

STATE OF VERMONT  
PUBLIC SERVICE BOARD

Docket No. 6490

Petition of Arlington Water Company for )  
Authority to Borrow \$680,000 to be Used to )  
Construct a Water Storage Tank and )  
Appurtenant Facilities )

Order entered: 7/3/2001

**I. INTRODUCTION**

Arlington Water Company ("Company") proposes to borrow \$680,000 from the Vermont Drinking Water State Revolving Fund through a twenty-year loan. The Company will use the proceeds of the twenty-year loan to construct a water storage tank designed to improve service to the Company's customers by reducing the probability of water contamination, improving the community's fire protection capabilities, and providing water at more consistent pressure levels.

Because of these benefits, I conclude the loan will be consistent with the general good of the state, and recommend that the Vermont Public Service Board ("Board") consent to the proposal without hearing.

**II. PROCEDURAL HISTORY**

On April 2, 2001, the Company filed a petition requesting (1) consent and approval by the Board to borrow up to \$680,000, mortgage its corporate property, issue notes or other evidences of indebtedness, and take other necessary action in regard thereto ("Corporate Borrowing") and (2) a finding, pursuant to 30 V.S.A. §108 (a), that such Corporate Borrowing will be consistent with the general good of the state. In support of its petition, the Company presented copies of plan documents and affidavits from Company Vice President Peter Putis, explaining the proposed Corporate Borrowing, and professional engineer Mark Youngstrom, P.E., explaining the design and engineering for the proposed water tank and associated facilities.

Copies of the filings were also served on the Vermont Department of Public Service (the "Department"), a statutory party to this proceeding. No other person sought to intervene in this proceeding. The Department and the Company (the "Parties") have discussed the project to resolve any areas of disagreement.

On May 3, 2001, the Department filed its response to the petition. In its response, the Department recommended that the Board issue an order of consent allowing the Company to borrow an amount not to exceed \$680,000 with the condition that within ten days of closing the Company must file with the Board and Department the final loan closing documents and signed approvals from (1) the Water Supply Division ("WSD") of the Vermont Agency of Natural Resources ("ANR"), Department of Environmental Conservation, and (2) the Vermont Economic Development Authority ("VEDA"). The Department further recommended that the Board find that the proposed transaction is consistent with the general good of the state and that the Board approve the petition without further investigation or hearing. On May 23, 2001, in response to a request from the Hearing Officer, the counsel for the Company submitted a letter describing the security interest it would pledge to the lender.

I have reviewed the petition and accompanying documents and the Department's response. Based upon the evidence of record, the testimony and exhibits presented in the Docket, I hereby report the following findings and conclusions to the Board in accordance with 30 V.S.A. § 8.

### **III. FINDINGS**

1. Arlington Water Company is a capital stock corporation organized and existing under the laws of the State of Vermont, with its principal office in Arlington, Vermont. Petition at 1.
2. The Company is engaged in the business of providing water service in the Towns of Arlington and Sunderland, Vermont, and is subject to the jurisdiction of the Vermont Public Service Board. Petition at 1.
3. The Corporate Borrowing for which the Company seeks approval will be used to fund the construction of a water storage tank and appurtenant facilities ("Tank Facilities"). Petition at 2.

4. The Tank Facilities are designed to improve service to the Company's customers in several ways. The tank, which will be a covered and secure vessel, will maintain the sanitary quality of water by avoiding contamination that occurs with open storage. The volume of water provided by the tank will improve the communities' fire protection capabilities. The tank will stabilize water pressure, which has been a problem. Putis affidavit at 2.

5. The Tank Facilities are mandated under the Vermont Water Supply Rules. Putis affidavit at 2; Vermont Water Supply Rule, Ch. 21, Appendix A, Part 7.

6. The Company has negotiated a schedule with the WSD, with the knowledge and concurrence of the Department, that includes petitioning for Board approval in the first quarter of 2001 to allow an orderly progression of activities leading to an in-service date for the Tank Facilities of September 1, 2002. Petition at 2.

7. The Company estimates that the cost of design, permits and approvals and purchasing and constructing the Tank Facilities is approximately \$676,850 ("Tank Facility Costs"). Petition at 2.

8. Without the Corporate Borrowing, the Company would not be able to construct the Tank Facilities or otherwise be able to comply with the Order of the WSD requiring their construction. Petition at 2.

9. The Company's Board of Directors has approved the construction of the Tank Facilities and the Corporate Borrowing contemplated by its petition at a Board of Directors Meeting held on September 23, 2000. Petition at 2.

10. The Company is eligible to apply for a loan from the Vermont Drinking Water State Revolving Fund ("DWSRF"). Nearly all water system improvement projects that facilitate compliance with or further the health protection objectives of the Safe Drinking Water Act are eligible for financing through the DWSRF. Petition at 2.

11. As required by DWSRF procedures, the Tank Facility is on the comprehensive project list established by ANR and is on the project priority list for funding under the current funding cycle. Petition at 2.

12. Subject to meeting ANR application and underwriting requirements, the Company will be eligible for a DWSRF loan of up to \$680,000 at three percent (3%) annual interest and for a term of 20 years. Petition at 3.

13. The Company believes the only other potential sources of financing would be equity financing or a conventional term loan from a bank. A conventional bank loan with a term of 15 or 20 years would carry an interest rate of between 9 and 12 percent. The Company believes its cost of equity financing would be between 10 and 15 percent. Putis affidavit at 3.

14. The proposed loan is less expensive than alternative means of financing. Finding 13, *supra*.

15. The book value of the Company's assets was roughly \$400,000 as of December 31, 2000. Construction of the Tank Facilities will increase the Company's assets by roughly 170 percent. Putis affidavit at 3.

16. The Company and VEDA have not yet negotiated the security provisions of the loan. The Company expects the security for the loan may include some or all of the following: a first or second mortgage on all relevant real estate and fixtures; a security agreement and perfected security interests under Title 9 of the Uniform Commercial Code securing personal property, fixtures or accounts receivable; and contingent assignment of the ability to operate the water system and collect accounts receivable. Readnour letter of 5/21/01.

17. The Company has an existing loan from Factory Point National Bank, which loan is secured by some of the same instruments and security that may secure the loan from VEDA. The Company, VEDA and Factory Point National Bank must reach an agreement on which security is pledged to which lender. Readnour letter of 5/21/01.

18. Upon Board approval of the Company's petition, the Company intends to seek approval from the Board for rates adequate to support the debt service arising from the Corporate Borrowing. Petition at 3.

19. Upon approval of the loan application by ANR, the Company must also meet underwriting requirements of VEDA, the disbursing and management authority for the loan. VEDA underwriting requirements include a certificate of public good, the Board's approval of the

Company's petition and a decision of the Board approving rates sufficient to demonstrate the Company's ability to meet debt service requirements for the loan. Petition at 3.

20. The Company applied to the ANR for funding by letter of intent on April 25, 2000. The Company is on the active funding list for FY2000. The Company will submit an application to VEDA following Board consent hereto and approval of the Board of rates sufficient to support the debt service. Petition at 3.

21. The issuance by Arlington Water Company of notes in an amount not to exceed \$680,000 for the purposes set forth in the Findings of Fact is consistent with the general good of the State of Vermont. Findings 1 through 20, *supra*.

#### **IV. DISCUSSION AND CONCLUSIONS**

Section 108 of 30 V.S.A. provides that a regulated utility shall not mortgage nor pledge any of its corporate property nor issue any stocks, bonds, notes or other evidences of indebtedness without the consent of the Board given on petition and after opportunity for hearing of the corporation and a finding that the proposed action will be consistent with the general good of the state.

The Company proposes to borrow \$680,000 from the DWSRF through a twenty-year loan. The Company will use the proceeds of the twenty-year loan to construct a water storage tank designed to improve service to the Company's customers by reducing the probability of water contamination, improving the communities' fire protection capabilities, and providing water at more consistent pressure levels. I conclude the customers of the Company are likely to benefit from these improvements to their water service, and, therefore, from the loan necessary to finance the improvements.

Further, the record demonstrates that the proposed loan from the DWSRF is the best means of financing the system improvements. The three percent rate of interest available to the Company through the DWRSF is substantially lower than through a conventional term loan from a commercial bank, which would likely charge nine percent or more, thus saving the Company and its customers substantial amounts of interest expense over the term of the loan (\$40,000 in the initial year, alone). The Company's cost of service will incorporate this low-cost loan, should

it request an increase in service rates.<sup>1</sup> I conclude the Company's customers will benefit, relative to alternative sources of capital, from the low interest rate, which minimizes the economic burden of paying for the improved service.

The pledge of a security interest in corporate property expressly requires consent of the Board under 30 V.S.A. § 108. The petition did not identify the precise form of security contemplated to secure the loan from VEDA. Instead, the petitioner provided only a copy of a "boiler-plate" loan agreement typically used by VEDA, which presumably would be customized and completed before execution. Section 1.03 of the draft loan entitled "Security" was incomplete. To clarify this matter, I requested the Company to provide either proposed language for Section 1.03 of the loan agreement or a reasonably detailed description of the security interest contemplated.<sup>2</sup> In response, the Company stated that the precise terms of Section 1.03 have yet to be negotiated between the Company and VEDA, and instead provided a general description of the types of security typically required by VEDA.

According to the Company, First or Second Mortgages on real estate and fixtures, or a Security Agreement securing personal property, fixtures or accounts receivable are the types of security contemplated by the Company and VEDA. Security interests of this type are widely-used, and, in my opinion, will not unduly constrain the Company's ability to raise capital and serve customers. The Company also mentioned, as possible security for the loan, contingent assignment of ability to operate the water system and collect accounts receivable. In my view, these forms of security would be reasonable, as well, although the Company and VEDA should note that prior Board approval would be required in the event that VEDA wished to assume operating control of the water system. *See* 30 V.S.A. §§ 107, 231 *generally*.

A supplement to a condition recommended by the Department<sup>3</sup> should be sufficient to remedy any uncertainty that might result for the present lack of specificity regarding the security provisions of the loan. I recommend that the Board consent to the loan, but with the condition

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1. The Company represented that it intends to apply for rates sufficient for it to support the debt service on this loan. That rate request is not now before the Board. The Board can make no determination at this time of what the Company's rates should be in the event that a rate request is filed.

2. Memorandum from Hearing Officer to parties, 5/14/01.

3. See letter of 5/3/01 from Geoffrey Commons, Esq., to Susan Hudson.

that, prior to closing, the Company file with the Department for comment, and the Board for approval, the exact language of the security interest to be granted. I recommend that the Board not allow the Company to execute the loan until the Board has approved the specific security interest to be granted. The Company should also be required, after closing, to file the final loan closing documents and signed approvals of the WSD and VEDA.

For the reasons discussed above, I recommend to the Board that it conclude that the proposed borrowing will be consistent with the general good of the state, and that it consent to the financing without hearing.

### **Additional Matters**

Two other matters bear noting and action.

First, the Company correctly notes that the Board ordered it to construct the water storage facility. Specifically, the Board in Docket 4429 approved a stipulation between the Company and the Department in which the Company committed to constructing certain improvements to its physical plant in three identified phases.<sup>4</sup> One such improvement, the water storage tank that gives rise to the need for the financing presently under consideration, comprised the second of the three phases of improvements. The Company agreed, as was ordered, to complete the Phase Two improvements, including construction of the water storage tank, during the period 1994 to 1998.

The record in this investigation includes no explanation for the three-year delay. To avoid violating the Board Order requiring timely construction of the system improvements, the Company should have requested an amendment of the 1989 Order, or submitted for the Board's approval a superceding schedule. Regardless of the reason or reasons for inaction, I find it troubling that the Company did neither. It would be counter-productive, however, to delay approval of the instant financing petition in order to investigate the matter of the Company's failure to comply. To ascertain what action, if any, should be taken in a separate investigation, I recommend that the Board order the Company to provide the following information:

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4. Docket 4429, Order of 8/9/89.

- (1) a report on the extent to which it implemented the Phase One improvements, which it was ordered in Docket 4429 to complete by November 30, 1991;
- (2) an explanation of the reasons for delay in implementation of Phase Two improvements, and its reason(s) for not requesting the Board to amend or waive the deadline for those improvements established in Docket 4429; and
- (3) a report on its current intentions with respect to timely completion of the Phase Three system improvements, which the Company is currently required to complete by the end of 2003.<sup>5</sup>

I also recommend that the Department be requested to advise the Board regarding the degree to which the Company has not complied with a Board Order, and on what, if any, sanctions, enforcement measures, or other remedies should be imposed by the Board against the Company for any such non-compliance.

Second, the Company notes that the security provisions of its existing loan from Factory Point National Bank might have to be amended to accommodate the security interests that will be pledged to VEDA. Although a precise description of the existing loan is not in the record, it appears to be a long-term loan that may be subject, as well, to the same statute, 30 V.S.A § 108, that governs issuance of the VEDA loan now before the Board. If this is the case, any material change to the security provisions of the loan from Factory Point would require prior Board approval. While it is premature, absent a full record and petition, to render a judgment about whether such an amendment would be consistent with the general good of the state (*i.e.*, the standard for review under § 108), I would not anticipate any problem so long as the security interest is similar to that described as the most likely terms of the VEDA loan. Nonetheless, the Company is reminded that Board approval may be required prior to execution of any amendment

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5. The Board's 1989 Order required the Company to complete the Phase One improvements, with the exception of acquiring a back-up well, by November 30, 1991. Phase Three consists of 4,500 linear feet of water line along Routes 7 and 7A. I cannot discern, from the record in this investigation, the extent to which the Phase One and Phase Three improvements have been constructed.

to that loan. The Company may wish to confer with the Department about whether the existing loan, or an amendment thereto, from Factory Point requires Board approval under § 108.

In my view, neither of these matters – compliance with the 1989 Order or the applicability of § 108 to the existing Factory Point loan – requires investigation in this docket. Accordingly, I recommend the Board close this investigation upon receipt of the Company's compliance filing of the final loan closing documents and signed approvals from the WSD and VEDA. If appropriate, these other matters can be taken up separately, upon petition of the Company or Department, or upon the Board's initiative.

#### **Circulation of a Proposal for Decision**

The draft order filed by the Company indicated that approval may occur without hearing. Similarly, the Department recommended approval without further investigation or hearing. Regarding the Section 108 approval now sought, the order I recommend the Board issue is equivalent in substance to the decision sought by the Company (and upon which the Department based its recommendation). Were it not for the Company's apparent failure to comply with a prior Board Order, I would conclude it is unnecessary to circulate a proposal to the parties for comment. While I believe it is more appropriate to address matters regarding the Company's compliance with the 1989 Order separately, I am circulating this proposal for decision to the parties for comment.

Dated at Montpelier, Vermont, this 20<sup>th</sup> day of June, 2001.

s/Lawrence Lackey

Lawrence F. Lackey  
Hearing Officer

## **V. BOARD FINDINGS AND DISCUSSION**

The Board adopts the Hearing Officer's findings and conclusions, as supplemented and modified by the following additional findings and discussion.

### **Findings**

22. The Company has roughly 485 customers and annual revenues of approximately \$168,000. Annual Report of Arlington Water Company to the Department of Public Service for year ended December 31, 1998.

23. The Company's \$680,000 investment in the project will increase its annual depreciation and interest expenses (assuming a twenty-year life and a three-percent interest rate) by approximately \$54,000, or roughly \$112 per customer. Hearing Officer's Findings 12 and 13, *supra*.

24. At the current level of rates, residential customers of the Company pay roughly \$313 per year. Annual Report of Arlington Water Company to the Department of Public Service for year ended December 31, 1998.

### **Discussion**

While we adopt the findings and recommendation of the Hearing Officer, and consent to the financing, several matters warrant our comments.

First, as the Company has noted, the \$680,000 expenditure on the project will significantly increase its expenses. It is not unusual for the plant investments of small utilities to increase in proportionally large increments. The Company has indicated that, due to capital expenditures for the project, upon arrangement of the financing, it will likely request approval of this Board for an increase in service rates. To be clear, at this juncture we are not pre-judging the merit of, or necessity for, such an increase.<sup>6</sup> Instead, in this Order we are consenting to the proposed

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6. Our review of rate requests typically entails consideration of all relevant aspects of a utility's financial situation, including the return on investment the utility is likely to achieve absent approval of its request to increase rates.

financing, because the record demonstrates that this project is designed to provide significant benefits to the community that justify the investment.

Second, in written comments responding to the Hearing Officer's draft proposal for decision, the Company acknowledged its failure to seek an amendment of the timetable for plant improvements ordered by the Board in Docket 4429.<sup>7</sup> While we commend the Company for this forthright admission, and for its compliance with the Board's Order in that docket to submit annual status reports on its system improvements, we do not agree that providing notice of deviations from the ordered schedule of improvements through the annual compliance reports absolved the Company of its duty to implement those improvements in accordance with the schedule ordered by the Board. Only an order amending or superceding the Board Order in Docket 4429 would modify the Company's duty.

The Company states that a complete review of the Docket 4429 timetable, ordered by the Board in 1989, is justified because circumstances and regulatory requirements have changed in the intervening years. We agree that this is an appropriate juncture for the Board to consider whether the Company should be under a continuing order to implement specific improvements.

The Company recommends that the Department and Company be advised to work on developing a revised schedule of improvements that gives full consideration to changing system needs, current regulatory requirements and rate impacts to customers. The Hearing Officer had proposed<sup>8</sup> that we order the Company to report within sixty days of this Order on: (a) the extent to which it implemented Phase One improvements (the deadline for which has now passed); (b) its reasons for any delay in implementation of Phase Two improvements; (c) its reasons for not requesting the Board to amend or waive the deadline established in Docket 4429; and (d) its current intentions with respect to completion of Phase Three improvements, which the Company is currently required to complete by the end of 2003.

The narrative report by the Company's Chief Operating Officer, which was attached to its June 15, 2001, comments on the proposal for decision, serves as an adequate initial response to

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7. Letter of Jon S. Readnour, Esq., to Susan M. Hudson, June 15, 2001. The Department of Public Service did not submit comments in response to the Hearing Officer's proposal for decision.

8. Proposal for Decision at 8-10.

the questions posed by the Hearing Officer. Accordingly, an order requiring such a report is unnecessary. We do, however, wish to hear the Department's advice regarding the need for continuing, amending or waiving the Company's continuing obligation to implement system improvements consistent with the Board's August 9, 1989, Order in Docket 4429. We encourage the Department and Company to discuss the matter, and we request the Department to submit a recommendation within ninety days of this Order. So that no ambiguity is created by this Order, we state explicitly that this Order does not modify, waive, or suspend the timetable established in Docket 4429; absent further order, the Company's duty to implement the improvements is on-going. Moreover, we make no findings at this time regarding the extent of the Company's compliance with the Board Order in Docket 4429 requiring timely system improvements, nor with respect to what, if any, sanctions, enforcement measures, or other remedies should be imposed by the Board against the Company for any non-compliance.

## **VI. ORDER**

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by the Public Service Board of the State of Vermont that:

1. The findings and conclusions of the Hearing Officer are hereby adopted, as supplemented and modified above.
2. Pursuant to 30 V.S.A. § 108(a), the Board finds that the Corporate Borrowing described herein will be consistent with the general good of the state.
3. The Board hereby approves and consents to Arlington Water Company borrowing up to \$680,000, mortgaging its corporate property, and issuing notes or other evidences of indebtedness, as described above, and subject to the following requirements. Prior to executing the final loan documents, the Company shall file with the Department of Public Service for comment, and the Board for approval, the exact language of the security interest to be granted. The Company shall not execute the loan until the Board has approved the specific security interest to be granted.

4. Within ten days of closing the loan agreement, the Company shall file with the Board and the Department of Public Service the final loan closing documents and signed approvals from the Water Supply Division of the Vermont Agency of Natural Resources and the Vermont Economic Development Authority.

5. The Department is requested to advise the Board, within ninety days of this Order, regarding the degree to which the Company has not complied with any Board Order regarding timely system improvements, and also to recommend what, if any, sanctions, enforcement measures, or other remedies should be imposed by the Board against the Company for any such non-compliance.

6. Absent further Board Order, this investigation shall be closed ten business days after the documents described in paragraph 4, above, are filed by the Company.

Dated at Montpelier, Vermont, this 3<sup>rd</sup> day of July, 2001.

<u>s/Michael H. Dworkin</u>	)	PUBLIC SERVICE
	)	
	)	BOARD
<u>s/David C. Coen</u>	)	
	)	OF VERMONT
	)	
<u>s/John D. Burke</u>	)	

OFFICE OF THE CLERK

FILED: July 3, 2001

ATTEST: s/Susan M. Hudson

Clerk of the Board

*NOTICE TO READERS: This decision is subject to revision of technical errors. Readers are requested to notify the Clerk of the Board (by e-mail, telephone, or mail) of any technical errors, in order that any necessary corrections may be made. (E-mail address: Clerk@psb.state.vt.us)*

*Appeal of this decision to the Supreme Court of Vermont must be filed with the Clerk of the Board within thirty days. Appeal will not stay the effect of this Order, absent further Order by this Board or appropriate action by the Supreme Court of Vermont. Motions for reconsideration or stay, if any, must be filed with the Clerk of the Board within ten days of the date of this decision and order.*