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RRA REGULATORY FOCUS

Flood of water utility rate cases completed in recent weeks

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Market Intelligence

Across the US, several water utility rate cases concluded in recent weeks, but return on equity trends remain difficult to pinpoint, given the relatively small dataset.

The Take

- ▶ Water utility rate proceedings were completed in Idaho, Kentucky, Missouri, North Carolina and Virginia, with cost-of-capital parameters provided in four proceedings. Returns on equity (ROEs) in those cases ranged from 9.25% to 9.80%, and the equity component of capitalization ranged from 40.73% to 55.57%. Notably, in Idaho, cost-of-capital parameters were disclosed for the first time since 2010 for the state's largest water utility. Another recently completed proceeding marked the first time Water Service Corp. of Kentucky completed a base rate case using an ROE calculation rather than the operating margin method.
- ▶ Year to date, ROEs across the water utility group have averaged 9.40%, with a historically low 8.70% litigated decision in Connecticut bringing down the average. In 2022, 10 water utility rate cases were completed nationwide, with an average ROE of 9.61%.
- ▶ A rate decision for Carolina Water Service Inc. of North Carolina marks the first instance of a water utility in the state being authorized multiyear, performance-based rates. Authorization of the utility's 9.80% ROE was not unanimous, with two commissioners dissenting because they felt that the ROE agreed to in the settlement was too high, given "the reduced risk to shareholders" that stemmed from using a multiyear, forward-looking approach rather than a historical test year.
- ▶ Infrastructure surcharge mechanisms were addressed in three proceedings. In Idaho, the company's request to implement one was denied. In Virginia, an earnings test was included before a surcharge could be implemented. In North Carolina, a mechanism was suspended during the period that performance-based rates are in effect.

Regulatory Research Associates evaluates water utility regulation in 22 state jurisdictions and monitors rate proceedings involving rate change requests of at least \$1.0 million for the 12 largest investor-owned and privately held water utilities.

In the first quarter, cost-of-capital parameters were provided in a single water utility rate proceeding in March: A litigated decision for Aquarion Water Co. of Connecticut Inc. (AWC-CT) resulted in an 8.70% ROE, the lowest nonpunitive return authorized for a water utility since 2010 as tracked by RRA.

In January, The York Water Co. finalized a base rate case that was silent with respect to rate of return and rate base parameters, which is common with black box settlements in Pennsylvania.

For additional details regarding water utility rate cases from Jan. 1, 2010, through March 31, 2023, please refer to this [industry document](#).

2023 Water utility rate case decisions

Date	Company	State	ROR (%)	ROE (%)	Common equity as percent of capital	Rate base (\$M)	Test year end
05/03/23	Missouri American Water Co.	Missouri	NA	NA	NA	NA	05/31/23
04/28/23	Veolia Water Idaho Inc.	Idaho	6.91	9.25	55.57	255	12/31/22
04/26/23	Carolina Water Service Inc. of North Carolina	North Carolina	7.22	9.80	50.00	151	03/31/22
04/24/23	Virginia American Water Co.	Virginia	6.29	9.70	40.73	NA	04/30/23
04/12/23	Water Service Corp. of Kentucky	Kentucky	7.07	9.55	50.09	6	12/31/23
03/15/23	Aquarion Water Co. of Connecticut	Connecticut	6.46	8.70	50.35	992	08/31/22
01/12/23	The York Water Co.	Pennsylvania	NA	NA	NA	NA	02/29/24
Average rate award			6.79	9.40	49.35		

As of May 5, 2023.
NA = not available; ROR = return on rate base; ROE = return on equity.
Source: Regulatory Research Associates, a group within S&P Global Commodity Insights.
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Recent rate decisions

Idaho – An April 28 decision for Veolia Water Idaho, formerly Suez Water Idaho Inc., marked the first base rate case in a decade that provided cost-of-capital details for the company. In a litigated order, Veolia Water Idaho was authorized a \$2.8 million (7.06%) rate increase, based on a 9.25% return on equity (55.57% of capital) and a 6.91% rate of return on an average rate base of \$255.2 million for a test year ended Dec. 31, 2022.

The company had originally requested a \$12.1 million (23.4%) rate increase based on a 10.80% ROE and a \$280.8 million rate base. The PUC rejected the company's proposal to implement a distribution system improvement charge (DSIC). Similar DSIC mechanisms have been authorized in over 20 states and

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9.25
9.8
9.7
9.55
9.57
4 | 38.30
34
23

are considered a best practice by the National Association of Regulatory Utility Commissioners' Water Committee.

RRA has not formally evaluated the Idaho regulatory environment as Veolia Water Idaho is the only large investor-owned water utility in the state, and its rate cases have only been resolved through black box settlements over the last decade. The recent decision does not appear to be constructive for investors, considering the authorized revenue increase, the below-average ROE and the commission's use of an average rate base and historical test year. The approval of a DSIC mechanism would have somewhat mitigated the regulatory lag created by the test year and rate base methodology.

Veolia Water Idaho, a subsidiary of France-based Veolia Environnement SA provides water service to 105,000 customers in Boise City and surrounding areas.

Kentucky — In a small proceeding for Water Service Corp. of Kentucky, the company was authorized a \$0.6 million (18.9%) rate increase based on an average rate base valued at \$6.4 million for a test year ended Sept. 30, 2022. This proceeding was the first time the Kentucky Public Service Commission required the company to base its request on an ROE calculation rather than the operating margin method.

Kentucky regulation of water utilities is generally balanced from an investor perspective. For the larger investor-owned utilities, authorized equity returns tend to be at or below prevailing nationwide industry averages at the time established. Smaller privately held systems with high levels of contributed capital use an operating ratio instead of an ROE methodology to determine returns. Kentucky-American Water Co. Inc. utilizes a forward test year and has been authorized interim rate relief, which has accorded the company a reasonable opportunity to earn its allowed returns. The commission supports rate consolidation, which minimizes the number of rate tariffs during rate proceedings and enables a utility to spread the cost of infrastructure projects across a larger customer base. Larger historical merger approvals have included certain restrictive provisions. Recent smaller transactions, however, have been authorized without onerous requirements.

RRA accords Kentucky regulation an Average/2 rating as it pertains to water utilities.

Water Service Corp. of Kentucky, a wholly owned subsidiary of Corix Regulated Utilities (Us) Inc., sells water to approximately 6,200 customers in Bell, Clinton and Hickman counties. Kentucky-American Water is a subsidiary of American Water Works Co. Inc.

Missouri – On May 3, the Missouri Public Service Commission issued an order adopting a black box settlement in Missouri American Water Corp.'s water and wastewater base rate case.

The decision authorizes a \$44.3 million annualized increase in water and wastewater revenues, excluding \$50.7 million in previously approved infrastructure surcharges, which are effective May 31. The order was silent regarding cost-of-capital parameters and rate base.

Missouri American Water had sought combined water and wastewater base rate increases of \$105.1 million (25.7%) based on a 10.50% return on equity (50.43% of capital) and a 7.50% overall return on a rate base valued at \$2.379 billion. The proposed rate increase included the transfer to base rates of \$40.2 million associated with the company's water and sewer infrastructure rate adjustment mechanism. This amount was adjusted to \$50.7 million during the proceeding.

Missouri regulation of water utilities is relatively balanced from an investor perspective. Authorized ROEs have been at or below prevailing industry averages at the time established. Rate requests are typically filed based on historical test period data, which is updated during the proceeding to reflect actual results. The PSC has approved water utility merger proposals without imposing onerous restrictions and has supported consolidation of rate tariffs. Legislation enacted in 2021 broadened the parameters of the water and sewer infrastructure rate adjustment mechanism, which allows for the recovery of investments between base rate proceedings.

RRA accords Missouri regulation of water utilities an Average/2 rating.

Missouri American Water, a subsidiary of American Water, provides water service to approximately 475,000 customers and wastewater service to approximately 18,000 customers in several counties throughout Missouri.

North Carolina — On April 26, the North Carolina Utilities Commission (NCUC) authorized a \$4.0 million (8.5%) rate increase for Carolina Water Service Inc. of North Carolina, effective April 1, based on a rate base valued at \$151.2 million for a test year ended March 31, 2022. Step rate increases of \$2.7 million (5.0%) for year two and \$2.7 million (5.0%) for year three were approved for an approved multiyear rate plan.

In a settlement filed Nov. 22, 2022, the parties agreed that Carolina Water Service Inc. of North Carolina should be authorized to implement the multiyear rate plan. The settlement also set performance-based metrics related to water quality, customer service and operating expense efficiency. Additionally, the settlement called for suspending the company's infrastructure surcharges, known as the water system improvement charge and sewer system improvement charge, during the term of its rate plan.

The settlement resolved all issues except ROE and the details related to the 5% cap on rate increases in years two and three of the plan.

The NCUC authorized the company a 9.80% ROE, stating that this return "appropriately balances [Carolina Water Service Inc. of North Carolina's] need to obtain equity and debt financing with its customers' need to pay the lowest possible rates." In their dissent, Commissioner Jeffrey Hughes and Commissioner Floyd McKissick Jr. said, "[T]he majority's approved ROE of 9.80% for the [rate plan's rate years] fails to sufficiently consider and quantify the reduced risk to shareholders that necessarily flows from the transition from a historic test year to a multiyear forward looking approach. When considering the same, a specific 15- to 20-basis point reduction as proposed by public staff ... is more than appropriate. This reduction would demonstrate at least some financial benefit to customers due to this transition."

The disputed issue regarding the 5% rate increase in years two and three of the plan centered on whether the 5% cap was to be applied on a total company basis or on a rate division basis. The decision hinged on the definition of "utility" in state law, and the NCUC determined that it was appropriate to apply the cap to Carolina Water Service Inc. of North Carolina's total service revenues, on a combined basis, for the preceding year.

The Corix subsidiary serves approximately 32,000 water customers and 20,300 sewer customers in North Carolina.

North Carolina regulation of water utilities had been considered somewhat restrictive from an investor viewpoint. Historically, the NCUC has adopted equity returns that have been at or slightly below the prevailing national average when established. Though rate cases have been settled in a timely fashion, regulatory treatment of expenses has not adequately reflected the operating environment, making it difficult for utilities to earn their authorized return. The

NCUC has allowed acquisition adjustments and consolidation of rate tariffs, which encourage the consolidation of small systems. The use of infrastructure surcharge mechanisms minimizes regulatory lag.

In the recent proceeding, Carolina Water Service Inc. of North Carolina was the first water utility authorized a multiyear, performance-based rate plan, and the approved ROE was above the prevailing nationwide industry average.

RRA currently accords the North Carolina regulatory environment an Average/3 rating as it pertains to water utility regulation.

Virginia — On April 24, the Virginia State Corp. Commission (SCC) approved a settlement reached Sept. 26, 2022, in Virginia-American Water Co.'s base rate proceeding. The settlement called for a \$10.8 million rate increase based on a 9.70% return on equity (40.73% of capital) and a 6.28% overall return. Rate base was not disclosed in the settlement or final order. Interim rates became effective May 1, 2022, and since the interim increase exceeded the approved permanent amount, the difference is subject to refund with interest within 90 days of the date of the order.

In its decision, the SCC added an earnings test to accompany Virginia-American Water's DSIC mechanism, known as a water and wastewater infrastructure surcharge (WWISC), and required the company to provide refunds to customers in one rate district. The commission said, "The evidence in the record shows that in the Alexandria district, VAWC earned a 10.03% ROE for the 28-month WWISC period when both base rate and WWISC revenues are considered. After accounting for refunds ... the company's resulting earned return is 9.57%, which is above the weighted average benchmark of 9.55% determined by the authorized ROEs during the period."

The SCC also supported the company's second phase of consolidating water service rates across its customer base.

Virginia-American Water is a subsidiary of American Water.

Regulation of water utilities in Virginia is relatively balanced from an investor viewpoint. ROE determinations historically have approximated industry averages when established. The SCC relies on test periods that are historical when rate decisions are issued but utilizes a year-end rate base valuation. In addition, the SCC allows certain post-test-year adjustments to expenses and investment, and interim rates may be implemented prior to final rate case decisions. Purchased water adjustment and infrastructure surcharge mechanisms are utilized by some water utilities. The SCC has not been receptive to revenue decoupling mechanisms or declining usage adjustments but has been supportive of consolidated rate structures proposed by the utilities.

RRA accords Virginia regulation an Average/2 ranking as it pertains to water utilities.

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