under SCC rules, this rate increase will become effective on August 13, 2010, but would be subject to a refund with interest if the SCC later determines that a lower rate was appropriate. In July 2008, the Water Company requested a 24.9 percent increase that went into effect, however refunds were ordered when the SCC determined that a 9.5 percent increase was more appropriate. The proposed 16.0 percent increase for Alexandria customers is driven largely by capital investments and questionable water customer and water usage statistics, as well as the Water Company's request for an increase in the rate of return on common equity.

City staff has reviewed the rate case documents and recommends that the City of Alexandria submit formal comments to the SCC objecting to the proposed size of the general increase of 16.0 percent in water rates. Staff has found that the rate case documentation contains sufficient information to support a rate increase, but not as large as requested. The following are items that staff noted in the rate case documentation:

- The Water Company's last submitted rate increase documentation was for the test year that ended September 30, 2007. Since then, the Water Company has invested approximately \$11 million in improvements to the facilities that support Alexandria customers.

- Staff compared the annual revenues and expenses from the prior rate case (test year ended September 2007) to this rate case (test year ended September 2009). Staff noted in the two-year period total operating revenues on an annual basis increased 19.6 percent, operations and maintenance expense increased by 14.1 percent, depreciation and amortization expense increased 8.7 percent, and interest expense increased by 1.6 percent.
- The Water Company's Percentage Rate of Return on Common Equity for the test year ending in September 2009 in their rate case documentation was 3.41 percent. The Water Company is requesting enough revenue to increase its rate of return on common equity to 11.5 percent. The prior approved rate increase was designed by the SCC to provide the Water Company with a 10.5 percent rate of return on common equity.
- Staff is not convinced of the merits of all the arguments and facts associated with the rate increase request for the following reasons:
 - Increase in Rate of Return on Common Equity: As stated above, the Water Company is requesting an 11.5 percent rate-of-return on common equity. This rate-of-return is based on the work of a consultant hired by the Water Company who developed a rate-of-return calculation for the Virginia-American Water Company as a whole and not for the Alexandria district independently. The consultant determined that the Water Company should receive a higher rate-of-return because the water utility industry has a higher business risk due to three factors: high operating leverage, demand uncertainty, and supply uncertainty. Staff believes that Alexandria residents should not have to pay more because of the uncertainty associated with the Water Company's industrial customers in Hopewell. In addition, the Water Company purchases the water sold in the Alexandria District from the Fairfax County Water Authority. Staff believes Alexandria customers' solid and consistent revenue stream, coupled with no risk of water production, reduces revenue generation and cost risks substantially and should reduce the proposed rate of return of 11.5 percent to no higher than the 10.5 percent the SCC approved in 2008.
 - Increase in Customers: The SCC develops approved water rates from historical data accumulated for test years. According to the rate case documentation for the City of Alexandria, the number of customer meter billings increased from test year 2007 to test year 2009 by 4,480 billings (3,468 residential customers and 1,024 commercial customers). According to the Water Company, the Company sold 220 million gallons less water in 2009 than it did in test year 2007. This does not correlate with the increased number of customers and with the City's growth in population. In addition, from test year 2003 to 2007, the Water Company lost 6 residential customers and sold 65 million gallons less water. This year's rate case has fewer gallons of water sold in 2009 than the 2000, 2003, and 2007 rate case filings. Staff believes there is some anomaly in the 2003 and 2007 water usage numbers and cautions its use in determining the City's water rates.

- **Large Rate Increase:** The 16.0 percent rate increase for Alexandria customers requested by the Water Company would generate \$1.3 million a year in additional income for common equity. The Water Company's investment in common equity increased by \$1.3 million between 2007 and 2009, and the investment in the rate base increased by \$2.2 million in the same period of time. With this large rate increase, the Water Company would recoup its investment in one year, which is less time than is customary for capital investments of this type.

In prior years, the SCC staff has concurred with many of the issues identified by the City. In addition, the SCC has raised additional issues, which have resulted in the SCC approving rate increases substantially lower than requested by the Water Company. As mentioned earlier, in 2008 the Water Company requested a rate increase of 24.9 percent; the SCC approved a rate of 9.5 percent. In 2004, the Water Company requested a rate increase of 8.5 percent and was approved a rate increase of 3.5 percent. The Water Company has invested heavily in its infrastructure located in the City and thus has justified a rate increase, but not a 16 percent increase for Alexandria customers.

Based on past practice, the SCC will likely take until the end of the year to reach a rate decision. As the SCC welcomes public input, and has a web site which the public can access to provide input, it is recommended that the City's concerns be disseminated to City residents and businesses and that they be encouraged to provide input to the SCC.

FISCAL IMPACT: If the proposed percent rate increase is approved, Alexandria customers will experience a 16.0 percent overall water rate increase. The average increase for an Alexandria family of two would compute to about \$10 more per quarter. If City water bills increase 16 percent, the City government's own water bill would increase \$92,000 annually.

STAFF:

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