

COMMONWEALTH OF PENNSYLVANIA



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IRWINA. POPOWSKY
Consumer Advocate

June 4, 2010

Rosemary Chiavetta, Secretary
Pa. Public Utility Commission
400 North Street
Harrisburg, PA 17101

Re: Pa. Public Utility Commission
v.
Aqua Pennsylvania, Inc.
Docket No. R-2009-2132019

Dear Secretary Chiavetta:

Enclosed for filing please find the Exceptions of Jerome Linden. The Office of Consumer Advocate files these Exceptions in the above-referenced proceeding at the request of and as a courtesy to Mr. Linden.

Copies have been served upon all parties of record as shown on the attached Certificate of Service.

Sincerely yours,

A handwritten signature in black ink, appearing to read "Shaun A. Sparks".

Shaun A. Sparks
Assistant Consumer Advocate
PA Attorney I.D. #87372

Enclosures

cc: Honorable Angela T. Jones
Office of Special Assistants
Certificate of Service

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**BEFORE THE PENNSYLVANIA PUBLIC
UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY	:	
COMMISSION, ET. AL.	:	
v.	:	DOCKET NO. R-2009-2132019
	:	C-2010-2152328
AQUA PENNSYLVANIA, INC.	:	et. al.

**EXCEPTIONS OF
JEROME LINDEN**

JUNE 4, 2010

I. INTRODUCTION

The history of this Proceeding has been detailed by the ALJ in the Recommended Decision (R.D.). During the course of the Proceeding, I filed a Formal Complaint on January 11, 2010 which as docketed at C-2010-2152328, and a Prehearing Conference Memorandum on January 27, 2010. I served Interrogatories on Aqua Pennsylvania on February 16, 2010, which were answered on February 25, 2010 and March 3, 2010. I attended the Public Input Hearing in Radnor Township on March 3, 2010, but did not speak, so that I could maintain my status as an active formal complainant. I filed Rebuttal Testimony on March 11, 2010.

I was not included in whatever settlement discussions occurred, and became aware that certain of the parties had reached a settlement around the same time the ALJ was informed. In an effort to join in that settlement, I proposed four additional settlement provisions to the active parties via email on April 6, 2010.

On April 29, 2010, I served my objection to the Joint Petition for Settlement and filed my Main Brief (M.B.), which included five arguments and offered the same four additional settlement provisions I had provided to the active parties earlier.

I have reviewed the Aqua Pennsylvania Reply Brief (Aqua R.B.), the Office of Small Business Assistance (OSBA) Reply Brief (OSBA R.B.), and the Recommended Decision. After reviewing these documents, I am concerned that important issues I have raised during this proceeding have not been answered or addressed by the Joint Settlement. In the Recommended Decision, many of my arguments have been combined with those of other complainants and summarized in such as way that the substance of the original

argument has been lost. In several cases, the ALJ has relied upon Aqua's misreading of my Main Brief and has dismissed my entire argument based only on a minor point of the argument that either Aqua or the OSBA focused upon in their Reply Briefs. For these reasons, I have decided to file these Exceptions to the Recommended Decision.

II. EXCEPTIONS

Exception No. 1: The ALJ Erred by Relying on an Unsupportable Assertion Made by Aqua Pennsylvania and Failed to Address the Issue of Whether Aqua Pennsylvania Met the Burden of Proof for a Rate Increase.
(R.D. at 22 and 30-32; Linden M.B. at 1-2).

This Exception relates to the first argument I included in my Main Brief. This argument was stated in the M.B. as:

A. Aqua Pennsylvania has not demonstrated that the return under present rates is inadequate to attract the additional capital needed to finance future plant improvements. (M.B. at 1)

In the Recommended Decision, the ALJ combined my argument with that of another complainant, and summarized my argument, as well as my second argument, as "...or the failure to provide a reasonable revenue requirement". (R.D. at 22 and 30)

In my Main Brief in support of the first argument, I repeat Aqua's basis for a rate increase, as taken from the "Statement of Specific Reasons for the Proposed Increase in Rates" they provided at the beginning of this rate case:

"the indicated return on common equity under present rates is anticipated to be 9.08% which is grossly inadequate by any reasonable standard and far less than required to provide the Company with a reasonable opportunity to attract the additional capital needed to finance future plan improvements." (M.B. at 1)

As a simple test to this assertion, I cite that York Water Company was able to raise capital in the equity markets in September, 2009, at time when it was experiencing a Return on Equity of 9.20%, and also explain that York was not just able to raise capital, but in fact the issuance was oversubscribed.

In response to the first argument, in their Reply Brief, Aqua contends that it cannot determine whether the Return on Common Equity I provided for York Water Company is on a book or ratemaking basis. Aqua's position is clearly ludicrous. The source of document provided is clearly cited in my Rebuttal Testimony and repeated back in the Aqua Reply Brief as "York's Quarterly Earnings Report to the PUC for the 12 months ending June 30, 2009". Aqua is intimately familiar with this filing as it is identical to the report that it files for itself. Aqua fully understands the basis of presentation of the filing, and should be clear of the direct comparison that can be made of the Return on Common Equity to that calculated in this proceeding.

The ALJ should have seen that Aqua's position is unsupportable and rejected it. Since she did not, the Recommend Decision is devoid of an analysis of Aqua's claim that it cannot come close to raising capital at the indicated rate of return, while York Water was able to easily raise capital at that rate of return in the same capital markets.

It is also not clear if the ALJ relied upon Aqua's criticism of the timing differences cited between York for the 12 months ended June 2009 and Aqua for the 12 months ended June 2010, since she references Aqua's statement (M.B. at 31), but does not subsequently comment on it. To the extent that this was relied upon in the Recommended Decision, it would be inconsistent with the ALJ's reliance on a comparison of Returns on Equity over

a two year period offered by the OSBA (R.D. at 32) to compare the rate of return granted in the last case with that computed for this case.

However, the comparison of Aqua's rate of return with that of York was presented only to test the reasonableness of Aqua's assertion that they cannot raise capital at the indicated rate of return based on present rates. Even rejecting any comparison with York does not satisfy the argument I presented. The burden of proof is still upon Aqua that a rate increase is needed, not upon complainants to prove that it is not. A Settlement should not remove this requirement if all parties are not in agreement with the settlement.

Exception No. 2: The ALJ Failed to Address the Issue of the Settlement Providing More than a Fair Rate of Return to Shareholders. (R.D. at 30-32; Linden M.B. at 2-3).

This Exception relates to the second argument I included in my Main Brief. This argument was stated in the M.B. as:

B. Aqua America shareholders are being more than fairly compensated for their capital. (M.B. at 2)

As stated regarding the last exception, in the Recommended Decision, the ALJ combined this argument with my first argument, along with that of another complainant, and summarized my two arguments as "...or the failure to provide a reasonable revenue requirement". (R.D. at 22 and 30)

In my Main Brief, I reference my Rebuttal Testimony, which includes an analysis of stock appreciation returns realized by Aqua America shareholders over the last one and two business cycles, in addition to generous dividend payments, as well as information

provided by Aqua America to investors explaining how the granted return on equity feeds this appreciation. (M.B. at 2-3)

In her analysis, the ALJ references Aqua's Rebuttal Testimony stating that the settlement precludes a calculation of return on equity, but noting that a 10.5% return on equity would be a reduction from 11% awarded in the last case. Aqua claims this reduction is "substantial". (R.D at 31 and 32, Aqua R.B. at 7) The ALJ relies on a similar contention provided by the OSBA, concerning the reduction in the return on equity from the last case to rebut my objection of the settlement. (R.D. at 31 – 32, OSBA R.B. at 5 – 6)

The ALJ errs by not addressing the key point in my Main Brief that argues that a 10.5% return on equity unfairly overcompensates Aqua America shareholders. In my Main Brief, I argue that Aqua America shareholders have realized stock appreciation returns well in excess of the S&P 500. (M.B. at 2) No party in this proceeding, including Aqua, challenged in a Reply Brief the observation of Aqua America's stock performance, or that the S&P 500 index is a valid comparison. I also make the statement in my Main Brief that "A return of 10.5% is similar to the returns granted and realized by Aqua Pennsylvania over the last eight years, and would thus continue to overcompensate Aqua America shareholders." (M.B. at 3) While two parties did reply that the 10.5% return on equity is lower than the 11% granted in the last rate case, no party has refuted the assertion that 10.5% is representative of the returns granted over the last eight years.

There is no evidence that the return on equity of 10.5% that will result from this settlement addresses the overcompensation of Aqua America's shareholders. Dismissing the argument solely by saying "it's less than last time" is wholly inadequate.

Exception No. 3: The ALJ Failed to Address the Issue of the Aqua Pennsylvania Ratepayers Subsidizing Other Aqua America subsidiaries.
(R.D. at 22 and 28-29; Linden M.B. at 3-4, Aqua R.B. at 7).

It appears that the ALJ simply forgot to address this issue. The original text in my Main Brief was stated as:

C. Aqua Pennsylvania ratepayers are subsidizing other Aqua America state subsidiaries. (M.B. at 3)

In summarizing the Issues Presented on pg 22 of the R.D., the ALJ makes reference to this issue in point (b), in combination with another issue from another complainant. However, in the Analysis section of the R.D., while the other complainant's issue is addressed in point (c) [there are two point (c)'s in the Analysis section, and no point (b)], my issue is not addressed. I find no other place in the R.D. where there is any reference or analysis of this important issue.

In its Reply Brief, Aqua provided a two sentence response to this issue. Aqua's response is unsupported and irrelevant to the point raised in my Main Brief.

The examination of the relative contribution of Aqua America's subsidiaries is inseparable from the analysis of Aqua America's returns to shareholders as described in Exception No. 2. As noted in my Main Brief, Aqua Pennsylvania is providing only 54% of Aqua America revenues, yet Aqua Pennsylvania is providing 80% of Aqua America net income. (M.B. at 4)

Exception No. 4: The ALJ Erred by Relying on Aqua Pennsylvania’s False Reading of the Main Brief of Jerome Linden and Erred in Not Considering the Cumulative Effect of Rate Increases Over Time .
(R.D. at 41-43; Linden M.B. at 5-6, Aqua R.B. at 7-8).

This exception relates to the fifth argument presented in my Main Brief. The original text of my argument is:

D. Taken together, the continuing series of substantial rate increases, well in excess of inflation, are not “just and reasonable”. (M.B. at 5)

The ALJ dismisses this argument in part based on relying upon a misreading by Aqua America of a statement in my Main Brief , contending that I did not understand that Aqua funds capital improvements with a mix of debt and equity. Aqua and the ALJ contend that I believe that Aqua funds capital improvements only with equity. (R.D. at 42, Aqua R.B. at 7-8)

I am, in fact, fully aware that Aqua funds capital expenditures with a mix of debt and equity, and seeks to maintain roughly a 1:1 debt/equity ratio. The full text of the statement in my Main Brief is:

The Joint Petition for Settlement does not adequately address this situation. With or without any rate increase in the immediate term, the Settlement or Recommended Decision should address the long term trend in rates, both in the past and in the future. The present method of funding any capital expenditures with equity, magnified by an income tax effect, is simply too expensive when compared with government issued debt. I respectfully recommend that the Public Utility Commission include in its decision a provision for a study of long-term capital and operating requirements,

including an examination of alternative capital funding mechanisms and possible restructuring of water regulation. (M.B. at 6)

Had I believed that only equity was used, I would have said “The present method of funding all capital expenditures with equity...”

I renew my request made in the statement for the Commission to commence a study of alternative capital funding mechanisms. As an example, if the assets currently funded with Pennvest loans were held by Pennvest and leased to Aqua, the debt would not appear on Aqua’s books. This would permit Aqua ratepayers to benefit from the capital improvement at the low interest rate for government debt, while permitting Aqua to maintain its debt/equity ratio without having to make a corresponding equity backed capital investment. I recognize that this particular example may or may be feasible, but believe it is within the purview of the Commission to initiate such a study of potential alternatives.

I also take exception to the ALJ’s position that prior rate increases are not relevant in assessing the reasonableness of the present rate increase. For example, a 14% increase may be more reasonable if there had been no increase for 10 years than if there was just another 14% increase two years prior.

III. CONCLUSION

I believe that the discussion of the four exceptions clearly shows that important issues raised in my Main Brief and Rebuttal Testimony have not been fairly or adequately addressed in the Recommended Decision, and that the need for a rate increase has not been proven.

I do not take filing Exceptions to the Recommended Decision lightly, nor did I take filing a Formal Complaint lightly. In prior rate cases in 2006 and 2008, I provided comments to the Commission, as well as written, sworn testimony at public input hearings on many of the same issues I raised in this proceeding. I was disappointed that I found no evidence that the issues I raised were even addressed in the prior proceedings.

Even though I believe the issues I raised are well supported, I realize that the Commission is unlikely to disapprove the Joint Settlement. However, I hope that the Commission will give serious consideration to initiating a study, prior to the next rate case, to address the issues of: the adequacy of models used to determine a fair rate of return given the history of stock returns realized by investors; the impact of varying rates of returns from non-Pennsylvania subsidiaries; long-term capital and operating requirements and the impact on ratepayers; alternative methods of funding capital improvements; and potential changes to the regulatory model. The scope of this study could be limited to Aqua Pennsylvania, or could include all regulated water utilities in the Commonwealth.

I also hope the Commission will give consideration to forming an Aqua Pennsylvania Consumer Advisory Committee, as suggested in my Settlement recommendations. I believe the concerns raised about this committee by the OSBA and the ALJ can be easily resolved with some minor changes and further explanation. I believe the OSBA's concerns could have been addressed had they taken the opportunity to speak with me, as is contemplated and encouraged in the settlement process.

Lastly, I hope the Commission will give serious consideration to the ALJ's comment regarding including the effect and consequence of the DSIC in public notices. (R.D. at 47)

I would welcome the opportunity to discuss the concerns I have raised with any of the Commissioners.

Respectfully submitted,

A handwritten signature in cursive script that reads "Jerome Linden". The signature is written in black ink and is positioned to the right of the typed name.

Jerome Linden

Date: June 4, 2010

CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission
v.
Aqua Pennsylvania, Inc.
Docket No. R-2009-2132019

I hereby certify that I have this day served a true copy of the foregoing Exceptions of Jerome Linden upon parties of record in this proceeding. Service is in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 4th day of June 2010.

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