

COMMONWEALTH OF PENNSYLVANIA



OFFICE OF CONSUMER ADVOCATE

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July 23, 2014

Rosemary Chiavetta, Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
Harrisburg, PA 17120

Re: Petition of Pennsylvania-American Water
Company Wastewater Operations for Approval of
Long Term Infrastructure Improvement Plan and
Approval to Establish and Implement a Distribution
System Improvement Charge
Docket No. P-2014-2431005

Dear Secretary Chiavetta:

Attached for electronic filing is the Answer of the Office of Consumer Advocate in the above-referenced proceeding.

Copies have been served per the attached Certificate of Service.

Respectfully submitted,

A handwritten signature in cursive script that reads "Christine Maloni Hoover".

Christine Maloni Hoover
Senior Assistant Consumer Advocate
PA Attorney I.D. # 50026
E-Mail: CHoover@paoca.org

Attachment

cc: Office of Administrative Law Judge
Office of Special Assistants
Certificate of Service

187182.doc

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Petition of Pennsylvania-American Water :
Company Wastewater Operations For :
Approval of Long Term Infrastructure : Docket No. P-2014-2431005
Improvement Plan and Approval to Establish:
And Implement a Distribution System :
Improvement Charge :

ANSWER OF THE OFFICE OF CONSUMER ADVOCATE
TO THE
PETITION OF PENNSYLVANIA-AMERICAN WATER COMPANY
WASTEWATER OPERATIONS

I. INTRODUCTION

Pursuant to Section 5.61 of the Pennsylvania Code, 52 Pa. Code § 5.61, the Office of Consumer Advocate (OCA) provides the following Answer to the Petition of Pennsylvania-American Water Company Wastewater Operations (PAWC Wastewater or the Company) for Approval of Long Term Infrastructure Improvement Plan and Approval to Establish and Implement a Distribution System Improvement Charge (Petition). Through its Petition, PAWC Wastewater seeks approval of its Long Term Infrastructure Improvement Plan (LTIIP), and permission to implement a surcharge of up to 5% on all customer bills under Section 1353 of the Public Utility Code, 66 Pa.C.S. § 1353. This surcharge would recover return and depreciation on certain plant placed in service between base rate filings.

As set forth more fully below, the Company's proposed Supplement No. 4 to Tariff Wastewater - Pa. P.U.C. No. 15 attached to the Petition is contrary to Pennsylvania statute, case law and established Public Utility Commission policy. The Commission should deny the PAWC Wastewater Petition as filed. The OCA requests that the Commission suspend the Company's

proposed Tariff Supplement No. 4 and order a full hearing and investigation pursuant to the OCA Complaint filed at this docket against the Tariff Supplement. Further, the OCA requests that Company not be permitted to implement the surcharge until the conclusion of such investigation and hearing.

II. THE OCA'S ANSWER

This is the second request by a wastewater utility to implement a DSIC under a new statute and the Commission's Final Implementation Order¹ but the first company to request approval of a DSIC following the Commission's approval of a combination of the water and wastewater revenue requirements pursuant to Section 1311(b) of the Public Utility Code. PAWC Wastewater's proposed DSIC will increase rates for service and presents several important issues. The Petition should be denied and Tariff Supplement No. 4 should be rejected as filed. Alternatively, this matter should be referred to the Office of Administrative Law Judge for development of an evidentiary record.

While the OCA continues to review the PAWC Wastewater filing, the OCA has identified the following preliminary concerns with the proposed surcharge:

1. PAWC Wastewater's filing does not contain any sample calculations of the projected DSIC rate. If PAWC Wastewater proposes to have a single DSIC rate for all of its systems, a number of matters must be clarified and considered with regard to the computation and reset of the DSIC and application to customers in different operating divisions.
2. PAWC Wastewater's proposed tariff does not adopt the language of the Commission's model tariff in ways that are or may be material.
3. The proposed DSIC computation, by ignoring the balance of accumulated deferred income taxes associated with DSIC-eligible investments, will allow PAWC Wastewater to earn a return on an investment balance that exceeds PAWC Wastewater's actual investment in DSIC-eligible plant.

¹ Implementation of Act 11 of 2012, Docket No. M-2012-2293611, Order (Aug. 2, 2012) (Final Implementation Order).

4. The calculation of the state income tax component of the DSIC revenue requirement requires further examination to ensure that it is consistent with the actual taxes paid doctrine.

Each of these concerns is discussed more fully below.

The OCA's first concern is that the filing does not contain a sample calculation of the projected DSIC rate. As a result of multiple acquisitions of small, discrete wastewater systems, the Company has approximately 9 systems. The 9 systems are consolidated into five zones² for purposes of cost of service and revenue requirement. If PAWC Wastewater proposes a single DSIC rate, it is unclear how various issues will be treated if the Company files a base rate case for fewer than all of its systems. For example, what return on equity (ROE) will be used to calculate the DSIC and how will the statutory charge reset provision, 66 Pa. C.S. § 1358(b) be applied, *i.e.* which effective date of new base rates will be used and how will earnings be reported? Other issues may also arise and need clarification.

Moreover, due to the variation in rates across the 5 rate zones, the application of a single DSIC rate will have different impacts on the monthly bill for customers in different systems. For example, a metered customer using 5,000 gallons pays \$71.90 per month in Rate Zone 1 (Coatesville, Claysville, and Clean Treatment), \$58.18 per month in Rate Zone 2 (Clarion and Pocono Country Place), \$71.90 per month in Rate Zone 3 (Blue Mountain Lake and Lehman Pike), \$41.65 in Rate Zone 4 (Koppel) and a flat rate customer pays \$85 in Rate Zone 5 (Franklin). If a 5% DSIC is applied to these bills, the metered customer using 5,000 gallons per month in Rate Zone 1 or 3 would be charged \$8.28 more in the DSIC surcharge per year than a

² In the Table of Contents page included in Appendix A, there is a Rate Zone 6 listed under Part I Rates. That Rate Zone does not appear in the current tariff that is posted on the PUC's website. For purposes of this pleading, the OCA will refer to the five rate zones discussed in the Petition.

customer in Rate Zone 2.³ It should be considered whether a single DSIC rate would increase the disparity in monthly rates charged to PAWC Wastewater's customers in different systems rather than narrow those disparities as has been the practice over several base rate cases.

The second concern identified by the OCA is that, in several respects, the tariff proposed by PAWC Wastewater is not consistent with the model tariff adopted by the Commission for wastewater utilities as required by 66 Pa. C.S. § 1353(b)(1). The OCA has identified several substantive differences and continues to review the proposed tariff to determine whether there are others. Those identified in the OCA's preliminary review include the following paragraphs.

First, in the General Description, Eligible Property language (Appendix A, Original page 5H), the account numbers listed by PAWC Wastewater are not the same as those listed in the model tariff. Some account numbers are omitted and others are added. The OCA submits that this difference needs to be explained.

The OCA has underlined the model tariff language that is omitted from other provisions of PAWC Wastewater's proposed tariff:

2. Computation of the DSIC

Application of the DSIC: To calculate the DSIC, one-fourth of the annual fixed costs associated with all property eligible for cost recovery under the DSIC will be divided by the Company's projected wastewater revenue, including all applicable clauses and riders, for the quarterly period

Formula:

$$PQR = \text{Projected quarterly revenues for wastewater service } \underline{\text{including all applicable clauses and riders}} \text{ from existing customers....}$$

3. Customer Safeguards

³ If Rate Zones 4 and 5 are included the disparity would grow. With a 5% DSIC, a customer in Rate Zone 5 would pay \$26.04 more per year than a customer in Rate Zone 4.

Cap: The DSIC is capped at 5% of the amount billed to customers for distribution service (including all applicable clauses and riders) under otherwise applicable rates and charges.

In the following instances, PAWC Wastewater's proposed tariff changes words in the model tariff:

2. Computation of the DSIC

Pre-tax return: The pre-tax return ~~will~~ shall be calculated....

* * *

If more than two years shall have elapsed between the entry of such a final order and the effective date of the DSIC, then the equity return rate used in the calculation will be the equity return rate calculated by the Commission in the latest most recent Quarterly Report

The OCA submits that PAWC Wastewater's proposed tariff cannot be adopted until and unless the Company meets its burden of showing that all material changes are consistent with Act 11, 66 Pa. C.S. §§ 1350, *et seq.* and the Commission's Final Implementation Order.

The OCA's third concern relates to the applicability of the DSIC to the Franklin and Koppel systems. PAWC Wastewater witness Cox certified that PAWC Wastewater's last rate case was in 2013. Appendix C. He also indicates that the Franklin and Koppel systems were acquired after PAWC's last rate case. Id. In the Final Implementation Order, the Commission addressed the applicability of the DSIC to customers of companies acquired between rate cases as follows:

Comments: PAWC argues that projected revenue from customers who are acquired when utilities take over troubled companies should not be included in projected quarterly revenue (PQR) in the DSIC formula. PAWC also argues that the customers from the acquired company should not be surcharged for a DSIC until their rates have been established by a base rate case by the acquiring utility. PAWC at 17.

Resolution: We agree. It is the normal course of business for utilities to plan for the normal dynamics of customers entering and leaving their systems. It is appropriate for such customers' revenue stream to be factored into the DSIC calculation via the PQR and for such customers to be surcharged. However, revenue from customers acquired from troubled companies or by the acquisition

of such companies should not be factored into PQR and those customers should not be surcharged until their rates have been established by a base rate case of the acquiring utility. The projects affecting service to such customers are not eligible for DSIC treatment until it has been rolled into the acquiring utility's base rates. To the extent that extraordinary relief is required by the acquiring utility to accommodate the customers from the acquired utility, the acquiring utility and Commission should address that need in the proceeding relative to the acquisition.

Final Implementation Order at 52-54. The Commission then modified the model tariff to include a note at the end of the Formula section to reflect its finding on this issue. *Id.* Thus, it appears that the DSIC should not be applied to Franklin and Koppel customers. The proposed tariff does not distinguish Rate Zones 4 and 5 (which are the Franklin and Koppel rate zones) from the other rate zones or exclude Rate Zones 4 and 5 from the applicability of the proposed DSIC. This issue does not appear to have been addressed in the Petition or in the testimony. However, in the LTIP (Appendix B at page 7, Table 2), Franklin and Koppel property is included as eligible property for the DSIC. Applying the PUC's determination in the Final Implementation Order, the DSIC should not be applied to Franklin and Koppel until they are included in a base rate case for PAWC Wastewater and the DSIC eligible property of the Franklin and Koppel systems should be removed.

The OCA's fourth concern is the Company's failure to reflect accumulated deferred income taxes (ADIT) in its calculation of the DSIC. The DSIC is intended to be an exception to the prohibition against single-issue ratemaking; however, that single issue must be calculated fairly and correctly. To make the DSIC calculation correct (to allow recovery only for costs actually incurred by the utility), the rate base on which the pretax return is calculated must reflect an offset for ADIT. If the balance of ADIT is not recognized, PAWC Wastewater will be allowed to earn a return on DSIC incorrectly assuming that all of that plant was paid for with investor-supplied capital when, in fact, it was partially paid for with zero-cost capital in the form

of ADIT. The calculation of investment on which PAWC Wastewater is entitled to earn a return for DSIC purposes should be no different than the calculation of the balance for purposes of base rates. That is, the eligible balance should equal plant less accumulated depreciation on that plant, less ADIT associated with that plant.

The OCA is also reviewing the Company's calculation of state income taxes in the DSIC revenue requirement determination to ensure that ratepayers receive the full benefit of tax deductions. The actual taxes paid doctrine provides that a utility is only permitted to charge rates which reflect its actual tax expense for any given year. Barasch v. Pa. P.U.C., 507 Pa. 496, 491 A. 2d 94 (1985); Pittsburgh v. Pa. P.U.C., 182 Pa. Super. 551, 128 A.2d 372 (1956); Public Systems v. FERC, 709 F.2d 73, 76 (6th Cir. 1983).

III. CONCLUSION

The surcharge proposed by Pennsylvania-American Water Company Wastewater Operations is contrary to Pennsylvania case law, as well as several well-established principles of sound ratemaking. The surcharge as proposed would also constitute bad regulatory policy. The OCA respectfully requests that the Commission reject the proposed surcharge, for the reasons set forth above.

Respectfully submitted,



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Dated: July 23, 2014

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CERTIFICATE OF SERVICE

Re: Petition of Pennsylvania-American Water Company Wastewater Operations
For Approval of Long Term Infrastructure Improvement Plan and Approval to
Establish and Implement a Distribution System Improvement Charge
Docket No. P-2014-2431005

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

Dated this 23rd day of July, 2014.

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