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February 22, 2010

James J. McNulty, Secretary  
Pennsylvania Public Utility Commission  
Commonwealth Keystone Building  
400 North Street  
P. O. Box 3265  
Harrisburg, PA 17105-3265

Re: Docket No. R-2009-2117550  
Pa. P.U.C. v. The Newtown Artesian Water Company

Dear Secretary McNulty:

Enclosed for filing on behalf of The Newtown Artesian Water Company are an original and nine (9) copies of its Exceptions to the Recommended Decision of Administrative Law Judge Ky Van Nguyen in the above matter. Copies of the Exceptions are being served upon the persons and in the manner set forth on the certificate of service attached to it.

Very truly yours,

THOMAS, LONG NIESEN & KENNARD

By

Thomas T. Niesen

Encl.

cc: Certificate of Service (w/encl.)  
Brenden Brett, Esq. (w/encl.)

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Before The  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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Administrative Law Judge  
Ky Van Nguyen, Presiding

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Pennsylvania Public Utility Commission : Docket No. R-2009-2117550  
Office of Consumer Advocate : Docket No. C-2009-2122003  
:  
v. :  
:  
The Newtown Artesian Water Company :

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EXCEPTIONS OF  
THE NEWTOWN ARTESIAN WATER COMPANY TO THE  
RECOMMENDED DECISION OF  
ADMINISTRATIVE LAW JUDGE KY VAN NGUYEN

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## I. INTRODUCTION

### A. The Company

This proceeding concerns The Newtown Artesian Water Company (“NAWC” or “Company”). NAWC provides water service to 10,086 customers in Bucks County.<sup>1</sup> Its total annual revenue is approximately \$4,657,000.

NAWC purchases 57% of its present water supply from the Bucks County Water and Sewer Authority (“BCWSA”).<sup>2</sup> At existing rates of \$2.68 per 1,000 gallons, NAWC’s annual purchased water expense totals \$1,104,000 or approximately \$92,000 on a monthly basis.<sup>3</sup>

NAWC’s Agreement with BCWSA for the purchase and sale of water was approved by the Public Utility Commission (“Commission”) at Docket No. P-840513.<sup>4</sup> Under the terms of the Agreement, NAWC must take or pay for one million gallons of

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<sup>1</sup> Rec. Dec., Finding of Fact 2.

<sup>2</sup> Rec. Dec., Finding of Fact 5. NAWC’s percentage of water supply provided by purchased water is significantly higher than is typical in the water industry. NAWC St. No. 1 at 2. The Company’s purchased water expense for 2008 represented 34% of the Company’s total operation and maintenance expenses and equaled 24% of the Company’s revenues. Rec. Dec., Finding of Fact 6.

<sup>3</sup> NAWC St. No. 2 at 3-4; Additional details about the Company and its purchased water expense can be found in the Recommended Decision, Findings of Fact 1 through 11.

<sup>4</sup> Rec. Dec., Finding of Fact 8.

water per day.<sup>5</sup> The Agreement allows BCWSA to modify or amend its purchased water rate or rate structure at any future time without notice and in its sole discretion.<sup>6</sup>

The Company experiences significant and substantial shortfalls in the recovery of its purchased water expense when BCWSA increases its purchased water rate.<sup>7</sup> The last two BCWSA increases, in 2005 and 2008, resulted in Lost Purchase Water Expense of approximately \$187,000 and \$207,000, respectively, that NAWC was unable to recover from customers because of the lag in base rate recovery.<sup>8</sup>

Most recently, in 2008, BCWSA increased its rate from \$2.15 per 1,000 gallons to \$2.68 per 1,000 gallons, an increase of approximately \$244,000 on an annual basis<sup>9</sup>

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<sup>5</sup> Rec. Dec., Finding of Fact 9. The take-or-pay provision is specifically noted in footnote 1 of the Order of the Commission entered July 6, 1984 at Docket No. P-840513, approving the Agreement. At Findings of Fact 21 through 23, the Recommended Decision explains that the Company is attempting to locate a new lower cost well supply and is exploring potential well sites. The lower cost alternatives that the Company has been exploring are not done with any thought of eliminating the Agreement and the take-or-pay clause. The Agreement and the clause have 15 years remaining on their forty year life. The effort to locate alternative water sources is because the Agreement has an escalator. If the Company's existing wells fail to produce or produce below current levels and the Company, as a result, must resort to additional purchases, increased charges could occur. The escalators, which would increase the price of water from BCWSA, might be avoided or reduced through the development of additional groundwater sources. Under the terms of the Agreement, the take-or-pay threshold would increase if average peak day demand over a twelve month period rises to 2,000,000 gallons. NAWC Exhibit I, Attachment 1, Section 4; *Also see Petition of The Newtown Artesian Water Company*, Docket No. P-2009-2109670, Order entered August 6, 2009 and NAWC Reply Brief at 16 and fn. 23.

<sup>6</sup> Rec. Dec., Finding of Fact 9. The Agreement is included in the evidentiary record as Attachment I to NAWC Exhibit I.

<sup>7</sup> NAWC Exhibit I, Supporting Information, page 2.

<sup>8</sup> BCWSA has increased its purchased water rate six times since the inception of the Agreement. During the first eighteen years of the Agreement, BCWSA increased the rate two times - - increases of \$0.20 per 1,000 gallons in 1993 and \$0.15 per 1,000 gallons in 1995 - - total increases of \$0.35 per 1,000 gallons. NAWC St. No. 1REJ at 8. Over the seven years, 2002-2008, however, BCWSA has increased its purchased water rates four times - - a total increase of \$1.23 per 1,000 gallons - - or about 3.5-times more than over the previous 18 years. NAWC received only an average 55-day notice of these increases. In comparison to the first eighteen years of the Agreement, *moreover, the rate, or dollar amount, of the increases has been accelerating at an increasing rate and the percentage change varies from rate hike to rate hike.* NAWC St. No. 1REJat 8.

<sup>9</sup> NAWC St. No. 1 at 6.

and, significantly, for the purpose of these Exceptions, approximately 5.2% of present billed revenue.<sup>10</sup>

The solution to BCWSA increases and Lost Purchase Water Expense is obvious. An automatic adjustment clause is available as a cost recovery mechanism under Section 1307 of Public Utility Code. The Commission has recognized the benefit of Section 1307 many times in the past for many purposes including the recovery of purchased water expense.<sup>11</sup> In doing so, it has done nothing more than implement the clear language of the Code as enacted by the General Assembly.<sup>12</sup>

**B. Supplement No. 68 to Tariff Water - Pa. P.U.C. No. 9 and History of Proceeding**

NAWC filed Supplement No. 68 to Tariff Water-Pa. P.U.C. No. 9 ("Supplement No. 68") on July 1, 2009.<sup>13</sup> Supplement No. 68 would include a PWAC in the Company's Tariff as permitted by Section 1307 of the Public Utility Code, 66 Pa. C.S. § 1307. The PWAC would allow the Company to timely recover *increases* in purchased

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<sup>10</sup> Purchased water increase of \$244,000 divided by annual revenue of \$4,657,000 equals 5.2%.

<sup>11</sup> In *Petition of Pennsylvania-American Water Company for Approval to Implement a Tariff Supplement Establishing a Distribution System Improvement Charge*, 86 Pa. P.U.C. at 420, the Commission explained that it has adopted a policy statement that encourages water companies to seek Section 1307(a) cost recovery for their PENNVEST debt costs, 52 Pa. Code § 69.361, and policy statements approving Section 1307 cost recovery for certain FERC Order 636 stranded costs, 52 Pa. Code § 69.341(b)(4), and electric utility coal uprating costs, 52 Pa. Code § 57.124(a). The Commission also noted that, since 1970, it has authorized all utilities to use an automatic adjustment clause mechanism to recover certain incremental changes in state tax rates. 52 Pa. Code § 69.44. Additionally, in a fashion virtually identical to NAWC's proposal here, natural gas distribution companies collect natural gas supply costs through Section 1307 automatic adjustment clauses.

<sup>12</sup> NAWC has an exemplary program of system maintenance and leak repair. By approving the PWAC, the Commission will be assisting a well-managed Company in the recovery of the just and reasonable costs of providing water service.

<sup>13</sup> Supplement No. 68 was initially filed as Supplement No. 67 to Tariff Water-Pa. P.U.C. No. 9. By letter dated July 16, 2009, NAWC advised that Supplement No. 67 should be designated as Supplement No. 68. Rec. Dec. at 1.

water costs from customers or to timely pass through *decreases* in purchased water costs to customers.<sup>14</sup>

NAWC's PWAC would be calculated based on changes in the BCWSA rate from the purchased water rate included in the Company's Baseline Cost. The Baseline Cost is the annual purchased water cost reflected as an operating expense in the Company's most recently concluded general rate case. NAWC would provide notice to its customers of a change in rates resulting from application of the PWAC.<sup>15</sup>

When BCWSA changes its purchased water rate, the Company would re-compute the PWAC based upon its annual purchased water cost reflecting the level of consumption and other billing determinants that formed the basis for the Baseline Cost.<sup>16</sup> As required by Section 1307(e) of the Public Utility Code, 66 Pa. C.S. § 1307(e), the Company will provide an annual reconciliation of purchased water charge revenues with the cost of purchased water from BCWSA.<sup>17</sup>

By Order entered August 27, 2009, at Docket No. R-2009-2117550, the Commission suspended Supplement No. 68 and instituted an investigation into the proposed PWAC. The Office of Consumer Advocate ("OCA") filed a Complaint against Supplement No. 68 at Docket No. C-2009-2122003. The Office of Trial Staff ("OTS") filed a Notice of Appearance.

The matter was assigned to Administrative Law Judge Ky Van Nguyen. An Initial Prehearing Conference was held on October 9, 2009. An evidentiary hearing was held on December 15, 2009.

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<sup>14</sup> NAWC Exhibit I, Supporting Information, page 3.

<sup>15</sup> Rec. Dec., Finding of Fact 13.

<sup>16</sup> Rec. Dec., Finding of Fact 14.

<sup>17</sup> NAWC Exhibit I, Supporting Information, page 5. The proposed reconciliation procedure is presented in NAWC Exhibit I, Attachment II.

NAWC presented the testimony of Harold Walker III and George A. Forsyth, Jr., in support of its proposed PWAC. The OCA and OTS presented the testimony of Marilyn J. Kraus and Jeremy Hubert, respectively, in opposition to the proposed PWAC.

By Recommended Decision dated January 25, 2010, Judge Nguyen recommended that NAWC be allowed to implement a PWAC capped, however, at 3% of the amount billed to customers, exclusive of amounts recovered under the State Tax Adjustment Surcharge.

NAWC submits the following Exceptions to the Recommended Decision.<sup>18</sup>

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<sup>18</sup> Consistent with Section 5.533 of the Commission's Rules of Practice and Procedure, 52 Pa. Code § 5.533, NAWC, as appropriate, refers to and incorporates by reference relevant passages from its previously filed Main and Reply Briefs.

## II. EXCEPTIONS

1. **EXCEPTION NO. 1** - NAWC excepts to that portion of the Recommended Decision that concludes that the PWAC should be capped at 3% of the amount billed to customers, exclusive of amounts recovered under the State Tax Adjustment Surcharge. Rec. Dec. at 13 and Ordering Paragraph 4. NAWC's PWAC should not be capped.

### A. Introduction

Section 1307(a) of the Public Utility Code, 66 Pa. C.S. § 1307(a), allows any public utility to establish a "method for the automatic adjustment of the rates of the public utility as shall provide a just and reasonable return on the rate base of such public utility." Consistent with Section 1307(a), the Recommended Decision concludes that NAWC's request to create a PWAC should be approved.<sup>19</sup>

The Recommended Decision proposes, however, that the PWAC be capped at 3% of the amount billed to customers, exclusive of amounts recovered under the State Tax Adjustment Surcharge.<sup>20</sup> The capping is proposed to address OCA's and OTS's concerns over a disassembling of the traditional rate-making process and unfair treatment of ratepayers.<sup>21</sup> The 3% limit is based on Section 1308(d) which defines a

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<sup>19</sup> Rec. Dec., Ordering Paragraph 1, at 19. NAWC's proposed PWAC and how it is consistent with the statutory criteria are addressed throughout NAWC's Main and Reply Briefs and specifically in Section V.B.3 of NAWC's Main Brief. NAWC's proposed PWAC addresses the recovery of a specific, identifiable expense - - purchased water cost increases. The recovery includes a reconciliation feature assuring that recovery of increases (credit of decreases) would be on a dollar-for-dollar basis. The PWAC would provide NAWC with the opportunity to avoid the significant Lost Purchased Water Expense that occurs when BCWSA increases its purchased water rate and, thereby, provide NAWC with the opportunity for a just and reasonable return on rate base while assuring that customers will pay no more than the increased charges and, in the event of a BCWSA rate decrease, will receive a rate decrease.

<sup>20</sup> Rec. Dec. at 13 and Ordering Paragraph 4.

<sup>21</sup> Rec. Dec. at 13.

general rate increase as one which affects more than 5% of customers and amounts to in excess of 3% of total gross operating revenue.<sup>22</sup>

NAWC submits that the proposed capping of the PWAC would not provide the opportunity for a just and reasonable return consistent with Section 1307, as would a non-capped PWAC. NAWC submits further that the proposed capping of the PWAC is inconsistent with the Public Utility Code and decisional precedent. The “cap” should not be part of the Commission’s final Opinion and Order.

**B. A “Cap” Would Not Provide for An Opportunity for A Just and Reasonable Return**

The Recommended Decision appropriately concludes, as a threshold matter, that an “automatic adjustment clause that enables a utility to recover applicable increased water costs on a dollar-for-dollar basis fits a Section 1307(a) surcharge.”<sup>23</sup> A clause that operates in this way, such as the one proposed by NAWC, would provide the utility with the opportunity for a just and reasonable return consistent with Section 1307(a).

The additional 3% “capping” feature eliminates the opportunity for the automatic adjustment clause to operate in a just and reasonable manner. The most recent BCWSA increase was over 5% of NAWC’s billed revenue. With an increase of over 5%, an automatic adjustment clause capped at 3% as proposed by the Recommended Decision will *not* provide the opportunity for NAWC to recover the increase in full and will *not* provide a just and reasonable return on rate base.<sup>24</sup>

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<sup>22</sup> Rec. Dec. at 13, fn. 2.

<sup>23</sup> See Rec. Dec. at 12 citing *Rate Case Handbook* (1983) B2.

<sup>24</sup> NAWC’s annual purchased water expense increased by approximately \$244,000 as a result of BCWSA’s most recent rate increase. With an automatic adjustment clause capped at 3%, NAWC would have been able to begin to recover approximately \$140,000 (annualized) through the PWAC but would have had to initiate a general rate filing to recover the remaining \$104,000 shortfall. With a capped clause, NAWC will be in substantially the same position it is in presently without the

The same result will occur with increases that are less than the 3% “cap.” The BCWSA increases, which are now occurring more frequently, will quickly accumulate to the level of the cap. Once the “cap” is reached, the Company will be precluded from further Section 1307 cost recovery without first going through an expensive general rate filing to “zero out” the PWAC. Again, the “cap” as proposed by the Recommended Decision will **not** provide the opportunity for a just and reasonable return on rate base.

The Recommended Decision proposes the “cap” to address concerns of the OTS and OCA but the result is a hobbled automatic adjustment clause that does not fully address economic reality.<sup>25</sup> The Commission should decline to “cap” the clause and, instead, approve the clause as proposed so that the Company will be able to recover purchased water increases on an immediate, dollar-for-dollar basis without the need for expensive Section 1308 general rate proceedings either to recover the balance of a large BCWSA increase or to “zero out” the charge after frequent smaller BCWSA increases.

**C. The Proposed Capping of the PWAC Is Inconsistent With Section 1307 and Not Required By It**

In Pennsylvania, utility costs are recovered from customers through Section 1308 base rates *and* through Section 1307 automatic adjustment clauses.<sup>26</sup> In regard to Section 1307 automatic adjustment clauses, the only statutory limitation is that the

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clause - - a position necessitating a base rate increase to fully recover the increase in BCWSA purchase water charges.

<sup>25</sup> A Section 1307 automatic adjustment clause is not a “disassembling” of the traditional ratemaking process, nor is it unfair to ratepayers. See Rec. Dec. at 13. A properly implemented automatic adjustment clause, as proposed by NAWC in this proceeding, is one of the two statutorily prescribed methods of cost recovery. Since it does no more than provide for the dollar-for-dollar recovery of an increased expense, it is not unfair to ratepayers.

<sup>26</sup> *Petition of Pennsylvania-American Water Company for Approval to Implement a Tariff Supplement Establishing a Distribution System Improvement Charge*, 86 Pa. P.U.C. at 419; *Pa. P.U.C. v. Pennsylvania American Water Co.*, Docket No. R-00027982 (Order entered November 7, 2003), slip op. at 13.

automatic adjustment methodology “shall provide a just and reasonable return on the rate base of such public utility.”

The Recommended Decision cites Section 1308(d) for authority to cap a Section 1307(f) automatic adjustment clause. The two statutory sections, however, are separate and distinct. If the General Assembly had intended to “cap” the application of an automatic adjustment clause under Section 1307(a) it would have done so with specific statutory language. The General Assembly, however, did not cap the application of an automatic adjustment clause to 3% of customer billings. The “cap” proposed by the Recommended Decision is not part of the statutory scheme for a Section 1307(a) automatic adjustment clause and the Commission should decline to adopt that part of the Recommended Decision that would “cap” NAWC’s PWAC.

**D. The Proposed Capping of the PWAC Is Inconsistent with Decisional Precedent**

In *Pennsylvania Indus. Energy Coalition v. Pa. P.U.C.*, 653 A.2d 1336, 1349 (1995), cited at page 12 of the Recommended Decision, the Commonwealth Court explained that “*the General Assembly did not limit the allowance of automatic adjustment to only fuel costs and taxes which are generally beyond the control of the utility. Instead, the General Assembly specifically allowed the recovery of fuel costs and also allowed the PUC or the utilities to initiate the automatic adjustment of costs within specific procedures.*”<sup>27</sup> Those specific procedures have never included a “cap” on the recovery of purchased water expense. The Commission’s formal Regulation at 52 Pa. Code § 53.54(c), for example, does not “cap” the purchased water adjustment clause for small water utilities with less than \$250,000 annual revenue, nor does the

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<sup>27</sup> Emphasis added. See also *Petition of Pennsylvania-American Water Company for Approval to Implement a Tariff Supplement Establishing a Distribution System Improvement Charge*, 86 Pa. P.U.C. at 420.

Regulation express any concern that an “uncapped” clause will evade Section 1308 rate review.

In *Petition of Philadelphia Suburban Water Company (PSWC) for Approval to Implement a Tariff Supplement Establishing a Distribution System Improvement Charge (DSIC)*, Docket No. P-00961036, 26 Pa.B. 4490, (1996), the Commission capped PSWC's DSIC surcharge at 5%. Subsequently, the Commission increased the DSIC “cap” for both PSWC (now Aqua Pennsylvania) and Pennsylvania American Water Company from 5% to 7.5%.<sup>28</sup> The DSIC caps at 7.5% are, thus, more than twice the level of 3% proposed in the Recommended Decision for NAWC's PWAC.

Irrespective of the obvious, significant difference between the 7.5% DSIC “cap” and the 3% PWAC “cap” proposed in the Recommended Decision, Commission decisions to “cap” DSIC surcharges provide no authority for a “capping” of automatic adjustment clauses designed to recover purchased water expense.<sup>29</sup> Water system improvements that are recovered through DSIC surcharges are largely within the control of the utility. They can be postponed if the DSIC is “full” at 5% or 7.5%. Purchased water expense, however, is completely beyond the control of the utility.<sup>30</sup> An automatic adjustment clause implemented for the purpose of recovering purchase water expense increases should not be “capped.”

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<sup>28</sup> *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, 275 P.U.R.4th 247, 2009 WL 2475413 (Pa.P.U.C.) and *Petition of Pennsylvania American Water Company*, Docket No. P-00062241, Order entered August 14, 2007.

<sup>29</sup> See, again, the Commission's formal Regulation at 52 Pa. Code § 53.54(c), which does not “cap” the purchased water adjustment clause for small water utilities with less than \$250,000 annual revenue.

<sup>30</sup> Rec. Dec., Finding of Fact 20.

**E. Conclusion**

The Commission should grant NAWC's Exception No. 1 and decline to "cap" NAWC's PWAC. Capping the PWAC would be inconsistent with the Public Utility Code and decisional precedent. Significantly, a capping of the PWAC also would not provide NAWC with the opportunity for a just and reasonable return on rate base.

- 2. EXCEPTION NO. 2 -** NAWC excepts to that portion of the Recommended Decision that provides for one-way directional interest on overcollections. Rec. Dec. at 18 and Ordering Paragraph 6. No interest should be levied on either under or over collections.

The Recommended Decision recommends that the PWAC provide for one-way *directional interest on overcollections with the interest being calculated at the residential mortgage lending rate in accord with the Loan Interest and Protection Law, 41 P.S. § 101, et seq.* The Company's original proposal included carrying charges (interest) on undercollected and overcollected recoveries of purchased water expenses.<sup>31</sup> In opposition to the Company's proposal, OTS proposed that the interest component be one-directional with interest calculated on overcollections only and at the residential mortgage rate.

The Recommended Decision adopts the OTS proposal and recommends one-directional interest on overcollections at the residential mortgage lending rate. OTS provided no statutory or regulatory citation in support of one-directional interest and no citation is provided in the Recommended Decision for one-directional interest. In response to the recommended one-directional interest proposed by the OTS and now recommended by the Recommended Decision, NAWC proposes, in the alternative, that *no interest be levied on either under or over collections.*

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<sup>31</sup> NAWC St. No. 1 at 10-11 and N.T. 43.

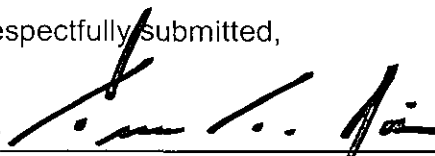
NAWC's Exception No. 2 should be granted. No interest should be levied on either under or over collections.

### III. CONCLUSION

NAWC's Supplement No. 68 and proposed automatic adjustment clause for recovery of purchased water expense is a method of cost recovery specifically allowed under Section 1307 of the Public Utility Code, 66 Pa. C.S. § 1307, and consistent with Court and Commission precedent. NAWC's Exceptions to the Recommended Decision should be granted. Supplement No. 68 and the proposed Purchased Water Adjustment Clause should be approved.

Respectfully submitted,

By



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*Attorneys for  
The Newtown Artesian Water Company*

DATED: February 22, 2010

NAWC Exceptions (Final).wpd

**Before The  
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Administrative Law Judge  
Ky Van Nguyen, Presiding**

<b>Pennsylvania Public Utility Commission</b>	:	<b>Docket No. R-2009-2117550</b>
<b>Office of Consumer Advocate</b>	:	<b>Docket No. C-2009-2122003</b>
	:	
<b>v.</b>	:	
	:	
<b>The Newtown Artesian Water Company</b>	:	

**CERTIFICATE OF SERVICE**

I hereby certify that I have this 22<sup>nd</sup> day of February 2010, served a true and correct copy of The Exceptions of The Newtown Artesian Water Company, upon the persons and in the manner indicated below:

**EMAIL AND FIRST CLASS MAIL, POSTAGE PREPAID**

Honorable Ky Van Nguyen  
Administrative Law Judge  
Pennsylvania Public Utility Commission  
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Philadelphia, PA 19107

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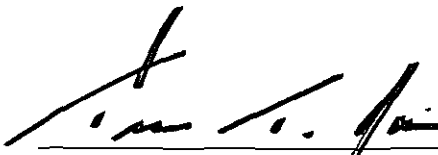
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