

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2018-3002502
	:	
Pennsylvania-American Water	:	
Company- Water Division	:	
Supplement No. 6 to Tariff Water- Pa.	:	
P.U.C. No. 5	:	
	:	
Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2018-3002504
	:	
Pennsylvania-American Water	:	
Company- Wastewater Division	:	
Supplement No. 6 to Tariff Wastewater-	:	
Pa. P.U.C. No. 16	:	

**REPLY EXCEPTIONS
OF THE
BUREAU OF INVESTIGATION AND ENFORCEMENT**

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I. STATEMENT OF THE CASE

A. Introduction

Administrative Law Judge Marta Guhl correctly recommended that Pennsylvania American Water Company (“PAWC” or “Company”) not be permitted to use the no gross-up method for customer advances for construction (“CAC), contributions in aid of construction (“CIAC”) and customer deposits for construction (collectively, “Contributions and Advances”) as proposed in Tariff 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”). The Company’s proposed no gross-up method allows it to recover income taxes paid on Contributions and Advances from existing PAWC customers rather than from the developer or future customers. I&E opposed Supplement No. 6 because it does not comply with the longstanding, industry standard that water and wastewater utilities utilize the gross-up method, which requires the contributor to bear the total cost including the income tax associated with the deposit, advance or contribution. The ALJ correctly determined that PAWC failed to meet its burden of establishing that its proposed no gross-up method should be adopted and found that Supplement No. 6 is not just, reasonable or in the public interest.¹ The Company and the Pennsylvania Builders Association (“PBA”) except to the ALJ’s determination and continue to maintain that these costs should be shifted to existing PAWC customers. I&E files these timely Reply Exceptions in support of the ALJ’s recommendation that

¹ RD at 29-30.

Supplement No. 6 be denied and that PAWC's Contributions and Advances be subject to the gross-up method.

B. Background

The Commission extensively reviewed who should be required to pay the tax for Contributions and Advances in the late 1980s and clearly articulated that the financial burden should remain on developers and new customers, not shifted to existing water and wastewater ratepayers. PAWC is proposing the exact opposite in this proceeding as the no gross-up method in Supplement No. 6 shifts the tax responsibility to its current customers.

PAWC's proposed no gross-up method is contrary to the prior Commission Order and the public interest. In its *Investigation of Accounting and Ratemaking Associated with Contributions in Aid of Construction and Customer Advances* ("TRA-86 Order"), the Commission articulated the general rule that CIAC and CAC tax expenses should be assigned to developers or new customers through the gross-up method.² The Commission correctly recognized that the increased tax cost related to water and wastewater plant that will be used solely to provide utility services to developers and future potential clients should generally rest with the developer and eventually the new lot owners. This method has been in place for approximately thirty years and PAWC and PBA failed to demonstrate why this long-standing policy should be abandoned.

² *Investigation of Accounting and Ratemaking Associated with Contributions in Aid of Construction and Customer Advances*, Docket No. I-880083 (Order entered June 14, 1989).

Additionally, as explained in I&E's briefs, the Commission retained flexibility in the TRA-86 Order to use the no gross-up method for "special circumstances" such as demonstrating that the new project will upgrade facilities that benefit current customers or where extensions provide a "public good" that benefits the existing community at large.³ Therefore, the relief requested by PAWC and PBA already exists under the Commission's TRA-86 Order if it can be demonstrated how the specific extension projects will benefit the community. That flexibility is apparently not sufficient for PAWC and PBA as they are asking the Commission to abandon the gross-up method and permanently shift the tax responsibility for all projects to existing PAWC ratepayers through the no gross-up method.

Doing so will disrupt the industry-wide standard that currently insulates current water and wastewater customers from these costs and will result in unjust and unreasonable rates. Accordingly, the cost shifting proposed in Supplement No. 6 should be rejected and PAWC should be required to continue to use the gross-up method as recommended by ALJ Guhl.

³ I&E Main Brief, pp. 24-25; I&E Reply Brief, pp. 9-10.

II. REPLY EXCEPTIONS

A. Reply to PAWC Exception No. 1 and PBA Exception No. 2(a), (c): The ALJ correctly analyzed the TRA-86 Order and determined that the gross-up method continues to be just, reasonable and in the public interest.

The Commission undertook a comprehensive review of who should bear the added costs associated with the taxable status of CIAC and CAC in the late 1980s and determined that developers or new customers should be responsible for those costs rather be subsidized by existing water and wastewater customers. Under the Tax Reform Act of 1986, CIAC and CAC became taxable and I&E's predecessor, the Office of Trial Staff ("OTS"), filed a Petition requesting that an Investigation be initiated to address the appropriate accounting and ratemaking treatment of CIAC and CAC. In response to the OTS Petition the Commission initiated an *Investigation of Accounting and Ratemaking Associated with Contributions in Aid of Construction and Customer Advances*, at Docket No. I-880083, and named all jurisdictional fixed utilities as respondents.⁴ Six different ratemaking methods for CIAC and two for CAC were investigated. The Commission approved three gross-up methodologies for water and wastewater companies because it determined that existing ratepayers should not be required to subsidize the construction of new plant for new customers and developers.⁵

The PBA argues that the ALJ's rejection of the no gross-up method is based on a flawed interpretation of the thirty-year-old TRA-86 Order and the "unsupported conclusion that the Commission's analysis in that Order is still applicable today."⁶ The

⁴ TRA-86 Order, p. 5.

⁵ TRA-86 Order, p. 25.

⁶ PBA Exceptions, p. 6.

PBA's characterization is incorrect. Rather, the ALJ, as the fact finder in this proceeding, determined that PAWC failed to meet its burden of establishing that the Company should be allowed to use the no gross-up method. Specifically, she correctly determined that (1) there is no record evidence supporting that water and wastewater industries have changed to warrant the no gross-up method; (2) there is no record evidence supporting that the no gross-up method will encourage more development or that I&E's recommended gross-up method will discourage development; (3) there is no record evidence showing that the Company would not add new customers if the gross-up method is used.⁷ Therefore, while the ALJ pointed to the TRA-86 Order in support of her recommendation, the fact remains that she used the record in this proceeding, or the lack thereof, to conclude that continuation of the gross-up method is warranted.

1. Economic Development

PBA argues that there is substantial record evidence that the no gross-up method will provide a benefit in the form of economic development.⁸ In support, PBA makes vague representations that the construction of new businesses and residential developments "will assist in bringing new jobs and resources to the surrounding communities."⁹ However, it provided no evidence showing how existing PAWC customers will benefit, which was required in the Commission's TRA-86 Order. As explained in I&E's Main Brief, if PAWC can demonstrate that specific extension projects will actually benefit the community, that is the type of "special circumstance" that would

⁷ RD at 30-31.

⁸ PBA Exceptions, p. 10.

⁹ PBA Exceptions, p. 11.

potentially warrant approval of the no gross-up method and a sharing of those costs.¹⁰ This addresses PBA's concerns given that the TRA-86 Order recognized that the no gross-up method was warranted if existing utility customers benefit from upgrades to backbone facilities and where the new large user will provide a "public good" to the existing community at large, such as increased jobs or economic development for the area.¹¹ However, PBA does not want to make such a showing and instead relies on general claims of economic development in support of Supplement No. 6. I&E asserts that the relief requested by PBA is already contemplated in the Commission's TRA-86 Order, it just requires a demonstration that the project does, in fact, benefit existing PAWC customers or the general community. Absent this showing, developers should continue to bear the tax responsibility as contemplated in the TRA-86 Order.

PBA further argues that there are serious consequences if the Commission adopts the gross-up method because it would place an "extreme financial burden" on developers and may serve as a deterrent for developers to undertake such projects.¹² This argument fails to justify requiring existing water and wastewater customers to subsidize this "extreme financial burden" because the Public Utility Code mandates that rates must be just and reasonable. The Commission's TRA-86 Order took this ratemaking responsibility seriously, stating, "regulatory bodies are charged with the responsibility to protect the interests of ratepayers by assuring reliable service and reasonable rates" and, in discharging that responsibility, found the gross-up method to be appropriate for water

¹⁰ I&E MB, pp. 24-25.

¹¹ TRA-86 Order, p. 22.

¹² PBA Exceptions, p. 11.

and wastewater utilities.¹³ Additionally, PBA's vague threats of deterring development are unsupported. The gross-up method was approved almost thirty years ago and PBA and PAWC failed to demonstrate that its use deterred past development or demonstrate that continuing this method will, in fact, stall future development. As such, the ALJ correctly determined that there was no evidence in the record supporting these claims.¹⁴

PBA next asserts that the

TRA-86 Order does not establish that the no gross-up method is not just, reasonable, and in the public interest, and in accord with Pennsylvania law and the Commission's rules and regulations. Rather in the TRA-86 Order, the Commission specifically acknowledged that there may be circumstances that warrant the adoption of the no gross-up method.¹⁵

As previously discussed, I&E fully recognizes that the TRA-86 Order permitted the no gross-up method to be used in "special circumstances;" however, absent that showing, the Commission's general rule that such costs should not be passed to existing ratepayers remains sound. PBA's general allegations of economic development to justify wholesale abandonment of the gross-up method to permanently and completely shift the tax responsibility to current PAWC ratepayers does not comply with the "special circumstances" articulated in the TRA-86 Order. In reality, the Commission approved just the opposite in the TRA-86 Order as it articulated the general rule that such costs should be assigned to the developers or new customers through the gross-up method.

¹³ TRA-86 Order, p. 23.

¹⁴ RD at 30.

¹⁵ PBA Exceptions, p. 6.

Therefore, the ALJ correctly found Supplement No. 6 to be contrary to the public interest.

2. Utility Preference

PAWC and PBA's Exceptions argue that the Commission considered the preferences of each utility sector in the TRA-86 Order and, at that time, the majority of water companies preferred the gross-up methodology.¹⁶ Those parties argue that the Commission should reverse the methodology in this proceeding because PAWC and other water utilities currently prefer the no gross-up methodology. I&E disagrees that the utility preference was an overriding concern in the TRA-86 Order or should be today. Rather, the Commission's focus in the TRA-86 Order was ensuring just and reasonable rates for utility customers:

While we believe that a regulatory agency should not act in such a way as to assume the duties and decision making responsibilities of utility management or board of directors, regulatory bodies are charged with the responsibility to protect the interests of ratepayers by assuring reliable service and reasonable rates. A *laissez-faire* approach to regulation with regard to this issue will not ensure the accomplishment of those goals.¹⁷

In discharging that responsibility in the TRA-86 Order, the Commission correctly determined that current water and wastewater customers should be insulated from construction related costs:

¹⁶ PAWC Exceptions, pp. 4-5; PBA Exceptions, p. 16.

¹⁷ TRA-86 Order, p. 23 (Emphasis added).

Logic would dictate that where a contributor is a developer who may pass costs on to lot purchasers and all of the dollars contributed are committed to plant that will be used solely to provide utility services to that developer and his future potential clients, the increased tax cost should generally rest with the developer and eventually the new lot owners. Current customers would have no vested interest in such a contribution and would not benefit from it. As such, they should not be responsible for the related income taxes.¹⁸

PAWC and PBA's current preference to shift costs to existing ratepayers through approval of Supplement No. 6 cannot override these important considerations.

3. Competition

The Commission approved the no gross-up method for the gas industry in the TRA-86 Order was because it determined that gas utilities operate in an energy competitive environment and have the potential to provide a "public benefit" in the form of economic development.¹⁹ However, the Commission approved the gross-up method for water and wastewater utilities because the same competitive considerations did not apply.²⁰ The Commission stated that for the water and wastewater industry "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."²¹

¹⁸ TRA-86 Order, p. 22.

¹⁹ TRA-86 Order, pp. 23-24.

²⁰ TRA-86 Order, p. 25.

²¹ TRA-86 Order, p. 25.

PAWC argues that the “competitive forces” that warranted approval of the no gross-up method for the gas industry in the TRA-86 Order no longer exist given deregulation and the availability of low-cost Marcellus shale supply; therefore, water and wastewater utilities should similarly be permitted to use the no gross-up method used by the gas industry.²² PAWC’s arguments fail to recognize that there are still many alternatives to natural gas such as electric, geothermal, wood, propane and oil, that simply do not exist for water and wastewater service.²³ Additionally, as explained in I&E’s Reply Brief, PAWC’s argument concerning diminished competition in the gas industry fails to support approval of Supplement No. 6.²⁴ The Commission’s approval to use the no gross-up method for gas utilities was premised on the existence of competition; therefore, PAWC’s argument of diminished competition in the gas industry supports potentially transitioning gas utilities to the gross-up method used by water and wastewater companies, not the other way around. PAWC has not demonstrated that competition is any more vibrant in the water and wastewater industry than it was thirty years ago; instead, it simply argues that competition in the gas industry has diminished so it is no longer appropriate to treat PAWC differently than gas utilities. If competition in the gas industry is less vibrant now as PAWC argues, it may be appropriate for gas utilities, like water and wastewater utilities, to use the gross-up method. PAWC argues that the ALJ did not address the changes in the natural gas sector and the Commission’s

²² PAWC Exceptions, pp. 5-6.

²³ RD at 23.

²⁴ I&E Reply Brief, pp. 5-6.

continued approval of the no gross-up method for that sector.²⁵ This is incorrect as the ALJ explained arguments made by I&E and the Company and determined that, “While PAWC and PBA contend the markets have changed, there is no evidence in the record to support that the water and wastewater industries have changed such that the no gross up method is warranted.”²⁶

For the first time in Exceptions, PAWC argues that the water industry in Pennsylvania is “experiencing significant competitive forces” from municipally-owned water systems.²⁷ PAWC provided no record evidence in testimony that municipally-owned water systems are a “significant competitive force” and also failed to make this argument in either its Main or Reply Briefs. In support of this claim, PAWC cites to a handful of cases that purport to demonstrate an increasing effort by municipalities seeking to compete directly with PUC regulated water utilities.²⁸ From the outset, I&E disputes that these few cases demonstrate that municipally-owned water systems are a “significant competitive force” that would warrant approval of Supplement No. 6. More importantly, PAWC’s referenced cases predate the passage of Section 1329, which encourages the sale of municipal water and wastewater systems to Commission regulated utilities. Section 1329 establishes a new process to determine the fair market value of water and wastewater systems that are owned by municipalities or authorities and encourages the sale of these municipal systems to regulated investor owned utilities by

²⁵ PAWC Exceptions, p. 7.

²⁶ RD at 29-30.

²⁷ PAWC Exceptions, p. 5.

²⁸ PAWC Exceptions, p. 6.

allowing enhanced rate base adjustments.²⁹ Since its passage, PAWC has sought Commission approval to acquire large municipal water and wastewater systems, such as The Municipal Authority of the City of McKeesport, Sadsbury Township and Exeter Township, and more potential acquisitions are expected to be filed soon, such as the acquisition of the Steelton Borough Authority's water assets. Accordingly, PAWC's claim that municipal water systems are a "significant competitive force" is undermined by the fact that those systems are quickly and increasingly being acquired by PAWC and other Commission regulated water companies.

PBA argues that developers have many alternatives, such as wells and septic tanks, that may become a viable option if the gross-up method is approved.³⁰ The ALJ was appropriately unpersuaded by these arguments.³¹ These private options existed when the Commission issued its TRA-86 Order but the Commission correctly determined that they were not viable stating, "competition in the [water/wastewater] industry is not as vital a force as it is in the energy based industries."³² PBA's own evidence demonstrates that there is an overwhelming preference for public and wastewater service over private wells and septic systems given that 85% of single-family homes built in 2017 used public water and 80% used public wastewater.³³ PBA states that the Commission's approval of the gross-up method will cause developers to consider these private alternatives, but it failed to address I&E's argument that the private alternatives come at a significant cost.

²⁹ 66 Pa. C.S. § 1329 (Effective June 13, 2016).

³⁰ PBA Exceptions, p. 12.

³¹ RD at 30.

³² TRA-86 Order, p. 57.

³³ RD at 30.

Specifically, I&E witness Grab indicated that the average cost to install both a septic system and well is \$20,000 to \$50,000 per lot.³⁴ Additionally, Mr. Grab correctly noted that septic systems and wells potentially impact lot size that may decrease developers' profitability:

While Mr. Durden is quick to identify on lot septic systems and wells as viable economic alternatives, inclusion of both on lot septic and water could have significant impact on the planned lot size due to setback and separation requirements. If lot size doubled due to these on lot options, the developers would have half of the amount of properties to sell and over which to recoup other development costs (roads, sidewalks, electric, cable), which would remain the same due to overall development size. Recouping these other costs over fewer lots would significantly increase cost per lot and ultimately profitability due to reduced lot count.³⁵

Therefore, the PBA failed to show that these private systems are a realistic alternative given that it wholly ignored the significant costs associated with its proposed alternatives.

The PBA further threatens that developers will "territory shop" and potentially build in other states that do not have the gross-up method, such as New York or Missouri, if the RD is approved.³⁶ This is another unsupported threat in its effort to require existing utility customers to subsidize developers' cost. The PBA touts its witness Mr. Daniel Durden as "an individual with vast experience in the building industry"³⁷ yet Mr.

³⁴ I&E St. No. 1-SR, p. 8. The PBA attempts to refute Mr. Grab's cost estimate in footnote 5 of its Exceptions by stating that I&E witness Grab based his analysis on websites and that he has no experience in the development and building industry. I&E notes that the PBA was able to provide responsive testimony and cross-examine Mr. Grab on his cost estimate, but PBA failed to avail itself of this opportunity as it chose not to provide rejoinder testimony or cross-examine Mr. Grab at the evidentiary hearing. The fact finder in this proceeding, ALJ Guhl, found Mr. Grab's testimony to be credible.

³⁵ I&E St. No. 1-SR, p. 9.

³⁶ PBA Exceptions, p. 13-14.

³⁷ PBA Exceptions, p. 11.

Durden provided no examples or evidence that developers have in the past or will in the future actually relocate to other states if the gross-up method continues to be used in Pennsylvania. The Commission approved the gross-up method approximately thirty years ago; therefore, it was possible for PBA to provide concrete evidence, not just vague assertions, that development has moved to other states due to Pennsylvania's use of the gross-up method. The PBA likely failed to produce this evidence because, as noted by I&E witness Grab, it may not be as easy for developers to simply pick up and leave Pennsylvania as the PBA wants the Commission to believe:

Mr. Durden's statement that developers will move to other areas, such as New York, York Water Company's territory, and municipalities or authority-owned water/wastewater companies, due to the cost associated with using the gross-up method seems farfetched. If a developer does business or builds in certain areas it is unlikely that the cost associated with the gross-up method (i.e., the CIAC tax) will cause the developer to move to another area to avoid this cost. The cost of moving to another area, I believe, could be much greater than having to pay the CIAC tax associated with the gross-up method. For example, moving to new areas would require the cost of finding new land to develop, potentially finding new contractors/work crews, or requiring the developer to pay the travel expenses of the contractors and builders that it normally uses. Further, development is planned based on local housing demands, so it is unreasonable to assume that a developer could simply move a project to a less costly area and achieve the same level of sales if the housing demand was not equivalent.³⁸

These are all factors that the PBA wants the Commission to ignore. Instead, it is asking the Commission to accept its vague representations that development will move to New York or Missouri if the gross-up method is continued in Pennsylvania. The ALJ correctly

³⁸ I&E St. No. 1-SR, p. 10.

refused to require PAWC ratepayers to subsidize the developers tax costs based on these unfounded assertions.

**B. Reply to PAWC Exception No. 2 and PBA Exceptions No. 1, 2(b) and 2(d):
The RD correctly found that the no gross-up method is unjust and unreasonable.**

ALJ Guhl correctly determined that shifting costs to existing utility customers as proposed in Supplement No. 6 was unjust, unreasonable and contrary to the public interest. The Commission thoroughly analyzed this issue when CIAC and CAC became taxable approximately thirty years ago and made it clear that the financial burden should remain on new customers, not shifted to existing water and wastewater ratepayers. This is the exact opposite of what is proposed in Supplement No. 6 as PAWC's proposed no gross-up method shifts the CIAC and CAC tax responsibility into rate base to be paid by existing customers. The ALJ correctly found that the Company failed to satisfy its burden to demonstrate how Supplement No. 6 was just and reasonable.

The Company and the PBA argue that approval of Supplement No. 6 will provide a net benefit for customers because adding new customers significantly benefits existing customers.³⁹ In support, the Company conducted an analysis showing that a new average residential water provides a net benefit to the Company and existing customers of \$2,797 and that any contribution less than \$9,681 is a net benefit to the Company and its existing customers.⁴⁰ As reflected in the RD, I&E does not dispute PAWC's general premise that adding new customers benefits current customers; however, PAWC provided no evidence

³⁹ PAWC Exceptions, p. 8; PBA Exceptions, p. 15.

⁴⁰ PAWC Exceptions, p. 8.

that I&E's recommended gross-up method in any way deters new development or prevents new customers from joining the system.⁴¹ ALJ Guhl appropriately determined that "there is nothing in the record to show that the Company would not be able to add new customers if the gross up method is used."⁴² In short, there is no record evidence that charging the tax associated with CIAC and CAC to the contributor will prevent or decrease new customers growth. I&E witness Grab opined, "It is likely that contributions will be unaffected by inclusion of the tax gross-up because water and wastewater are services that are essential and on-lot alternatives, septic and wells, are often significantly restricted for new development."⁴³ Moreover, the gross-up method was used from 1989 until the tax exemption became effective in 1996 and no support was provided that development stagnated during that time due to developers being required to pay the tax. Therefore, PAWC and PBA's argument that adding new customers provides a general benefit, does not support its request to shift the tax burden for those new customers to its existing customers.

In contrast, shifting the tax responsibility to existing PAWC ratepayers will absolutely harm those customers. In the TRA-86 Investigation, OTS examined the impact on rates under the six different CIAC accounting methodologies and concluded that the net present value ("NPV") effect of the no gross-up method is a "very costly alternative for ratepayers."⁴⁴ PAWC conducted a similar analysis in this proceeding and

⁴¹ RD at 25, 30. I&E St. No. 1-R, p. 4.

⁴² RD at 31.

⁴³ I&E St. No. 1, p. 14.

⁴⁴ TRA-86 Order, p. 16.

compared the NPV of the effect on water customers based on an annual CIAC estimate of \$5 million for the no gross-up method (Method 3) proposed in Supplement No. 6 and the three gross-up methods (Method 2, Modified Method 2, and Method 5) approved in the Commission's 1989 Investigation Order.⁴⁵ The Company's no gross-up proposal had an NPV of \$931,000, which would be recovered from all customers, while the three gross-up methodologies either decreased rates (CIAC Method 2) or did not affect customer rates (CIAC Modified Method 2 and CIAC Method 5).⁴⁶ The same was true for the wastewater service. An annual CIAC estimate of \$500,000 resulted in an NPV of \$93,000 with the no gross-up method and the three gross-up methodologies either decreased rates or did not affect customer rates.⁴⁷

While PBA concedes that it is “technically true” that adoption of the no gross-up method will increase costs for PAWC customers, it argues that it will not result in unreasonable rates because “the effect will be virtually undetectable to the average customers.”⁴⁸ The PBA further attempts to demonstrate that the gross-up method has “virtually no impact on customers” because the annual NPV estimates for water and wastewater are just over \$1,000,000 and will be recovered from approximately 2.4 million people served by PAWC over a 25-40 year period.⁴⁹ PBA’s premise that its no gross-up method should be adopted because it will not really cost ratepayers much is contrary to all sound ratemaking principles. Setting just and reasonable rates mandates

⁴⁵ I&E St. No. 1, p. 16; I&E Exhibit No. 1, Sch. 2, pp. 2-3.

⁴⁶ I&E St. No. 1, p. 16; I&E Exhibit No. 1, Sch. 2, pp. 2-3.

⁴⁷ I&E St. No. 1, p. 16, I&E Exhibit No. 1, Sch. 3, pp. 2-3.

⁴⁸ PBA Exceptions, p. 17.

⁴⁹ PBA Exceptions, pp. 17-18.

that utilities are only permitted to recover prudent expenses from their customers. An imprudent expense does not magically become prudent simply because it does not significantly impact the average customers' bill. Recovering imprudent costs from ratepayers is unjust and unreasonable, regardless of how much or how little that specific cost impacts the bill.

PAWC further argues that it need only show that its proposal is just and reasonable and that the Commission must consider the total effect of the rate at issue.⁵⁰ I&E counters that the Commission has already conducted this analysis and correctly rejected the no gross-up methodology. In the TRA-86 Order the Commission recognized that current ratepayers should be insulated from costs arising from CIAC or CAC stating that, "Current customers would have no vested interest in such a contribution and would not benefit from it. As such, they should not be responsible for the related income taxes."⁵¹ The Commission further found that the gross-up methodology was appropriate for water and wastewater utilities stating that the "contributor bears the total cost, including taxes of the plant because he also will reap its full benefit."⁵² There is no reason why customers today should be responsible for this cost when the Commission expressly sought to insulate PAWC customers thirty years ago from such costs.

⁵⁰ PAWC Exceptions, p. 9.

⁵¹ TRA-86 Order, p. 22.

⁵² TRA-86 Order, p. 25.

C. Reply to PAWC Exception No. 3: The RD correctly determined that adoption of the gross-up method will achieve uniformity in the water and wastewater industry.

The RD correctly found that the Commission is working towards consistency and uniformity with respect to the treatment of CIAC and CAC within each utility industry.⁵³

The need for consistency and uniformity was one of the reasons that OTS initially requested an Investigation of this issue in the 1980s because it was not appropriate for neighboring water and wastewater utilities to employ different accounting methodologies. The Commission agreed and recognized the importance of uniformity with respect to the treatment of CIAC and CAC stating, “some degree of consistency and uniformity must be established with regard to this issue in order to maintain fairness in setting utility rates.”⁵⁴ Through the Investigation, uniformity was established because the Commission articulated the appropriate methodology on an industry-by-industry basis, which has been in place since the Commission’s Order was entered in 1989. Since that time, water and wastewater utilities, have employed the gross-up method. Approving PAWC’s Supplement No. 6 will disrupt that uniformity.

PAWC argues that the ALJ’s recommendation fails to produce consistency and uniformity because municipal water and wastewater providers do not pay income tax; therefore, developers will territory shop to the detriment of PUC regulated utilities.⁵⁵ This argument must fail. First, it is understood that this Commission only establishes rules and regulations for public utilities under its jurisdiction; therefore, the focus has

⁵³ RD at 30.

⁵⁴ TRA-86 Order, p. 23.

⁵⁵ PAWC Exceptions, p. 10.

always been on consistency and uniformity among Commission regulated entities. Therefore, when addressing this issue thirty years ago and today, the focus is clearly on establishing uniformity among Commission regulated entities. The fact that municipalities were not subject to the tax did not stop the Commission from appropriately charging it to developers in the TRA-86 Order and it is not a valid reason to shift the cost to utility customers today. Second, PAWC and PBA provided no record evidence that developers are, in fact, territory shopping and choosing to build in municipal boundaries rather than in PAWC's service territory. Developers were assigned the tax responsibility in the TRA-86 Order; however, other than unfounded scare tactics, PAWC failed to produce any evidence that developers chose not to build in its service territory due to the tax concern.

PAWC further argues that the ALJ's proposal fails to create consistency and uniformity among investor-owned utilities because a developer could pay a gross-up for water infrastructure and no gross-up for gas infrastructure.⁵⁶ Again, this argument ignores the point of the TRA-86 Order, which was to determine the appropriate treatment 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.⁵⁷

As plainly stated above, there was never an intention or need to establish one

⁵⁶ PAWC Exceptions, p. 10.

⁵⁷ TRA-86 Order, p. 23

methodology across all utility industries. Rather, the goal was to establish uniformity within each industry because, by doing so, PAWC and other water and wastewater providers are subject to the same rules and are neither advantaged or disadvantaged. Therefore, contrary to PAWC's argument, the fact that there is not uniformity across all utility industries is irrelevant as the goal has been to establish consistency on an industry-by-industry basis.

D. Reply to PBA Exception No. 3: The RD correctly refused to adopt the PBA's preferred gross-up methodology.

PBA requests that if the Commission adopts a gross-up method, it should require utilities to utilize the "discounted gross-up method."⁵⁸ The RD correctly denied PBA's request to exclusively implement the "discounted gross up method" and determined that PAWC should be permitted to implement one of the three gross up methods that best works for it and its customers.⁵⁹ The ALJ also correctly concluded that the PBA provided no compelling reason that its preferred method should be chosen to the exclusion of the other permissible gross-up methods.

As noted in I&E's Reply Brief, this is the first time I&E has seen this method referred to as the "discounted gross-up method" but it appears to be the same as Method No. 5 that was approved in the TRA-86 Order. I&E does not oppose PBA's request to use Method No. 5; however, it opposes PBA's request to use Method No. 5 exclusively given that water and wastewater utilities were authorized to use three different gross-up methods in the Commission's TRA-86 Order, not just the method preferred by PBA.

⁵⁸ PBA Exceptions, p. 18.

⁵⁹ RD at 31.

The PBA argues that the ALJ's recommendation to permit PAWC to implement different gross-up methods is contrary to her stated goal of uniformity.⁶⁰ PBA's argument is contrary to the Commission's TRA-86 Order, which expressly sought to balance the need for uniformity with flexibility. As a result, the Commission determined that the gross-up method was appropriate for the water and wastewater industry but recognized that there was no consensus about which of the three identified gross-up methodologies should be used.⁶¹ The Commission concluded:

given the varying degrees of sophistication in the water and sewer industry we shall authorize a great deal of flexibility. Therefore, we adopt a policy to allow the water and sewer utilities to select one of the following gross up methodologies: OTS Method No. 2, OTS Modified Method No. 2 or OTS Method No. 5.⁶²

Like the TRA-86 Order, ALJ Guhl's recommendation promotes uniformity by adopting the gross-up method, but also recognizes that flexibility is important through the adoption of the three gross-up methodologies.

Additionally, PBA first made its recommendation to use OTS Method No. 5 and to disallow the other two gross-up methods in its Main Brief. Although PBA served Direct, Rebuttal and Surrebuttal Testimonies in this proceeding, it failed to argue why OTS Method No. 5 should be approved and why OTS Method No. 2 and OTS Method No. 2 Modified should be disallowed. The record is silent on this issue because PBA never raised it. I&E's Reply Brief⁶³ noted PBA's failure to provide record evidence and

⁶⁰ PBA Exceptions, p. 18.

⁶¹ I&E MB, pp. 18-19.

⁶² TRA-86 Order, pp. 25-26.

⁶³ I&E Reply Brief, p. 10-11.

the RD⁶⁴ also noted the lack of testimony on this issue; however, PBA failed to address this concern in its Exceptions. Given that the TRA-86 Order approved three gross-up methodologies and PBA did not provide testimony that only one of those methodologies be approved, the ALJ correctly found that PAWC should continue to be permitted to use the three gross-up methodologies that were approved in the TRA-86 Order.

E. Reply to PAWC Exception No. 4: The RD correctly subjected the wastewater capacity reservation fee to gross-up.

The Company argues that the ALJ erred in subjecting capacity reservation fees to the no gross-up method because they are materially different from traditional Contributions and Advances.⁶⁵ The ALJ correctly found that capacity reservation fees are booked as CIAC and, as such, should not be gross-up. In this determination, PAWC argues that the ALJ improperly applied a “deterrent” standard rather than the appropriate “just and reasonable” standard.⁶⁶ This argument is without merit. In agreeing with I&E that the record is devoid of evidence that charging the tax associated with Capacity Reservations will decrease the number of potential wastewater customers, the ALJ appropriately commented on the lack of record evidence supporting how and why capacity reservation fees should be treated differently than other Contributions and advances. Capacity reservation fees are booked as CIAC and are taxable as contributions; therefore, the ALJ correctly rejected PAWC’s request to require current customers to pay for these tax expenses.⁶⁷

⁶⁴ RD at 26.

⁶⁵ PAWC Exceptions, p. 11.

⁶⁶ PAWC Exceptions, p. 11.

⁶⁷ I&E St. No. 1-SR, p. 26.

III. CONCLUSION

The Commission thoroughly examined this issue on an industry-by-industry basis nearly thirty years ago and concluded that new customers, not current water and wastewater customers, should bear the full cost of Contributions and Advances. This issue was again examined by ALJ Guhl in this proceeding and she correctly found that PAWC failed to meet its burden of establishing that it should be allowed to shift the cost to its existing ratepayers as proposed in Supplement No. 6. Accordingly, I&E respectfully requests that the ALJ's recommendation to reject Supplement No. 6 and require PAWC to file a tariff supplement utilizing the gross-up methodology for CIAC and CAC be approved without modification.

Respectfully submitted,



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