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March 1, 2018

Via Electronic Filing

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

In re: Docket No. R-2017-2624240, *et al.*
Pa. P.U.C., *et al.* v. The Newtown Artesian Water Company

Dear Secretary Chiavetta:

We are counsel to The Newtown Artesian Water Company in the above matter and are submitting, via electronic filing with this letter, the Company's Exceptions to the Recommended Decision of Deputy Chief Administrative Law Judge Christopher P. Pell. Copies of the 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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**Before The
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Deputy Chief Administrative Law Judge
Christopher P. Pell, Presiding**

Pennsylvania Public Utility Commission	:	Docket No. R-2017-2624240
Office of Consumer Advocate	:	Docket No. C-2017-2626954
	:	
v.	:	
	:	
The Newtown Artesian Water Company	:	

**EXCEPTIONS OF
THE NEWTOWN ARTESIAN WATER COMPANY
TO THE RECOMMENDED DECISION OF
DEPUTY CHIEF ADMINISTRATIVE LAW JUDGE CHRISTOPHER P. PELL**

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Dated: March 1, 2018

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I. INTRODUCTION

This proceeding concerns The Newtown Artesian Water Company's ("NAWC" or "Company") Supplement No. 126 to Tariff Water – Pa.P.U.C. No. 9 ("Supplement No. 126"), issued September 1, 2017, to become effective November 1, 2017.

Supplement No. 126 proposes to increase NAWC's existing Distribution System Improvement Charge ("DSIC") cap to 7.5% of the amount billed to customers consistent with Section 1358 of the Public Utility Code, 66 Pa. C.S. § 1358. NAWC's DSIC is currently capped at 5%. With the filing of its most recent quarterly DSIC at M-2018-2643814, the Company's DSIC calculation is already in excess of 5.0%.

By Order entered October 5, 2017, the Public Utility Commission ("Commission") instituted an investigation into the rates, rules, and regulations contained in Supplement No. 126 and, pursuant to Section 1308(b) of the Public Utility Code, 66 Pa. C.S. § 1308(b), suspended Supplement No. 126 by operation of law until May 1, 2018.

By Recommended Decision dated February 6, 2018, Deputy Chief Administrative Law Judge Pell recommended that the Commission deny the proposed increase to the DSIC cap. The Recommended Decision should be reversed as set forth in these Exceptions.

The Commission has allowed three other water utilities to increase their DSIC caps from 5.0% to 7.5%: Aqua Pennsylvania, Inc. ("Aqua"),¹ Pennsylvania American Water Company

¹ *Pa. P.U.C., et al. v. Aqua Pennsylvania, Inc.*, Docket No. R-2008-2079310 (Opinion and Order entered July 23, 2009).

(“PAWC”)² and United Water Pennsylvania Inc. (“United”).³ The Recommended Decision is inconsistent with these prior Commission decisions.

The Company, moreover, has a Commission approved Long Term Infrastructure Improvement Plan (“LTIIIP”) reflecting a significant acceleration of infrastructure improvements with projected DSIC eligible capital expenditures of \$4,251,000 for 2017 through 2021. The projected capital expenditures total approximately 41% of existing rate base and, on an annual basis, are more than double the historic level of capital expenditures.

Within the projected five year period, NAWC projects that all cast iron pipe (“CIP”) and asbestos cement pipe (“ACP”) more than 100 years old will be replaced.⁴ All remaining CIP and ACP mains are projected to be replaced within 40 years (in contrast to the roughly 72 year replacement rate that was found in March 2017 in the Focused Management and Operations Audit of NAWC at Docket No. D-2016-2559577). NAWC’s system will be safer and more reliable as a result of the replacement of CIP and ACP, which are more susceptible to breaks, leaks and corrosion.⁵

NAWC has not had a base rate proceeding since 2011. With the proposed increase to the DSIC cap, NAWC will be able to continue to postpone a base rate filing into some time in the future. In the absence of the DSIC cap increase, the Company will be forced into a base rate filing (or filings) to accommodate the recovery of its significant LTIIIP investment – the accelerated LTIIIP investment already approved by the Commission is, once again,

² *Petition of Pennsylvania-American Water Company*, Docket No. P-00062241 (Opinion and Order adopted July 11, 2007 and entered August 14, 2007).

³ *Petition of United Water Pennsylvania Inc. for Approval of a Tariff Supplement to Revise its Maximum Distribution System Improvement Charge to 7.5% of Billed Revenues*, Docket No. P-2013-2389331 (Order entered December 19, 2013).

⁴ Less than 1% of NAWC’s distribution system is over 100 years old. This small percentage of aged pipe, however, is the focal point of eligible property to be replaced under the LTIIIP. NAWC St. No. 2, Attachment 1 at 6.

⁵ NAWC St. No. 2, Attachment 1 at 4 – 5 and 13 – 14.

approximately 41% of existing rate base and more than double the level of historic capital expenditures on an annual basis.

The Bureau of Investigation and Enforcement did not oppose the proposed increase to the DSIC cap. Only the OCA opposed the cap increase. While the OCA's opposition may be consistent with its position in other proceedings, it is wholly inconsistent with prior Commission decisions. In 2007, Commissioner Fitzpatrick described the opposition of the OCA (and, at that time, other parties) to an increase in the DSIC cap, proposed by PAWC, as logically inconsistent with legislative intent:

I support the well-reasoned Motion of Chairman Holland in this case. As the Motion recognizes, both Pennsylvania and the United States face a major problem with aging infrastructure. The General Assembly created a tool to combat this problem in the water industry when it authorized water companies to institute a distribution system improvement charge (DSIC). Based upon the record in this proceeding, it is clear that allowing Pennsylvania American Water Company to raise its DSIC cap from 5% to 7.5% of billed revenues is consistent with the purpose of the General Assembly in establishing a DSIC.

The parties that opposed raising the DSIC cap in this proceeding used logic that is inconsistent with establishing a DSIC in the first place--they plainly do not favor allowing a utility to collect expenditures outside of base rate proceedings. While the policy that utility expenditures will only be recovered in setting base rates still applies in most situations, the General Assembly has created an exception for expenditures by water utilities for distribution system infrastructure. Our decision today is consistent with the legislative intent in establishing the DSIC mechanism.⁶

Commissioner Fitzpatrick's criticism of the OCA's "logic" has even greater application today than it did in 2007. Subsequent to the PAWC proceeding, the General Assembly enacted Act 11 of 2012 ("Act 11") including Section 1358(a)(2). Unlike the statutory circumstances in 2007, current statutory law expressly allows a DSIC cap of 7.5% for water utilities.⁷

⁶ *Petition of Pennsylvania-American Water Company*, Docket No. P-00062241 (Opinion and Order adopted July 11, 2007 and entered August 14, 2007, concurring statement of Commissioner Terrance J. Fitzpatrick).

⁷ Section 1358(a)(2) of the Public Utility Code, 66 Pa. C.S. § 1358(a)(2).

Indeed, we submit that Act 11 reflects a legislative *quid pro quo* that, in return for an approved LTIP with accelerated replacement of infrastructure, a water utility may request and receive a DSIC that does not exceed 7.5%. Notably, a permitted DSIC cap of 7.5% for water utilities under Section 1358(a)(2) is in clear contrast to all other utility types, which, unlike water utilities, must, under Section 1358(a)(1), petition for a waiver of a 5% DSIC cap.

The DSIC eligible projects projected and accelerated as part of the Company's Commission approved LTIP will further the continued provision of reasonable and adequate service. It is entirely appropriate and in the public interest that the DSIC cap be increased so that the LTIP projects may be reflected in the DSIC calculation.⁸ Increasing the DSIC cap will enable the Company to meet its five-year LTIP on time, without undue delays, and will reduce the need for more frequent, and costly, base rate proceedings.⁹

NAWC submits the following Exceptions to the Recommended Decision. The Commission should reverse the Recommended Decision and, as expressed herein and in the Company's Main and Reply Briefs, approve NAWC's Supplement No. 126, as filed, increasing the DSIC cap to 7.5% of billed revenue.¹⁰

⁸ NAWC St. No. 1R at 2.

⁹ NAWC St. No. 1R at 6.

¹⁰ Pursuant to 52 Pa. Code Section 5.533, NAWC will incorporate into its Exceptions, by reference and citation, relevant pages of its previously filed Main and Reply Briefs.

II. EXCEPTIONS

EXCEPTION NO. 1 - APPLICABLE LEGAL STANDARDS – BURDEN OF PROOF

NAWC excepts to the burden of proof analysis and the failure of the Recommended Decision to recognize that Supplement 126 is a non-general rate filing. Recommended Decision, Section IV.A.1., pages 9 and 10, and Conclusion of Law 8, page 69. NAWC has met its burden of proof and Supplement No. 126 should be allowed to go into effect, as filed, on May 1, 2018.

NAWC acknowledges that Section 315 of the Public Utility Code, 66 Pa. C.S. § 315, places the burden of proof upon it to show that its proposed DSIC cap increase to 7.5% is just and reasonable. NAWC, however, disagrees with the burden of proof analysis presented in the Recommended Decision.

Supplement No. 126 presents a non-general rate filing for Commission consideration. The Commission in its Order entered October 5, 2017, suspended Supplement No. 126 pursuant to Section 1308(b) acknowledging that Supplement No. 126 is *not* a general rate filing.¹¹ The DSIC cap increase, moreover, is *not* in excess of 3.0% of NAWC's gross operating revenue.¹²

It is well established that, because of their modest nature, the Commission, in non-general rate filings, may determine whether a public utility's rates are just and reasonable based on the general information required under 52 Pa. Code § 53.52(b).¹³ The general information provided by the Company in response to Section 53.52(b)¹⁴ establishes that Supplement No. 126 and the proposed increase to the DSIC cap – a non-general rate increase – is just and reasonable.

¹¹ Non-general rate filings are addressed in Section 1308(b) of the Code, while general rate filings are dealt with in Section 1308(d) of the Code. *Popowsky v. Pa. P.U.C.*, 683 A.2d 958, 961 (Pa. Commw. 1996).

¹² Section 1308(d) defines a general rate filing as “a tariff filing which affects more than 5% of the customers and amounts to in excess of 3% of the total gross annual intrastate operating revenues of the public utility.”

¹³ *Popowsky v. Pa. P.U.C.*, 683 A.2d at 961 (Pa. Commw. 1996).

¹⁴ NAWC Exhibit I, Supporting Information for Supplement No. 126 at 7 – 9.

The burden of proof analysis presented in the Recommended Decision commits an error of law by failing to account for the fact that Supplement No. 126 is a modest, non-general rate filing. As explained by the Commonwealth Court, if the analysis presented in the Recommended Decision applied, there would be no significant difference between non-general rate filings under Section 1308(b) and general rate filings under Section 1308(d).¹⁵

Irrespective of the applicable standard, we submit, as set forth in our Main and Reply Briefs and the following Exceptions, that NAWC has met its burden to support its proposed DSIC cap of 7.5%. A DSIC cap of 7.5% is just and reasonable, allowed by clear and unambiguous statutory law, supported by the evidence of record and indistinguishable from prior decisions of this Commission allowing DSIC caps of 7.5% for three other Pennsylvania water utilities.

NAWC's Exception No. 1 should be granted. As set forth above and in the Company's Main Brief, Section I.B, and Reply Brief, Section I.B, NAWC has met its burden of proof and Supplement No. 126, a non-general rate filing, should be allowed to go into effect, as filed, on May 1, 2018.

EXCEPTION NO. 2 - NAWC'S REQUEST TO INCREASE THE DSIC CAP

NAWC excepts to the conclusion that its request for an increase in the DSIC cap from 5.0% to 7.5% should be denied. Recommended Decision, Section IV.B, pages 13 through 31 and Conclusion of Law 8, page 69. NAWC has met its burden of proof and Supplement No. 126 should be allowed to go into effect, as filed, on May 1, 2018.

The Recommended Decision concludes that NAWC failed to present evidence that it has accelerated its rate of infrastructure replacement and also that an increase to the DSIC cap is necessary and in the public interest. On these bases, the Recommended Decision recommends

¹⁵ *Popowsky v. Pa. P.U.C.*, 683 A. 2d at 961 (Pa. Commw. 1996).

that the Company's request for an increase to the DSIC cap from 5.0% to 7.5% be denied. The Recommended Decision is incorrect in fact and law.

A. Legal Standard for Increasing the DSIC Cap

1. Section 1358(a)(2)

Section 1358(a)(2) of the Public Utility Code states, in clear and unambiguous language, that a water utility DSIC may not exceed 7.5% of the amount billed to customers:

(2) A distribution system improvement charge granted to a water utility under former Section 1307(g) ... or this subchapter may not exceed 7.5% of the amount billed to customers.

Section 1358(a)(2) clearly contemplates a DSIC cap of 7.5% for water utilities and NAWC submits that the plain language of the Section supports the simple tariff change proposed through Supplement No. 126. NAWC is allowed by statute to increase its DSIC to 7.5% and its proposed DSIC cap of 7.5% is just and reasonable.¹⁶ Through the above codification, the General Assembly recognized the reasonableness of prior Commission decisions allowing a DSIC cap of 7.5% for water utilities.

We submit, further, that the totality of Act 11 reflects a legislative *quid pro quo* that, in return for the accelerated replacement of infrastructure reflected in a Commission approved LTIP, a water utility may request and receive a DSIC that does not exceed 7.5%. Here, NAWC has projected and the Commission has approved accelerated investment over the next five years totaling 41% of existing rate base and more than double its annual level of historic capital expenditures. Act 11 contemplates a DSIC cap of 7.5% to accommodate this significant investment.

¹⁶ The Statutory Construction Act of 1972 explains that “[t]he object of all interpretation and construction of statutes is to ascertain and effectuate the intention of the General Assembly.” 1 Pa.C.S. § 1921(a). In order to ascertain the intent of the General Assembly, the ruling body should first look at the plain language of the statute. *Commonwealth v. Segida*, 985 A.2d 871, 874 (Pa. 2009). When the language of the statute is free from all ambiguity, the letter of the statute is to be followed. 1 Pa.C.S. § 1921(b). The plain language of Section 1358(a)(2) contemplates a DSIC cap of 7.5% for water utilities.

2. The Commission's Decisions Allowing Other Water Utilities to Increase Their DSIC Cap to 7.5%

The Commission has approved and allowed United, Aqua and PAWC to increase their DSIC caps from 5.0% to 7.5%.¹⁷ There is no basis upon which these requests of other Pennsylvania water utilities to increase their DISC cap, ultimately approved by the Commission, can be distinguished from the request of NAWC to increase its DSIC cap. Indeed, we submit that, based on the Commission's prior approvals, a water utility request to increase its DSIC cap to 7.5% is not even controversial.¹⁸ Significantly, to NAWC's knowledge, the Commission has *never* rejected a request by a water utility to increase its DSIC cap from 5% to 7.5%.¹⁹

Of the three prior Commission approvals, the United proceeding is the most recent. There, the Commission in its Order entered December 19, 2013, at P-2013-2389331,²⁰ approved United's petition to revise its maximum DSIC rate to 7.5% of billed revenue. The Order entered December 19, 2013, which was entered subsequent to the enactment of Act 11, is a short seven pages and explains that United's proposed DSIC cap of 7.5% was not opposed and no hearings were held. It explains further that I&E filed a letter stating that the United petition was consistent with the previously approved requests of PAWC and Aqua to increase their respective DSIC caps to 7.5% and that approval of the United petition was warranted.²¹

¹⁷ Some of the reasons identified by the Commission for increasing the maximum DSIC surcharge percentage for other water utilities include: (1) to provide water utilities with the resources to accelerate the rate of aging water distribution system infrastructure replacement in a timely, cost-effective manner; (2) to recover the fixed costs (depreciation and pre-tax return) of certain nonrevenue producing, non-expense reducing distribution system improvement projects completed and placed in service between base rate cases; and (3) to reduce the potential need for more frequent base rate proceedings, with their attendant increased rate case expense. Additionally, rate payers benefit from the DSIC through infrastructure remediation and improved service and service reliability. NAWC St. No. 1 at 4. Each of these reasons exists here in support of NAWC's proposed increase to its DSIC cap.

¹⁸ We submit that the absence of controversy is confirmed by the fact that I&E did not find it necessary to participate in this proceeding.

¹⁹ *See* Tr. 52.

²⁰ The Order entered December 19, 2013 is included in the evidentiary record as NAWC Cross Examination Ex. No. 1.

²¹ I&E, similarly, has not opposed a DSIC cap of 7.5% for NAWC in this proceeding. *See* Tr. 54.

The Order entered December 19, 2013, increasing the United DSIC cap explains as follows:

The Commission previously approved maximum DSIC rates of 7.5% of billed revenues for two other Pennsylvania water utilities. *See Re: Petition of Pennsylvania-American Water Company for Approval to Implement a Tariff Supplement . . . Revising the Distribution System Improvement Charge*, PA PUC Docket No. P-00062241 (Order entered July 11, 2007) (“PAWC Order”); *Aqua Pennsylvania, Inc. Supplement No. 88 to Tariff Water – PA P.U.C. No. 1, (Revision of Distribution System Improvement Charge)*, PA PUC Docket No. R-2008-2079310 (Order entered July 23, 2009).

By letter of November 21, 2013, the Bureau of Investigation and Enforcement stated that it is of the opinion that the terms and conditions contained in UWPA’s Petition are consistent with the previously approved requests of Pennsylvania American Water Company and Aqua Pennsylvania Water Inc. where such relief was sought, and as such, approval of the Petition is warranted. On November 20, 2013, the Office of Small Business Advocate filed a Notice of Intervention which was subsequently withdrawn on November 25, 2013. No other protests were filed and no hearings were held.

The Main Replacement Study examined the current composition of UWPA’s 877 miles of pipe and identifies the pipe that is at greatest risk of failure based on main break history. The UWPA system contains the following types of at-risk pipe: asbestos cement (26%); cast iron (18%), and small-diameter galvanized steel (2%). While such pipe collectively accounts for only 46% of UWPA’s system, it accounts for 83% of the main breaks. Accordingly, the Main Replacement Study concludes and proposes that UWPA focus particular attention on such pipe and replace it on an accelerated basis.

The Main Replacement Study also analyzes the costs of main replacement, finding that costs have increased dramatically since the DSIC was first approved in 1998 and the DSIC cap was initially set at 5.0%. The actual average cost per foot of main replacement in 2012 was \$176.36 – *i.e.*, a 241% increase over the cost per foot experienced in the year 2000. The increased cost is largely driven by municipal demands for roadway remediation. The effect of the increased costs is that a 5.0% DSIC cap allows for far fewer projects today than it did when the DSIC was first implemented. An increase to a 7.5% cap would help to ameliorate the impact of increased main replacement costs and allow UWPA to accelerate, on an incremental basis, its main replacement.

In addition to an accelerated main replacement cycle with a focus on at-risk pipe, the Main Replacement Study concludes that an increase to UWPA’s maximum DSIC rate to 7.5% would benefit UWPA customers by reducing the

frequency of base rate filings, reduce Non-Revenue Water, enhance fire protection and reduce service and public disruptions and low pressure.²²

In the Aqua proceeding approving that company's request to increase its DSIC cap to 7.5%, the Commission cited its approval of the PAWC petition and summarized the purpose of the DSIC as follows:

The purpose of the DSIC is: (1) to provide water utilities with the resources to accelerate the rate of aging water distribution system infrastructure replacement in a timely, cost-effective manner; (2) to recover, through a sliding scale of rates, the fixed costs (depreciation and pre-tax return) of certain non-revenue producing, non-expense reducing distribution system improvement projects completed and placed in service between base rate cases; (3) to facilitate the achievement of the Commission's policy at 52 Pa. Code §§ 69.701 and 69.711 of promoting the acquisition of small and non-viable water systems; (4) to promote the Commission's policy at 52 Pa. Code § 69.721 of regionalization of water systems; and (5) to reduce the potential need for more frequent base rate proceedings, with their attendant increased rate case expense. *See generally Re: Petition of Pennsylvania-American Water Company for Approval to Implement a Tariff Supplement To Tariff Water-PA P.U.C. No. 4 Revising the Distribution System Improvement Charge*, Docket Nos. P-00062241, *et al.*, (July 11, 2007) (*PAWC Petition*).²³

The Commission in its Aqua decision also discussed the benefits of the DSIC to rate payers.

DSIC-approved projects include main and valve replacement, main cleaning and relining, fire hydrant replacement, main extensions to eliminate dead ends, solutions to regionalization projects and meter change outs. Ratepayers benefit from the DSIC through infrastructure remediation and improved service and service reliability.²⁴

NAWC's Supplement No. 126 and proposed increase in its DSIC cap to 7.5% is fully consistent with the DSIC purpose as explained by the Commission in its prior decisions approving DSIC caps of 7.5% for United, Aqua and PAWC. Supplement No. 126 and proposed

²² NAWC Cross Examination Ex. No. 1 at 4 – 5.

²³ Opinion and Order entered July 23, 2009 at R-2008-2079310, slip op. at 4 and 5; NAWC Exhibit I, Supporting Information for Supplement No. 126 at 3 – 4.

²⁴ Opinion and Order entered July 23, 2009 at R-2008-2079310, slip op. at 5; NAWC Exhibit I, Supporting Information for Supplement No. 126 at 4.

increase in the DSIC cap to 7.5% will facilitate the implementation of the accelerated infrastructure investment reflected in the Company's approved LTIP. Customers will benefit from the increased cap through the related accelerated infrastructure remediation and corresponding decline in the number of main breaks and service interruptions, increased fire protection and an improvement in water quality through replacement, lining, cleaning and tie-ins.²⁵

B. Accelerated Infrastructure Replacement

The Company's annual infrastructure expenditures will more than double – a significant acceleration of infrastructure investment – as a result of its approved LTIP. At page 14 of its Order entered July 12, 2017, at P-2017-2594725 (“Order entered July 12, 2017”), the Commission expressly noted the acceleration as follows:

“Upon review of Newtown's LTIP and all supplemental information filed, the Commission finds that the requirements of element six of the Final Implementation Order, the manner in which replacement of aging infrastructure will be *accelerated* and how repair, improvement or replacement will maintain safe and reliable service, have been fulfilled.” (emphasis added)²⁶

The acceleration is readily apparent for the Tables 4 and 7 of the Order entered July 12, 2017. As demonstrated in Table 7, reproduced below, NAWC's average annual capital expenditures were approximately \$341,000 for the historic five year period 2012 – 2016:²⁷

²⁵ NAWC Exhibit I, Supporting Information for Supplement No. 126 at 4.

²⁶ A copy of the Order entered July 12, 2017 at P-2017-2594725 is included in the evidentiary record as Attachment 1 to NAWC Statement No. 2.

²⁷ $\$1,704,578 \div 5 \text{ years} = \$340,916$. NAWC St. No. 2, Attachment 1 at 12. In Finding of Fact 6, the Recommended Decision presents an historic, average annual DSIC expenditure of \$478,513 citing NAWC Statement No. 2, Attachment 1, page 12. It does this by unreasonably excluding 2012 and 2013 from the calculation.

Table 7: Newtown Historic DSIC-Eligible Capital Improvement Program

Project Designation & Description*						Total Cost (\$)	Annual Expenditures (\$)				
Main Improvements	S	H	M	V	P		2012	2013	2014	2015	2016
Liberty St. Main Replacement – 775 LF	27	2		5	CIP	117,927		117,927			
Yardley Pike Main Replacement – 1,586 LF	3	3		11	ACP	385,856			385,856		
Frost Lane Main Replacement – LF	13	2		0	CIP/ACP	157,515				157,515	
South State St. Main Replacement – 933 LF	14	2		9	CIP	366,896					366,896
Fire Hydrants		5				23,964		5,734	7,743		10,487
Meter Replacements			1,661			652,420	83,853	61,525	63,427	174,386	269,229
Distribution Total						1,704,578	83,853	185,186	457,026	331,901	646,612

*Note: S=Services H=Hydrants M=Meters V=Valves P=Pipe Type

In comparison, Table 4, reproduced below, projects annual expenditures of approximately \$850,000 for the projected five year period 2017 – 2012.²⁸ NAWC’s projected annual expenditures, thus, are more than double the level of historic annual expenditures and a clear and significant acceleration of infrastructure replacement. Once again, the total projected investment for the projected period is approximately 41% of current rate base.

Table 4: Newtown Five-Year DSIC-Eligible Capital Improvement Program

Project Designation & Description*						Total Cost (\$)	Estimated Annual Expenditure (\$)				
Main Improvements	S	H	M	V	P		2017	2018	2019	2020	2021
Maple St. Main Replacement – 690 LF	8	0		2	CIP	190,000		190,000			
N. Chancellor St. Main Replacement – 2,120 LF	14	1		7	CIP	750,000			375,000	375,000	
S. Chancellor St. Main Replacement – 1,850 LF	42	2		5	CIP	650,000			650,000		
Liberty St. Main Replacement – 700 LF	12	1		2	CIP	225,000					225,000
State St. Main Replacement – 940 LF	40	1		7	CIP	650,000	650,000				
Fire Hydrants		20				125,000	25,000	25,000	25,000	25,000	25,000
Meter Replacement Plan			3,978			1,661,000	355,000	269,000	369,000	338,000	330,000
Distribution Total						4,251,000	1,030,000	484,000	1,419,000	738,000	580,000

*Note: S=Services H=Hydrants M=Meters V=Valves P=Pipe Type

²⁸ \$4,251,000 ÷ 5 years = \$850,000. NAWC St. No. 2, Attachment 1 at 12. See also Recommended Decision, Finding of Fact 8. The State Street Main Replacement Project was originally projected at a cost of \$650,000 but was completed under budget at a cost of \$400,000. NAWC explained in its LTIIP petition that DSIC expenditures may rise or fall in any one year. NAWC St. No. 2, Attachment 1, slip op. at 13. Going forward, other LTIIP projects may be completed on budget or under or over budget but the fact that one project was under budget provides no basis for denying the DSIC cap increase as was contended by the OCA in Section III.A.2.d of its Main Brief.

The significant acceleration of infrastructure investment acknowledged and accepted by the Commission in the Order entered July 12, 2017 is substantial support for the proposed increase to the DSIC cap. The Recommended Decision failed to consider the accelerated infrastructure investment and concluded, incorrectly, that NAWC had not presented any evidence to establish that it will accelerate its rate of infrastructure replacement.²⁹ The Recommended Decision is contrary to the evidence of record and the Order entered July 12, 2017.

Citing the *Final Implementation Order*,³⁰ the Recommended Decision concludes that a *further* acceleration, beyond the significant acceleration already acknowledged and accepted by the Commission in the Order entered July 12, 2017 is required to support an increase to the DSIC cap.³¹ Neither Act 11 nor the *Final Implementation Order* requires a *further* acceleration (beyond the projected doubling of annual expenditures) to support the Company's modest, 2.5% increase to its DSIC cap. Significantly, the Order entered July 12, 2017 does not, in any way, preclude NAWC from increasing its DSIC cap to the statutory maximum of 7.5%. The Recommended Decision is inconsistent with Act 11, contrary to the evidence of record and the Order entered July 12, 2017.

While a further acceleration of infrastructure replacement is not required and the Company intends to meet its LTIIP commitment, increasing the DSIC cap will facilitate compliance with the LTIIP's timing. In the absence of the cap increase, LTIIP timing could be impacted due to the financial resources necessary and delays associated with more frequent rate

²⁹ Recommended Decision, slip op. at 27 and 30.

³⁰ *Implementation of Act 11 of 2012*, Docket No. M-2012-2293611, Final Implementation Order entered August 2, 2012 ("*Final Implementation Order*").

³¹ Recommended Decision, slip op. at 28 – 29; *See also* Recommended Decision, Finding of Fact 14, slip op. at 5.

cases that will arise without increasing the DSIC cap.³² Facilitating compliance with an LTIP is a recognized statutory justification for a DSIC.³³

NAWC submits that its Commission approved accelerated replacement of aging infrastructure – a more than doubling of the Company’s historic annual level of infrastructure replacement – is appropriate justification for the Company’s increase to its DSIC cap.

C. The Proposed Increase in the DSIC Cap is in the Public Interest

The Company’s proposed increase in the DSIC cap is in the public interest. Compliance with the Company’s accelerated infrastructure replacement schedule and LTIP plan elements will be facilitated by increasing the DSIC cap to the statutory maximum of 7.5%.³⁴ It will do this by allowing the Company to recover the fixed costs (depreciation and pre-tax return) of completed DSIC eligible LTIP projects until they, ultimately, are reflected in base rates in the Company’s next base rate case.³⁵ Increasing the DSIC cap also will provide the Company with the resources to continue the accelerated replacement of aging infrastructure and to comply with evolving regulatory requirements including compliance with the Commission approved LTIP.

The benefits are not one-sided. Increasing the DSIC cap also will benefit customers by reducing the frequency of base rate cases. Delaying the filing of base rate cases reduces rate case expense³⁶ and the Commission has consistently recognized a reduction in base rate cases (with their attendant increased rate case expense) as a benefit of DSIC cost recovery and a reason for

³² NAWC St. No. 1R at 3.

³³ See Section 1353(b)(2) of the Public Utility Code, 66 Pa. C.S. § 1353(b)(2).

³⁴ NAWC St. No. 1 at 3; NAWC St. No. 1R at 2 – 3; NAWC Exhibit I, Supporting Information for Supplement No. 126 at 3. The Company intends to meet its LTIP plan; however, adherence to the LTIP’s timing may be impacted due to the financial resources necessary and delays associated with more frequent rate cases that will arise without increasing the DSIC cap. NAWC St. No. 1R at 3.

³⁵ NAWC St. No. 1R at 4; Tr. 30.

³⁶ NAWC St. No. 1 at 5; NAWC Exhibit I, Supporting Information for Supplement No. 126 at 5.

increasing the DSIC cap.³⁷ It is likely that the frequency of DSIC cap related base rate cases will be cut in half as a result of increasing the DSIC cap to 7.5%.³⁸

Customers will benefit in additional ways as well. As presented in the Commission approved LTIP, the Company has pipe in need of replacement in the near term future. Additional customer benefits include a decline in the number of main breaks and service interruptions, increased fire protection and an improvement in water quality through replacement, lining, cleaning and tie-ins.³⁹ The value of accelerated infrastructure improvement in accordance with the approved LTIP is substantial, benefiting customers today and well into the future.⁴⁰

The foregoing benefits, notably, will occur without impeding existing customer safeguards. The General Assembly has included legislated safeguards within the DSIC process to ensure that the DSIC is appropriately monitored and that ratepayers are adequately protected. Safeguards assure that NAWC's DSIC is reflecting only DSIC eligible projects and that NAWC is not over-earning. Ultimately, the DSIC represents only the dollar-for-dollar recovery of prudent expenses incurred for improving reliability to customers.⁴¹

The Recommended Decision concludes, wrongly, that the Company failed to demonstrate that increasing the DSIC cap is necessary and in the public interest. Significant in this regard is the Recommended Decision's failure to acknowledge that increasing the DSIC cap will postpone the filing of a base rate case or case. This failure to acknowledge the benefit of postponement of

³⁷ NAWC St. No. 1R at 4.

³⁸ NAWC St. No. 1 at 5; NAWC St. No. 1R at 3. NAWC has expended \$1.4 million on capital projects since its last base rate case in 2011, while projecting expenditures of \$4.3 million over the next four years. Obviously, there will be more base rate cases going forward than has been the case historically. Increasing the DSIC cap, however, will alleviate the sheer number of rate cases going forward. Tr. 32 – 33.

³⁹ NAWC St. No. 1 at 5.

⁴⁰ NAWC St. No. 1 at 5.

⁴¹ NAWC Exhibit I, Supporting Information for Supplement No. 126 at 4.

base rate cases is inconsistent with legislative intent⁴² and with statements of the Commission in the previously cited United and Aqua proceedings. The postponement of base rate cases is a recognized public benefit of a DSIC. The evidence of record here is that it is likely that the frequency of DSIC cap related base rate cases will be cut in half as a result of increasing the DSIC cap to 7.5%.⁴³

Citing the fact that the Company has not had a base rate proceeding since 2011, the Recommended Decision also finds unconvincing the Company's argument that increasing the DSIC cap will benefit customers by reducing the frequency of base rate cases.⁴⁴ Rather than allowing the Company to increase its DSIC cap, the Recommended Decision would reject the proposed increase and, instead, require the Company to file a time consuming and costly base rate proceeding. A time consuming and costly base rate proceeding is not a customer benefit. Postponing a base rate case and reducing the frequency of base rate cases is a recognized customer benefit.

NAWC submits, moreover, that it is a misreading of the Commission's prior decisions in the PAWC, Aqua and United proceedings, where the Commission allowed DSIC caps of 7.5%, to suggest, as the Recommended Decision does (by relying on testimony of OCA witness Mierzwa), that there is a rate case interval beyond which the Commission would not allow a cap increase.⁴⁵ Irrespective of a utility's current rate case interval, reducing the potential need for

⁴² See Statement of Commissioner Fitzpatrick, *supra*.

⁴³ NAWC St. No. 1 at 5; NAWC St. No. 1R at 3. As Mr. Walker explained, NAWC has expended \$1.4 million on capital projects since its last base rate case in 2011, while projecting expenditures of \$4.3 million over the next four years. Obviously, there will be more base rate cases going forward than has been the case historically. Increasing the DSIC cap, however, will alleviate the sheer number of rate cases going forward. Tr. 32 – 33.

⁴⁴ Recommended Decision, slip op. at 29 – 30.

⁴⁵ Recommended Decision, slip op. at 29 – 30. See *Petition of UGI Central Penn Gas, Inc. for a Waiver of the Distribution System Improvement Charge (DSIC) Cap of 5% of Billed Distribution Revenues and Approval to Increase the Maximum Allowable DSIC to 10% of Billed Distribution Revenues*, Docket No. P-2016-2537609 (Order entered May 10, 2017), slip op. at 39, where the Commission explained, in the context of a gas utility petition

more frequent base rate proceedings, with their attendant increased rate case expenses, is an accepted justification for a DSIC and an increase in the DSIC cap.⁴⁶ We also submit that further increasing the interval between base rate cases should be encouraged, not discouraged.⁴⁷ Rather than force the Company into a base rate filing, an increase in the DSIC cap to 7.5% is just and reasonable and a recognized public benefit.

The Recommended Decision concludes further that the Company's proposed increase in the DSIC cap should be denied because the Company's DSIC has never reached the 5% cap.⁴⁸ The fact that the Company's DSIC, in the past, has been rolled back and restarted before reaching the 5% cap has no bearing on the reasonableness of the Company's present request. Again, the Company has a Commission approved LTIP with accelerated infrastructure replacement that calls for investment totaling \$4,251,000 for 2017 through 2021 and equals 41% of the Company's existing rate base. Both in dollar terms and on a percentage basis, the Company's LTIP commitment is, obviously, significant. Irrespective of whether its DSIC has ever exceeded 5% in the past, the Company's DSIC presently exceeds 5%.

D. Conclusion

NAWC's Exception No. 2 should be granted for all the reasons set forth above and in the Company's Main Brief, Section III.A, and Reply Brief, Section III.A. The proposed increase in the DSIC cap is supported by a substantial acceleration of infrastructure investment approved by the Commission in the Order entered July 12, 2017, necessary and reasonable and in the public

pursuant to Section 1358(a)(1), that "it is our policy to conduct an evaluation of a DSIC cap waiver request on a case-by-case basis on the merits of the record evidence in each individual case."

⁴⁶ *Pa. P.U.C., et al. v. Aqua Pennsylvania, Inc.*, Docket No. R-2008-2079310 (Opinion and Order entered July 23, 2009), slip op. at 4 and 5; NAWC Exhibit I, Supporting Information for Supplement No. 126 at 3 – 4.

⁴⁷ Aqua PA, for example, has a DSIC cap of 7.5% and its last base rate filing was in 2011. So, the DSIC cap, apparently, accomplishes the desire of both the Commission and the General Assembly – that is, to elongate the time period between rate cases in order to reduce rate case expense. Tr. 31 – 32.

⁴⁸ Recommended Decision, slip op. at 30.

interest. The DSIC eligible projects projected as part of the Commission approved LTIP will further the continued provision of reasonable and adequate service. It is entirely appropriate that the DSIC cap be increased so that they may be reflected in the DSIC calculation.⁴⁹ Increasing the DSIC cap will enable the Company to meet its five-year LTIP on time, without undue delays, and will reduce the need for more frequent, and costly, base rate proceedings.⁵⁰

EXCEPTION NO. 3 - THE OCA'S "RED HERRING" ISSUES

NAWC excepts to the conclusion that recommendations of the OCA are properly raised within the context of this proceeding. Recommended Decision, Section IV.C and Section IV.C.6.a, pages 31-32 and 55-56.

In Exceptions Nos. 4 through 10 that follow this Exception No. 3, we except to recommendations of the OCA recommended to the Commission in the Recommended Decision. Preliminary to those Exceptions, we submit that the OCA unnecessarily complicated this case and the issue of whether NAWC should be allowed to increase its DSIC cap to 7.5%. Section 1358 of the Public Utility Code provides that a water utility DSIC may not exceed 7.5%. NAWC has filed a tariff supplement proposing to do no more than increase its DSIC cap to the statutory maximum.

The recommendations proposed by the OCA and recommended by the Recommended Decision, by and large, do not address the issue of whether NAWC should be allowed to increase its DSIC cap to 7.5%; rather they raise "red herring" issues. The OCA has the burden of proof in regard to these issues and NAWC submits that the OCA has failed to meet its burden. Indeed,

⁴⁹ NAWC St. No. 1R at 2.

⁵⁰ NAWC St. No. 1R at 6.

the OCA has failed to demonstrate any nexus between NAWC's simple request for a DSIC cap of 7.5% and its many recommendations.⁵¹

NAWC's Exception No. 3 should be granted. As set forth above, in the Company's Main Brief, Section III.B, Reply Brief, Section III.B and Exceptions 4 through 10, the Commission should reverse the Recommended Decision and reject the recommendations of the OCA.

EXCEPTION NO. 4 - APPLICATION OF ACT 40 TO DSIC MECHANISM

*NAWC excepts to the conclusion that Act 40 of 2016 applies to this proceeding and to NAWC's DSIC mechanism. Recommended Decision, Section IV.C.1 and Section IV.C.6.b, pages 32 through 36 and 56 through 58.*⁵²

The Recommended Decision concludes that Act 40 of 2016 applies to this proceeding. NAWC excepts to this attempt to apply Act 40 to this proceeding and to the Company's DSIC mechanism.

Act 40 inserted a new Section 1301.1 into the Public Utility Code. Subsection (a) of the new Section states as follows:

(a) Computation.--If an expense or investment is allowed to be included in a public utility's rates for ratemaking purposes, the related income tax deductions and credits shall also be included in the computation of current or deferred income tax expense to reduce rates. If an expense or investment is not allowed to be included in a public utility's rates, the related income tax deductions and credits, including tax losses of the public utility's parent or affiliated companies, shall not be included in the computation of income tax expense to reduce rates. The deferred income taxes used to determine the rate base of a public utility for ratemaking purposes shall be based solely on the tax deductions and credits received by the public utility and shall not include any deductions or credits generated by the expenses or investments of a public utility's parent or any affiliated entity. The income tax expense shall be computed using the applicable statutory income tax rates.⁵³

⁵¹ NAWC St. No. 1R at 1 – 2.

⁵² NAWC also excepts to Findings of Fact 20 through 30 – Act 40 Issues, pages 6 and 7, of the Recommended Decision to the extent that these Findings are the bases for the Recommended Decision's proposed interpretation of Act 40.

⁵³ 66 Pa. C.S. § 1301.1.

Act 40 has no application to this proceeding and no bearing on NAWC's proposed DSIC cap increase. Act 40 addresses consolidated income tax expense for base rate purposes. Consolidated taxes are not relevant to NAWC since it is not a holding company nor a subsidiary of a holding company. NAWC is a stand-alone company. This proceeding, moreover, is not a base rate proceeding. A DSIC rate is a surcharge mechanism for the recovery of the costs related to the repair, improvement, and replacement of eligible property outside of a rate case. Surcharges are not part of a base rate proceeding.⁵⁴

The legislative history as recorded in the Pennsylvania House Journal clearly shows that the sole purpose of the Act was the elimination of the consolidated tax adjustment ("CTA"). In testimony before the House Consumer Affairs Committee ("Committee"), Commission Chairman Brown testified that "[t]he proposed bill introduces legislation that requires a public utility's federal income tax expense to be calculated on a 'stand-alone' basis ... *when establishing base rates* for the regulated public utility"⁵⁵ Committee Chairman Godshall explained the scope and application of Section 1301.1 in remarks on the House floor by stating that "this section applies to *base rate cases*" and "would only go into effect when a utility comes in for a *base rate case*." Concerned that the Bill was detrimental to ratepayers, the OCA asked the Committee to "table" the Bill "as it will negatively impact Pennsylvania ratepayers."⁵⁶

⁵⁴ NAWC St. No. 1R at 9.

⁵⁵ Prepared Testimony of Gladys M. Brown, Chairman, Pennsylvania PUC (Sept. 28, 2015), at 4, *available at* http://www.legis.state.pa.us/WU01/LI/TR/Transcripts/2015_0229_0004_TSTMNY.pdf. *See also* Public Hearing In Re: House Bill 1436, Pennsylvania House Consumer Affairs Committee (Sept. 29, 2015), Tr. at 41 (acknowledging receipt of testimony from Commission Chairman Brown for inclusion into the record), *available at* http://www.legis.state.pa.us/WU01/LI/TR/Transcripts/2015_0229T.pdf.

⁵⁶ Pennsylvania House Legislative Journal, 2016 Reg. Sess. No. 7, at 117 (emphasis added), *available at* <http://www.legis.state.pa.us/WU01/LI/HJ/2016/0/20160208.pdf>. Consistent with the rules of statutory construction, the ruling body should first look at the plain language of the statute to ascertain the intent of the General Assembly. *Segida*, 985 A.2d at 874. If, however, the plain words are not explicit, then intent may be gleaned from the contemporaneous legislative history. 1 Pa.C.S. § 1921(c)(7). Legislative history may include previous drafts of house bills, as well as statements made by legislators during the time of the statute's enactment. *See Commonwealth*

Irrespective of the testimony of Chairman Brown, the explanation of Committee Chairman Godshall and its own opposition to the Bill, the OCA contended, and the Recommended Decision agreed,⁵⁷ that the first sentence of Section 1301.1 has a very different and more expansive purpose than the elimination of the CTA. This one sentence, as contended by the OCA and recommended by the Recommended Decision, undoes a settled Commission DSIC computation methodology and a Commonwealth Court decision. We respectfully submit that the contention of the OCA and the recommended interpretation of Act 40 are not plausible.

While we are aware of a Recommended Decision of Administrative Law Judge Cheskis, dated July 26, 2017, in *Petition of Metropolitan Edison Company for Approval of a Distribution System Improvement Charge*, Docket No. P-2015-2508642 (“*MetEd*”), addressing Act 40 and apparently applying Act 40 to the DSIC calculations of electric utilities outside the context of a base rate case proceeding, the Recommended Decision remains pending before the Commission. Unless and until the Commission adopts the Cheskis Recommended Decision and then applies it to water utilities, Act 40 has no application NAWC’s DSIC mechanism. NAWC’s DSIC mechanism is in accordance with statutory and decisional law as discussed in Exception No. 5 *infra*.

More importantly, the issue at hand is simply whether NAWC should be permitted to increase the DSIC cap to 7.5% as allowed by statute. In whatever way it may ultimately be interpreted, Act 40 has no relevance to the issue of whether the Commission should approve Supplement No. 126 and allow NAWC to increase its DSIC cap to 7.5%.⁵⁸

v. *Wilson*, 602 A.2d 1290 (Pa. 1992) (relying on statements made by the legislature during the enactment process and recorded in the Legislative Journal to determine legislative intent).

⁵⁷ Recommended Decision, slip op. at 59.

⁵⁸ NAWC St. No. 1R at 9.

NAWC's Exception No. 4 should be granted. For all the reasons set forth above and in the Company's Main Brief, Section III.B.1, and Reply Brief, Section III.B.1, the Commission should reverse the Recommended Decision. Act 40 has no application to this proceeding.

EXCEPTION NO. 5 - REFLECTION OF FEDERAL AND STATE INCOME TAXES IN THE CALCULATION OF THE DSIC RATE

NAWC excepts to the conclusion that the Company be directed to account for and reflect all federal and state income tax deductions and credits in the calculation of the DSIC going forward. Recommended Decision, Section IV.C.1.a and Section IV.C.6.c, pages 37 through 40 and 58 through 61, and Conclusion of Law 9, page 69.

NAWC excludes accumulated deferred income taxes ("ADIT") and state income tax deductions and credits associated with DSIC plant from its DSIC calculations. The Company's DSIC calculation methodology is wholly consistent with the Commission's approved DSIC calculation methodology as affirmed by the Commonwealth Court in *McCloskey*.⁵⁹

Relying on its interpretation of Act 40, the Recommended Decision concludes that the Commission must now change its approved DSIC calculation methodology and, in this proceeding, direct NAWC to account for and reflect all federal and state income tax deductions and credits in its DSIC calculation going forward.⁶⁰

The Recommended Decision is contrary to statutory law. Act 11 of 2012 established a new Subchapter B – Distribution Systems within Chapter 13 of the Public Utility Code providing an additional mechanism – a DSIC – for recovery of costs related to the repair, improvement and replacement of eligible property.⁶¹ Within subchapter B, Section 1357 provides a method for

⁵⁹ *McCloskey v. Pa. P.U.C.*, 127 A.3d 860 (Pa. Cmwlth. 2015) ("*McCloskey*").

⁶⁰ Relating to the foregoing and as addressed in Exception No. 10, *infra*, the Recommended Decision also recommends that the Company be directed to amend its tariff to include the phrase "net of accumulated deferred income taxes and accumulated depreciation" in the definition of distribution system improvement projects.

⁶¹ Prior to Act 11 of 2012, only water utilities had Commission approved DSICs. With Act 11 of 2012, all utility types are allowed a DSIC.

computing the DSIC charge.⁶² ADIT is not part of the statutory computation. The statutory computation directs, moreover, that the pretax return includes Federal and State income taxes. NAWC computes its DSIC consistent with Section 1357.⁶³

The Recommended Decision is also contrary to decisional law. Following the enactment of Subchapter B, the Commission specifically rejected an attempt by the OCA to include ADIT and income tax deductions in the DSIC calculation. The Commission explained in its Final Implementation Order entered August 2, 2012 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;” that “[i]nclusion of an ADIT adjustment would be inconsistent with that goal and would likely invite litigation over its calculation;” and that statutory tax rates would be used in the DSIC calculation.⁶⁴

The OCA vigorously opposed the Commission’s DSIC calculation methodology and continued to contend that Section 1357 should be interpreted to reflect accumulated deferred income taxes and actual state and federal income taxes. The Commission rejected the OCA’s contentions. The OCA unsuccessfully appealed the Commission’s methodology to the Commonwealth Court. The Court affirmed the Commission and rejected the OCA’s contention in *McCloskey*.

Rather than follow the Commission’s directive and its conclusion 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,” the Recommended Decision concludes that Act 40 displaces both the Commission’s conclusion concerning ADIT and taxes as well as *McCloskey*.

⁶² 66 Pa. C.S. § 1357.

⁶³ NAWC St. No. 1R at 8.

⁶⁴ *Final Implementation Order*, slip op. at 31, 38 and 39; NAWC St. No. 1R at 10 and 12.

Act 40, however, concerns base rate cases and consolidated taxes neither of which is involved in this proceeding as set forth in Exception No. 4 *supra*. The Commission, moreover, has not adopted the Recommended Decision of Administrative Law Judge Cheskis in *MetEd*,⁶⁵ nor has it applied the Recommended Decision to water utilities.

NAWC's Exception No. 5 should be granted. For all the reasons set forth above and in the Company's Main Brief, Section III.B.1.a, and Reply Brief, Section III.B.1.a, the Commission should reverse the Recommended Decision. Act 40 has no application to the DSIC calculation and the Commission should reject the Recommended Decision and its proposed calculation of the DSIC rate.

EXCEPTION NO. 6 - REFLECTION OF INVESTMENT-RELATED INCOME TAX DEDUCTIONS IN THE APPLICATION OF THE EARNINGS CAP

NAWC excepts to the conclusion that Act 40 requires the inclusion of federal and state income tax deductions in the calculation of the overall return used to apply the DSIC earnings cap. Recommended Decision, Section IV.C.1.b and Section IV.C.6.d, pages 40 through 43, 61 and 62, and Conclusion of Law 10, page 69.

NAWC (and other utilities) file a quarterly financial report with the Commission pursuant to Chapter 71 of Title 52 of the Pennsylvania Code. The Company's Financial Reports, the most recent of which was filed November 30, 2017, at M-2017-2582572, for the 12-months ended September 30, 2017, are acceptable to Commission Staff.⁶⁶ The Company will continue to submit its quarterly financial reports as required by Chapter 71.

⁶⁵ *Petition of Metropolitan Edison Company for Approval of a Distribution System Improvement Charge*, Docket No. P-2015-2508642 (Recommended Decision dated July 26, 2017).

⁶⁶ *See* NAWC St. No. 1R at 7 in respect the refiled Financial Report for the 12-months ended June 30, 2017, which is included in the record as Attachment 1 to NAWC Statement No. 1R and discussed at pages 6 and 7 of NAWC Statement No. 1R.

At issue here, once again, is the interpretation of Act 40. The Recommended Decision concludes that Act 40 applies to Chapter 71 Financial Reporting and that the Act requires the inclusion of investment-related income tax deductions in the calculation of the earnings cap. This issue, which is a matter of policy applicable to the utility industry, has not been addressed by the Commission heretofore and, we submit, should not be addressed here.

Act 40, moreover, applies to a “public utility’s rates.”⁶⁷ The earnings cap is not a “public utility rate.” It, rather, is a quarterly submission required of utilities under 52 Pa. Code Chapter 71. Chapter 71 has a stated purpose of “establishing uniform and industry-wide financial reporting requirements designed to improve the Commission’s ability to monitor on a regular basis the financial performance and earnings of the ... public utilities subject to Commission jurisdiction.”⁶⁸

On the basis of its interpretation of Act 40, the Recommended Decision recommends that the Company be directed to include a federal tax normalization adjustment, similar to the adjustment in its November 2017 revised Financial Earnings Report, in all future earnings report. The Company, as set forth above, will continue to submit its quarterly financial reports as required by Chapter 71. Whether a federal tax normalization adjustment will be appropriate in “all” future earnings reports is a matter of policy for the utility industry and not something addressed by Act 40. Act 40 has no application to Chapter 71 financial reporting.

NAWC’s Exception No. 6 should be granted. For all the reasons set forth above and in the Company’s Main Brief, Section III.B.1.b, and Reply Brief, Section III.B.1.b, the Commission should reverse the Recommended Decision. Act 40 has no application to financial reporting under 52 Pa. Code Chapter 71.

⁶⁷ 66 Pa. C.S. § 1301.1(a).

⁶⁸ 52 Pa. Code § 71.1.

EXCEPTION NO. 7 -

EXCLUSION OF SHORT TERM DEBT FROM COST OF DEBT AND USE OF CURRENT LONG TERM DEBT

NAWC excepts to the failure of the Recommended Decision to recognize that the exclusion of short term debt and use of current long term debt in the DSIC calculation are offsetting. Recommended Decision, Section IV.C.2 and Section IV.C.6.e, pages 43 through 46 and 63 and 64, and Conclusion of Law 11, page 69.

The Recommended Decision recommends that, going forward, the Company should exclude short term debt and use the actual cost of long-term debt to calculate the DSIC rate and earnings cap. NAWC acknowledged that, going forward, it will eliminate short term debt from its DSIC calculation⁶⁹ and use the cost of long term debt in its DSIC calculation that is acceptable to Commission Staff.⁷⁰ The Company, accordingly, does not except to the exclusion of short term debt and use of actual cost of long-term debt.

We do except, however, to the failure of the Recommended Decision to acknowledge that the changes are offsetting. Based on present debt cost rates, the use of the actual cost of long term debt will decrease the DSIC charge. The exclusion of short term debt, however, will increase the DSIC charge. The offsetting nature of the adjustments bears on the issue of overcollections/refunds discussed in the following Exception No. 8 and should be recognized in the Commission's final order.

As also addressed in Exception No. 8 *infra*, the Company removed short term debt and included the current cost of long term debt in its most recent quarterly DSIC filing, effective February 1, 2018, at M-2018-2643814. The calculated DSIC was 5.44% (0.44% in excess of the current cap).

⁶⁹ NAWC St. No. 1R at 7.

⁷⁰ NAWC St. No. 1R at 14.

NAWC's Exception No. 7 should be granted. The Commission in its final order should recognize that the exclusion of short term debt and use of current long term debt in the DSIC calculation are offsetting.

EXCEPTION NO. 8 - OVERCOLLECTIONS/REFUNDS

NAWC excepts to the conclusion that NAWC's "miscalculation of its DSIC when it claims that it is approaching the DSIC cap also weighs heavily against granting the Company's request to increase its DSIC." Recommended Decision, Section IV.C.3 and Section IV.C.6.f, pages 46 through 51 and 64 and 65, and Conclusion of Law 11, page 69.

The Recommended Decision concludes that the Company miscalculated its DSIC rate by using an incorrect (historic) cost of debt since November 2013 rather than its actual (current) cost of debt and that this miscalculation may have given rise to a DSIC overcollection. The Recommended Decision further states that this miscalculation weighs heavily against granting the Company's request to increase its DSIC.

The Recommended Decision is incorrect to the extent that it is suggesting that the correction of the debt cost rate could reduce the DSIC calculation below the existing 5.0% cap. The Company removed short term debt and included the current cost of long term debt in its most recent quarterly DSIC filing of Supplement No. 129, effective February 1, 2018, at M-2018-2643814. The calculated DSIC (removing short term debt and using the current cost of long term debt of 5.56%) was 5.44%. The actual DSIC rate was, of course, capped at 5.0%. By secretarial letter dated January 29, 2018, the Commission advised that the Bureau of Audits had reviewed the DSIC filing and that it was permitted to go into effect as filed.

The Recommended Decision also is incorrect to the extent that it is suggesting that the correction of the debt cost rate might produce a material overcollection/refund for customers. We have gone back and recalculated the quarterly DSIC rate for each quarter from November

2013 (four years prior to the OCA's complaint) through August 2017 using the actual cost of long term debt and excluding short term debt.⁷¹ In each instance, the recalculated quarterly DSIC is *higher* than the actual DSIC charged to customers. We anticipated this possibility in our Main and Reply Briefs.⁷² The recalculation confirms an undercollection.

We do not except to providing the verified debt cost rate for 2013 through 2017 in the next 1307(e) reconciliation filing. The verification will show an undercollection and NAWC can then move forward and collect the undercollection through the reconciliation tariff filing. We, however, do except to this red herring issue being used as an attempted justification to deny the proposed increase to the DSIC cap.⁷³ This matter of the calculation of the historic DSIC has no bearing on the merits of the proposed increase in the DSIC cap to 7.5% going forward especially when the correction will demonstrate that customers have been historically undercharged. Section 1358(a)(2) states, in clear and unambiguous language, that a water utility DSIC may not exceed 7.5% of the amount billed to customers.

NAWC's Exception No. 8 should be granted. The matter of overcollections/refunds provides no basis for denying the Company's request to increase its DSIC cap to 7.5%.

⁷¹ OCA witness Mierzwa had presented a recalculation of the DSIC surcharge from November 2013 through November 2017 using the current combined cost of short term debt and long term debt and also included short term debt in the capital structure ratios in Schedule JDM – 5 to OCA St. No. 1. The calculated differentials range from -0.02% points in November 2013 to -0.20% points in November 2017.

⁷² NAWC Main Brief, Section III.B.3 and Reply Brief, Section III.B.3.

⁷³ NAWC continues to contend, moreover, that consideration of refunds is outside the scope of this proceeding and that the OCA's failure to plead a refund claim is a violation of due process. NAWC Main Brief, Section III.B.3.

EXCEPTION NO. 9 - PRIVATE FIRE PROTECTION

NAWC excepts to the recommendation that it begin charging the DSIC to private fire protection service customers. Recommended Decision, Section IV.C.4 and Section IV.C.6.g, pages 52 through 54 and 65 through 66, and Conclusion of Law 12, page 69.

NAWC does not charge the DSIC to either public or private fire protection service customers. The Recommended Decision recommends that the Company begin charging the DSIC to private fire protection customers.

Private and public fire protection service customers are similarly situated irrespective of the tariff language. Both are non-metered, flat rate customers.⁷⁴ The Company has always interpreted its tariff to exempt both public and private fire protection service from the DSIC and not charged the DSIC to private fire protection service customers. NAWC submits that the Commission should not upset this long standing practice.

Section 1358(a)(2) explains that all practices and procedures of a water utility operating under a DSIC prior to the effective date of the Section shall remain in effect unless specifically amended or revoked by the Commission. The Company's practice of not billing the DSIC to private fire protection customers has not been amended or revoked by the Commission.

NAWC's Exception No. 9 should be granted. For all the reasons set forth above and in the Company's Main Brief, Section III.B.4, and Reply Brief, Section III.B.4, the Commission should reverse the Recommended Decision and reject the recommendation that the Company begin charging the DSIC to private fire protection customers.

⁷⁴ NAWC St. No. 1R at 12.

EXCEPTION NO. 10 - RECOGNITION OF ACCUMULATED DEPRECIATION IN THE DSIC TARIFF

NAWC excepts to the recommendation that it should modify its Commission approved tariff to reflect accumulated depreciation and ADIT in its definition of DSI. Recommended Decision, Section IV.C.5 and Section IV.C.6.h, pages 54 through 55 and 67.

The Company's currently effective DSIC tariff language is patterned after the Model Tariff published by the Commission in its Supplemental Implementation Order entered September 15, 2016 at M-2012-2293611 following the enactment of Act 11 of 2012. The currently effective tariff defines DSI as follows:

“DSI = Original cost of eligible distribution system improvement projects.”

The Company's existing tariff language was submitted by the Company in compliance with the Supplemental Implementation Order and in compliance with the Model Tariff. The compliance filing was accepted by the Commission by Secretarial letter dated November 16, 2016 at R-2016-2575172.

The Recommended Decision recommends that the Company be directed to modify its approved definition of DSI to reflect the phrase “net of accumulated deferred income taxes and net of accumulated depreciation” as follows:

“DSI = Original cost of eligible distribution system improvement projects net of accumulated deferred income taxes and accumulated depreciation.”

The Recommended Decision suggests that its tariff recommendations are inconsequential but they are not. The Model Tariff uses the term “accrued depreciation,” not “accumulated depreciation” as recognized in footnote 10 of the OCA's Main Brief. The Final Implementation Order also uses the term “accrued depreciation,” not “accumulated depreciation” as recognized in footnote 1 of the Recommended Decision.

Although the OCA witness never used the phrase “accrued” depreciation, the OCA stated in its Main Brief that it “supports either phrasing.” As used by the OCA, “accrued” and “accumulated” are, however, not the same. It is clear from the OCA’s Main Brief that its use of the phrase “accumulated depreciation” has a specific meaning that is contrary to the Commission’s view of the DSIC calculation.

While the Secretarial letter of November 16, 2016, cited above, explains that it is not a determination that the Company’s tariff revisions are just and reasonable, the Recommended Decision offers no explanation how the recommended tariff modifications are required by statute or Commission policy. The modifications, in fact, are inconsistent with the Model Tariff.

The tariff modifications recommended in the Recommended Decision are matters of policy that, if implemented, would complicate the DSIC computation methodology. The complication that would be created as a result of the Recommended Decision was rejected by the Commission as set forth in Exceptions Nos. 4 and 5, *supra* and affirmed by the Commonwealth Court in *McCloskey*.

NAWC’s Exception No. 10 should be granted. For all the reasons set forth above and in the Company’s Main Brief, Section III.B.5, and Reply Brief, Section III.B.5, the Commission should reverse the Recommended Decision and reject the recommended changes to the tariff definition of DSI.

III. CONCLUSION

NAWC's proposed increase in the DSIC cap to 7.5% is supported by the evidence of record, allowed by clear and unambiguous statutory law, consistent with well-established Commission precedent, just and reasonable and in the public interest. The Commission should grant the Company's Exceptions as set forth above, reverse the Recommended Decision and approve NAWC's Supplement No. 126, as filed, increasing the Company's DSIC cap to 7.5% of billed revenue.

Respectfully submitted,

By 

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Dated: March 1, 2018

**Before The
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Chief Deputy Administrative Law Judge
Christopher P. Pell, Presiding**

Pennsylvania Public Utility Commission	:	Docket No. R-2017-2624240
Office of Consumer Advocate	:	Docket No. C-2017-2626954
	:	
v.	:	
	:	
The Newtown Artesian Water Company	:	

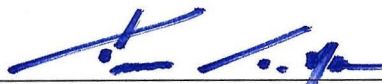
CERTIFICATE OF SERVICE

I hereby certify that I have this 1st day of March, 2018, served a true and correct copy of the Exceptions of The Newtown Artesian Water Company to the Recommended Decision of Deputy Chief Administrative Law Judge Christopher P. Pell, upon the persons and in the manner indicated below:

VIA EMAIL AND FIRST CLASS MAIL, POSTAGE PREPAID

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