

Fishers Island Water Works Corporation
P.O. Drawer E
Fishers Island, New York 06390

August 4, 2017

Honorable Kathleen H. Burgess, Secretary
New York State Public Service Commission
Three Empire State Plaza
Albany, NY 12223-1350

Re: Fishers Island Water Works Corporation – Minor Rate Filing

Dear Secretary Burgess:

On behalf of Fishers Island Water Works Corporation (“FIWWC”), I enclose herewith tariff amendments in compliance with the requirements of the Public Service Commission of the State of New York:

P.S.C. No. 2 – Water

Fourth Revised Leaf No. 14

Fifth Revised Leaf No. 16

Seventh Revised Leaves Nos. 12, 13, 15

Effective: January 1, 2018

This application for a rate increase, which, if granted, is projected to yield an annual increase in aggregate revenues of no more than \$300,000, differs from prior applications in that it reflects two out-of-the-ordinary events:

1. A significant engineering analysis of capital improvements and costs necessary to assure service; and
2. Significant improvements to our management services agreement.

Accordingly, we believe a bit of background is appropriate.

Introduction

This rate application is being submitted to the New York State Public Service Commission (hereinafter, the “Commission”) by Fishers Island Water Works Corporation (hereinafter, “FIWWC”). FIWWC, incorporated in New York on April 18, 1942, is a privately owned public utility and is the sole entity providing water service on Fishers Island, New York, a small island community.

Market Description

Fishers Island is located in Long Island Sound, three miles south of the Connecticut shore, opposite the Connecticut towns of New London, Mystic and Stonington. It is eight miles long and 1.5 miles wide. The island has no local government but is part of the Town of Southold in Suffolk County, New York. There is a year round population of 230 and a peak summer population of approximately 3,000. Consequently, the infrastructure used on a daily basis by a population of 230 must also support a “peak load” for two months for a population of 3,000.

Like most isolated, seasonal communities, and especially island communities, the year round population on Fishers Island has been declining steadily. Island living can be inconvenient and expensive. Yet, the year round population provides critical support for the island’s school, the volunteer fire department, the ambulance (including an ambulance boat) and EMT’s, health services and many other essential functions for the Island, not to mention most of the services provided to the seasonal community. Fishers Island is fortunate in that it has a wealthy seasonal population that, over the years, has been willing, and pro-active, in supporting many community undertakings with jobs, volunteer help, charitable and other financial support.

System Description

FIWWC provides water service to approximately 650 metered residential customers of whom 168 are year-round customers served under Service Classification No. 1 (SC1) and 482 are seasonal customers (June through September) served under Service Classification No. 2 (SC2). The company also provides public fire protection service under Service Classification No. 3 (SC3) to the local fire district through 148 hydrants.

The water supply on Fishers Island is currently sourced from two wells, one constructed in 1989 and the other in 1995, both of which are located in the Middle Farms area of the Island. These sources are augmented during periods of peak demand in summer and dry periods with surface water from Barlow Pond. Prior to pumping into the island’s distribution system, the well water is treated at a ground water treatment facility and pond water is run through a surface water treatment plant, constructed in 1928, and treated with soda ash for pH control and liquid hypochlorite solution for disinfection. The treated well water and surface water are blended before going into the distribution system.

FIWWC operates approximately 22 miles of water mains and 148 fire hydrants leased to the Fire District. The company has an emergency generator for backup power in case of a power failure.

The water infrastructure system has not had major improvements to the basic process flow and distribution system since its construction in the early 1900s.

Corporate Structure

FIWWC is owned 40% by the Fishers Island Utility Company (hereinafter, "FIUC"), an independent New York corporation owned by private individual shareholders, that operates a

management services business on Fishers Island. The remaining 60% ownership interest is held by the Fishers Island Development Corporation (hereinafter, "FIDCO"), an independent New York corporation owned by private individual shareholders, that is engaged in real estate management and development on Fishers Island. As set out in Section 7 of the Service Agreement, there is only minor cross-over among the individual shareholders of each of FIUC and FIDCO. FIUC and FIDCO do not own shares in each other.

The FIWWC board of directors consists of two directors nominated by FIUC and three directors nominated by FIDCO.

Business Operations Services

FIWWC obtains business operation and other services from FIUC. The proposed terms of service are set out in a Service Agreement (hereinafter, the "Service Agreement"), one of four, based upon a common template, that were filed with the Commission on June 8, 2017, (Matter Number/Case No.: 17-0124; hereinafter, the "Service Agreement Filing"). A copy of the Service Agreement Filing is included as Exhibit A.

FIUC also provides business operations and other services, under separate Service Agreements, to two other Commission-regulated operating companies -- the Fishers Island Electric Corporation (hereinafter, "FIEC") and the Fishers Island Telephone Corporation (hereinafter, "FITC") – and to FIDCO. FIEC is owned 50.99% by FIUC and 49.01% by FIDCO. FIUC nominates three directors; FIDCO nominates two. FITC is owned 51.05% by FIUC and 48.95% by FIDCO. FIUC nominates three directors and FIDCO nominates two directors.

As explained in the Service Agreement Filing, the primary purpose of the Service Agreements is to document clearly the manner in which the business operation and other services costs of FIUC are allocated among FIUC's four client companies: FIWWC, FIEC, FITC and FIDCO. No costs are incurred for the directors of the service company (FIUC) or any of the regulated operating companies (FIWWC, FIEC and FITC), all of whom serve without compensation.

In the past, the Commission expressed a concern that no formal agreement existed between FIUC and the four client companies. The lack of a written agreement raised a question as to whether the allocation methodology used by FIUC was sufficiently transparent and assured a fair allocation of costs, free of any subsidy of FIDCO by any of the three regulated operating companies. Accordingly, the Commission was reluctant to grant rate increases that cover the full level of business operation and other services costs FIUC determined as properly allocable to FIWWC. Based upon work with our consultants and with the Commission staff prior to the Service Agreement Filing, we believe these concerns have been addressed in the written Service Agreements.

Required Revenue

FIWWC filed its most recent annual report with the Commission on March 31, 2017. FIWWC's Financial Statements for December 31, 2016 and 2015, included as Exhibit B, show that, the

company suffered a net operating loss in 2016 of \$212,029, following a loss in 2015 of \$32,027. 2016 was a challenging year for FIWWC primarily due to a summer drought concurrently with a failure of the company's two wells to produce at their historical volumes. FIWWC had to rely more heavily on surface water from Barlow Pond to cover the shortfall. This added expense due to the higher cost of operating the aging surface water treatment plant. Moreover, the accelerated rate of draw down from the pond led the Suffolk County Department of Health to advise that restrictions be imposed on use of water for garden and lawn irrigation. This led to a decline in revenue.

The Fishers Island Water Financial Model (the "Financial Model") included as Exhibit C projects growing revenue shortfalls out to 2026 under the current rate structure. The Financial Model is an Excel-based spreadsheet model consisting of a series of interactive schedules that document historical and current expenses and water customers and consumption and project these financial and operating data into the future. All data are tied to adopted budgets or comparable data sources that are used consistently. Any formulae are identified and viewable by the user of the model. The model produces, on both a utility basis of accounting and a cash basis of accounting, the schedules and data traditionally requested by the Commission in rate cases. Using standard industry ratemaking practices, and based on the data and projections included in the Financial Model, it is obvious that FIWWC must increase its revenues if the water utility on Fishers Island is to be sustainable.

Capital Investment

As indicated in the Financial Model, FIWWC needs to make significant capital investments in water infrastructure each year for the foreseeable future. Based on its review of the system in 2016, the engineering firm of EA Engineering, PC concluded:

“Overall, the age and condition of the existing water supply facilities on Fisher Island indicate that they are beyond their useful life without significant repairs and/or upgrades. Additionally, based on evaluations performed by EA and others, a new treatment system is required to treat iron and manganese in groundwater, an additional well is required to meet peak water demand, the surface water plant requires significant repairs/upgrades or replacement, and the distribution system should be modified to meet fire demand throughout the island.”

See letter dated December 19, 2016, to FIWWC from EA Engineering, PC, included as Exhibit D.

The capital investments in question are described in more detail below.

The following capital investments are priorities over the next twelve months:

Well Water. FIWWC took major actions in 2016 to address the risk to water sources and the shortfall in operating cash flow from less revenue and higher operating expense. The shareholders, FIUC and FIDCO, made \$300,000 in equity contributions to the company.

\$60,000 of this amount was applied to refurbish both wells, resulting in significant improvements in output. \$52,000 funded engineering advice from EA Engineering, PC. The balance was applied to fund operating costs.

The combined maximum production from the two wells, at 250 gallons/minute, is insufficient, however, to supply the peak demand on the water system of approximately 380 gallons/minute. Any shortfall must be supplied from Barlow Pond which, itself, is a limited resource for a number of reasons, as we learned during 2016. First, the Suffolk County Health Department advised that this surface water source can be used only for three months annually unless substantial capital improvements, testing and reporting requirements are put in place. Secondly, water from the pond can be discolored due to natural tannins in the pond and can have taste impacts even when blended with well water. Neither the color nor taste issues are health hazards but they do concern customers. Third, Barlow Pond is a finite resource, dependent on rain for replenishment, which results in restrictions on pump rates from the pond.

The most promising and cost-effective way to increase FIWWC's water sources is to reactivate a well that was closed down several years ago due to rising levels of iron and manganese. The well has an estimated capacity of 150 gallons/minute. Bringing this third well back into production is estimated to cost \$410,000, of which \$60,000 is estimated to refurbish the well and \$340,000 is estimated to install a ground water filtration system. In addition to serving this third well, the new filtration system can service the two existing production wells, which we expect will soon be required by the New York State Department of Health.

Remote meter. FIWWC plans to install water meters that can be read remotely, thereby saving on the cost of meter reading and avoiding the revenue losses from under-reading. The cost of this improvement is projected to be \$60,000.

Highlift pump. The highlift pump used to maintain adequate water pressure in FIWWC's distribution system is dated and in need of refurbishment. The projected cost is \$50,000.

Beyond the next twelve months, our capital investment plan anticipates the following:

Surface Water. Preserving the surface water treatment capabilities of the system and making it less costly to operate will involve replacing its antiquated and highly manual filtration system with a modern system and upgrading the storage tanks for treated water, at an estimated cost of \$500,000.

Water Quality. FIWWC regularly tests water produced from its wells and Barlow Pond. As required by law, FIWWC produces annual water quality reports for its customers. Over time, these reports have indicated that the levels of manganese in the water will need to be managed with better filtration.

As noted above, the capital improvements for filtration facilities have already been identified by our consulting engineers.

Well Water Storage. In addition to increasing ground water sources with a third well, it is advisable to add well water storage tanks to the system for an estimated cost of \$100,000.

Distribution Infrastructure. The distribution infrastructure of Fishers Island needs major investment in replacement of mains and valves. For this purpose, the Financial Model includes projected capital expenditures over several years, beginning in 2019 at over \$700,000 per year.

Hydrants. Many of the fire hydrants on the island are well past their useful lives. The Financial Model provides for hydrant replacements at the rate of two to four hydrants per year at an estimated cost of \$3,000 per hydrant. Further study is needed of the fire protection system as a whole and we anticipate a future rate applications will be needed to escalate the hydrant replacement schedule beyond current projection.

Employee Housing. As in many seasonal communities with a limited housing stock, affordable housing for FIWWC employees presents a significant challenge. As the demand for housing rises, the price of real estate for purchase or rent increases and affordable housing becomes less available. In order to assure 24-hour coverage of the water system, FIWWC finds itself with no option but to provide subsidized housing for its employees. FIWWC expects this situation to continue and, therefore, is planning to obtain its own employee housing stock, through purchases or through construction of new units over the next few years.

The proposed increase in rates for FIWWC should significantly improve the company's ability to finance capital improvements by borrowing funds in the near term and repaying the debt over time out of improved revenues. Currently, FIWWC is unable to meet the debt service coverage ratio under an existing bank loan, although the bank has waived the non-compliance for 2016. As a privately-owned utility, FIWWC does not have access to the municipal bond market or other financings available to municipally-owned utilities.

FIWWC has incurred costs for professional consultants to assist in financial modeling and capital investment planning. See the schedule in Exhibit E. We have not reflected these costs in the model enclosed as Exhibit C but propose recovering these as an unusual item over three years as part of account 186 per 16 NYRR §561.18.

Proposed Rate Design

Policy

FIWWC and the other two operating utility companies on Fishers Island (FIEC and FITC) have made it a policy to structure rates that put a disproportionately larger share of rates on the seasonal residents, thereby favoring the full-time, year-around residents with lower rates. Our seasonal customers in the community understand the situation here and are supportive of this

allocation structure. The Fishers Island Ferry District, a New York State chartered tax district, has a rate structure for its ferry services that does the same. This policy continues to be reflected in the rate structure proposed in this application.

Current vs. Proposed Rates

The Financial Model shows FIWWC's current rates and the rates FIWWC proposes for its future revenue requirement.

In addition, attached as Exhibit F are copies of the relevant tariff leaves amended to reflect the rate changes requested in this application.

Although both year round and seasonal residents will experience rate increases, the rate structure would remain weighting more heavily toward the seasonal residents. This weighting is justifiable due to the higher cost of providing water service under maximum demand conditions of the summer season than under average demand conditions.

We are requesting a 44.5% rate increase to produce additional annual revenues of \$298,126, to match the increase in the annual revenue requirement to \$968,363. This increase provides an average annual bill of \$475.08 for year round residents and an average annual bill of \$609.84 for seasonal customers. The company's last increase of \$115,652 annually, or 19.4%, was effective from May 1, 2015 (Case 14-W-0322).

As noted above, Fishers Island is an unusual place. However, the two classes of rates are designed to protect and promote the long term interests of the community and are supported by our rate payers. The community's goal of increasing the year round population will be helped by making it more affordable to live on the Island.

Public Notice

FIWWC respectfully requests a waiver of the requirements for newspaper publication of the proposed minor rate filing as we will individually notify our customers of the proposed rate change.

Experts and Exhibits

In preparing this application, FIWWC has worked extensively with the following professional advisors:

PKF O'Connor Davies LLP, accountants and advisors. This firm reviewed FIWWC's financial statements included as Exhibit B and advised on cost allocation methodology in the Service Agreement included in Exhibit A. Our principal contact at the firm is Thomas O. Marien; his CV is attached as Annex H1.

Municipal & Financial Services Group, a specialized management consulting firm that advises on the management and financial needs of municipal utilities. M&FSG prepared the Financial

Model included as Exhibit C. Our principal contacts at the firm are Edward J. Donahue and Michael R. Maker; their CVs are attached as Annexes H2 and H3.

EA Engineering, PC, an engineering firm specialized in environmental matters. This firm conducted a study on potential new sources of ground water and provided advice on the useful life of existing plant in service and on necessary improvements to the surface water treatment plant. EA's letter of December 19, 2016 is included as Exhibit D. Our principal contact at the firm is Laura Jo Oakes.

We believe that the rates for which approval is sought in this application are essential to assure that FIWWC will be able to provide safe, adequate and efficient service at just and reasonable rates. We will be happy to address any questions the Commission may have in connection with this application. Please feel free to contact the undersigned.

Respectfully submitted,

J. Christopher Finan,
President

List of Exhibits:

- A. Services Agreement Filing with the Commission (private and confidential)
- B. FIWWC Financial Statements for December 31, 2016 and 2015 (private and confidential)
- C. Fishers Island Water Financial Model 2016 to 2026 (private and confidential)
- D. Letter from EA Engineering, PC to FIWWC, dated December 19, 2016 (private and confidential)
- E. Schedule of professional consultant expenses for preparing Service Agreement and related cost allocation system and for preparing this rate case application.
- F. Tariff leaves 12 to 16, amended to reflect the rate changes proposed in this application.
- G. Text of Public Notice of this application
- H1. CV for Thomas O. Marien, Partner, PFK O'Connor Davies LLP
- H2. CV for Edward J. Donahue, III, President/CEO, Municipal & Financial Services Group
- H3. CV for Michael R. Maker, Senior Manager, Municipal & Financial Services Group