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April 8, 2014

Via Electronic Filing

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
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In re: Docket No. P-2013-2366873, *et al.*
Petition of Little Washington Wastewater Company – DSIC

Dear Secretary Chiavetta:

We are counsel to Little Washington Wastewater Company in the above matter and, in accordance with Judge Colwell's Scheduling Order dated October 8, 2013, are submitting the Company's Reply Brief via electronic filing. Copies of the Company's 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

cc: Certificate of Service (w/encl.)
The Honorable Susan D. Colwell (w/encl.)
Mary McFall Hopper, Esquire (w/encl.)

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Petition of Little Washington Wastewater Company : **P-2013-2366873**
(LWWC) for Approval of its Long-Term Infrastructure :
Improvement Plan :

Petition of Little Washington Wastewater Company : **P-2013-2366873**
(LWWC) for Approval of a Distribution System :
Improvement Charge :

Office of Consumer Advocate :

v. :

C-2013-2369886

Little Washington Wastewater Company :

**REPLY BRIEF OF
LITTLE WASHINGTON WASTEWATER COMPANY**

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Date: April 8, 2014

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I. INTRODUCTION

This proceeding involves the Petitions of Little Washington Wastewater Company (“LWWC” or “Company”) for approval of its Long Term Infrastructure Improvement Plan (“LTIIIP”) (“LTIIIP Petition”) and Distribution System Improvement Charge (“DSIC”) (“DSIC Petition”). In its Order entered September 12, 2013, the Public Utility Commission (“Commission”) found that LWWC’s DSIC “complies with the requirements of Act 11 and our Final Implementation Order ... and [is not] inconsistent with the applicable law or Commission policy.”¹ The Commission allowed LWWC to implement a DSIC mechanism “subject to recoupment and/or refund pending final resolution” and assigned the following issues to the Office of Administrative Law Judge for hearing and preparation of a recommended decision:

- a. Impact of accumulated deferred income taxes associated with DSIC investments; and
- b. Calculation of the state income tax component of the DSIC revenue requirement.²

The appropriate resolution of these issues is clear and obvious. As addressed in the Company’s Main Brief, the ADIT and state income tax adjustments proposed by the OCA to the Company’s DSIC calculation are inconsistent with the plain language of Act 11 and its legislative history, the historic calculation of water DSICs in Pennsylvania and, significantly, the Commission’s Final Implementation Order entered August 2, 2012, where the Commission rejected (and adopted a model tariff rejecting) the two adjustments.³ The OCA’s adjustments are also inconsistent with the Recommended Decision of Administrative Law Judges Hoyer and

¹ *Petition of Little Washington Wastewater Company*, Docket No. P-2013-2366873 (Opinion and Order entered September 12, 2013) (“Order entered September 12, 2013”) at 43.

² Order entered September 12, 2013 at 44-45.

³ *Implementation of Act 11 of 2012*, Docket No. M-2012-2293695 (Final Implementation Order entered August 2, 2012) (“*Final Implementation Order*”) at 31 and 38-39.

Watson, dated February 25, 2014, in *Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge*, Docket No. P-2012-2338282 (*“Columbia DSIC Recommended Decision”*).

LWWC submits this Reply Brief in accordance with the litigation schedule memorialized in the Scheduling Order dated October 8, 2013. The Company’s Reply Brief is supplemental to its Main Brief and is limited to those matters which require additional discussion as a result of the Main Brief filed by the OCA. The Section II subsections to the Company’s Reply Brief correspond, generally, to Section II and the Section IV subsections to the OCA’s Main Brief.

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

A. Burden of Proof – Legal Standard

The OCA contends that LWWC bears the burden of proof to establish the justness and reasonableness of every element of its proposed DSIC and that its burden is “formidable.”⁴

Although the Company acknowledges that it has the burden of proof, we point out that the Commission already found, in its Order entered September 12, 2013, that the Company’s DSIC “complies with the requirements of Act 11 and the Final Implementation Order,”⁵ while referring only two issues for hearing and recommended decision. As addressed by the Company in its Main Brief, LWWC has met its burden and demonstrated by a preponderance of substantial evidence that its DSIC (as modified by the Joint Stipulation Addressing Application of Distribution System Improvement Charge to Contract Customers and Woodloch Pines) is consistent with the requirements of Act 11 and the Public Utility Code.⁶

The OCA’s characterization of the Company’s burden as “formidable” is an incorrect statement of the law. Section 332(a) of the Public Utility Code requires the proponent of a rule or order “to bear the ultimate burden of persuading the Commission, by a preponderance of substantial evidence, that the relief sought is proper and justified under the circumstances.”⁷ “Formidable” is not part of either the statutory or the case law definitions of “burden of proof.”

The OCA’s characterization of the burden as “formidable” also ignores the findings and conclusions expressed by the Commission in the *Final Implementation Order*. The OCA has failed to demonstrate why the Commission should adopt adjustments to the DSIC calculation

⁴ OCA Main Brief at 5-6.

⁵ Order entered September 12, 2013 at 43.

⁶ LWWC Main Brief at 8.

⁷ 66 Pa. C. S. § 332(a). *Motheral, Inc. v. Duquesne Light Co.*, 95 Pa. P.U.C. 261 (2001) (citing *Se-Ling Hosier v. Margulies*, 70 A.2d 854 (Pa. 1954); see also LWWC Main Brief at 8.

formula that were not adopted by the Commission in the *Final Implementation Order* or included by the Commission in the model tariff.

B. Accumulated Deferred Income Taxes

1. Introduction

In support of its proposal to include the ADIT balance in the DSIC calculation, the OCA presents the same arguments previously rejected by the Commission in its *Final Implementation Order* and by Judges Hoyer and Watson in their *Columbia DSIC Recommended Decision*.⁸ Language from the *Final Implementation Order* and the *Columbia DSIC Recommended Decision* explaining the rationale for rejecting the OCA's adjustment is reproduced at length in the Company's Main Brief.⁹

In the introductory section of its discussion of the ADIT issue, the OCA states that the "bottom line" is that rates charged to LWWC's customers must be calculated correctly – whether they are base rates or surcharge rates."¹⁰ While it is true that rates should be "calculated correctly," the OCA's unwillingness to acknowledge a difference between base rates and surcharge rates is a critical failing in its legal analysis. The DSIC surcharge mechanism is an exception to traditional base rate procedures as recognized and addressed at length by Judges Hoyer and Watson in their *Columbia DSIC Recommended Decision* as follows:

Columbia correctly asserts, because the DSIC surcharge mechanism is an exception to traditional base rate procedures, correct statutory interpretation requires that the adjudicating body look at what has expressly been provided in the statute. In this instance, the DSIC statute provides the elements for the DSIC mechanism, which is a mechanism distinct from the 1308(d) base rate mechanism. The DSIC statute is designed to accomplish a different goal than the

⁸ Although issued on March 6, 2014, prior to the filing of Main Briefs on March 11, 2014, the OCA, a party to the Columbia DSIC proceeding at Docket No. P-2012-2338282, did not address the *Columbia DSIC Recommended Decision* in its Main Brief.

⁹ See, for example, LWWC Main Brief at 9-11.

¹⁰ OCA Main Brief at 9.

1308(d) mechanism, and therefore has different adjustments associated with it. The OCA's proposed adjustments are not provided for in the statute. The plain language of the statute does not provide for the OCA's proposed adjustments. Further, to resolve any potential ambiguity, the legislative history does not provide for the OCA's proposed adjustments. The General Assembly rejected an amendment that would have included tax benefits in the calculation of the DSIC, such as ADIT and accelerated tax depreciation adjustments, modeled from the Commission's prior practice under the water DSIC.¹¹

In sum, for all of the reasons presented in the Company's Main Brief and expressed at length in the *Final Implementation Order* and in the *Columbia DSIC Recommended Decision*, the Commission should approve the Company's DSIC calculation formula without the ADIT adjustment proposed by the OCA.

2. ADIT Need Not Be Included in the DSIC formula to Ensure that Rates Are Just and Reasonable

In support of its ADIT adjustment, the OCA contends that ADIT must be included in the DSIC formula to ensure that rates are just and reasonable.¹² This contention is an inaccurate statement of the law. The reasonableness of the DSIC surcharge is ensured by the earnings cap that the General Assembly legislated as part of Act 11 – not the OCA's ADIT adjustment. As the Commission explained in the *Final Implementation Order*, the earnings cap under Section 1358(b)(3) “captures the revenue impact of *all other adjustments* and insure[s] that the DSIC does not result in unreasonable rates.”¹³ The phrase “*all other adjustments*” includes the ADIT adjustment proposed by the OCA. The *Columbia DSIC Recommended Decision*, likewise, concludes that ADIT adjustment is not necessary to ensure that rates are just and reasonable.

Judges Hoyer and Watson explained as follows:

The proposal to include ADIT is unnecessary, as the General Assembly has included an earnings cap provision and other customer protection provisions

¹¹ *Columbia DSIC Recommended Decision* at 47-48 (footnotes omitted).

¹² OCA Main Brief, Section IV.A.2.

¹³ *Final Implementation Order* at 39 (emphasis added).

to protect against overearnings and to ensure that the rates are just and reasonable. Accordingly, it is the conclusion of the undersigned that the proposal to include an ADIT adjustment should be rejected.¹⁴

Citing several regulatory treatises, Commission base rate orders and decisions/regulatory practice in other jurisdictions, the OCA contends that “under standard ratemaking procedure ... the balance of deferred federal taxes is treated as a reduction in the utility’s rate base”¹⁵ and that “[t]he rate base and revenue requirement for DSIC plant additions should be calculated the same way that rate base and revenue requirement are calculated for base rate purposes.”¹⁶ The DSIC surcharge mechanism, however, is an exception to traditional base rate procedures as discussed above.

Additionally, none of the citations offered by OCA alters the fact that the General Assembly, through Act 11, enacted a DSIC calculation formula that does not include an ADIT adjustment or that the Commission in its *Final Implementation Order* declined to include an ADIT adjustment in the DSIC calculation formula and the model tariff.¹⁷ In point of fact and contrary to the conclusion offered by the OCA, it is accepted, Pennsylvania regulatory practice to exclude ADIT from the DSIC calculation formula. As addressed at length in the Company’s Main Brief and recognized by the Commission in its *Final Implementation Order*, ADIT has never been part of the water DSIC calculation which has been used successfully in Pennsylvania for more than 15 years.¹⁸

In addition and significantly, all of the OCA’s citations are outside the context of Act 11. With Act 11, the General Assembly added language to the Public Utility Code that encourages

¹⁴ *Columbia DSIC Recommended Decision* at 48; LWWC Main Brief at 18-20.

¹⁵ OCA Main Brief at 11.

¹⁶ OCA Main Brief at 13.

¹⁷ All of the OCA’s citations, moreover, predate the enactment of Act 11.

¹⁸ LWWC Main Brief at 17-18.

utilities to accelerate the replacement of aging infrastructure.¹⁹ The encouragement that is part of the Act includes implementation of a DSIC.²⁰ None of the OCA's citations is material, relevant or even informative as to the interpretation of a new statute enacted with the background of encouraging accelerated replacement of infrastructure. Hampering the effectiveness of the DSIC by including an ADIT adjustment as proposed by the OCA would be contrary to the intent of the General Assembly and the objectives of the Act.

As a final point, the OCA contends, citing Sections 1351 and 1353,²¹ that the Company's DSIC calculation formula will result in the Company recovering costs it has not "incurred," contrary to the language of Act 11.²² This contention is inconsistent with the rules of statutory interpretation. Sections 1351 and 1353 are general provisions regarding definitions and procedures for obtaining approval of the DSIC. The actual DSIC mechanism is set forth in Section 1357 – Computation of Charge and Section 1358 – Customer Protections.²³ It is these latter two provisions that establish the specific methodology for calculating the DSIC rate, and they do not provide for an ADIT adjustment as part of the DSIC calculation.

¹⁹ 66 Pa. C.S. § 1352(a)(6).

²⁰ To qualify for a DSIC, the Act directs the utility to include an LTIP as part of its DSIC petition. Section 1352(a)(6) provides that the LTIP shall include "the manner in which the replacement of aging infrastructure will be accelerated and how the repair improvement or replacement will ensure and maintain adequate, efficient, safe, reliable and reasonable service."

²¹ 66 Pa. C.S. §§ 1351 and 1353.

²² OCA Main Brief at 14.

²³ 66 Pa. C.S. §§ 1357 and 1358.

3. **The DSIC Is Correctly Calculated Without the OCA’s ADIT Adjustment**

a. **The OCA’s ADIT Adjustment Would Add Unnecessary Complexities to the DSIC**

Inconsistent with the express language of the *Final Implementation Order*, the OCA argues that recognizing ADIT is not overly complicated.²⁴ The *Final Implementation Order* explains, however, that the “[ADIT] adjustment, which was not previously used in the DSIC by the water industry, would add unnecessary complexities to the DSIC ...”²⁵ Judges Hoyer and Watson have also concluded in the *Columbia DSIC Recommended Decision* that the ADIT adjustment is not easy to calculate and that the adjustment, as a result, could invite unwanted litigation:

With regard to Columbia’s assertion that the DSIC mechanism was intended to be straightforward and easy to calculate, the undersigned agree. One of the purposes of a surcharge mechanism is to establish a simple adjustment mechanism that does not require examination of every component that would be considered in a full base rate case proceeding. In contrast, base rate case calculations have many complexities, and reflect all of the changes in revenues, expenses, plant additions and offsetting rate base deductions.

Columbia correctly asserts that the ADIT adjustment is not easy to calculate, and could invite litigation over the utility’s past, present, and future income tax status, something the Commission attempted to avoid when enacting the *Final Implementation Order*.²⁶

In further support of its ADIT adjustment, the OCA cites the practice in other jurisdictions in respect to DSIC-type mechanisms.²⁷ The practice in other jurisdictions is not informative where, as here, there is no indication that the General Assembly based Pennsylvania Act 11 on the practice elsewhere. Simply stated, the General Assembly was not required to follow the practice in other jurisdictions in enacting a Pennsylvania statute which encourages

²⁴ OCA Main Brief, Section IV.A.3.a.

²⁵ *Final Implementation Order* at 39.

²⁶ *Columbia DSIC Recommended Decision* at 40-41 (footnotes omitted)..

²⁷ OCA Main Brief, Section IV.A.3.a.

utilities to accelerate the replacement of aging infrastructure. Judges Hoyer and Watson addressed the OCA’s contention in the *Columbia DSIC Recommended Decision* and correctly concluded that the practice in other states provides no relevant guidance:

Although the OCA points to the practice of utilities in other states to support its argument to include ADIT in the DSIC, the jurisdictions that the OCA has identified in this proceeding have mechanisms that are dissimilar from the Pennsylvania mechanism. In the instant case, even if a review of the practices of other states in interpreting the Pennsylvania statute was appropriate, the mechanisms in the other states vary significantly from the Pennsylvania DSIC such that that they provide no relevant guidance in judging the reasonableness of the proposed ADIT adjustment.²⁸

In further support of a “correct” DSIC calculation that includes an ADIT adjustment, the OCA interprets several sections of Act 11.²⁹ Computation of the DSIC charge is addressed in Section 1357 of the Act which provides that the DSIC shall be calculated to recover the “fixed cost of eligible property ...” Section 1357(a)(3) provides that the “fixed cost of eligible property shall consist of depreciation and pretax return.” Act 11 simply does not provide for the inclusion of an ADIT adjustment in the “fixed cost of eligible property” as the Commission has already concluded in its *Final Implementation Order* and Judges Hoyer and Watson have already concluded in their *Columbia DSIC Recommended Decision*.

b. The Earnings Cap Protects Against Over Earning

Inconsistent with the express language of Act 11, the *Final Implementation Order* and the *Columbia DSIC Recommended Decision*, the OCA argues that the earnings cap does not prevent the DSIC from being overstated.³⁰ The earnings cap is a customer protection specifically included by the General Assembly in Section 1358(b)(3) of the Act. The *Final Implementation Order* and the *Columbia DSIC Recommended Decision* accurately explain that “consumers

²⁸ *Columbia DSIC Recommended Decision* at 47.

²⁹ OCA Main Brief, Section IV.A.3.a.

³⁰ OCA Main Brief, Section IV.A.3.b.

remain protected against over earning by the earnings cap under Section 1358(b)(3) which “captures the revenue impact of all other adjustments and insure[s] that the DSIC does not result in unreasonable rates.”³¹ The earnings cap protects customers against over earning by utilities.

The OCA argues that the earnings report submitted by a utility is not subject to the type of scrutiny that occurs in a base rate proceeding.³² The earnings report, however, is calculated pursuant to a formula established by the Commission, incorporating the same elements that are included in a base rate assessment. The earnings cap compares the utility's current earnings, as reflected in its Earnings Report, to the Commission's allowed rate of return. The DSIC may not be charged if the utility is over earning the allowed return and, accordingly, prevents the DSIC from being overstated.

c. Summary

As addressed by LWWC in its Main Brief and this Reply Brief, the DSIC surcharge mechanism is an exception to traditional base rate procedures. The ADIT adjustment proposed by the OCA is not part of the framework of Act 11, which encourages utilities to accelerate replacement of aging infrastructure. The ADIT adjustment, which was rejected by the Commission in the *Final Implementation Order* and by Judges Hoyer and Watson in the *Columbia DSIC Recommended Decision* should be rejected here.

4. The Commission Appropriately Acknowledged that the Water DSIC, Used Successfully for More Than 15 Years, Did Not Include an ADIT Adjustment

In further support of its ADIT adjustment, the OCA mistakenly contends that the Commission should depart from its successful experience with the water DSIC and modify the

³¹ *Final Implementation Order* at 39; *Columbia DSIC Recommended Decision* at 47.

³² OCA Main Brief, Section IV.A.3.b.

model tariff.³³ With more than 15 years experience and success with a water DSIC that did *not* include an ADIT adjustment, it is understandable that the Commission would rely on that experience and success in its *Final Implementation Order*. Legislative history demonstrates, moreover, that the water DSIC was used as a model for the DSIC mechanism enacted with Act 11.³⁴ The OCA has failed to identify a single substantive reason why the Commission should reconsider the clear finding presented in the *Final Implementation Order* relying on its successful experience with the water DSIC.

The OCA also contends that its ADIT adjustment recognizes the experience and developments in other states in refining the DSIC formula that was created in Pennsylvania 16 years ago.³⁵ Other jurisdictions, however, do not support the inclusion of an ADIT adjustment in Pennsylvania. Significantly, there is no evidence that the General Assembly relied upon any other jurisdiction in developing Act 11. As recognized by Judges Hoyer and Watson in their discussion of this contention in the *Columbia DSIC Recommended Decision* reproduced above, other states “provide no relevant guidance in judging the reasonableness of the proposed ADIT adjustment.”³⁶

With the enactment of Act 11, the General Assembly created a regulatory framework for accelerating the replacement of aging infrastructure which includes a DSIC mechanism patterned after Pennsylvania’s existing water DSIC mechanism. The OCA’s attempt to effect a modification of Pennsylvania’s long established DSIC calculation formula to include an ADIT adjustment is contrary to the plain language of Act 11 and its legislative history and contrary to

³³ OCA Main Brief, Section IV.A.4.

³⁴ LWWC Main Brief at 12-14.

³⁵ OCA Main Brief, Section IV.A.4.

³⁶ *Columbia DSIC Recommended Decision* at 47.

the plain language of both the *Final Implementation Order* and the *Columbia DSIC Recommended Decision*.

5. Conclusion

The Company's DISC calculation formula is consistent with the plain language of Act 11, legislative history, the *Final Implementation Order*, the *Columbia DSIC Recommended Decision* and the model tariff. The calculation formula is straightforward, easy to calculate and easy to audit. It does not require full rate case analysis. The formula is based on the water DSIC that the Commission and water utilities have used successfully for more than 15 years. The earnings cap, which is a customer protection specifically included by the General Assembly in Section 1358(b)(3) of Act 11, "captures the revenue impact of all other adjustments and insure[s] that the DSIC does not result in unreasonable rates." The OCA's ADIT adjustment should be rejected.

C. State Income Taxes

The OCA states that it has identified a "correction" that must be made to LWWC's calculation of state income taxes in the DSIC revenue requirement determination. It contends that the amount of state income taxes that LWWC will pay on DSIC revenues will be affected by tax deductions and that the state income tax rate used to calculate the DSIC revenue requirement should reflect the state income tax expense actually paid.³⁷

In support of its state income tax adjustment, the OCA cites the "actual taxes paid" doctrine. The doctrine has no application to this DSIC proceeding – it has only been applied in base rate proceedings. The doctrine, moreover, is a judicial construct which can be modified by

³⁷ OCA Main Brief, Section IV.B.

the General Assembly.³⁸ To the extent that the doctrine could have had any application to the DSIC, the General Assembly rejected that application in Act 11 when it legislated a DSIC calculation formula *without* the adjustments proposed by the OCA.

In further support of its state income tax adjustment, the OCA argues that, absent its adjustment, the Company will recover costs not actually incurred in violation of Sections 1351 and 1353 of the Act.³⁹ Sections 1351 and 1353 are general provisions regarding definitions and the procedures for obtaining approval of the DSIC. The actual DSIC mechanism is set forth in Section 1357 – Computation of Charge and Section 1358 – Customer Protections.⁴⁰ It is these latter two provisions that establish the specific methodology for calculating the DSIC rate, and they make no mention of the additional components proposed by OCA. The General Assembly has defined what costs may be reflected in the DSIC calculation, and OCA has offered no valid basis to add to that definition.

Finally, as addressed at length in the Company’s Main Brief, each and every one of the arguments of Mr. Catlin and the OCA in support of their state income tax “correction” was considered and rejected by Judges Hoyer and Watson in the *Columbia DSIC Recommended Decision*.⁴¹ The OCA’s “correction,” likewise, should be rejected here. The Company’s use of the statutory Federal and State income tax rates in the DSIC calculation formula should be approved without modification.

³⁸ *Barasch v. Pa. P.U.C.* 491 A. 2d 94, 104 (Pa. 1985).

³⁹ 66 Pa. C.S. §§ 1351 and 1353.

⁴⁰ 66 Pa. C.S. §§ 1357 and 1358.

⁴¹ LWWC Main Brief at 20-23.

III. CONCLUSION

For all of the reasons presented in this Reply Brief and the Company's Main Brief, Little Washington Wastewater Company requests that the Pennsylvania Public Utility Commission (1) approve and confirm, without modification (other than the modification presented in the Joint Stipulation Addressing Application of Distribution System Improvement Charge to Contract Customers and Woodloch Pines), its DSIC surcharge language and DSIC calculation formula as implemented through its filing of Supplement No. 85 on September 23, 2013 and reflected in the Company's presently effective tariff and (2) reject the adjustments proposed by the Office of Consumer Advocate.

Respectfully submitted,

LITTLE WASHINGTON WASTEWATER COMPANY

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Date: April 8, 2014

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	:	:	
v.	:	:	C-2013-2369886
	:	:	
Little Washington Wastewater Company	:	:	

CERTIFICATE OF SERVICE

I hereby certify that I am this 8th day of April 2014, serving a true and correct copy of the Reply Brief of Little Washington Wastewater Company upon the persons below via electronic and first class mail, as follows:

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