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May 27, 2014

Via Electronic Filing

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

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 the Public Utility Commission's secretarial letter dated April 29, 2014, as amended by action of the Office of Special Assistants on May 12, 2014 extending the due dates for the filing of Exceptions and Replies to Exceptions, enclosed via electronic filing are the Company's Exceptions to the Recommended Decision of Administrative Law Judge Susan D. Colwell. Copies of the Company's Exceptions are being served upon the persons and in the manner set forth on the certificate of service attached to them.

Very truly yours,

THOMAS, NIESEN & THOMAS, LLC

By

Thomas T. Niesen

cc: Certificate of Service (w/encl.)
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Mary McFall Hopper, Esquire (w/encl.)

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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|--|----------|-----------------------|
| Petition of Little Washington Wastewater Company (LWWC) for Approval of its Long-Term Infrastructure Improvement Plan | : | P-2013-2366873 |
| | : | |
| Petition of Little Washington Wastewater Company (LWWC) for Approval of a Distribution System Improvement Charge | : | P-2013-2366873 |
| | : | |
| Office of Consumer Advocate | : | |
| | : | |
| v. | : | C-2013-2369886 |
| | : | |
| Little Washington Wastewater Company | : | |

**EXCEPTIONS OF LITTLE WASHINGTON WASTEWATER COMPANY
TO THE RECOMMENDED DECISION OF
ADMINISTRATIVE LAW JUDGE SUSAN D. COLWELL**

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Date: May 27, 2014

AND NOW, comes Little Washington Wastewater Company, by its attorneys, and submits the following Exceptions to the Recommended Decision of Administrative Law Judge Susan D. Colwell, dated April 16, 2014.

I. INTRODUCTION

This proceeding involves the Petitions of Little Washington Wastewater Company (“LWWC” or “Company”) for approval of its LTIP (“LTIP Petition”) and DSIC (“DSIC Petition”). The LTIP and DSIC Petitions were filed on May 31, 2013 and assigned Docket No. P-2013-2366873.¹ LWWC served copies upon the statutory advocates in accordance with the Final Implementation Order entered August 2, 2012 at Docket No. M-2012-2293695 (“*Final Implementation Order*”). LWWC’s DISC Petition included proposed Supplement No. 85 to Tariff Sewer – Pa. P.U.C. No. 1 introducing the DSIC into the Company’s tariff with an effective date of October 1, 2013.²

Proposed Supplement No. 85 contained all the elements required by the Commission’s *Final Implementation Order* including a description of eligible property, the effective date of the DSIC and a detailed example and explanation of the computation of the DSIC. It also included the method by which LWWC will provide quarterly updates to its customers as well as a description of the consumer safeguards included in the DSIC.³

The Office of Consumer Advocate (“OCA”) filed Comments to the LTIP Petition on June 20, 2013 and a Formal Complaint, Comments and an Answer to the DSIC Petition on June

¹ Subsequent to the filing of its LTIP and DSIC Petitions, LWWC’s corporate name was changed to Aqua Pennsylvania Wastewater, Inc., effective January 1, 2014.

² *Petition of Little Washington Wastewater Company*, Docket No. P-2013-2366873 (Opinion and Order entered September 12, 2013) (“Order entered September 12”) at 2; *See also* Little Washington Wastewater Company St. No. 1 at 3-4.

³ Little Washington Wastewater Company St. No. 1 at 4.

20, 2013. OCA's Formal Complaint was assigned Docket No. C-2013-2369886. On July 1, 2013, the Company filed a letter response to the OCA Complaint pursuant to 52 Pa. Code § 5.61(d).⁴

In its Order entered September 12, 2013, the Commission approved LWWC's LTIIP Petition, finding that the "[LTIIP] and manner in which it was filed conforms to the requirements of Act 11 and our Final Implementation Order."⁵ The Commission also approved the Company's DSIC, finding that it "complies with the requirements of Act 11 and the Final Implementation Order" and that it is not "inconsistent with the applicable law or Commission policy."⁶

In Ordering Paragraph No. 5 of the Order entered September 12, 2013, the Commission directed LWWC to file a tariff implementing its DSIC surcharge, consistent with the Order, on ten days' notice effective October 1, 2013. Thereafter, LWWC filed Supplement No. 85 to its Tariff Sewer – Pa. P.U.C. No. 1 ("Supplement No. 85") on September 23, 2013 implementing its DSIC in compliance with the Order entered September 12, 2013.⁷

In Ordering Paragraph No. 6 of the Order entered September 12, 2013, the Commission 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

⁴ Order entered September 12, 2013 at 2.

⁵ Order entered September 12, 2013 at 43.

⁶ Order entered September 12, 2013 at 43.

⁷ Little Washington Wastewater Company St. No. 1S at 2-3. Tariff language that had been part of the Company's proposed DSIC supplement as filed with the Commission on May 31, 2013, and accepted by the Commission in its Order entered September 12, 2013 was mistakenly excluded from the compliance filing and the Company, on October 11, 2013, filed a Revised Supplemental No. 85. Revised Supplement No. 85 as filed on October 11, 2013, is attached to Little Washington Wastewater Company Statement No. 1S as Appendix A. Little Washington Wastewater Company St. No. 1S at 3.

- b. Calculation of the state income tax component of the DSIC revenue requirement.⁸

Following hearing and briefing,⁹ Administrative Law Judge Colwell issued her Recommended Decision, dated April 16, 2014. The Recommended Decision acknowledges that LWWC's DSIC is consistent with the model tariff adopted by the Commission in its *Final Implementation Order*.¹⁰ It further acknowledges that LWWC's DSIC is consistent with the 15-year history of water DSIC tariffs in Pennsylvania¹¹ and that the two tax adjustments referred for hearing are *inconsistent* with the *Final Implementation Order*.¹² Ignoring the *Final Implementation Order*, the Recommended Decision recommends that the Commission adopt the ADIT adjustment proposed by the OCA¹³ and that the Commission flow through the benefits of state income tax deductions associated with DSIC plant.¹⁴

LWWC excepts to the Recommended Decision's modification of the Company's DSIC calculation formula to include the ADIT and state income tax adjustments proposed by the OCA. In its Order entered May 22, 2014, in *Petition Of Columbia Gas Of Pennsylvania, Inc. For*

⁸ Order entered September 12, 2013 at 44-45.

⁹ In its History of the Proceeding, the Recommended Decision recites that LWWC presented prepared direct, supplemental direct and rebuttal testimony of Meghan P. Kreszswick and prepared direct testimony of Gordon Miller. LWWC also presented prepared rejoinder testimony of Ms. Kreszswick which was admitted into the record as Little Washington Wastewater Company St. No. 1REJ. N.T. 20

¹⁰ "There is no dispute that the LWWC proposed tariff is reflective of the model tariff associated with the Commission's Final Implementation Order." Rec. Dec. at 23.

¹¹ "There is no dispute that ... the 15-year old water tariffs do not include an ADIT adjustment." Rec. Dec. at 23.

¹² Rec Dec at 18-19. The Recommended Decision also acknowledges that the two tax adjustments are inconsistent with the conclusions expressed by Administrative Law Judges Hoyer and Watson in their Recommended Decision in *Petition of Columbia Gas of Pennsylvania, Inc. for Approval of a Distribution System Improvement Charge*, Docket No. P-2012-2338282, Recommended Decision of Administrative Law Judges Hoyer and Watson dated February 25, 2014 ("*Columbia DSIC Recommended Decision*").

¹³ Recommended Decision at 17-23.

¹⁴ Recommended Decision at 25-26.

Approval Of A Distribution System Improvement Charge, Docket No. P-2012-2338282 (“*Columbia DSIC Opinion and Order*”), the Commission reaffirmed its *Final Implementation Order* and rejected the OCA’s adjustments. As set forth in these Exceptions, the Company’s DISC calculation formula is consistent with the *Final Implementation Order*, the *Columbia DSIC Opinion and Order*, the plain language of Act 11, legislative history and the model tariff. The DSIC calculation formula is straightforward, easy to calculate and easy to audit. 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.”¹⁵ The Recommended Decision should be rejected (other than the recommended adoption of the Joint Stipulation Addressing Application of Distribution System Improvement Charge to Contract Customers and Woodloch Pines) and the OCA’s ADIT and state income tax adjustments should be denied.¹⁶

¹⁵ *Final Implementation Order* at 38-39 (citations omitted); Little Washington Wastewater Company St. No. 1R at 2-3.

¹⁶ Consistent with 52 Pa. Code § 5.533(c), LWWC will incorporate by reference pertinent sections of its Main and Reply Briefs in support of its Exceptions. We note, additionally, that the original due date for the submission of Exceptions was May 19, 2014. On May 12, 2014, the Office of Special Assistants granted the unopposed request of counsel for LWWC to extend the due date for Exceptions to May 27, 2014.

II. EXCEPTIONS

Accumulated Deferred Income Taxes (ADIT)

EXCEPTION NO. 1 LWWC excepts to the recommended adoption of the OCA's ADIT adjustment and the failure of the Recommended Decision to follow the reasoning expressed by the Commission in the *Final Implementation Order*. Recommended Decision at 17-23 and Ordering Paragraphs 1 and 3; *Also* Finding of Fact 26 and Conclusion of Law 12.¹⁷ The ADIT adjustment and that portion of the Recommended Decision addressing it should be rejected consistent with the *Final Implementation Order* and the *Columbia DSIC Opinion and Order*.

In a manner entirely consistent with the procedures, guidelines and model tariff adopted by the Commission in the *Final Implementation Order*, LWWC did not include an ADIT adjustment in its DSIC calculation formula.¹⁸ The OCA proposed, however, that the Commission require the Company to modify its DSIC calculation formula to reduce the rate base included in the DSIC calculation by the ADIT balance associated with DSIC eligible property.¹⁹ Although recognizing that the Commission in its *Final Implementation Order* rejected the OCA's ADIT adjustment,²⁰ the Recommended Decision recommends that the Company be directed to modify its DSIC calculation to include the ADIT adjustment.²¹

¹⁷ LWWC excepts to the cited Finding and Conclusion to the extent that they suggest that traditional ADIT ratemaking principles apply here. They do not. The DSIC surcharge mechanism is an exception to traditional base rate procedures. *See Columbia DSIC Recommended Decision* at 48.

¹⁸ Little Washington Wastewater Company St. No. 1S, Appendix A, Original Page No. 10DSIC2.

¹⁹ OCA St. No. 1 at 4 and 6. OCA witness Catlin explained that ADIT arises because certain income tax deductions such as accelerated tax depreciation and bonus tax depreciation must be normalized under the provisions of the Internal Revenue Code. The resulting difference between the taxes actually paid (taking into account accelerated and bonus depreciation) and the income taxes for ratemaking (taking into account book depreciation) generates what is known as deferred income taxes. ADIT is the cumulative balance of the deferred taxes generated over time. OCA St. No. 1 at 4-5.

²⁰ Rec. Dec. at 18-19.

²¹ Rec. Dec. Ordering Paragraphs Nos. 1 and 3.

In its *Final Implementation Order*, the Commission discussed the *Comments* filed by the OCA in support of its ADIT adjustment and, in very clear language and for several reasons, declined to adopt the adjustment:

4. Accumulated Deferred Income Taxes (ADIT)

* * *

Resolution: OCA has proposed that the DSIC calculation include an adjustment for accumulated deferred income taxes to recognize the difference between the utilities' tax depreciation and book depreciation, which can be viewed as a source of zero cost capital. OCA Comments at 10. Accumulated deferred income taxes (ADIT) and a number of additional items, including working capital and taxes associated with DSIC-eligible property, are accounted for in the normal base rate case process. Upon review, we agree with PPL's comments that the DSIC is intended to be a straightforward mechanism which is easy to calculate, easy to audit and which does not require a full rate case analysis. Inclusion of an ADIT adjustment would be inconsistent with that goal and would likely invite litigation over its calculation. Moreover, we note that the water DSIC, used successfully for over 15 years, did not include an ADIT adjustment. And, in any event, consumers remain protected against over earnings by the earnings cap under Section 1358(b)(3) which "captures the revenue impact of all other adjustments and insure that the DSIC does not result in unreasonable rates."

Therefore, the Commission declines to adopt the OCA proposal to include, in the DSIC calculation, an adjustment for accumulated deferred income taxes. The adjustment, which was not previously used in the DSIC by the water industry, would add unnecessary complexities to the DSIC and, accordingly, will not be included in the model tariff.²²

In its recently entered *Columbia DSIC Opinion and Order*, the Commission reaffirmed its *Final Implementation Order* and, once again, declined to adopt the OCA's ADIT adjustment:

Moreover, we have previously addressed this issue in our *Final Implementation Order*, in which we declined to adopt the OCA's proposal to include an adjustment for ADIT in the DSIC calculation. As we indicated in our *Final Implementation Order*, we believe that the DSIC is intended to be a straightforward mechanism that is easy to calculate and audit, and does not require a full rate case analysis. We concluded that the inclusion of an ADIT adjustment would be inconsistent with that goal and would likely lead to litigation

²² *Final Implementation Order* at 38-39 (citations omitted); Little Washington Wastewater Company St. No. 1R at 2-3.

over the DSIC calculation. *Final Implementation Order* at 39. Thus, we agree with Columbia that, through the enactment of Act 11, the General Assembly intended to establish a surcharge mechanism to produce just and reasonable rates without the need for the type of comprehensive and detailed analysis required in a base rate proceeding under Section 1308(d) of the Code. Columbia R. Exc. at 2-4.²³

Summarizing its view of the OCA's ADIT adjustment, the Commission held as follows:

Accordingly, we find that the inclusion of an ADIT adjustment as proposed by the OCA is not required by Act 11, would add unneeded complexity to the DSIC calculation, and is unnecessary to ensure that the DSIC rates will be just and reasonable. As we stated in our *Final Implementation Order*, the historic water DSIC, which was used successfully for many years, did not include an adjustment for ADIT. *Final Implementation Order* at 39. Accordingly, we will deny the OCA's Exception on this issue.²⁴

The OCA's ADIT adjustment and that portion of the Recommended Decision addressing it should be rejected consistent with the *Final Implementation Order* and the *Columbia DSIC Opinion and Order*.²⁵ An ADIT adjustment is not required by Act 11, would add unneeded complexity to the DSIC calculation, and is unnecessary to ensure that the DSIC rates will be just and reasonable. The historic water DSIC, which was used successfully for many years, did not include an adjustment for ADIT.²⁶

LWWC's Exception No. 1 should be granted.

²³ *Columbia DSIC Opinion and Order* at 35-36.

²⁴ *Columbia DSIC Opinion and Order* at 37.

²⁵ See also LWWC Main Brief, Section IV.B and Reply Brief, Section II.B.

²⁶ *Columbia DSIC Opinion and Order* at 37.

EXCEPTION NO. 2 LWWC excepts to the conclusion that “plain language” supports the ADIT adjustment. Recommended Decision at 22. The “plain language” of Act 11 does not require that the calculation of the DSIC include recognition of ADIT.

Citing Section 1353(a) of the Public Utility Code,²⁷ the Recommended Decision concludes that the “plain language” of Act 11 supports the inclusion of the ADIT adjustment in the DSIC formula.²⁸ The Commission, however, concluded otherwise in its *Columbia DSIC*

Opinion and Order:

After consideration of the evidence and the arguments set forth on this issue, we will decline to adopt the OCA’s proposal to include an adjustment for ADIT in Columbia’s DSIC calculation. Initially, we emphasize that we do not agree with the OCA’s assertion that the plain language of Act 11 requires that the calculation of the DSIC include recognition of ADIT. Rather, as discussed above, we agree with the ALJs that the General Assembly intended to leave the technical mechanics of the DSIC calculation to the Commission. R.D. at 22. Accordingly, we find no reason to conclude that Act 11 would require Columbia to include recognition of ADIT in the calculation of its DSIC.²⁹

Consistent with the *Columbia DSIC Opinion and Order*, Act 11 does not require LWWC to include recognition of ADIT in the calculation of its DSIC. “Plain language” and the legislative history behind it do not warrant factoring ADIT in the Company’s DSIC calculation.³⁰ The Recommended Decision, accordingly, should be rejected. The OCA’s ADIT adjustment should be denied.

LWWC Exception No. 2 should be granted.

²⁷ 66 Pa.C.S. § 1353(a).

²⁸ Rec. Dec. at 22.

²⁹ *Columbia DSIC Opinion and Order* at 35.

³⁰ See also LWWC Main Brief, Section IV.B.1 and Reply Brief, Section II.B.3.a.

EXCEPTION NO. 3

LWWC excepts to the conclusion that LWWC has failed to meet its burden of proving that its DSIC formula is just and reasonable without the ADIT adjustment. Recommended Decision at 23. The earnings cap protects customers against utility over earning and, thus, ensures that the DSIC will be just and reasonable.

The Recommended Decision erroneously concludes that “in the absence of the application of the *Final Implementation Order*, LWWC has failed to meet its burden of proving that its DSIC formula is just and reasonable without the ADIT adjustment.”³¹ The Recommended Decision fails to appreciate the significance of the statutorily prescribed “earnings cap” – one of the customer protections legislated by the General Assembly as part of Act 11. Section 1358(b)(3) of the Public Utility Code provides as follows:

§ 1358. Customer protections

* * *

(3) The distribution system improvement charge shall be reset at zero, if in any quarter, data filed with the commission in the utility’s most recent annual or quarterly earnings report show that the utility will earn a rate of return that would exceed the allowable rate of return used to calculate its fixed costs under the distribution system improvement charge.

The Commission recognized the significance of the “earnings cap” in the *Final Implementation Order* when it considered and rejected the OCA’s ADIT adjustment:

[C]onsumers remain protected against over earnings 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.”³²

In its recently entered *Columbia DSIC Opinion and Order*, the Commission reaffirmed its *Final Implementation Order* and the significance of the statutory earnings cap:

We also do not agree with the OCA that failure to include the ADIT adjustment in the DSIC calculation will result in a DSIC rate that is unjust or unreasonable. As we stated in our *Final Implementation Order*, consumers will remain protected against over-earnings by the earnings cap provision under

³¹ Rec. Dec. at 23.

³² *Final Implementation Order* at 38-39 (citations omitted); Little Washington Wastewater Company St. No. 1R at 2-3.

Section 1358(b)(3) of the Code. *Final Implementation Order* at 39. As Columbia points out, its quarterly earnings reports, which are used to determine the Company's achieved rate of return for earnings cap purposes, capture both upward and downward impacts of a wide variety of individual adjustments that would be considered in a base rate proceeding, including the current book amount of ADIT. Columbia R. Exc. at 13-14. Thus, we do not agree with the OCA that the earnings cap will fail to protect customers from being charged DSIC rates that are unjust or unreasonable. Additionally, we agree with the ALJs' reliance on the *Duquesne* case for the conclusion that the total effect of the rate should be considered in determining whether the DSIC is just and reasonable. *See*, R.D. at 45-46. While the main issue in that case was whether a Pennsylvania law amounted to a taking of a public utility's property in violation of the Fifth Amendment, that case also included a discussion of ratemaking principles and the applicable law for determining just and reasonable rates. The United States Supreme Court, in *Duquesne*, addresses and relies upon the landmark case of *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), for its statement that there is not any single formula that must be used in determining just and reasonable rates. *Duquesne*, 488 U.S. at 315, 316. As Columbia indicates, the Court acknowledged that the test for determining whether rates are just and reasonable involves an analysis of whether the end result of the rates is just and reasonable.³³

The statutory earnings cap "captures the revenue impact of *all other adjustments*," including the OCA's ADIT adjustment and "*insure[s] that the DSIC does not result in unreasonable rates.*"³⁴ The Recommended Decision should be rejected as it is contrary to law and inconsistent with a proper understanding of the earnings cap. It is also inconsistent with established legal precedent in *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989), cited by the Commission in its *Columbia DSIC Opinion and Order*.³⁵

The OCA's ADIT adjustment is unnecessary and should be denied. The General Assembly has included an earnings cap provision and other customer protection provisions to protect customers against utility over earning and to ensure that rates are just and reasonable. Simply stated, the provisions of Act 11 ensure that the DSIC will **not** result in unreasonable

³³ *Columbia DSIC Opinion and Order* at 36-37.

³⁴ *Final Implementation Order* at 38-39 (citations omitted) (emphasis added); Little Washington Wastewater Company St. No. 1R at 2-3.

³⁵ *See also* LWWC Main Brief, Section IV.B.4 and Reply Brief, Sections II.B.2 and II.B.3.b.

rates. LWWC has included the earnings cap and other customer protections in its DSIC surcharge language.³⁶ It has met its burden of proving that its DSIC formula is just and reasonable without the ADIT adjustment.

LWWC's Exception No. 3 should be granted.

EXCEPTION NO. 4 LWWC excepts to the discussion of "complexity" in the context of the ADIT adjustment, to the conclusion that complexity is not a legal excuse and to the further conclusion that there is no complexity associated with the adjustment. Recommended Decision at 19. The ADIT adjustment would inject significant complexity into an otherwise straightforward mechanism and go beyond the scope of what is required by Act 11.

In its *Final Implementation Order*, the Commission concluded that "the DSIC is intended to be a straightforward mechanism which is easy to calculate, easy to audit and which does not require a full rate case analysis" and that "[i]nclusion of an ADIT adjustment would be inconsistent with that goal and would likely invite litigation over its calculation."³⁷ The Recommended Decision disagrees with the *Final Implementation Order* and concludes that "complexity is not a legal excuse" and that "there is no complexity" associated with the adjustment.³⁸

Contrary to the conclusions offered in the Recommended Decision, the Commission, in its *Final Implementation Order*, concluded that an ADIT adjustment would add unnecessary complexities to the DSIC mechanism:

Therefore, the Commission declines to adopt the OCA proposal to include, in the DSIC calculation, an adjustment for accumulated deferred income taxes. The adjustment, which was not previously used in the DSIC by the water

³⁶ LWWC St. No. 1S, Appendix A, Original Page No. 10DSIC2, Section III – Safeguards.

³⁷ *Final Implementation Order* at 38-39 (citations omitted); Little Washington Wastewater Company St. No. 1R at 2-3.

³⁸ Rec. Dec. at 19.

industry, would add unnecessary complexities to the DSIC and, accordingly, will not be included in the model tariff.³⁹

In its recently entered *Columbia DSIC Opinion and Order*, the Commission similarly concluded that the OCA's ADIT adjustment would add unneeded complexity to the DSIC process:

While the OCA does not believe its proposed ADIT adjustment would add significant complexity to the DSIC calculation, we disagree. As Columbia states, ADIT is a dynamic element that is constantly changing based on available tax deductions, the mix of plant in service, and the Company's current tax position, and such changes cannot be accurately captured in the straightforward formula used to calculate the DSIC. *See*, Columbia Exc. at 19. Thus, although we agree with the OCA that federal income taxes are an element of the DSIC formula, we believe that the inclusion of an ADIT adjustment would involve a level of analysis and complexity that goes beyond the scope of what is required by Act 11 with regard to the calculation of the DSIC. Similarly, we believe that using the annual reconciliation process to overcome the difficulties involved in providing accurate projections of incremental ADIT, as the OCA suggests, would also add unneeded complexity to the implementation of the DSIC.⁴⁰

LWWC witness Kreszwick agreed with the *Final Implementation Order* and the Commission's concerns that adding an ADIT adjustment to the DSIC procedure would further complicate the process, sidestepping the original model tariff and intent of the DSIC program.⁴¹ Ms. Kreszwick also acknowledged the Commission's desire to implement a simple, straightforward DSIC calculation and, with that goal in mind, explained that the Commission has chosen to deal with ADIT adjustments (as well as the state income tax adjustment addressed in Exception No. 5 *infra*) in the context of full base rate proceedings, which have separate

³⁹ *Final Implementation Order* at 38-39 (citations omitted); Little Washington Wastewater Company St. No. 1R at 2-3.

⁴⁰ *Columbia DSIC Opinion and Order* at 36.

⁴¹ Little Washington Wastewater Company St. No. 1R at 4.

calculations and supporting documentation for tax matters that have a greater likelihood of litigation.⁴²

The Recommended Decision and its conclusions concerning a lack of complexity with an ADIT adjustment are contrary to the *Final Implementation Order* and the *Columbia DSIC Opinion and Order*.⁴³ The Recommended Decision should be rejected. The OCA's ADIT adjustment should be denied.

LWWC Exception No. 4 should be granted.

Calculation of the State Income Tax Component

EXCEPTION NO. 5 LWWC excepts to the recommended adoption of the OCA's state income tax adjustment. Recommended Decision at 25-26 and Ordering Paragraphs 2 and 4; *Also* Conclusions of Law 12 and 16.⁴⁴ The state income tax adjustment and that portion of the Recommended Decision addressing it should be rejected consistent with the *Final Implementation Order* and the *Columbia DSIC Opinion and Order*.

In a manner entirely consistent with the procedures, guidelines and model tariff adopted by the Commission in the *Final Implementation Order*, LWWC's DSIC calculation formula calculates the pre-tax return using statutory federal *and* state income tax rates, along with the Company's actual capital structure and actual cost rates for long-term debt and preferred stock.⁴⁵ The Recommended Decision recommends, however, that the Company be required to modify its

⁴² Little Washington Wastewater Company St. No. 1REJ at 2. Additionally, in response to testimony of OCA witness Catlin to the effect that tax matters and the effects on ADIT are much more significant today than in the past, Ms. Kreszwick testified that bonus depreciation has been in effect for many years since 2001, and most recently in 2011 at 100%, 2012 at 50%, and finally 2013 at 50%. All the while the Commission has not changed its view that these matters should be dealt with in base rate cases due to their complexity and the Commission's desire for a straight forward DSIC mechanism. Little Washington Wastewater Company St. No. 1REJ at 3.

⁴³ See also LWWC Main Brief, Section IV.B.2, and Reply Brief, Section II.B.3.a.

⁴⁴ LWWC excepts to the cited Conclusions to the extent that they suggest that traditional ratemaking principles apply here. They do not. The DSIC surcharge mechanism is an exception to traditional base rate procedures. See *Columbia DSIC Recommended Decision* at 48.

⁴⁵ Little Washington Wastewater Company St. No. 1S, Appendix A, Original Page No. 10DSIC1.

pre-tax return in the DSIC calculation to recognize the flow-through of state income tax benefits associated with DSIC investments.⁴⁶ In Proposed Ordering Paragraph 2, the Recommended Decision recommends that the LWWC DSIC calculation, which includes a state income tax gross-up, be disapproved.

The Recommended Decision's disagreement with using the statutory state income tax rate in calculating the pre-tax return is contrary to the plain language of Act 11 and legislative intent and to the conclusion expressed in the *Final Implementation Order*, page 31, where the Commission explained, citing 66 Pa. C.S. § 1357(b)(1), that the "***[t]he pre-tax return would be calculated using the Federal and State income tax rates***, the utility's actual capital structure and actual cost rates for long-term debt and preferred stock, and the cost of equity from the utility's most recent fully litigated base rate case." The clear meaning of this language is that the statutory federal ***and*** state income tax rates are to be used in the calculation without adjustment. This gross-up at statutory rates is consistent with the current water DSIC procedure. It also is reflective of a straightforward process that is easy to calculate/audit, and does not require a full rate case analysis.⁴⁷

The Recommended Decision is also inconsistent with the *Columbia DSIC Opinion and Order*. There, the Commission rejected the OCA's state income tax adjustment:

Based on our consideration of the record and the positions of the Parties on this issue, we decline to adopt the OCA's proposal to eliminate the state tax gross-up included in Columbia's DSIC calculation. While we agree that Columbia's rates should reflect the state taxes that the Company actually pays, we are not convinced that eliminating the state tax gross-up included in the DSIC calculation would properly achieve that result. As Columbia points out, its base rates currently reflect deductions for the repairs allowance and accelerated depreciation that may no longer apply, because such deductions have been reduced or eliminated after the test year considered in the Company's last base rate proceeding. Therefore, to reflect these same types of deductions in relation to DSIC eligible plant in the DSIC calculation may result in overall rates that are

⁴⁶ Rec. Dec. at 25-26 and Ordering Paragraphs 2 and 4.

⁴⁷ Little Washington Wastewater Company St. No. 1R at 4.

further out of alignment with Columbia's actual tax position. As Columbia argues and the ALJs concluded, the only way to determine Columbia's actual taxes paid for state income tax purposes would be to conduct a full rate case analysis, which could subject the DSIC calculation to litigation regarding the proper determination of the Company's state tax liability. Columbia R. Exc. at 24; R.D. at 63. However, as we stated with regard to the ADIT issue, we believe that the DSIC is intended to be a straightforward mechanism that is easy to calculate and audit and does not require a full rate case analysis.

In addition, as we stated in our discussion of ADIT, Columbia's customers will remain protected by the earnings cap provision of Act 11. The Company's quarterly earnings reports, which are used to determine its achieved rate of return for earnings cap purposes, reflect a wide variety of individual adjustments that would be considered in a base rate proceeding, including Columbia's state income tax deductions. Accordingly, we believe that the earnings cap will ensure that customers will not be charged DSIC rates that are unjust or unreasonable. For the foregoing reasons, we shall deny the OCA's second Exception.⁴⁸

The OCA's state income tax adjustment and that portion of the Recommended Decision addressing it and the proposed elimination of the state income tax gross-up should be rejected consistent with the *Final Implementation Order* and the *Columbia DSIC Opinion and Order*. The only way to determine LWWC's actual taxes paid for state income tax purposes would be to conduct a full rate case analysis, which could subject the DSIC calculation to litigation regarding the proper determination of the Company's state tax liability. The DSIC, moreover, is intended to be a straightforward mechanism that is easy to calculate and audit and does not require a full rate case analysis. Additionally, as with the OCA's proposed ADIT adjustment, the OCA's state income tax adjustment is unnecessary as the earnings cap ensures that customers will not be charged DSIC rates that are unjust and reasonable.⁴⁹

LWWC Exception No. 5 should be granted.

⁴⁸ *Columbia DSIC Opinion and Order* at 46-47.

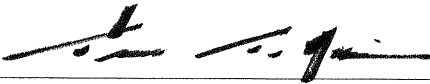
⁴⁹ *See also* LWWC Main Brief, Section IV.C and Reply Brief, Section II.C.

III. CONCLUSION

The Dispositions, Findings of Fact, Conclusions of Law and Proposed Ordering Paragraphs presented in the Recommended Decision in support of the recommended adoption of the OCA's ADIT and state income tax adjustments should be rejected for all the reasons set forth in these Exceptions and in the Company's Main and Reply Briefs. The OCA's ADIT and state income tax adjustments should be denied. LWWC has met its burden of proof and its DSIC calculation formula should be approved without modification (other than the modification presented in the Joint Stipulation Addressing Application of Distribution System Improvement Charge to Contract Customers and Woodloch Pines).

Respectfully submitted,

LITTLE WASHINGTON WASTEWATER COMPANY

By 

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*Attorneys for Little Washington Wastewater
Company*

Date: May 27, 2014

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

| | | |
|--|----------|-----------------------|
| Petition of Little Washington Wastewater Company (LWWC) for Approval of its Long-Term Infrastructure Improvement Plan | : | P-2013-2366873 |
| | : | |
| Petition of Little Washington Wastewater Company (LWWC) for Approval of a Distribution System Improvement Charge | : | P-2013-2366873 |
| | : | |
| Office of Consumer Advocate | : | |
| | : | |
| v. | : | C-2013-2369886 |
| | : | |
| Little Washington Wastewater Company | : | |

CERTIFICATE OF SERVICE

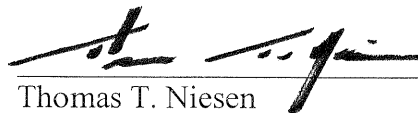
I hereby certify that I am this 27th day of May 2014, serving a true and correct copy of the Exceptions of Little Washington Wastewater Company upon the persons below, as follows:

*Via Electronic Mail and First Class Mail,
Postage Prepaid*

Honorable Susan D. Colwell
Administrative Law Judge
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
P. O. Box 3265
Harrisburg, PA 17105-3265
scolwell@pa.gov;

Via Electronic Mail and Hand Delivery

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