

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

DOCKET NOS. R-2021-3027385, R-2021-3027386

**AQUA PENNSYLVANIA, INC.
AQUA PENNSYLVANIA WASTEWATER, INC.**

**PREPARED REBUTTAL TESTIMONY OF
WILLIAM C. PACKER**

Topics Addressed:

**Certain Expense Claims, Rate Base Claims, Rate Design, Capitalization Structure,
Return on Equity Considerations, COVID-19 Deferral and Impacts, Act 11 Revenue
Allocation, Satisfaction of 2018 Settlement Commitments,
And Various Other Matters (Tax Collar & Level of Repair)**

DATE SERVED: December 2, 2021
DATE ADMITTED: _____

Aqua Statement No. 1-R

1 **I. INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. William C. Packer. My business address is 762 W. Lancaster Avenue, Bryn Mawr,
4 Pennsylvania 19010.

5
6 **Q. Did you previously submit testimony in this proceeding on behalf of Aqua
7 Pennsylvania, Inc. and Aqua Pennsylvania Wastewater, Inc. (“Aqua PA,” “AP” or
8 the “Company”)?**

9 A. Yes. I submitted my direct testimony, AP Statement No. 1, on August 20, 2021.

10

11 **Q. What is the purpose of your rebuttal testimony?**

12 A. My testimony responds to certain portions of the direct testimony submitted by the
13 Pennsylvania Public Utility Commission’s (“PUC” or “Commission”) Bureau of
14 Investigation and Enforcement (“I&E”), the Coalition for Affordable Utility Services and
15 Energy Efficiency (“CAUSE-PA”), and the Office of Consumer Advocate (“OCA”).

16 Specifically, I will be responding to the following pieces of testimony and the
17 identified issues raised therein:

- 18 • OCA Statement No. 1, the direct testimony of Ralph Smith, regarding Overall
19 Financial Summary, Cash Working Capital, Stock Based Compensation,
20 Supplemental Executive Retirement Plan Expense, and COVID-19 Deferral.
- 21 • OCA Statement No. 2, the direct testimony of Morgan DeAngelo, regarding
22 COVID-19 impacts.
- 23 • OCA Statement 3, the direct testimony of David Garrett, regarding management

1 performance.

- 2 • OCA Statement No. 4, the direct testimony of Glenn A. Watkins, regarding Act 11
- 3 Subsidization and revenue allocation.
- 4 • OCA Statement No. 5, the direct testimony of Roger Colton, regarding management
- 5 performance.
- 6 • I&E Statement No. 1, the direct testimony of Christine Wilson, regarding Overall
- 7 I&E Position, Cash Working Capital, and COVID Deferral.
- 8 • I&E Statement No. 2, the direct testimony of Anthony Spadaccio, regarding
- 9 management performance.
- 10 • I&E Statement No. 5, the direct testimony of Joseph Kubas, regarding Act 11
- 11 revenue allocation.
- 12 • CAUSE-PA Statement No. 1, the direct testimony of Harry S. Geller, regarding
- 13 COVID-19 impacts.

14

15 **Q. Are you sponsoring any exhibits associated with your rebuttal testimony?**

16 A. Yes, I am sponsoring the Company's revised accounting exhibits. Specifically, AP Exhibit

17 1-A(a) through AP Exhibit 1-G(g) present the Company's revised revenue, expense and

18 rate base claims for water and wastewater operations, respectively. These exhibits contain

19 all of the pages found in Exhibit 1-A through Exhibit 1-G, which are the fully projected

20 future test year ("FPFTY") accounting exhibits that the Company originally filed in this

21 proceeding. The pages that have been revised are so marked. In addition, Schedule A-1.1

22 to the exhibits sets forth all of the changes that were made in AP Exhibit 1-A(a) through

23 AP Exhibit 1-G(g) from the Company's original accounting exhibits (AP Exhibit 1-A

1 through AP Exhibit 1-G). Also included in Schedule A-1.1 is a list of the Company's
2 original and revised claims and references to the source of the change and the responsible
3 Company witness. As a result, AP Exhibit 1-A(a) through AP Exhibit 1-G(g) fully reflect
4 the Company's final revenue, expense and rate base claims in this case for water and
5 wastewater operations, respectively.

6 I am also sponsoring Aqua PA Exhibit WCP-1-R (the Company's response to
7 discovery request OCA-X-7).

8
9 **Q. Please generally describe the revisions set forth in Exhibit 1-A(a) through Exhibit 1-**
10 **G(g).**

11 A. The revisions presented in AP Exhibit 1-A(a) through AP Exhibit 1-G(g) are intended to
12 reflect: (1) corrections to the Company's initial filing; (2) the Company's decision to adopt
13 certain adjustments proposed by the active parties; and (3) more recent data or the
14 Company's revised position on certain issues, as previously set forth in interrogatory
15 responses.

16
17 **II. IMPACTS OF COVID-19**

18 **Q. OCA Witness DeAngelo and CAUSE-PA Witness Geller present various observations**
19 **regarding the impacts of COVID-19 upon customers. Would you like to comment?**

20 A. The Company recognizes the impacts that COVID-19 pandemic has had on the Company's
21 customers and communities that it serves. The Company has introduced new practices and
22 efforts to help customers who are struggling to pay their bill and proactively provided
23 educational outreach to help customers gain access to its Helping Hand program. Having

1 said that, water and wastewater utilities during the pandemic were deemed an essential
2 service, regardless of a pandemic. The Company's obligations to provide safe and reliable
3 service continued through the pandemic and the Company must continue to invest in its
4 infrastructure. I believe that rate relief is just and reasonable in this case. I would note that
5 similar arguments were made by intervening parties in opposition to the Columbia Gas of
6 Pennsylvania, Inc.'s 2020 base rate case. The Commission ultimately rejected those
7 intervenors' arguments.

8
9 **Q. Can you please elaborate on ways the Company has kept Ms. DeAngelo and Mr.
10 Gellar's concerns in mind?**

11 A. The Company continues to be sensitive to any economic pressure on our customers. I point
12 out in my direct testimony (AP Statement No. 1) that the Company deferred \$5.6 million
13 of uncollectible expense pursuant to the PUC's direction. In this proceeding, the Company
14 has proposed that it receive permission to continue the deferral of any incremental impacts
15 of COVID-19 until our next base rate case, which is expected to be completed in 2025.
16 Simply said, Aqua PA is not asking for any cost recovery related to the COVID-19
17 uncollectible expense deferral in this rate case from customers to a known and measurable
18 expense that was incurred. This proposal was specifically done to allow more time for the
19 full effects of the pandemic to be realized, measured, and presented in the future in the
20 hopes that with economic recovery, those impacts would be lessened. While I do not think
21 anyone could say with any certainty that the pandemic is over, I can observe that people
22 are back to work, commercial businesses are open, and expectations of additional actions
23 from our government as far as infrastructure investment and other governmental assistance

1 is happening.

2
3 **Q. Has the economic recovery from COVID-19 had impacts on Aqua PA's costs that**
4 **have not been reflected in the filing?**

5 A. Yes. I'll point to a couple. First on supply chain, the Company began receiving notice of
6 production delays of pipe, valves, and other appurtenances necessary to complete projects
7 in early to mid-summer of 2021. Production and delivery times, normally in the 20-to-30-
8 day range, were expected to move to 40-to-60 day or worse. To combat these supply chain
9 delays, the Company had to move up its ordering schedule for projects requiring this
10 inventory and as a result, the Company's inventory balances have climbed substantially
11 since filing this rate case. For rate making purposes, the recovery for the working capital
12 required to maintain adequate inventory supply is a component of rate base, calculated
13 using a 13-month average. In the Company's initial filing in this case, that average shown
14 in Exhibit 1-A, Sch. G-4 Line 17 was \$7,672,303. As of October 31, 2021, however, that
15 balance is now \$17,996,441. In short, this difference will be covered by the Company, not
16 its customers unless an adjustment were to be made or allowed to increase the Company's
17 rate base claim by approximately \$10 million dollars.

18 Secondly, inflation is certainly in the news and a real issue that needs to be dealt
19 with. The Company's as filed claims for operating and maintenance expenses ("O&M"),
20 that are not subject to specific adjustments are adjusted instead by a general inflation
21 adjustment. At the time of the initial filing, the data available to the Company pointed to
22 a 1.70% inflation factor, which the Company applied to approximately 20% of the overall
23 O&M expense categories. Certainly, the factor is higher today than it was just six months

1 ago, and the Company expects the factor to be sustained well into 2022. Again, this is yet
2 another example of a cost that will likely be experience by the Company that is not reflected
3 in Aqua PA's as-filed case.

4 In summary, the economic concerns are real for both customer and the Company.
5 The requirements upon Aqua PA as a utility providing an essential service do not cease
6 and require fair treatment from the Commission in its evaluation of the Company's claim
7 for rate relief. The Company is entitled to a fair opportunity to earn a reasonable rate of
8 return on its investment. The Company believes that its position in this case is reasonable
9 and strikes a fair balance in light of the current conditions.

10
11 **Q. OCA Witness Smith has expressed a concern that certain one-time recognition**
12 **awards paid in 2020 may have been included in FPFTY operating expenses or rate**
13 **base. OCA St. 1 at 64. Please comment.**

14 **A.** The referenced awards were paid in 2020 and were not included in FPFTY O&M expenses,
15 rate base, or as a component of the \$5.6 million that has been deferred as a COVID-19
16 Regulatory Asset.

17
18 **Q. I&E Witness Wilson recommends that the Company discontinue recording a**
19 **regulatory asset for COVID-19 related incremental uncollectible accounts expense**
20 **after the effective date of new rates in this proceeding. I&E St. 1 at 39. Relatedly,**
21 **OCA Witness Smith recommends that Aqua PA terminate recording incremental**
22 **uncollectible accounts expense related to COVID-19 as of the end of the FPFTY in**
23 **this case. OCA St. 1 at 63. Please respond.**

1 A. I do not agree with either I&E and OCA’s recommendations, and believe that the
2 Company’s proposal was appropriate and reasonable. The Company’s request is simply
3 allowing for time – time for the uncollectible expenses realized in 2020 to stabilize and
4 return back to normal in 2021 and possibly fully mitigate with a slower recovery.

5
6 **Q. Can you provide an example?**

7 A. As of October 31, 2021, the uncollectible expense deferral amount now is at approximately
8 \$4.7 million or \$900,000 less than the balance as of the historic test year ended March 31,
9 2021 (“HTY”). The reduction was due to the fact that the Company was permitted to
10 resume collection activities from the termination moratorium being lifted which was in
11 place during the HTY. In turn, the reserves for uncollectible expenses improved due to the
12 aging of our outstanding accounts receivable. To the extent this trend continues, then with
13 time the Company’s future claim for the deferred impact would be lower. This would
14 result in less impact on customers.

15 Moreover, the Company is not asking for any time value of the money related to
16 these deferrals, which is occasioned by delayed cash inflow from aging accounts
17 receivable. Thus, the Company and its shareholders are funding these cash needs currently.

18 The Company has not included in its deferral any incremental expenses for safety
19 supplies, masks, hand sanitizers, social distancing signage, that were required in many
20 facilities. In short, the Company has and continues to be conservative in its request to the
21 Commission for COVID related expenses. Further, based on my experience in reviewing
22 Aqua PA’s expenses, the prospect of a future, unmitigated, and every growing deferral
23 posited by I&E and OCA’s witnesses is overblown in my view. That is not the intention

1 or what the current facts would support.

2
3 **Q. I&E Witness Wilson further argues that the Company has not provided sufficient**
4 **support for its deferred regulatory asset balance of \$5,695,030 as of March 31, 2021,**
5 **and that the Company provide support for its regulatory asset amount accrued to**
6 **date, or be denied the right to recover the regulatory asset. She further recommends**
7 **that the Company reflect a three-year amortization of the deferred incremental**
8 **uncollectible accounts balance in this case. What is the Company's response?**

9 A. To be clear, the Company is not requesting, at this time, to recover the incremental deferred
10 expense. The Company does not agree with I&E Wilson's recommendation. The
11 Company in its response to OCA-X-7, provided a schedule showing the balances of
12 Accounts Receivable ("A/R"), Reserve for Uncollectible Accounts, and finally its COVID-
13 19 deferred account. It is clear from that schedule that there is a correlation between the
14 increasing balances of A/R and Reserve for Uncollectible Accounts, and the requisite
15 impact to the deferred regulatory asset balance. That response also shows the decline in
16 the balance as I mentioned earlier. While I do not believe this information is necessary,
17 the Company provided OCA-X-7 in response on this issue on November 3, 2021, and is
18 included in my testimony as Aqua PA Exhibit WCP-1-R.

19
20 **Q. What is your understanding of prior Commission decisions associated with**
21 **implementing a hard cut-off date for accumulations of deferred uncollectible expense.**

22 A. I do not agree that a hard cutoff is in the best interest of customers and thus proposing
23 addition costs in this case or even the next, with limited offsetting benefit in reduce O&M

1 expense. The Commission recently declined to create a cut-off for accumulations of
2 deferred uncollectible expense for Pennsylvania-American Water Company.¹

3
4 **Q. OCA Witness Smith also contends that Aqua’s regulatory asset balance should be
5 offset by savings in expenses due to COVID-19. OCA St. 1 at 63. Do you agree?**

6 A. Yes, in part. I certainly recognize there were savings in the general and administrative
7 expense categories of the Company, notably work travel, hotel, seminars, and conferences.
8 Based on my experience and review of the Companies financials, those savings are
9 minimal. I attempted to quantify those savings in the response to OCA-X-10, whereby I
10 reviewed HTY accounts for these categories and identified approximately \$360,000 in
11 savings compared to historical averages for the same accounts. I note that this response
12 was not submitted for review prior to Witness Smith submitting his direct testimony.

13
14 **III. RATE BASE ADJUSTMENTS (CASH WORKING CAPITAL)**

15 **Q. Please describe OCA Witness Smith’s proposed adjustment to Aqua PA’s Cash
16 Working Capital allowance.**

17 A. Mr. Smith proposes to recompute the interest expense offset to cash working capital by
18 (\$718,000) for Aqua PA’s water operations. OCA Exhibit LA-2, Schedule B-3, p. 1.
19 He also proposes adjustments to cash working capital for the Company’s wastewater
20 operations. OCA Exhibit LA-2, Schedule B-3, pp. 2-7.

¹ Petition of Pennsylvania-American Water Company for Authorization to Defer, and Record as a Regulatory Assets for Future Recovery: (1) Incremental Expenses Incurred Because of the Effects of the COVID-19 Emergency; (2) Revenue Reductions Attributable to the Effects of the COVID-19 Emergency; and (3) Carrying Charges on the Amounts Deferred, at Docket No. P-2020-3022426, (Opinion and Order entered September 15, 2021).

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Q. What is the basis for these proposed adjustments?

A. These adjustments all are related to OCA Witness Garrett’s proposal to adopt a capital structure with greater long-term debt than the Company’s actual projected capital structure. Because payment of interest generally lags receipt of revenues, an increase in interest expense reduces the cash working capital requirement.

Q. Does Aqua PA agree with the OCA’s proposed adjustments to cash working capital?

A. No. The Company has never been subject to a hypothetical capitalization structure for rate making purposes as compared to an actual capitalization structure of the business. This structure is not reflective of the cost of service of the Company. In order to do so, or recapitalize the business to match this hypothetical structure, that would require borrowing \$160 million more in long term debt and dividend it directly to its parent Company. This is simply not reasonable or appropriate. I will refer also to the rebuttal testimony of Paul R. Moul (AP Statement No. 7-R) for further arguments supporting the reasonableness of our capital structure relative to our peers in the industry.

Q. Has I&E proposed reductions to the Company’s cash working capital claim?

A. Yes. I&E has proposed adjustments to the Company’s cash working capital claims associated with its proposed changes to the Company’s revenues and expenses. I&E St. 1 at 31.

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Q. What is the Company’s position on the I&E’s adjustment to the Company’s cash working capital claims?

A. As a result of I&E’s proposed adjustments to various revenue and operating expenses, the resultant impacts on the calculation of Cash Working Capital in their models result in reduction of \$216,000. From a method perspective, I&E Witness Wilson and I are in agreement. However, given the Company’s positions supporting our as-filed claims for cost of service, I do not agree with her result.

IV. OPERATING AND MAINTENANCE EXPENSE ADJUSTMENTS

A. SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN (“SERP”)

Q. Please describe the Company’s SERP.

A. The SERP or Non-Qualified Pension plan is simply a replacement benefit plan for certain highly compensated employees that are removed from the Qualified Pension plan due to IRS limitations. Mr. Smith in his direct testimony accurately describes the purpose of the plan.

Q. Has any party challenged the Company’s recovery of SERP costs?

A. Yes. OCA Witness Smith proposes to disallow recovery of \$695,612 in SERP costs for water operations, and \$57,050 for wastewater operations. OCA St. 1 at 62.

Q. What is Mr. Smith’s basis for disallowing SERP expenses?

A. Mr. Smith asserts that the provision of additional retirement benefits to a limited number

1 of current and former executives “to remedy a perceived deficiency in retirement benefits
2 relative to the Company’s other employees is not a reasonable expense that should be
3 recovered in rates.” Mr. Smith asserts that shareholders, rather than customers, should be
4 responsible for these executive retirement benefits.

5
6 **Q. Do you agree with Mr. Smith?**

7 A. No. To the best of my knowledge, the Company’s benefit packages offered to its
8 employees has been reviewed many times and I was unable to find any challenge to the
9 contrary in the last four base rate cases filed by Aqua PA. Specifically, the Company had
10 offered a pension plan to its employees hired prior to April of 2003. After that, only a
11 401K is offered to participating employees. The PUC has always supported the Company’s
12 pension expense claims and to my knowledge, has always supported the Non-Qualified
13 Plan as well. I was unable to find any challenge to the SERP in any case going back to the
14 Company’s last fully-litigated case in 2007, to which our pension expense claims equally
15 went unchallenged.

16 As I said before, the pension plan is not available to new employees and that has
17 been the case for quite some time, and by extension, the SERP to new executives. Thus,
18 the claimed SERP costs are a legacy program cost. There is no disputing that the cost of a
19 401K defined contribution plan versus a defined benefit plan is a lower cost benefit to the
20 Company and by extension its customers. As the pension plan and the eligible employees
21 ultimately retire, that reduction in cost of service, along with future reductions in SERP
22 will reduce cost of service. Again, the SERP is only available to those executives who
23 were enrolled in the pension plan, hired prior to 2003. It is not available to new executives

1 and ultimately will be reduced as the eligible members to the plan utilize their benefit.

2 What is not reasonable is to realize the benefits of the lower cost of service
3 associated with the Company's movement towards a defined contribution plan, but then
4 cherry pick a supplemental benefit because it has a cost and recommend the supplemental
5 benefit's disallowance as unreasonable. Given the Commission's historical support of a
6 pension plan and inclusion of SERP in cost of service in prior cases along with the
7 Company's proactive work to end and subsequently reduce the cost of the pension plan,
8 Mr. Smith's proposal to reduce the Company's O&M expense claim by \$695,612 for water
9 and \$57,050 for wastewater, should be rejected.

11 **B. INCENTIVE COMPENSATION – STOCK BASED**

12 **Q. Please describe the adjustments proposed by OCA witness Mr. Smith to the**
13 **Company's claim for incentive compensation.**

14 A. Mr. Smith proposes to disallow all stock-based compensation expense, which would
15 decrease operating expenses for water operations by \$780,493 and wastewater operations
16 by \$66,000. OCA St. 1 at 45.

17
18 **Q. Please summarize Mr. Smith's justifications for this proposed adjustment.**

19 A. Mr. Smith would disallow approximately \$800,000 of the Company's payroll expense
20 claim attributable to incentive compensation. Specifically, Mr. Smith proposes to eliminate
21 all payments, totaling \$780,493, made under Aqua America, Inc.'s ("Aqua America")
22 Omnibus Equity Compensation Plan ("Equity Plan"), as well as associated payroll tax
23 expense. Mr. Smith asserts this is appropriate because he believes that the payment of the

1 incentive compensation available under the Equity Plan is triggered solely by Aqua
2 America meeting its corporate financial goals and, as such, is unrelated to the cost of
3 service or the quality of service provided to customers. Mr. Smith also asserts that stock-
4 based compensation is simply a dilution of shareholder equity and, therefore, is not a cash-
5 based expense that should be included in operating expenses for ratemaking purposes.
6

7 **Q. Does Mr. Smith recommend other adjustments to the Company's incentive**
8 **compensation package?**

9 A. No, he does not.
10

11 **Q. Do you agree with Mr. Smith's proposal?**

12 A. No, I do not. First, I believe an overview of the Company's incentive compensation plan,
13 which is simply a component of the Company's total compensation package, is appropriate.
14 In its 1988 Management Audit of the Company (completed in August 1990), the
15 Commission recommended that AP "establish an incentive plan" (reference III-R4, page
16 61). The audit report suggested that such a plan would "provide a mechanism by which
17 members of management stay focused on the Company's priorities," and noted that "tying
18 larger incentives to particular goals sends a clear message as to their importance and
19 priority." The report further noted that "short-term incentive bonuses are paid only upon
20 achievement of specific objectives and save the Company money." Lastly, the report noted
21 that bonuses are typically based on a percentage of salary and recommended ranges.

22 In 1989, in response to market pressures, the recommendation of its compensation
23 consultant and the Commission's 1988 Management Audit, the Company began to evaluate

1 the feasibility of an incentive compensation plan. The result of that investigation was the
2 implementation of an Incentive Compensation Plan (“the Plan”) in 1990. Under the Plan,
3 a portion of an employee’s total cash compensation was placed “at risk” pending the
4 achievement of key performance objectives. The portion placed at risk is called the “target
5 bonus”. The employee’s progress toward accomplishment of his / her key performance
6 objectives is then assessed and used to determine what percent of the “target bonus” the
7 employee should receive.

8 In a subsequent 1998 Management Audit of the Company, the Commission noted
9 that “the Company has a well-organized and comprehensive executive compensation
10 program.” The 1998 report further noted that there were “appropriate controls in place to
11 adjust compensation levels upward or downward based on performance.” The report
12 contained no recommended revisions in this area. Although the specific components of
13 the Plan have been fine-tuned over the years, the principles on which it was built, as
14 discussed below, have remained the same.

15
16 **Q. You mentioned that the stock-based incentive compensation program is one aspect of**
17 **the Company’s incentive compensation plan. Please explain.**

18 A. There are four major principles underlying the Plan that are particularly relevant to the
19 issues Mr. Smith raised:

20 **1. Plan Rationale**

21 The purpose of the Plan is to tie employee compensation to the accomplishment of
22 the Company’s key operating objectives, thereby ensuring that the entire workforce is
23 working toward the same end. Customers benefit from the participant’s individual

1 objectives being met, as improvements in performance are accomplished by controlling
2 costs, improving efficiencies and enhancing customer service. As a result, the need for rate
3 relief is mitigated.

4 **2. Total Cash Compensation**

5 The Company's compensation consultant, Pay Governance, LLC. ("Pay
6 Governance"), studies executive compensation to ensure (among other things) that the
7 Company's cash compensation and total direct compensation are competitive and
8 appropriate in light of current market conditions. The Company uses the 50th percentile of
9 the Willis Towers Watson Energy Services Executive Survey for this benchmarking
10 analysis. Pay Governance's, most recent compensation analysis showed that the average
11 of the annual salaries for the Company's top executives is equal to approximately 97% of
12 the target market and that the average of the target total cash compensation (annual salary
13 plus target annual incentive plan amount) and total direct compensation (total cash
14 compensation plus long-term incentives) for the Company's top executives equaled 96%
15 of the target market. In other words, even including the Company's target incentive plan
16 payments, the average target total cash compensation paid to these employees is below the
17 50th percentile of the target market. Clearly, this represents conservative compensation
18 levels, particularly when a portion is "at risk" pay, and should be included in the
19 Company's cost of service for rate setting purposes.

20 **3. Probability of Payment**

21 Incentive Compensation has been paid each year since the Plan's inception in 1990.
22 These payments represent a regular, recurring cost of service and a recognized and normal
23 portion of a qualifying employee's overall compensation. The regularity of payment is a

1 testament to the Plan's effect on ensuring the accomplishment of the Company's key
2 objectives and the ongoing control over operating costs.

3 **4. Pay Package**

4 To be competitive in today's business world, the Company's employment offers
5 reflect the total pay package for the employee, including his / her proposed participation in
6 the Plan. This package, in its entirety, is what it takes to attract and maintain an
7 appropriately trained and skilled workforce. It would be inappropriate to suggest that any
8 portion of this package was not simply a cost of providing appropriate utility service.
9

10 **Q. Please further explain the Company's reason why the Company's stock-based**
11 **incentive compensation program should be permitted as an expense for ratemaking**
12 **purposes.**

13 A. There are several reasons: (1) the incentive compensation is part of the standard pay
14 package necessary to attract and retain appropriate personnel, as I explained above; (2) any
15 disallowance would only serve to prevent the Company from earning its authorized rate of
16 return on equity; (3) the plan is structured to produce benefits for customers; and (4) the
17 plan was recommended by, later endorsed by, and for 18 years fully approved in the
18 Company's base rates by the Commission. In fact, similar arguments to those now
19 advanced by Mr. Smith were made and rejected by the Commission in the Company's 2007
20 rate case at Docket No. R-00072711 and 2003 rate case at Docket No. R-00038805.

21 Furthermore, a key component of the incentive compensation plan is employee
22 objectives that provide benefits to customers. Many of the employee objectives focus on
23 cost containment, quality service, productivity enhancements and compliance initiatives to

1 ensure reasonable cost and high-quality service to our customers. In addition, some of the
2 objections are geared toward O&M efficiencies which encourage the Company to be as
3 efficient as possible. It would be inappropriate to eliminate from the Company's cost of
4 service this particular component of compensation which is partially responsible for
5 controlling the Company's cost of service while maintaining its high-quality service
6 standard.

7 Finally, and in addition to the fact that the Plan was recommended, and later
8 endorsed through the Commissions Management Audit process, incentive compensation
9 was also approved in full in the Company's 2003 base rate proceeding at Docket No. R-
10 00038805.

11
12 **Q. Does Mr. Smith describe the types of stock-based compensation costs included by
13 Aqua PA in its claim?**

14 A. Yes. Costs for stock option compensation, performance share units ("PSU"), and restricted
15 stock units ("RSU") are included in the claim.

16
17 **Q. Mr. Smith asserts that the Company did not provide documents related to stock
18 options and further asserts that the Essential Utilities Proxy Statement dated March
19 22, 2021 states stock options are being removed from the long-term incentive
20 compensation program. OCA St. 1 at 46-47. Please respond.**

21 A. The Company is required to expense stock options on its financial statements under
22 Generally Accepted Accounting Practices, specifically, Accounting Standards
23 Codification 718. The Commission should recognize all of the reasonable costs of

1 providing utility service that directly bear on its utility operating income. Stock-based
2 compensation meets that criterion as a component of a reasonable pay package. The shelf
3 life of stock options is 10 years to exercise. Although noted in the proxy statement that
4 stock options are being removed as a component of future compensation, the cost expensed
5 through operating income will continue until expiration is completed. Indeed, the
6 Commission recently allowed UGI Utilities, Inc. – Electric Division (“UGI Electric”) to
7 recover stock-based compensation even though it is a “non-cash” expense. *See Pa. PUC,*
8 *et al. v. UGI Utilities, Inc. – Electric Division*, Docket No. R-2017-2640058, et al., at pp.
9 73-74 (Opinion and Order entered October 25, 2018).

10
11 **Q. Mr. Smith further describes PSUs and RSUs and asserts that, along with stock**
12 **options, the Company has not provided any studies that demonstrate a quantitative**
13 **benefit to ratepayers from the provision of stock-based compensation to Aqua PA and**
14 **Essential Utilities, Inc. executives. OCA St. 1 at 47-48. Please respond.**

15 A. The Company’s claims for incentive compensation, including all stock-based
16 compensation are certainly consistent with PUC precedent as I have noted and referenced.
17 Stock compensation is an equally important form of compensation at risk, promotes
18 retention, and emphasizes an investment interest in the business at the employee level that
19 promotes efforts to provide safe, adequate, and reliable utility service. The performance
20 of the Company as far as its market value has a direct correlation to the quality of the utility
21 service it provides to customers. Simply said, it begins and ends with quality service to
22 our customers. If the Company exhibited qualities that the PUC found to be unsatisfactory,
23 they have measures at their disposal to make appropriate remedies, such as disallowances

1 of costs or investments, lower returns, which would likely affect the value of stock-based
2 compensation, and thus the amount of at-risk compensation realized by employees. This
3 at-risk compensation is a reasonable component of a total compensation package that has
4 not been challenged as unreasonable.

5
6 **Q. Has the Commission previously rejected proposed adjustments to other utilities’
7 claim for incentive compensation, including stock-based compensation?**

8 A. Yes. In PPL Electric Utilities Corp.’s (“PPL Electric”) 2012 base rate proceeding,
9 witnesses on behalf of I&E and the OCA recommended disallowance of half of PPL
10 Electric’s performance compensation expense claim, thereby requiring shareholders to
11 share equally in the cost of its performance compensation plan. The Commission also
12 rejected that proposal:

13 We find that, because PPL’s incentive compensation plan is
14 reasonable, prudently incurred, and is not excessive in amount, PPL
15 is permitted full recovery of this expense. PPL correctly notes that
16 many of the cases the OCA and I&E rely on are distinguishable from
17 this case because, in those cases there was not adequate evidence
18 that the incentive compensation expense was reasonable or that
19 there was a benefit to ratepayers. Our decision to allow this
20 incentive compensation expense is consistent with our prior decision
21 approving incentive compensation programs that are focused on
22 improving operational effectiveness.²

23 In UGI Electric’s 2017 base rate case, a witness for I&E recommended the
24 complete disallowance of stock-based compensation, like Mr. Smith here, asserting that

² *Pa. P.U.C. v. PPL Electric Utilities Corp.*, Docket No. R-2012-2290597, at p. 26 (Final Order entered December 28, 2012) (internal citations omitted).

1 stock-based component of UGI Electric’s incentive compensation plan was based primarily
2 on financial metrics. The Commission rejected that proposed adjustment and explained:

3 We find that [UGI] has provided substantial evidence of record to
4 demonstrate that the incentive compensation program as a whole
5 includes both financial and operating metrics and goals which
6 benefit customers.

7 Where, as here, the incentive program as a whole establishes that the
8 employees’ eligibility to receive the benefit is based on performance
9 duties and metrics directly related to the provision of service, the
10 fact that the program includes a financial metric does not disqualify
11 it from allowance as an expense for inclusion in the rate base. We
12 find that because UGI’s incentive compensation plan is reasonable,
13 prudently incurred, and is not excessive in amount, UGI is permitted
14 full recovery of this expense.³

15
16 **Q. Have there been any significant changes in the Plan since Aqua PA’s 2007-2008 base**
17 **rate proceeding?**

18 A. Fundamentally, no. Stock-based compensation, along with cash incentive compensation
19 have been components of the total pay package for employees for many years. It is for
20 these many reasons and past precedent that the PUC should reject the positions taken by
21 Mr. Smith regarding stock compensation.

22
23
24
25
26

³ *Pa. PUC, et al. v. UGI Utilities, Inc. – Electric Division*, Docket Nos. R-2017-2640058, et al. at pp. 73-74 (Opinion and Order entered Oct. 25, 2018) (internal citations omitted).

1 **C. INTEREST SYNCHRONIZATION**

2 **Q. OCA Witness Smith has proposed substantial increases in the interest deduction**
3 **reflected in the calculation of income tax expense for water and wastewater**
4 **operations, with a resulting substantial deduction in state and federal income tax**
5 **expense. OCA Exhibit LA-1, Schedule C-4. What are the bases for this increase to**
6 **the interest deduction?**

7 A. The interest expense deductions for income tax purposes reflect the use of interest
8 synchronization, which calculates the pro forma interest expense deduction by multiplying
9 rate base times the weighted cost of debt. The Company used interest synchronization in
10 its calculation of the interest expense deduction for income tax purposes, using the
11 Company's FPFTY rate base for its water and wastewater operations times the weighted
12 cost of debt provided by Company witness Mr. Moul. This was explained in my direct
13 testimony (AP Statement No. 1 at 25).

14 OCA's adjustments reflect the proposed weighted cost of debt proposed by OCA
15 Witness Garrett, partially offset by reductions to rate base proposed by OCA Witness
16 Smith.

17
18 **Q. Does the Company agree with these adjustments?**

19 A. No. With respect to the proposed change to the weighted cost of debt, this is a result of
20 Mr. Garrett's recommended use of a 50% debt ratio in the capital structure, rather than the
21 use of the projected actual capital structure of the Company for the FPFTY, which reflects
22 a debt ratio of 53.92%. Mr. Moul explains in his rebuttal testimony (AP Statement No. 7-
23 R) the errors of Mr. Garrett in proposing a hypothetical capital structure.

1 With respect to other parties’ recommended changes to the Company’s rate base, I
2 refer to the rebuttal testimony of Company witness Ms. Erin Feeney (AP Statement No. 2-
3 R), and my prior rebuttal regarding cash working capital.
4

5 **V. ACT 11**

6 **Q. OCA Witness Watkins recommends lowering the Act 11 allocation from Wastewater**
7 **to Water, OCA St. 4 at 9. I&E Witness Kubas recommends a similar reduction in**
8 **the Act 11 allocation from Wastewater to Water. I&E St. 1 at 36. Please briefly**
9 **describe their adjustments.**

10 A. Both OCA Witness Watkins and I&E Witness Kubas arrive at a similar result as far as the
11 reduction itself, *i.e.*, approximately a \$9 million to \$10 million less allocation to water from
12 wastewater, but approach their respective reductions differently. OCA Witness Watkin’s
13 approach involves, what he defines as, an examination of “acquisition premiums”.
14 Specifically, OCA Witness Watkins examines the purchase price of the system acquired
15 relative to its net book value during the Section 1329 proceeding. For clarity, the term
16 acquisition premium is incorrect. Section 1329 proceedings set the ratemaking rate base
17 of an acquired system. Mr. Kubas focuses his position of the fairness of the allocation
18 from systems acquired under Section 1329 proceedings (“Zones 7-11”) primarily, with
19 reductions of the allocation from (“Zones 1–6”) as well, just not as much.
20

21 **Q. Please respond to both of these adjustments.**

22 A. From the Company’s perspective, we disagree with their reduction and still submit that the
23 Company’s proposal is the more reasonable approach in this case. The Company’s overall

1 proposal was a 30% allocation of the revenue requirement from wastewater to water. This
2 is not our first time proposing an Act 11 allocation of this nature. What is different about
3 the current rate proceeding is that the Company has increased the size and number of
4 systems it owns by virtue of acquisitions purchased under Section 1329. Many of these
5 systems were not owned by Aqua PA at the time of its last rate case, and thus this is the
6 first case in which the Commission will consider the increases to rates for these systems.
7 To that end, the Company' proposal of allocation via Act 11 are intended to provide a path
8 of gradualism for these systems.

9
10 **Q. Please address Mr. Kubas' misconception and observation regarding Section 1329**
11 **acquisitions. I&E St. 5 at 37.**

12 A. I disagree with the general observation implied by Mr. Kubas that municipal governments
13 believe that the cost of acquiring these systems would be borne solely by the Company's
14 existing customers. The Company in good faith explains how purchase price will impact
15 future customer rates, and the Company endeavors to educate municipal leaders on the rate
16 setting process. In addition, the acquisitions of these systems were all approved by the
17 PUC as in the public interest with full knowledge and awareness of the revenue
18 requirement deficiencies that existed at acquisition. Moreover, due to the results of various
19 settlements and legal appeals, the customer notifications sent to both existing and acquired
20 customers is even more clear as to the potential impacts on rates of acquisitions acquired
21 under Section 1329. Such notification via individual customer notice, makes it clear that
22 the impacts are estimates and subject to change by the PUC at their discretion. It should
23 be noted that the notice to customers is at full revenue deficiency of the acquired systems.

1 This belies Mr. Kubas' misconception that municipal governments are not fully informed
2 of the ratemaking process and its impact. Finally, Mr. Kubas insinuates that the same
3 allocation made in one base rate case will be indefinitely applied. It is not the Company's
4 position that once an allocation is established in a previous rate case, that the same
5 allocation will be used indefinitely. Thus the "untenable" concern posited by Witness
6 Kubas is without merit.

7 Regarding the position advanced by Mr. Watkins and his method of noting
8 acquisition premiums as a basis for his reduction in allocation from systems acquired by
9 1329, it is the result I disagree with as compared to the method used to arrive at his
10 recommendation. Simply stated, the intent of the analysis is to support higher rate increases
11 for the systems acquired via Section 1329 since the customers of those systems will benefit
12 as constituents of their respective township or municipality insofar as the proceeds from
13 their system sale are used to reduce, stabilize, or eliminate municipal costs recovered
14 through taxes. While I do not disagree that there is a benefit to customers in these systems
15 as far as local tax savings, I believe the principles of gradualism should prevail and be
16 utilized to mitigate these first in rate increases. All of these acquisitions were approved
17 individually by the PUC and deemed in the public interest. That determination was not a
18 short term only assessment. The PUC understands that these systems will be owned and
19 operated by the Company for many years and there will be plenty of opportunity to adjust
20 the rate design for these systems to balance the recovery of the cost of utility service. As
21 the Company builds a larger wastewater footprint, the ability to adjust the rates between
22 zones and systems will only be enhanced, as we have seen for many years on the water
23 utility side. It is for these reasons that I believe the adjustments to reduce the Act 11

1 allocation should be rejected. Please also refer to Ms. Heppenstall's rebuttal testimony
2 (AP Statement No. 5-R).

3
4 **VI. EXEMPLARY MANAGERIAL PERFORMANCE**

5 **Q. Has the Company provided evidence of exemplary management performance in this**
6 **proceeding?**

7 A. Yes. My direct testimony specifically addresses the performance of Aqua PA's
8 management (AP Statement No. 1 at 31-45) and provides detailed information regarding
9 the Company's efforts to safe and reliable water and wastewater service. Those efforts
10 include: (1) optimization of water quality and proactive efforts to improve system
11 reliability; (2) a leadership role in addressing, testing and educating its customers on
12 emerging contaminants; (3) acting to assist the Commission, OCA and the Department of
13 Environmental Protection's to address small systems and acting as a receiver for North
14 Heidelberg and Bell Aire; (4) cost containment and keeping operational expense at less
15 than 1.3% annual growth rate; (5) development and proposal of a new and improved water
16 and wastewater low income customer assistance program; and (6) the introduction of a new
17 customer service interactive system map. For all of these reasons, an increment for
18 exemplary management effectiveness has been fully supported and should be adopted if,
19 for any reason, the Commission were to consider adopting an ROE of less than 10.75%.

20
21 **Q. Have any parties opposed the Company's proposal for performance factor**
22 **recognition?**

23 A. Ms. Alexander, Mr. Colton, Mr. Garrett and Mr. Spadaccio oppose the Commission

1 considering AP's superior management effectiveness in determining the ROE to be granted
2 to the Company in this case. Please see the rebuttal testimony of Ms. Black to address
3 specific assertions raised by both Ms. Alexander and Mr. Colton on this topic in her
4 testimony. Please see Mr. Duerr's rebuttal testimony (AP Statement No. 9-R) responding
5 to specific assertions regarding wastewater compliance in Mr. Colton's direct testimony.
6

7 **Q. Why did Mr. Spadaccio oppose performance factor recognition?**

8 A. It does not appear that Mr. Spadaccio disputes my direct testimony about Aqua PA's
9 various initiatives and accomplishments that demonstrate superior management
10 effectiveness in several areas. Rather, he contends that Aqua PA's level of performance is
11 legally required and therefore no recognition of its management effectiveness is necessary.
12 Essentially, Mr. Spadaccio asserts that Aqua PA should not be recognized for many of the
13 initiatives I described in my direct testimony, including infrastructure improvement
14 programs, because they are either funded by customers or required by the Public Utility
15 Code. Mr. Garrett also makes this assertion. This is not a valid reason to reject the
16 Company's proposal for performance factor recognition in this case.
17

18 **Q. Please address Mr. Spadaccio's and Mr. Garrett's contention that Aqua PA should**
19 **not be rewarded for performing duties that they believe are already required as a**
20 **public utility.**

21 A. At the outset, I note that no witness has articulated objective criteria for determining where
22 the line should be drawn between a utility doing what the law requires and going the extra
23 mile to contain costs, provide excellent service and dedicate itself to vigorously pursuing

1 the policy goals of the Commission, environmental regulators and other government
2 agencies. Mr. Spaddacio’s and Mr. Garrett’s attempts to characterize exemplary
3 performance as something the law requires is contradicted by Section 523. The legislature
4 envisioned that utilities can achieve levels of performance that exceed the base level of
5 their legal requirements because, otherwise there would be no point in enacting Section
6 523.

7 In PPL Electric’s 2012 case, the OCA also argued that “all regulated utilities are
8 required to provide safe, adequate, reasonable and efficient service as a matter of law” and
9 “a utility must be doing more than providing efficient and reasonable service in order to
10 receive more than the indicated rate of return” (PPL Order, p. 95). Similarly, in UGI
11 Electric’s 2017 case, I&E contended – like Mr. Spadaccio and Mr. Garrett here – that no
12 utility should reap additional rewards for programs funded by customers or for meeting the
13 company’s statutory obligation to provide safe and reliable service (UGI Order, p. 111).
14 The Commission rejected I&E’s and the OCA’s position in the PPL and UGI Electric rate
15 cases, and it should do the same in this case.

16
17 **Q. Has the Commission previously granted performance based incentives to Aqua PA**
18 **and other utilities?**

19 A. Yes. For example, in Aqua PA’s 2007-2008 rate case, PPL Electric’s 2012 rate case and
20 UGI Electric’s 2017 rate case, the Commission granted incremental increases of 22 basis
21 points (Aqua PA), 12 basis points (PPL Electric) and 5 basis points (UGI Electric). In
22 those cases, the Commission’s grant of performance increments was based on factors that
23 Mr. Spadaccio believed are expected of utilities.

1 In Aqua PA’s 2007-2008 case, it requested a performance factor adjustment of 25
2 basis points and was granted 22 basis points. In support of its position, Aqua PA presented
3 evidence that it had complied with all Federal and State primary drinking water standards,
4 had “minimal” taste and odor water quality complaints, took a leadership role in solving
5 regional water supply problems, had undertaken a major infrastructure rehabilitation
6 program, had a robust customer assistance program and a long history of exemplary
7 community involvement (Final Order, p. 47). The Commission granted Aqua PA a
8 performance factor adjustment, finding that “[a]s in the [Aqua] 2004 rate case, Aqua’s
9 management performance related to its water quality, customer service and low income
10 program continues to be laudable and should be a factor in its cost of common equity”
11 (Final Order, p. 50). In the PPL Order (p. 98), the Commission specifically cited PPL
12 Electric’s performance in the areas of “advanced metering infrastructure, operating
13 initiatives, customer contact center, electric competition, customer education, energy
14 efficiency programs, and customer assistance programs.” The Commission noted that the
15 12 basis point increment it granted was “conservative.” Similarly, in the UGI Order (pp.
16 114-115), the Commission identified performance related to, among other things, a
17 voluntary long-term infrastructure improvement plan and programs focused on enhancing
18 customer satisfaction in granting a performance-based incentive.

19
20 **Q. Is there anything else you would like to add regarding this topic?**

21 A. Yes. The witnesses do not acknowledge the Company’s eligibility for performance factor
22 recognition under the Commission’s Policy Statement at 52 Pa. Code § 69.711(b)(1).
23 Notwithstanding their erroneous position with regard to Section 523, the Company

1 certainly has demonstrated that its performance deserved recognition based on the
2 Company's long history of aggressively implementing the Commission's and DEP's
3 policies to continuously address troubled water and wastewater systems and upgrading the
4 facilities in those systems to furnish safe and reliable service.

5

6 **VII. CONCLUSION**

7 **Q. Does this conclude your rebuttal testimony?**

8 **A. Yes, it does.**

Exhibit WCP-1-R

Witness: William C. Packer
Date: 11/3/2021

AQUA PENNSYLVANIA, INC.
AQUA PENNSYLVANIA WASTEWATER, INC.

OFFICE OF CONSUMER ADVOCATE

DATA REQUEST SET X

DOCKET NOS. R-2021-3027385 & R-2021-3027386

OCA-X-7: Show in detail, by month, from inception through the most current month-end available exactly how Aqua has accumulated its Covid-19 deferred regulatory asset for uncollectibles. Include a breakout of amounts between Aqua’s water and wastewater utility operations.

RESPONSE:

As noted in the testimony of William C. Packer – AP Statement No. 1, the only amounts that have been deferred to date occasioned by Covid-19 are those costs pertaining to uncollectible accounts expense as shown below:

Water or Sewer	FISCAL_YEAR	ACCOUNT	ACCOUNT_DESC	Values											
				January	February	March	April	May	June	July	August	September	October	November	December
Sewer	2020	141000	Customer Accounts Receivable	2,530,791	3,020,158	2,948,588	3,104,869	3,155,171	3,342,400	3,577,715	3,795,312	3,701,242	3,637,285	3,862,326	4,141,064
		143000	RESERVE-UNCOLLECTABLE ACCTS	(518,504)	(531,311)	(542,900)	(583,971)	(615,886)	(666,429)	(719,421)	(743,184)	(934,233)	(1,017,188)	(1,108,734)	(966,672)
		186520	Reg Asset-COVID19 Recovery Costs	-	-	-	-	-	32,953	32,953	32,953	194,317	194,317	194,317	392,224
		2020 Total			2,012,286	2,488,847	2,405,688	2,520,898	2,539,285	2,708,923	2,891,247	3,085,081	2,961,325	2,814,414	2,947,908
Sewer	2021	141000	Customer Accounts Receivable	4,161,023	4,285,555	4,555,115	4,066,338	3,678,058	4,126,075	3,874,183	3,707,316	4,473,378			
		143000	RESERVE-UNCOLLECTABLE ACCTS	(1,006,198)	(1,043,015)	(1,059,825)	(1,092,313)	(657,795)	(685,605)	(738,746)	(771,023)	(829,974)			
		186520	Reg Asset-COVID19 Recovery Costs	392,224	392,224	420,772	420,772	420,772	12,008	12,008	12,008	(115,212)			
		2021 Total			3,547,050	3,634,763	3,916,062	3,394,797	3,441,034	3,452,478	3,147,445	2,948,300	3,528,192		
Sewer Total			5,559,336	6,123,610	6,321,750	5,915,695	5,980,319	6,161,401	6,038,691	6,033,381	6,489,518	2,814,414	2,947,908	3,566,616	
Water	2020	141000	Customer Accounts Receivable	35,249,218	37,795,841	35,298,340	37,362,503	39,258,437	41,673,265	44,711,198	45,157,732	43,507,999	45,045,550	45,095,504	46,693,687
		143000	RESERVE-UNCOLLECTABLE ACCTS	(4,230,097)	(4,299,149)	(4,384,888)	(4,829,560)	(5,134,486)	(5,450,487)	(5,667,475)	(6,115,906)	(8,102,563)	(8,687,763)	(9,325,005)	(9,832,972)
		186520	Reg Asset-COVID19 Recovery Costs	-	-	-	-	-	701,365	701,365	701,365	2,941,910	2,941,910	2,941,910	4,334,423
		2020 Total			31,019,121	33,496,691	30,913,451	32,532,943	34,123,951	36,924,144	39,745,088	39,743,191	38,347,345	39,299,696	38,712,409
Water	2021	141000	Customer Accounts Receivable	50,730,738	50,115,861	40,811,600	44,451,187	46,943,839	46,051,183	48,426,554	45,816,311	47,522,021			
		143000	RESERVE-UNCOLLECTABLE ACCTS	(10,435,604)	(10,967,000)	(10,897,265)	(11,066,995)	(10,696,063)	(10,547,902)	(10,143,122)	(9,901,413)	(9,827,990)			
		186520	Reg Asset-COVID19 Recovery Costs	4,334,423	4,334,423	5,274,258	5,274,258	5,274,258	5,176,016	5,176,016	5,176,016	4,702,640			
		2021 Total			44,629,557	43,483,283	35,188,594	38,658,450	41,522,034	40,679,298	43,459,448	41,090,915	42,396,671		
Water Total			75,648,678	76,979,974	66,102,045	71,191,393	75,645,986	77,603,441	83,204,536	80,834,105	80,744,016	39,299,696	38,712,409	41,195,137	
Grand Total			81,208,014	83,103,584	72,423,795	77,107,088	81,626,305	83,764,842	89,243,228	86,867,486	87,233,534	42,114,110	41,660,317	44,761,753	