

---

Office of Utilities Regulation

---

**Can-Cara Development Limited**

**Application for Reconsideration -  
Review of Water Rates**

---

**Final Decision**

---



**OFFICE OF UTILITIES REGULATION**

August 15, 2007



**DOCUMENT TITLE AND APPROVAL PAGE**

**DOCUMENT NUMBER: WAT 2007/01**

**DOCUMENT TITLE: Can Cara Development Limited – Review of Water Rates, Application for Reconsideration**

**1. PURPOSE OF DOCUMENT**

Sets out the Office's Final Decision on Can-Cara's Application for Reconsideration with regard to Document No: WAT 2006/03.

**RECORD OF REVISIONS**

Revision Number	Description	Date
-	-	-

**APPROVAL**

This document is approved by the Office of Utilities Regulation and becomes effective on **August 15<sup>th</sup>, 2007.**

On behalf of the Office:



J Paul Morgan  
**Director General**

August 15, 2007  
Date

## Chapter 1: Background

### 1.0 Introduction

Can-Cara Development Limited submitted a water rate application to the Office on 16<sup>th</sup> February 2006. After public consultation and internal review, the Office issued a determination notice, *Document No. WAT 2006/03*, on 22<sup>nd</sup> December 2006. This document contained the water rates and charges as well as revised sewerage rates for Can-Cara. These rates became effective 1<sup>st</sup> January 2007.

1.1 A licensee is entitled to apply for a reconsideration of the Office's decision and concurrent with such application can request a stay of the Office's original determination until the review of the reconsideration application is completed. If the company does not apply for a stay of the decision, the Office's determinations remain in place and in effect as of the effective date of the decision.

1.2 Can-Cara requested a reconsideration of these rates on January 31<sup>st</sup> 2007 on the basis of the following reasons:

"... 1) *It is noted that a downward adjustment was made to the previous determined sewerage rates. We understand that this adjustment was made on the basis of shared salaries with the water unit. We seek further clarification and explanation of the basis for your revision.*

2) *With reference to item 5.3.1 (page 17) the OUR states that \$89.7 mil represents the value of assets transferred from Magil Palms to the company. This statement is incorrect and inconsistent with the statement at 3.7 on page 8. The sum represents the input of Can-Cara. We request that this error and consequences arising be addressed. Of particular import is with reference to item 5.3.2 and the adjustment of the total asset base that will attract a return on investment.*

3) *With reference to item 5.4.1 (page 17) we would wish to engage you in debate in the arbitrary bench marking debt to equity ratio of 55:45 to determine the Weighted Average Cost of Capital (WACC). Is it the policy of the OUR to direct enterprises to borrow from lending institutions at the usurious rates now prevailing in Jamaica?*

4) *With reference to item 6.1.1 we wish to restate most strongly our request for reconsideration to be given to a connection fee of \$2100.00 for the cost of labour and in some instances additional material for the proper installation of water meters. A field visit to Magil Palms will determine the need for this charge...."*

1.3 In the instant case Can-Cara did not apply for a stay of the Office's decision contained in the said document and as such the authorized rates are those determined by the Office in *Document No. WAT 2006/03*. The Office is aware

however, that Can-Cara has been billing customers at a flat rate of \$1,000 per month for water and sewerage services, notwithstanding the rates approved by the Office.

- 1.4 As a matter of policy, the Office consults with the public on all rate-related issues, and as such, notified the residents of Magil Palms, as well as issued a public notice in the print media, to inform the stakeholders of the application for reconsideration.

#### **1.5 Procedure for Reconsideration**

The Office's Draft Rules of Practice and Procedures (which are currently the subject of public consultation), provide that tariff applicants can request a reconsideration of an Office decision if they are of the view that the Office erred in fact or in law or if new facts or changed circumstances have occurred that the Office (or the applicant), with ordinary diligence, could not have known while the application was being reviewed.

- 1.6 The Draft Rules of Practice and Procedures (the Rule of Practice and Procedures) allows an applicant fourteen (14) days after the issuance of the Office's decision to submit a reconsideration application. It also provides that within five (5) working days of receiving an application for reconsideration, the Office will duly notify the public, by way of notice in the print media and on its website of this application.
- 1.7 With the exception of the applicant, it is proposed that respondents will have 5 working days within the issuance of the public notice to submit comments. The applicant, however, will be given 14 working days to provide additional information to substantiate its reconsideration application. After the 14 working days have expired, the Office will make a decision on the application within 30 working days. The decision at the end of the 30 working days will serve to rescind, modify or confirm the original determination and the Office will outline the reasons for its final position.

#### **1.8 Public Consultation**

Although the Office did not strictly follow the timelines set out in its draft Rules of Practice and Procedure, it ensured that the principle of allowing all interested parties opportunity to be heard was strictly adhered to. The public notice was published in the print media on 27<sup>th</sup> April 2007 and the relevant fliers were distributed to residents in the service area on the 28<sup>th</sup> April 2007. The public, including the affected customers in the service area, were asked to submit comments by 4<sup>th</sup> May 2007.

- 1.9 Can-Cara was also duly notified on 27<sup>th</sup> April 2007 of its obligation to submit additional information to substantiate its application. The company had fourteen (14) working days (17<sup>th</sup> May 2007) within which to provide this information.

- 1.10 The Office has not received any responses from the customers or the public. Despite formal requests by the Office, Can-Cara has not provided additional information to justify or validate the basis of its request for reconsideration. The Office has therefore not been able to evaluate the application for reconsideration and consequently it has been unable to consider the application on its merit. The Office will therefore conclude this matter by affirming its original decision dated 22<sup>nd</sup> December 2006 (a decision it has already communicated to Can-Cara).

## Chapter 2: Office's Decision

2.0 As outlined in Chapter 1, Can-Cara requested reconsideration of the Office's position on four (4) issues. In arriving at its final position, the Office will address each of the following issues in the order they were raised.

### 2.1 Downward adjustment in sewerage rates

On page 5 of *Document No: WAT 2005/02* the Office stated that:

*"...the sewerage rates which are the subject of this Determination may be adjusted to reflect the impact of any common costs when the water tariffs are being considered...."*

2.1.1 Can-Cara stated in its application that it required separate rates for water and sewerage services, and that these prices should be cost based. If the Office were to treat the sewerage and water operating costs as independent costs, without recognizing that these business units share some common costs it would result in over recovery of these expenses. This would be unfair to the consumer, and as such, the Office has recognized the shared element and passed on the savings to the consumer.

2.1.2 Can-Cara stated that the human resources will be shared across the two business units, and specifically, approximately 50% of this manpower will be dedicated to the sewerage business. As such, the Office made the appropriate reduction in the operating costs of the sewerage business. This lower operating cost would result in a lower revenue requirement. The rates that were determined are a function of the revenue requirement and volume treated hence the downward adjustment in the sewerage rates.

### 2.2 Capital base

The total capital costs as stated in 3.7 of *Document No. WAT 2006/03* is incorrect. It should read:

*".....the proposed capital investment for the water aspect of the business is \$113.85M....."*

2.2.1 During the evaluation of the rate application, the Office was informed that Can-Cara entered into a business arrangement with the developers of the Magil Palms housing scheme whereby the said developer would transfer ownership of the assets to Can-Cara. Can-Cara would be responsible for ongoing operation and maintenance. The Office took in good faith, that this transfer occurred and as such, excluded the value of the transferred assets from the calculation of the revenue requirement, as this cost would have already been included in the sale price of the houses.

- 2.2.2 The Office recognized that the company would have acquired additional assets, and based on the information submitted with the rate application, was calculated at \$25.4M. The company would earn reasonable return on this investment.
- 2.2.3 However, in the reconsideration application, Can-Cara stated that \$89.7M represented the sum invested by Can-Cara and not the value of the transferred asset. By virtue of the fact that Can-Cara is stating that the \$89.7M represents its own investment, it would seem to suggest that it did not receive any transfer of assets from the Magil Palms, which is contrary to initial declaration by Can-Cara.
- 2.2.4 The Office requested that Can-Cara submit further evidence to substantiate this claim but no additional information was received. It has therefore decided that its original decision on the investment by Can-Cara of \$25.4M stands.

**2.3 Justification for using debt to equity ratio of 55:45**

New high growth businesses tend to have a higher degree of leverage than more mature companies since they would not have generated sufficient revenues to build their share capital base. As such, it is unusual that in Can-Cara's instance, the business is being wholly financed by equity. Given this peculiarity, the Office had to make a decision as to the most appropriate debt to equity ratio to apply to the overall capital base of the business.

- 2.3.1 In a survey<sup>1</sup> that was conducted in the United States, it was found that in utilities industry, the debt to equity ratio ranges from 1.7:1 to 2.2:1. More specifically, the water and sewerage industry had a debt to equity ratio of 2.1:1. This would translate to leverage in the business being twice as much as equity.
- 2.3.2 In an OXERA 2002 report<sup>2</sup>, it was noted that in the initial stages of liberalization of the water sector, the regulator, OFWAT, used a higher leverage in the computation of cost of capital, even though the companies' average gearing was 20%. Overtime, however, OFWAT has used an average gearing of 50% in setting the rates and charges for these water companies, even though some companies are leveraged up to 90%.
- 2.3.3 The Office is of the view that in order to strike a balance between Can-Cara's proposal, and what obtains in the international marketplace, a debt ratio which is marginally higher than the equity, would satisfy the Office's objective of normalizing the cost of capital to represent the nature of capital financing in the company.

---

<sup>1</sup> See <http://www.bizstats.com/corpdcurrent.htm>

<sup>2</sup> See

[http://www.oxera.com/cmsDocuments/Reports/Ofwat%20capital%20structure%20Final%20Report%20\(amended\).pdf](http://www.oxera.com/cmsDocuments/Reports/Ofwat%20capital%20structure%20Final%20Report%20(amended).pdf)

Office of Utilities Regulation

Can-Cara Development Limited Application for Reconsideration: Review of Water Rates - Final Decision

Document No: WAT 2007/01

August 15, 2007

2.3.4 Given that the nature of Can-Cara's service is one in which there are no immediate competitors, it is reasonable to assume that the level of risk is lower than if the market was effectively competitive. As such, it is reasonable to use a higher degree of leverage than the 10% that Can-Cara proposed. In the determination, a conservative estimate of 1.2 has been made to satisfy the objectives as outlined above. In any event, if the Office were to revise this ratio, it would be more inclined to increase rather than decrease the amount of debt financing of the business.

**2.4 Connection fee**

Because all the costs of the business are passed on through the rates to the consumers, the Office is mindful to include only relevant and prudent costs in its calculations. Other providers within a similar area have been able to source the necessary services between \$1,000 and \$1,500. The Office interprets this to be the market range for the connection of water supply. The onus is therefore on Can-Cara to pay a reasonable and competitive price for contracted services, as the Office will only include reasonable cost in the determination of the rates.

**2.5 Office's Determinations**

The Office hereby confirms its decision contained in Document No. WAT 2006/03. For the avoidance of doubt, the following represents the Office's final position on the rates and charges for the services provided by Can-Cara. These rates are effective 1<sup>st</sup> January 2007.

**2.5.1 Determination 1**

*Where a connection, inclusive of meters, has already been provided by the developer, a connection fee is not applicable.*

*Customers that were receiving water service from Magil Palms shall not pay a water connection fee.*

*A water connection fee of \$1,500 is applicable to new customers*

**2.5.2 Determination 2**

*The proposed meter charge of \$50 is not allowed.*

**2.5.3 Determination 3**

*Initial deposit of \$1,500 is approved.*

**2.5.4 Determination 4**

*Reconnection fee of \$1,500 is approved. This amount should be paid prior to the reconnection of a service that had been disconnected for outstanding debt.*

2.5.6 The approved water and sewerage rates are outlined in Tables 1 and 2 respectively.



**Table 1a: Office determined water rates and charges in gallons**

Consumption Bands (gallons)	Office determined rates (\$/1000 gls)	% age of accounts billed	Total projected revenues (\$)
0-3000	130	100	14,066,520
Next 3,000	210	49	9,482,760
Next 6,000	290	11	4,076,820
Over 12,000	420	3	3,220,560
<b>Connection fee</b>	\$1,500 <sup>3</sup>	-	-
<b>Initial Deposit</b>	\$1,500	-	<b>2,025,000<sup>4</sup></b>
<b>Reconnection fee</b>	\$1,500	-	-

**Table 1b: Office determined water rates and charges in litres**

Consumption Bands (litres)	Office determined rates (\$/1000 litres)
0-14,000	28.58
Next 13,000	46.17
Next 28,000	63.76
Over 55,000	92.35
<b>Connection fee</b>	\$1,500 <sup>5</sup>
<b>Initial Deposit</b>	\$1,500
<b>Reconnection fee</b>	\$1,500

**Table 2a: Sewerage Rates and Charges in gallons**

Consumption bands (gallons)	Office determined rates (\$/1,000 gallons of water consumed)
0-3,000	110
Next 3,000	160
Next 6,000	280
Over 12,000	480
<b>Service charge</b>	<b>150</b>

<sup>3</sup> This fee is only applicable to customers that have switched providers.

<sup>4</sup> Revenues from initial deposit are not included as part of overall company's revenue. This is considered a prepayment, should be placed in a separate account and returned to customers upon the termination of service.

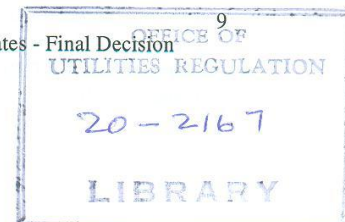
<sup>5</sup> This fee is only applicable to customers that have switched providers.

Office of Utilities Regulation

Can-Cara Development Limited Application for Reconsideration: Review of Water Rates - Final Decision

Document No: WAT 2007/01

August 15, 2007



**Table 2b: Sewerage Rates and Charges in litres**

<b>Consumption bands (litres)</b>	<b>Office determined rates (\$/1,000 gallons of water consumed)</b>
0-14,000	24.19
Next 13,000	35.18
Next 28,000	61.56
Over 55,000	105.54
<b>Service charge</b>	<b>150</b>

- 2.5.7 The Office is cognizant of the fact that based on the above rates, some customers may have been overcharged or undercharged as of January 2007, given that Can-Cara has opted to charge a flat rate of \$1,000 per month. The fact however, is that the rates approved by the Office in its determination Document No. WAT 2006/03 have been in force and applicable for billing as of January 2007.
- 2.5.8 In this regard, the Office takes the position that in the event that any customer has been overcharged since January 2007, Can-Cara must reimburse these customers the difference between the approved charges (based on the specified rates in Tables 1 and 2) and the amount for which they were billed. This difference shall be a lump sum credit to the customers' account and must appear as a separate line item on the customers' next bill.
- 2.5.9 In the instances in which Can-Cara has undercharged its customers, the company is by the same token to attempt to recover the difference from these customers on the same basis.
- 2.5.10 In the cases where over-billing has occurred, the Office will require evidence to satisfy itself that the customers are adequately reimbursed. In such instances Can-Cara shall submit names and addresses of affected customers (accounts), the amounts that were billed from January 2007, the amount that they should have been charged at the Office's determined rates, and the amount that has been credited to the accounts. Can-Cara is therefore directed to submit this information to the Office within 30 days of the date of this reconsideration decision.