



COMMONWEALTH OF PENNSYLVANIA  
PENNSYLVANIA PUBLIC UTILITY COMMISSION  
P.O. BOX 3265, HARRISBURG, PA 17105-3265

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July 24, 2018

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Secretary Rosemary Chiavetta  
Pennsylvania Public Utility Commission  
P.O. Box 3265  
Harrisburg, PA 17105-3265

PA PUC  
SECRETARY'S BUREAU  
FRONT DESK

Re: Pennsylvania-American Water Company- Wastewater Division  
Supplement No. 6 to Tariff Wastewater- Pa. P.U.C. No 16  
Docket No. R-2018-3002504

Dear Secretary Chiavetta:

Enclosed for filing please find the Formal Complaint of the Bureau of Investigation and Enforcement (I&E) in the above-captioned proceeding.

Copies have been served per the attached Certificate of Service. If you have any questions, please contact me at 717-783-7998.

Sincerely,

Allison C. Kaster  
Deputy Chief Prosecutor  
Bureau of Investigation and Enforcement  
PA Attorney I.D. No. 93176

ACK/smw  
Enclosure

cc: Certificate of Service  
Paul Zander (via e-mail)  
Sean Donnelly (via e-mail)

**PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**Formal Complaint**

**1. COMPLAINANT INFORMATION**

Richard A. Kanaskie, Chief Prosecutor

Pennsylvania Public Utility Commission  
Bureau of Investigation and Enforcement  
P.O. Box 3265  
Harrisburg, PA 17105-3265

Phone: (717) 787-4886  
Facsimile: (717) 772-2677

**2. FULL NAME OF UTILITY COMPANY**

Pennsylvania-American Water Company- Wastewater Division  
Supplement No. 6 to Tariff Wastewater-Pa. P.U.C. No. 16  
Docket No. R-2018-3002504

**3. TYPE OF UTILITY**

Wastewater

**4. COMPLAINT**

See attached

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**5. RELIEF**

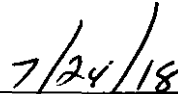
The Bureau of Investigation and Enforcement respectfully requests that the Commission:

- A. Reject Supplement Supplement No. 6 to Tariff Wastewater- Pa. P.U.C. No. 16; and
- B. Order PAWC to file a tariff supplement to employ one or more of the gross-up methods in compliance with the Commission's 1989 Investigation Order; or, in the alternative,
- C. Refer this matter to the Office of Administrative Law Judge for full evidentiary hearings to examine the reasonableness of PAWC's proposed Supplement No. 6.

**6. VERIFICATION AND SIGNATURE**

*I, Richard A. Kanaskie, Chief Prosecutor, hereby state that the facts above set forth are true and correct (or are true and correct to the best of my knowledge, information and belief) and that I expect to be able to prove the same at a hearing held in this matter. I understand that the statements herein are made subject to the penalties of 18 Pa. C.S. § 4904 (relating to unsworn falsification to authorities).*

  
 \_\_\_\_\_  
 (Signature of Complainant)

  
 \_\_\_\_\_  
 (Date)

**7. LEGAL REPRESENTATION**

Allison C. Kaster, Deputy Chief Prosecutor, PA Bar No. 93176  
 Pennsylvania Public Utility Commission  
 Bureau of Investigation and Enforcement  
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## COMPLAINT

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On June 5, 2018, Pennsylvania American Water Company (“PAWC” or “Company”) filed Supplement No. 6 to Tariff Water- Pa. P.U.C. No. 5 and Supplement No. 6 to Tariff Wastewater- Pa. P.U.C. No. 16 (collectively, “Supplement No. 6”) with an effective date of August 4, 2018. The Company filed Supplement No. 6 to memorialize how customer contributions, customer advances and certain customer deposits (collectively, “Contributions and Advances”) will be calculated as they are now taxable due to the recent Tax Cuts and Jobs Act (“TCJA”). Specifically, it is PAWC’s intent to adopt the “no gross-up” method to calculate Contributions and Advances, which allows it to segregate income taxes paid on Contributions and Advances into a deferred account and include those taxes in rate base in a future base rate proceeding. Under this method, the contributor of the capital is not charged the income tax associated with the deposit, advance or contribution as it is recovered from existing customers.

I&E opposes PAWC’s request to adopt the “no gross-up” method because current customers should not be required to subsidize the cost to construct new plant and serve new customers. PAWC should be required to continue to use the gross-up method where the contributor bears the total cost, including income taxes. Such taxes would not be included in rate base and recovered from current customers as proposed in Supplement No. 6. When Contributions and Advances became taxable in the mid-1980s, the

Commission extensively addressed this issue and adopted the gross-up method, which regulated utilities have followed and should continue to follow for future projects.

Contributions in Aid of Construction (“CIAC”) and Customer Advances for Construction (“CAC”) were not taxable prior to 1986; however, The Tax Reform Act of 1986 gave CIAC and CAC taxable status. I&E’s predecessor, the Office of Trial Staff (“OTS”), filed a Petition and requested that an Investigation be initiated to address the accounting and ratemaking treatment of CIAC and CAC given the new taxable status. In the Investigation, at Docket No. I-880083,<sup>1</sup> OTS analyzed six ratemaking methods for CIAC and two for CAC. OTS supported only those methods that did not change the revenue requirement because it argued that existing ratepayers should not be required to subsidize the construction of new plant for new customers and developers. The Commission agreed with OTS and adopted the gross-up method for water and wastewater companies stating, “a ‘gross-up’ methodology is more appropriate. The contributor bears the total cost, including taxes of the plant because he also will reap its full benefit.”<sup>2</sup> Interestingly, the Commission noted that “A great majority of the Water and Sewer utilities that supplied comments agreed that current ratepayers should be insulated from any costs arising from CIAC or CAC.”<sup>3</sup> PAWC was one of those utilities because in the 1989 Investigation it indicated that it preferred the full gross-up method (CIAC Method 2), where CIAC is grossed up for the full amount of the federal income tax and is charged

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<sup>1</sup> *Investigation of Accounting and Ratemaking Associated with Contributions in Aid of Construction and Customer Advances*, Docket No. I-880083 (Order entered June 14, 1989) (“Investigation Order”).

<sup>2</sup> Investigation Order at 25.

<sup>3</sup> Investigation Order at 25.

to the contributor, to the no gross-up method (CIAC Method 3).<sup>4</sup> PAWC's proposed Supplement No. 6 is a reversal of its position in the 1989 Investigation as it is now proposing the no gross-up method, also referred to as CIAC Method 3, which shifts the tax responsibility into rate base where it will be recovered from current customers.<sup>5</sup> The Commission already considered CIAC Method 3 in the Investigation Order but rejected it and ordered water and wastewater to file the appropriate tariff supplements necessary to employ one or more of the identified gross-up methodologies (CIAC Method 2, CIAC Modified Method 2 or CIAC Method 5).<sup>6</sup>

Soon after the Commission's Investigation Order, PAWC filed a Petition requesting permission to deviate from the gross-up methodology for construction made by political subdivisions or other governmental entities.<sup>7</sup> PAWC argued that requiring political subdivisions and governmental entities to pay the Federal Income Tax is contrary to public policy and that it is not in the public interest to require the gross-up method where the contributor is a political subdivision or other governmental entity.<sup>8</sup> The Commission agreed, stating "In the Opinion and Order [of June 14, 1989] we recognized that there are 'special circumstances' where there may be room for a sharing of additional tax costs, even though the new plant is not directly used to the benefit of existing ratepayers."<sup>9</sup> Accordingly, the Commission approved PAWC's request to depart

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<sup>4</sup> Investigation Order at 9.

<sup>5</sup> Docket No. R-2018-3002502, TUS Data Request Set 1, R-4; Docket No. R-2018-3002504, TUS Data Request Set 1, R-4.

<sup>6</sup> Investigation Order at 26.

<sup>7</sup> *Pa. PUC v. Pennsylvania-American Water Company*, Docket No. P-890376 (Order entered November 3, 1989).

<sup>8</sup> *Id.* at 3.

<sup>9</sup> *Id.* at 2.

from the gross-up method for CIAC and CAC made by political subdivisions or other governmental entities as a “special circumstance.”

In the decade after Contributions and Advances became taxable, water and wastewater ratepayers did not subsidize contributors because those utilities were required to utilize the gross-up method and, only upon demonstrating “special circumstances,” were permitted to deviate from that method. However, The Small Business Job Protection Act of 1996 restored the taxable exclusion of CIAC and CAC for water and wastewater utilities. This exclusion was recently eliminated by the TCJA, which mandates that CIAC and CAC be taxable to water and wastewater utilities. While the taxable status of Contributions and Advances in the water and wastewater industries has flip-flopped, the issue of who pays has not changed. The Commission thoroughly analyzed this issue when CIAC and CAC became taxable in 1986 and approved the gross-up method because ratepayers should not be required to subsidize new customers. Now that CIAC and CAC are once again taxable under the TCJA, water and wastewater ratepayers should continue to be insulated from these costs.

The ratemaking impact of the Company’s proposed no gross-up method is significant. In response to TUS Data Requests, the Company compared the net present value (“NPV”) of the effect on water ratepayers based on an annual CIAC estimate of \$5 million for its no gross-up proposal (CIAC Method 3) and the three gross-up methods (CIAC Method 2, CIAC Modified Method 2, CIAC Method 5) approved in the Commission’s 1989 Order. The Company’s no gross-up proposal had a NPV of \$931,000, while the three gross-up methodologies either decreased rates (CIAC Method

2) or did not affect customer rates (CIAC Modified Method 2, CIAC Method 5).<sup>10</sup> Similarly, on the wastewater side with an annual CIAC estimate of \$500,000, the no gross-up method had a NPV of \$93,000 and the three gross-up methodologies either decreased rates (CIAC Method 2) or did not affect customer rates (CIAC Modified Method 2, CIAC Method 5).<sup>11</sup>

In support of its proposed tariff, PAWC argues that “Supplement No. 6 should be approved because it provides a reasonable approach to addressing the changes in taxability of Contributions and Advances under the TCJA.”<sup>12</sup> I&E recognizes that the TCJA eliminated the exemption for water and wastewater utilities from recognizing CIAC and CAC as taxable income. However, these changes do not support PAWC’s proposal to abandon the gross-up method. As discussed above, when Contributions and Advances first became taxable in the mid-1980s the Commission thoroughly addressed this issue and adopted the gross-up method because, absent “special circumstances,” existing water and wastewater ratepayers should not subsidize the addition of new customers. Although the taxable status of Contributions and Advances changed under the TCJA, the fundamental principle that the contributor, not current water and wastewater customers, should bear the cost remains sound. The Commission’s 1989 Investigation Order sought to insulate current water and wastewater ratepayers from CIAC and CAC costs by approving the gross-up method, and nothing in the TCJA supports a departure from that position.

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<sup>10</sup> Docket No. R-2018-3002502, TUS Data Request Set 1, R-5.  
<sup>11</sup> Docket No. R-2018-3002504, TUS Data Request Set 1, R-5.  
<sup>12</sup> June 5, 2018 Letter.

Additionally, the Company believes that it is significant that the Commission has approved the no gross-up method for The York Water Company (“York Water”).<sup>13</sup> To I&E’s knowledge, York Water is the only jurisdictional water and wastewater company authorized to use the no gross-up method and all other jurisdictional water and wastewater utilities uniformly use the gross-up method. PAWC’s reliance on this one outlier as support for approval of Supplement No. 6 rings hollow given that the rest of the industry follows the gross-up method as directed by the Commission in the 1989 Investigation Order. The need for consistency in the industry was raised by OTS in the 1989 Investigation, “OTS expressed concern that there was no uniform treatment of CIAC and CAC among jurisdictional utilities...”<sup>14</sup>, which was rectified after the Investigation because water and wastewater utilities were ordered to file tariff supplements implementing one of the three identified gross-up methods. At some point, York Water became an outlier and was authorized to use the no gross-up method; however, it currently has a base rate case pending where this issue can be revisited to ensure that the water and wastewater industries uniformly uses the gross-up method. Approving PAWC’s proposed Supplement No. 6 will only serve to disrupt the industry practice as all water and wastewater utilities, other than York Water, appropriately use the gross-up method.

In further support of Supplement No. 6, PAWC points to the fact that gas utilities have been permitted to use the no gross-up method.<sup>15</sup> In the Investigation Order, the

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<sup>13</sup> Responses to Filing Requirements, No. 11.

<sup>14</sup> Investigation Order at 1.

<sup>15</sup> June 5, 2018 Letter.

Commission recognized the value of adopting an appropriate methodology on an industry-by-industry basis:

Establishing a viable methodology for accounting for CIAC and CAC will be approached on an industry basis. The different utility industries and their customers have varying needs and circumstances that may necessitate methodologies that differ.<sup>16</sup>

This industry specific approach resulted in the Commission examining various factors, resulting in the adoption of the no gross-up methodology for gas and electric companies and the gross-up method for water and wastewater companies. Specifically, in approving the no gross-up method (CIAC Method 3) for the gas and electric industries, the Commission indicated that approving a methodology that promotes growth should be available, even if existing customers share in the cost, because electric and gas utilities operate in an energy competitive environment and have the potential to provide a “public benefit” in the form of economic development.<sup>17</sup> However, the Commission approved the gross-up method in the water and wastewater industries because those factors were not as relevant: “competition within the industry is not as vital a force as it is in the energy based industries. Economic development, while an important consideration, is not as sensitive to water utility pricing as it is to energy costs.”<sup>18</sup> Therefore, the fact that energy companies have been permitted to utilize the no gross-up method does not support its use by water and wastewater companies.

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<sup>16</sup> Investigation Order at 23.

<sup>17</sup> Investigation Order at 26.

<sup>18</sup> Investigation Order at 27.

In summary, the substance of Supplement No. 6 has already been considered and rejected by the Commission in the 1989 Investigation Order. There, the Commission rejected the no gross-up method because it placed a disproportionate share of the tax responsibility on current water and wastewater customers and approved the gross-up method to insulate current ratepayers from these additional costs. Except for York Water, jurisdictional water and wastewater utilities have uniformly filed tariff supplements implementing the gross-up method. Contributions and Advances are once again taxable under the TCJA; however, it does not follow that ratepayers should pay those taxes as proposed in Supplement No. 6. Just the opposite is true as the Commission already has a long-standing, industry wide standard in place. Accordingly, PAWC should continue to use the gross-up method for Contributions and Advances.

For the above reasons, I&E respectfully requests that the Commission reject Supplement No. 6 and order PAWC to file tariff supplements employing one or more of the gross-up methods in compliance with the Commission's 1989 Investigation Order. In the alternative, I&E recommends that this issue be referred to the Office of Administrative Law Judge for full evidentiary hearings to examine the reasonableness of PAWC's proposed Supplement No. 6.

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania-American Water Company- :  
Wastewater Division Supplement No. 6 : Docket No. R-2018-3002504  
to Tariff Wastewater- Pa. P.U.C. No. 16 :

**CERTIFICATE OF SERVICE**

I hereby certify that I am serving the foregoing **Formal Complaint** dated July 24, 2018,  
in the manner and upon the persons listed below, in accordance with the requirements of  
52 Pa. Code § 1.54 (relating to service by a party):

**Served via First Class and Electronic Mail**

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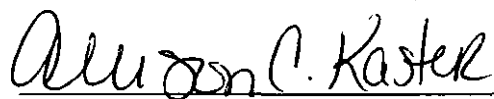
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Deputy Chief Prosecutor  
Bureau of Investigation and Enforcement  
PA Attorney I.D. No. 93176