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January 15, 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 Reply Brief in the above matter. Copies of the Reply Brief 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

Administrative Law Judge
Ky Van Nguyen, Presiding

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

REPLY BRIEF
OF
THE NEWTOWN ARTESIAN WATER COMPANY

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I. INTRODUCTION

This proceeding concerns The Newtown Artesian Water Company's ("NAWC" or "Company") proposed Purchased Water Adjustment Clause ("PWAC"). The PWAC would provide the Company with the opportunity to timely recover/credit *increases/decreases* in purchased water costs.

Currently at 57%, NAWC's purchased water supply is significantly higher than is typical in the water industry. For 2008, on a dollar basis, NAWC's purchased water expense was 34% of its total operation and maintenance expense ("O&M") and 24% of its total revenue.

NAWC purchases its water from one supplier, the Bucks County Water and Sewer Authority ("BCWSA"). BCWSA has increased its rate for purchased water many times. The last two BCWSA increases, in 2005 and 2008, have resulted in Lost Purchase Water Expense of approximately \$400,000.

The implementation of a PWAC would eliminate the opportunity for Lost Purchase Water Expense going forward and do so in a way that was contemplated by the General Assembly when it enacted the Public Utility Code. Section 1307(a) of the 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."

The Commission should reject the arguments of the Office of Trial Staff and the Office of Consumer Advocate in opposition to NAWC's PWAC. Their arguments are inconsistent with prior Commission and Court decisions and only serve to complicate an otherwise simple and straightforward matter. Consistent with the clear language of Section 1307, NAWC's PWAC would do no more than allow the Company the opportunity for a just and reasonable return on rate base.

This Reply Brief is submitted in further support of the Company's PWAC. It is supplemental to NAWC's Main Brief and is limited to those matters that warrant additional discussion as a result of the Main Briefs submitted by the Office of Trial Staff and the Office of Consumer Advocate. As set forth herein and in NAWC's Main Brief, the Commission should allow NAWC's PWAC to go into effect as proposed.

II. REPLY TO THE MAIN BRIEF OF THE OFFICE OF TRIAL STAFF

A. NAWC's PWAC Does Not Circumvent Normal Ratemaking Principles Nor Does It Constitute Single Issue Ratemaking

Contrary to the position of the OTS as presented in Section A of its Main Brief, the Commission has never viewed the principle of "single issue ratemaking" as an impediment to the implementation of an automatic adjustment clause under Section 1307. The General Assembly, moreover, has not enacted "single issue ratemaking" as a prohibition to the exercise of Section 1307.¹ In *Pennsylvania Indus. Energy Coalition v. Pa. P.U.C.*, 653 A.2d 1336, 1350 (1995), the Commonwealth Court explained that the doctrine of single issue ratemaking is inapplicable when, as here, a surcharge is permitted under the Code, with procedures to determine the reasonableness of the charges outside of a base rate case.

The recommendation of Judge Rainey concerning single issue ratemaking in the Aqua proceeding cited at pages 5 and 6 of the OTS Main Brief was never reviewed nor adopted by the Commission. Inasmuch as the recommendation is inconsistent with the Commission's obvious preference for automatic adjustment clause recovery,² as well as the clear language of the Court cited above, it likely would not have been approved by the full Commission if the Commission had been presented with the opportunity to

¹ The only statutory requirement of Section 1307(a) is that the automatic adjustment clause provide a just and reasonable return on the rate base of the public utility to be determined upon such equitable or reasonable basis as shall provide such fair return. 66 Pa. C.S. § 1307(a).

² See, for example, *Petition of Pennsylvania-American Water Company for Approval to Implement a Tariff Supplement Establishing a Distribution System Improvement Charge*, 86 Pa. P.U.C. 415 (1996) and the Commission's Order entered November 7, 2003, in *Pa. P.U.C. v. Pennsylvania American Water Co.*, Docket No. R-00027982 approving Pennsylvania-American Water Company's proposed Collection System Improvement Charge.

do so. Judge Rainey's concern with single issue ratemaking should not be followed here.³

B. Normal Ratemaking Principles and Recovery Outside of Base Rate Cases

OTS acknowledges that Section 1307 permits a utility to recover expenses outside of a base rate case. At pages 9 and 10 of its Main Brief, OTS states, in pertinent part as follows:

“ ... purchased water is a non-capital expense that is beyond the utility's control and easily determined. NAWC's purchased water expenses are not required by a government entity. Although NAWC has demonstrated that it has some degree of influence over its purchased water expenses, it has no control over the price of purchased water. Finally, NAWC's purchased water costs are easily identifiable as the Company only purchases water from a single supplier. Under the standards identified in *Popowsky v. PUC*, the Commission is not precluded from granting a PWAC under Section 1307. This position is evidenced by the Commission's adoption of 52 Pa. Code 53.54, which permits water and wastewater utilities with gross revenues of less than \$250,000 to implement a PWAC”⁴

Notwithstanding the foregoing, the OTS recommends at page 10 of its Main Brief that the Commission reject NAWC's PWAC. In actuality, however, the foregoing supports the Company's proposal. In *Popowsky v. Pa. P.U.C.*, 869 A.2d 1144, 1160 (2005), cited by the OTS, the Commonwealth Court addressed a proposed automatic adjustment clause for recovery of wastewater capital costs. It, however, drew a sharp distinction between the recovery of capital costs and recovery of identifiable expenses (such as purchased water expense) holding that a Section 1307(a) automatic adjustment clause is appropriate for easily identifiable expenses that are beyond the

³ After Aqua withdrew its proposed PWAC, the Commission, in its Opinion and Order entered July 31, 2008, at Docket No. R-00072711, mimeo at 80, made it clear that its decision was without prejudice to Aqua's right to propose a purchased water adjustment in the future and that any legal issues presented by such a proposal would be addressed at that time.

⁴ NAWC purchases water from BCWSA. Although perhaps not strictly a government entity, BCWSA is a municipal corporation formed by Bucks County. BCWSA purchases the water it sells to NAWC from the City of Philadelphia. The City is clearly a government entity. The water is supplied from the City's large Baxter Water Treatment Plant on the Delaware River.

utility's control. These are precisely the characteristics of NAWC's purchased water expense as outlined by the OTS in the passage from its Main Brief reproduced above.

C. Commission Precedent Supports NAWC's PWAC

Citing the Commission's Regulation at 52 Pa. Code § 53.54, the OTS argues that there is no Commission precedent supporting NAWC's PWAC. The Commission's Regulation at 52 Pa. Code § 53.54 is, however, clear evidence of the Commission's statutory authority to implement an automatic adjustment clause for recovery of purchased water expense.

The Regulation also contradicts any argument by the OTS that implementation of an automatic adjustment clause does not extend to purchased water expense but, instead, is limited to expenses specifically identified in the subsections of Section 1307⁵ as well as the further argument of the OTS that an automatic adjustment clause results in single issue ratemaking.⁶ Contrary to these arguments, the Regulation specifically contemplates a purchased water adjustment clause and nowhere does the Regulation cite single issue ratemaking as an impediment to the implementation of such a clause.

In *Popowsky v. Pa. P.U.C.*, *supra* at 1156, cited by the OTS at page 12 of its Main Brief, the Court explained as follows:

Indeed, the very function of the typical automatic adjustment clause is to permit rapid recovery of a specific, identifiable expense item, with a more comprehensive analysis upon reconciliation of actual costs with previously projected costs used to establish the effective rate. The initial process is essentially a mathematical review of the projections provided by the public utility. Therefore, there is no initial review to determine the appropriateness or necessity of the rate request. (Emphasis in original).

Popowsky does not suggest, in any way, that Section 1307 is inappropriate for larger utilities. Instead, *Popowsky* explains that the very function of Section 1307, for

⁵ See OTS Main Brief at 7-9.

⁶ See OTS Main Brief at 4-6.

all utilities, is to permit rapid recovery of a *specific, identifiable expense item*, with a more comprehensive analysis upon reconciliation of actual and projected costs. Consistent with *Popowsky*, NAWC's PWAC proposes the rapid recovery of purchased water expense increases - - a *specific, identifiable expense item* - - with a more comprehensive analysis upon reconciliation of actual and projected costs.

Finally, in the 1994 Bethel Township Water Company proceeding at Docket No. R-00932964, cited at page 13 of the OTS Main Brief, the utility was given the option of accepting a lesser increase than it originally sought. The utility's tariff, at that time, did not include a purchased water surcharge. Subsequently, however, as part of a 1996 proceeding, the Commission allowed United Water Bethel to place a purchased water adjustment clause in its tariff. OCA witness Kraus described Bethel as the only utility in Pennsylvania, to her knowledge, with a purchased water adjustment clause in its tariff.⁷

D. The Lack of a PWAC Has Had a Serious Detrimental Effect on NAWC's Financial Health

NAWC currently purchases approximately 57% of its water supply. On a dollar basis, NAWC's total annual revenue requirement is approximately \$4,657,000 of which \$1,120,000 is purchased water expense.⁸ When BCWSA last increased its purchased water rate, NAWC experienced an increase in its *monthly* purchased water expense of approximately \$23,000; equal to \$276,000 on an annual basis. The suggestion that this expense is the norm for Pennsylvania water utilities or that this expense increase could be offset by an increase in revenue or decreases in other expenses borders on the absurd.

⁷ N.T. 148-150; NAWC Main Brief at 23.

⁸ See NAWC St. No. 1R, Schedule 1, page 1 of 2.

Contrary to the position of the OTS,⁹ it is entirely appropriate to compare NAWC with other Pennsylvania water utilities, including those utilities that do not have a purchased water supply. Most Pennsylvania utilities do not purchase water and, thus, have no need for a purchased water automatic adjustment clause. NAWC does purchase water and the significant level of its purchases justify the implementation of a purchased water adjustment clause for all the reasons presented in NAWC's Main Brief and in this Reply Brief.

Contrary to the further position of the OTS,¹⁰ NAWC's position is not an expression of dissatisfaction in the settlement of its 2008 general rate proceeding. In the Company's Statement in Support of the Settlement, we did, however, point out the need for expeditious Commission action to enable the Company to begin to recover the increased BCWSA rate on a going forward basis as follows:

**Request for Expeditious Commission Action
As a Result of Increased Purchased Water Costs**

9. NAWC respectfully requests that the Commission act expeditiously to allow NAWC to implement the settlement rates as quickly as possible and respectfully submits that it is imperative that the Commission do so. NAWC purchases approximately 60% of its water supply from the Bucks County Water and Sewer Authority. The Authority increased its rates for purchased water by approximately \$285,000, or 24.8%, annually, effective July 1, 2008. The Company received only two months advance notice of the increase and, as a result of the Authority's rate change, has been paying approximately \$23,000 per month in increased purchased water costs for the past seven (7) months. NAWC St. No. 1 at 5. The Company needs expeditious rate relief to continue to meet its purchased water obligation. See *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, Docket No. R-00072711, Order entered July 31, 2008, slip op. at 22-24, where the Commission reopened the record of a then pending general rate proceeding of Aqua Pennsylvania, Inc. to reflect the impact of the Authority's rate increase.¹¹

⁹ See OTS Main Brief at 14-16.

¹⁰ See OTS Main Brief at 16-20.

¹¹ OCA Cross Examination Exhibit No. 1.

NAWC's dissatisfaction is with the significant Lost Purchased Water Expense that it has experienced and will continue to experience in the absence of a just and reasonable PWAC. NAWC's PWAC should be approved for all the reasons presented in NAWC's Main Brief and in this Reply Brief.

E. Interest on Over and Under Collections

Anticipating that the Commission may approve the Company's PWAC, OTS proposes that the interest component be one-directional with interest calculated on overcollections only and at the residential mortgage rate. OTS provides no statutory or regulatory citation in support of one-directional interest. If the Commission disagrees with the Company's interest proposal then no interest should be levied on either under or over collections.

III. REPLY TO THE MAIN BRIEF OF THE OFFICE OF CONSUMER ADVOCATE

A. Introduction

The OCA presents a direct challenge to the Commission's authority under Section 1307 to implement an automatic adjustment clause for purchased water expense. It states that the "primary issue" is whether the Commission has the authority to approve a "surcharge recovery of purchased water expense increases pursuant to the general Section 1307(a) provision."¹²

The Commission has never doubted its authority under Section 1307. It has, for example, approved automatic adjustment clauses for Pennsylvania American Water Company for recovery of both water and wastewater system improvements.¹³ Although its decision approving the wastewater system charge was reversed in *Popowsky v. Pa. P.U.C.*, *supra*, the Commonwealth Court, in doing so, made it as clear as it possibly could that an automatic adjustment clause for a specific, identifiable expense was allowed by Section 1307.

The Commission's authority to implement an automatic adjustment clause for recovery of an identifiable expense, such as purchased water expense increases, is clear and obvious.¹⁴ Ultimately, the OCA may seek judicial review of the Commission's decision here approving NAWC's PWAC but that possibility should not deter the

¹² OCA Main Brief at 12.

¹³ See Section II.A. *supra* and NAWC's Main Brief, Section V.A.

¹⁴ At its base line level, the position of the OCA would appear to be that the Commission has no authority under Section 1307(a) to implement an automatic adjustment clause except where the recovery of the expense is expressly authorized by statute. This position would be inconsistent with *Popowsky v. Pa. P.U.C.*, *supra*, at 1160, where the Court explained that a Section 1307(a) automatic rate adjustment is appropriate not only where expressly authorized *but also* for easily identifiable expenses that are beyond a utility's control. In addition to being inconsistent with *Popowsky*, the position of the OCA would render Section 1307(a) a statutory nullity.

Commission from exercising its authority and approving NAWC's just and reasonable Section 1307 cost recovery mechanism.¹⁵

B. NAWC's PWAC Is Lawful Under Section 1307(a)

1. Popowsky and Pennsylvania Industrial Energy Coalition

Citing *Popowsky v. Pa. P.U.C.*, *supra*, the OCA contends that NAWC's PWAC is not lawful under Section 1307(a). *Popowsky* dealt, however, with recovery of capital costs, not expenses. For expenses, the Court explained that a Section 1307 automatic rate adjustment is appropriate for "easily identifiable expenses that are beyond a utility's control." The increased purchased water expense that NAWC would recover through its PWAC is an easily identifiable expense that falls squarely within the Court's definition and which is appropriately recovered through a Section 1307(a) automatic adjustment clause.

In *Pennsylvania Indus. Energy Coalition v. Pa. P.U.C.*, *supra*, also cited by the OCA, the Court explained that the concept of single issue ratemaking is inapplicable to a Section 1307 surcharge.¹⁶ The Court also addressed the use of an automatic adjustment clause to recovery a "specific *identifiable* expense item" as follows:

In *National Fuel Gas Distribution Corp. v. Pennsylvania Public Utility Commission*, 81 Pa.Commonwealth Ct. 148, 171-72, 473 A.2d 1109, 1121 (1984), we held that the purpose of this section was to permit reflection in customer charges of changes in one component of a utility's cost of providing public service without the necessity of the broad, costly and time-consuming inquiry required in general rate cases and the

¹⁵ In the Introduction Section of its Main Brief, pages 1 and 2, the OCA expresses concern that approval of NAWC's PWAC would open the door to the recovery of any expense through an automatic adjustment clause. This concern is not rational and not supported by the evidence of record. NAWC's circumstances concerning purchased water expense are atypical. The Company's percentage of purchased water expense compared to revenue falls in the upper 96th percentile of the PA Water Industry. Further, the Company's percentage of purchased water expense compared to O&M falls in the upper 94th percentile of the PA Water Industry. NAWC has an average percentage of purchased water expense compared to revenue or O&M that is eight to ten times *greater* than the PA Water Industry. NAWC St. No. 1R at 8.

¹⁶ See Section II.A, *supra*, and NAWC's Main Brief at 27-28.

automatic provision does not eliminate the requirement for approval of revisions in the charges by the PUC. To be appropriate for automatic adjustment, the Industrial Coalition argues, the costs must be large in magnitude in relation to the utility's rate base, volatile, like fuel costs, specifically identifiable, and beyond the control of the utility, which it argues is unlike DSM program costs. It asserts that the statute is only applicable to fuel costs and certain taxes as it has already been applied by the PUC. It cites *Masthope Rapids Property Owners Council v. Pennsylvania Public Utility Commission*, 135 Pa. Commonwealth Ct. 437, 581 A.2d 994 (1990). In *Masthope*, we held that a water utility could not recover the principal and interest of a loan received under the Water Facilities Restoration Act, 32 Pa.C.S. §§ 7501-7518, through an automatic adjustment of rates because Section 1307 did not provide the necessary review required by the Water Act. We stated:

[T]he automatic adjustment of public utility rates may only occur in certain limited instances.... Section 1307 has been customarily employed, for example, as the statutory predicate for the implementation of electric cost rates by certain electric utilities, ... and is also employed for recovery of natural gas costs by natural gas utilities. Further, in all such proceedings the Commission's review is appropriately characterized as preliminary and cursory. Indeed, the very function of the typical automatic adjustment clause is to permit rapid recovery of a specific identifiable expense item, with a more comprehensive analysis upon reconciliation of actual costs with previously projected costs used to establish the effective rate. The initial process is essentially a mathematical review of the projections provided by the public utility. Therefore, there is no initial review to determine the appropriateness or necessity of the rate request.

Id. at 447-48, 581 A.2d at 999-1000 (emphasis in original).

Although we agree that Section 1307 should have limited application and the PUC should not use it to disassemble the traditional rate-making process, 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.¹⁷

NAWC's PWAC is lawful under Section 1307 for all the reasons presented in

NAWC's Main Brief and this Reply Brief.

¹⁷ *Pennsylvania Indus. Energy Coalition*, 653 A.2d at 1348-49 (footnotes omitted).

2. Business Risk Consideration Does Not Result in a “Double Recovery”

At pages 18 through 21 of its Main Brief, the OCA contends that the relationship between risk and the setting of a fair return would afford the utility “what is tantamount to a ‘double recovery’” if the Commission were to approve NAWC’s PWAC. NAWC has incurred approximately \$400,000 in Lost Purchased Water Expenses as a result of the last two BCWSA rate increases. There has been no risk adjustment made or proposed to NAWC’s equity return in its general rate proceedings that could have or would have compensated NAWC in any way for this significant lost expense. On an annual basis, the adjustment, if it existed or had been proposed, would have had to approach 4 percentage points to compensate the Company for the lost \$400,000.¹⁸

If the prospect of “double recovery” existed, NAWC’s experienced return would not have suffered as a result of the Lost Purchased Water Expense. The facts show, however, that return did suffer, and suffer significantly. Return fell to 6.9% for the five years ended 2008 when opportunity equity returns allowed by the Commission were 10% or higher. The experienced return reflects the impact of Lost Purchased Water Expense but it does not reflect any adjustment for the risk of the loss. As a result of the Lost Purchased Water Expense, shareholders are being denied their constitutional opportunity for a fair return.

C. NAWC’s PWAC Does Not Constitute Single Issue Ratemaking and Purchased Water Costs to NAWC Are Abnormal, Extraordinary and Non-Recurring

Similar to OTS, OCA challenges the PWAC as impermissible single issue ratemaking. As set forth above, in reply to the OTS, the Commission has never viewed the principle of “single issue ratemaking” as an impediment to the implementation of an

¹⁸ See NAWC Main Brief at 10-14.

automatic adjustment clause under Section 1307. The General Assembly, moreover, has not enacted “single issue ratemaking” as a prohibition to the exercise of Section 1307.¹⁹ In *Pennsylvania Indus. Energy Coalition v. Pa. P.U.C.*, *supra* at 1349-50, the Commonwealth Court explained that the doctrine of single issue ratemaking is inapplicable when, as here, a surcharge is permitted under the Code, with procedures to determine the reasonableness of the charges outside of a base rate case.

Although the baseline, annualized cost of purchased water at the most recent price is considered as part of the traditional, Section 1308(d) general rate filing, the increases that occur subsequently between general rate filings are not considered. *Those increases, in the form of Lost Purchased Water Expense, are never recovered from customers and are forever borne by Company shareholders.* These Lost Purchased Water Expenses are significant as explained over the course of this proceeding. They approximate \$400,000 just as a result of the immediately prior two BCWSA rate increases. Contrary to the argument of the OCA, these increases are never considered or recovered under the Section 1308 cost recovery mechanism.

As part of its Section C argument, the OCA contends that NAWC has the ability to offset additional purchased water costs by managing other expenses and operations and that, while the Company cannot control the price that BCWSA charges, it can control the level of the purchased water expense. This contention fails to grasp the significance of the take-or-pay provision of Section 4 of the Agreement with BCWSA which requires NAWC to take or pay for one million gallons a day.²⁰ The take-or-pay

¹⁹ The only statutory requirement of Section 1307(a) is that the automatic adjustment clause provide a just and reasonable return on the rate base of the public utility to be determined upon such equitable or reasonable basis as shall provide such fair return. 66 Pa. C.S. § 1307(a).

²⁰ 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. A copy of the Order is attached to this Reply Brief as Attachment A. NAWC witness Forsyth addressed the take-or-pay clause at transcript pages 112-114.

clause precludes the Company from controlling the level of purchases as suggested by the OCA. As required by the take-or-pay clause, NAWC must pay for 1,000,000 gallons per day whether it takes 5 gallons or 1,000,000 gallons.²¹

The OCA also speculates that a PWAC could act as a disincentive to control purchased water. NAWC has an exemplary program of leak repair and system maintenance that will continue irrespective of its PWAC.²² If anything, NAWC's repair and maintenance should assure the Commission that, 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.

D. Commission Regulations and Orders Support NAWC's PWAC

1. Commission Regulation at 52 Pa. Code § 53.54

At page 26 of its Main Brief, the OCA begins a lengthy discussion of the Commission's Regulation at 52 Pa. Code § 53.54 which allows purchased water cost adjustment - - sliding scale of rates - - for small water utilities. The OCA's discussion fails to grasp the import of the Regulation.

The Regulation is significant because it clearly shows that the Commission itself recognizes that it has the statutory authority to implement purchased water adjustment clauses. No mention is made by the Commission of single issue ratemaking or any other legal impediment to the exercise of Section 1307 and the implementation of purchased water adjustment clauses.

²¹ The last increase in BCWSA purchased water expense was approximately \$23,000 per month; \$276,000 on an annual basis. Realistically, there is no other expense or combination of expenses that could have offset this significant expense increase. OCA witness Kraus had no idea of the number of customers that would have to be added to offset increases in purchased water expense. Ms. Kraus also did not know which expenses might be decreased to offset an increase although she acknowledged that probably no one expense would have offset a \$200,000 annual increase in purchased water expense. N.T. 155.

²² NAWC's normal maintenance practices are discussed by Company witness Forsyth at transcript pages 110-111.

There is, moreover, no threshold level of purchased water required by the Commission for a small water utility to implement the charge. The utility also need not show that it is in need of extraordinary rate relief to implement a purchased water adjustment clause. The arguments raised in opposition to NAWC's PWAC are not recognized by the Commission.

2. Other Case Law and Regulatory Precedent

At pages 32 through 34 of its Main Brief, the OCA discusses several cases cited by NAWC in support of its PWAC. These cases and their import are addressed in Section V.B of NAWC's Main Brief. NAWC submits that the statutory authority, case law and other regulatory precedent cited and discussed in Section V.B. of its Main Brief support NAWC's PWAC as consistent with statutory criteria.

The OCA again contends in these pages that NAWC can control the level of purchased water expense. As discussed above in Section III.C. of this Reply Brief, this contention fails to grasp the significance of the take-or-pay provision of Section 4 of the Agreement with BCWSA which requires NAWC to take or pay for one million gallons a day of purchased water.

OCA argues further at pages 32 and 33 of its Main Brief that there is a link between the risk of lost purchased water expense and the Company's management efforts to minimize purchased water and that an automatic adjustment clause could work as a disincentive to continue its good management practices. NAWC does, indeed, exercise good management practices. Those practices will not cease upon the implementation of its PWAC. If anything, NAWC's good management practices should assure the Commission that, 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.

At page 33 of its Main Brief, the OCA argues that the Company is attempted to locate other well sources, suggesting that the Agreement with BCWSA might be supplanted. The lower cost alternatives that the Company has been exploring and that are the subject of footnote 3 of the OCA Main Brief 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.²³

3. United Water Bethel

At hearing, OCA witness Kraus was asked if she was aware of any purchased water adjustment clauses in place for a water company. She responded, without hesitation, that she believes "that the only one in place is United Water Bethel."²⁴ At pages 34 through 38 of its Main Brief, the OCA now contends in spite of Ms. Kraus's testimony that Bethel has a "surcharge" but not a purchased water adjustment clause.²⁵

The OCA's attempt to distinguish Bethel is not convincing. A surcharge exists in the tariff of United Water Bethel. The fact that no one complained against it does not mean that the surcharge is contrary to the Public Utility Code. On the contrary, the only

²³ The escalator is mentioned, for example, in the Commission's Order entered August 6, 2009, at Docket No. P-2009-2109670, which is included as part of Appendix B to the OCA's Main Brief. As explained at page 2 of that Order, the Company's Agreement with BCWSA is a take-or-pay agreement with an escalation clause. As further explained at page 2 of the Order, 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.

²⁴ N.T. 148. See also N.T. 149.

²⁵ At page 36 of its Main Brief, the OCA states that a "surcharge" was first mentioned in 1996. The 1996 proceeding at Docket No. R-00963804 is the proceeding cited by the Company in its Main Brief in support of the proposed PWAC.

reasonable conclusion, once again, is that the Commission favors the surcharge recovery of purchased water expense.²⁶

²⁶ The OCA suggests that "short-form" base rate filings are a possible way to recover BCWSA purchased water expense increases. "Short-form" base rate filings do not provide the opportunity for expedited resolution as do Section 1307 automatic adjustment clauses. A "short-form" filing would still be subject to a statutory six or seven month suspension period. If the filing were submitted by Petition, it might not have any statutory deadline. The reasonable and appropriate resolution for dealing with purchased water expense increases is a Section 1307 automatic adjustment clause.

IV. 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. Supplement No. 68 and the proposed Purchased Water Adjustment Clause should be approved as filed.

Respectfully submitted,

By 

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DATED: January 15, 2010
NAWC Reply Brief (Final).wpd

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SECRETARY'S BUREAU

Attachment A

PENNSYLVANIA
PUBLIC UTILITY COMMISSION
Harrisburg, PA 17120

Public Meeting held July 6, 1984

Commissioners Present:

Linda C. Taliaferro, Chairman
Michael Johnson
James H. Cawley
Frank Fischl
Bill Shane

Petition of Newtown Artesian Water Company
and Indian Rock Water Company to (1) Approve
their June 7, 1984 Agreement with Bucks County
Water and Sewer Authority which will Supplement
their Water Supply to Serve the Golden Acres
Residences in Newtown Township, Bucks County,
(2) Grant Special Permission to File Tariff -
Water Pa. P.U.C. No. 2, Consisting of an
Agreement Between Indian Rock Water Company
and FPA Corporation, and (3) Accept Tariffs
Eliminating Main Extension Refund Obligations
for Developments in Excess of Five Homes.

P-840513

O R D E R

BY THE COMMISSION:

On June 12, 1984, Newtown Artesian Water Company (Newtown) and its wholly-owned subsidiary Indian Rock Water Company (Indian Rock) filed a petition with the Commission seeking approval of a public utility municipal corporation (PUMC) agreement, dated June 7, 1984, between Newtown and Indian Rock and the Bucks County Water and Sewer Authority (Authority), special permission to file, on one day's notice, on or before July 15, 1984, Tariff Water-Pa. P.U.C. No. 2, consisting of an agreement, dated June 7, 1984, between Indian Rock and FPA corporation (a developer), and acceptance of tariff supplements eliminating main extension refund obligations for developments in excess of five homes. For the reasons set forth herein, we will, inter alia, approve the PUMC agreement between Newtown and Indian Rock and the Authority and direct that a certificate of filing be issued by July 15, 1984, treat the petition of Indian Rock for special permission to file Tariff Water-Pa. P.U.C. No. 2 on one day's notice, on or before July 15, 1984, as a petition for declaratory order to remove uncertainty as to the propriety of filing the agreement between Indian Rock and FPA Corporation (FPA) as a tariff, answer the question in the negative, but recognize the filing of that agreement and approve that agreement to the extent required to validate the PUMC agreement, approve the waiver of Indian Rock's tariff provision which would otherwise provide for main extension refunds to FPA, direct Indian Rock to file semiannual reports to monitor its rate of return, and sever the question of the reasonableness of the tariff supplements from this proceeding.

The PUMC agreement between Indian Rock and Newtown and the Authority provides for the eventual purchase by Newtown and Indian Rock of a minimum one million gallons of water per day from the Authority. As stated in the utilities' petition, this water supply is required to meet the present and future needs of their customers and to provide a water source for a new 1,751 - unit residential subdivision ("Golden Acres") in Newtown Township, Bucks County. The present rate to be charged by Authority for the water is approximately 64¢ per thousand gallons of water, which is the same rate charged to Authority's other wholesale customers in its southwest water system.

The Authority will, at its sole cost and expense, extend its facilities to the edge of Indian Rock's franchise area in Newtown Township and Indian Rock will then extend its facilities to that point. The costs of the Indian Rock extension will, under the terms of the Indian Rock/FPA agreement, be paid for by FPA. FPA is also responsible for the costs associated with extending service to the new Golden Acres development. FPA has agreed to fund an escrow account for \$3,340,550, which is the estimated maximum project cost, and to have \$500,000 of said escrow funds on deposit at all times.

Indian Rock and Newtown estimate that their combined average daily demand for water is 650,000 gallons per day, notwithstanding the water demand associated with the Golden Acres development. While the PUMC agreement requires the utilities to eventually^{1/} purchase a minimum of one million gallons of water per day from the Authority, FPA has agreed to pay the difference between the anticipated 650,000 gallon daily demand and the one million gallons per day required to be purchased pursuant to the PUMC agreement. To assure payment by FPA, FPA will add \$534,095 to the escrow account, which amount represents the estimated maximum liability to be incurred by FPA due to its obligation to pay for the excess water supply during the construction phase of the project. This \$534,095 is calculated to reflect the decrease in FPA's liability as new customers from Golden Acres are added to Indian Rock's system. FPA has also agreed to waive the main extension refunds to which it would otherwise be entitled under Indian Rock's tariff.

The PUMC agreement is subject to the filing of that agreement as well as the agreement between Indian Rock and FPA with this Commission as part of the Indian Rock's tariff, or otherwise, and our approval of both the PUMC agreement and the agreement between Indian Rock and FPA. By its terms, the PUMC agreement will become null and void unless approved by this Commission on or before July 15, 1984. The tariff supplements involving the elimination of main extension refunds, which were filed simultaneously with the PUMC agreement and the Indian Rock/FPA agreement, do not require our action by July 15, 1984.

^{1/} In accordance with the PUMC agreement, the utilities obligation to purchase a minimum of one million gallons of water per day does not commence until either July 1, 1985 or the completion of the inter-connection between Indian Rock and the Authority, whichever occurs last.

The PUMC agreement provides a needed additional water supply for the present and future customers of Newtown Artesian and Indian Rock. The PUMC agreement also provides a more secure source of water for a minimum forty-year term and will enhance operational flexibility. Indian Rock and Newtown may now be able to rest their overworked production wells and use them only as needed during periods of peak demand.

The agreement between Indian Rock and FPA provides for the payment by FPA of the entire cost associated with extending Indian Rock's facilities to connect with the Authority's facilities at the edge of Indian Rock's franchise area. FPA will also pay the entire cost of providing service to its Golden Acres development and has agreed to waive main extension refunds. These actions serve to protect existing and future ratepayers from the inclusion of various capital costs in rate base. FPA will also pay the difference between the anticipated daily water demand of the utilities and the one million gallons per day required to be purchased under the PUMC agreement.

We conclude that, based on the facts presented in the Petition, approval of both the PUMC agreement and the agreement between Indian Rock and FPA is in the public interest. However, we are concerned that the eventual increase of Indian Rock's customer base by more than 175%^{2/}, without a concomitant increase in rate base, could result in a higher rate of return for Indian Rock than permitted by the Commission in Indian Rock's last rate case. Therefore, we shall direct Indian Rock to submit semiannual income statements, balance sheets, and rate of return calculations, so that the rate of return can be monitored.

Indian Rock has filed the Indian Rock/FPA agreement as its proposed tariff (Tariff Water - Pa. P.U.C. No. 2). This agreement sets forth the terms and conditions under which water service will be extended to the Golden Acres development. It does not provide the terms and conditions under which water service will be provided to the public but instead focuses primarily upon the developer's financing of the extension. While such matters are clearly relevant inquiry for a rate proceeding, they are not appropriately filed as a utility's tariff. We note, however, that scrutiny of the Indian Rock/FPA agreement is helpful in ascertaining the reasonableness of the PUMC agreement.

The PUMC agreement does not require that the Indian Rock/FPA agreement be filed and approved by the Commission as a tariff in order for the PUMC agreement to be validated. It only requires the filing of the Indian Rock/FPA agreement as a tariff or otherwise and acceptance of this agreement by this Commission. We shall treat the petition of Indian Rock for special permission to file Tariff Water - Pa. P.U.C. No. 2 as a petition for declaratory order, pursuant to 66 Pa. C.S. §331(f), to remove uncertainty as to the propriety of filing the Indian Rock/FPA agreement as a tariff, and shall remove the uncertainty by determining that it is not proper to file the agreement as a tariff. We shall, however, recognize the filing of the agreement and, based on the facts presented in the Petition, grant our approval and acceptance of the agreement to the extent required to validate the PUMC agreement beyond July 15, 1984.

^{2/} Indian Rock presently serves approximately 1,000 customers. The Golden Acres development, when completed, would add another 1,751 customers to that total.

In addition, we note that FPA has, under the terms of the agreement, waived the main extension refunds to which it would otherwise have been entitled under Section 55(b) of Indian Rock's tariff (see Supplement No. 4 to Water-Pa. P.U.C. No. 1, first revised page No. 16, cancelling original page No. 16). Since this action involves a waiver of a tariff provision, we must authorize this waiver and will do so.

Simultaneously with the filing of the PUMC agreement and the Indian Rock/FPA agreement, Indian Rock and Newtown Artesian filed tariff supplements (Indian Rock Water Company Supplement No. 8 to Tariff Water-Pa. P.U.C. No. 1 and Newtown Artesian Water Company Supplement No. 39 to Tariff Water-Pa. P.U.C. No. 6) proposing the elimination of main extension refund obligations for developments in excess of five homes. These tariff supplements do not require our action by July 15, 1984 but instead are scheduled to become effective on August 11, 1984, unless suspended for investigation. Since there is insufficient information to ascertain the reasonableness of these supplements and there is no need for an immediate ruling, we shall sever the question of the reasonableness of these tariff supplements from this proceeding and direct the assigning of a separate "R" docket number.

We have determined that, on the basis of the facts presented by the petition, approval of the PUMC agreement is in the public interest, reporting requirements are indicated, FPA's waiver of main extension refunds should be permitted, and the question of the reasonableness of the tariff supplements should be severed from this proceeding; THEREFORE,

IT IS ORDERED:

1. That the agreement between Indian Rock Water Company and Newtown Artesian Water Company and Bucks County Water and Sewer Authority, (PUMC agreement) dated June 7, 1984, is hereby approved and accordingly, a certificate of filing shall be issued on or before July 15, 1984.

2. That the Petition of Indian Rock Water Company for special permission to file Tariff Water-Pa. P.U.C. No. 2 on one day's notice, on or before July 15, 1984, be treated as a petition for declaratory order to remove uncertainty as to the propriety of filing the agreement between Indian Rock Water Company and FPA Corporation as a tariff.

3. That the question of the propriety of the filing of the agreement between Indian Rock Water Company and FPA Corporation as a tariff be answered in the negative, but that the filing of that agreement with the Commission be recognized and, based on the facts presented in the Petition, that acceptance of that agreement be granted to the extent required to validate the agreement beyond July 15, 1984.

4. That no approval granted by the Commission herein shall be construed as approval, for rate-making purposes, of the reasonableness of any costs incurred pursuant to the PUMC agreement or the Indian Rock/FPA agreement.

5. That the waiver of main extension refunds by FPA Corporation, which constitutes a waiver of Section 55(b) of Indian Rock Water Company's duly-filed tariff, be and is hereby approved.

6. That beginning with the six-month period, on a calendar year basis, (i.e. January 1 - June 30; July 1 - December 31) in which water service is commenced by Indian Rock to its first residential customer in the Golden Acres development, Indian Rock Water Company shall, within ninety days of the end of each six-month period, submit to the Commission its income statements, balance sheets, and a calculation of its rate of return for that six-month period.

7. That the question of the reasonableness of Indian Rock Water Company Supplement No. 8 to Tariff Water-Pa. P.U.C. No. 1 and Newtown Artesian Water Company Supplement No. 39 to Tariff Water-Pa. P.U.C. No. 6 be severed from this proceeding and be assigned a separate "R" docket number.

8. That this Order be entered on the same day that it is adopted by the Commission.

BY THE COMMISSION,

A handwritten signature in cursive script, appearing to read "Jerry Rich", written over a horizontal line.

Jerry Rich
Secretary

(SEAL)

ORDER ADOPTED: July 6, 1984

ORDER ENTERED: July 6, 1984

**Before The
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

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

CERTIFICATE OF SERVICE

I hereby certify that I have this 15th day of January 2010, served a true and correct copy of The Newtown Artesian Water Company's Reply Brief, upon the persons and in the manner indicated below:

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Pennsylvania Public Utility Commission
801 Market Street
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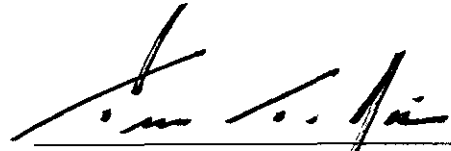
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