



COMMONWEALTH OF PENNSYLVANIA

March 26, 2024

E-FILED

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: Pennsylvania Public Utility Commission v. Pennsylvania American Water Company / Docket Nos. R-2023-3043189 (Water) / R-2023-3043190 (Wastewater)

Dear Secretary Chiavetta:

Enclosed please find the Main Brief, on behalf of the Office of Small Business Advocate (“OSBA”), in the above-captioned proceedings.

Copies will be served on all known parties in these proceedings, as indicated on the attached Certificate of Service.

If you have any questions, please do not hesitate to contact me.

Sincerely,

/s/ Steven C. Gray

Steven C. Gray
Assistant Small Business Advocate
Attorney ID No. 77538

Enclosures

cc: PA PUC Secretary Rosemary Chiavetta (Cover Letter & Certificate of Service only)
Brian Kalcic
Kevin Higgins
Parties of Record

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY
COMMISSION**

PENNSYLVANIA PUBLIC UTILITY :
COMMISSION :
 : **Docket Nos. R-2023-3043189 (Water)**
 v. : **R-2023-3043190 (Wastewater)**
 :
PENNSYLVANIA-AMERICAN :
WATER COMPANY :

**MAIN BRIEF
ON BEHALF OF THE
OFFICE OF SMALL BUSINESS ADVOCATE**

Steven C. Gray
Assistant Small Business Advocate
Attorney ID No. 77538

For: NazAarah Sabree
Small Business Advocate

Office of Small Business Advocate
Forum Place
555 Walnut Street, 1st Floor
Harrisburg, PA 17101
(717) 783-2525
(717) 783-2831 (fax)

Date: March 26, 2024

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**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
	:	
v.	:	Docket Nos. R-2023-3043189 (Water)
	:	R-2023-3043190 (Wastewater)
	:	
PENNSYLVANIA-AMERICAN WATER COMPANY	:	

**MAIN BRIEF
OF THE OFFICE OF SMALL BUSINESS ADVOCATE**

I. Introduction and Overview

A. Description of the Office of Small Business Advocate

The Office of Small Business Advocate (“OSBA”) is authorized and directed by the Small Business Advocate Act, Act 181 of 1988, 73 P.S. §§ 399.41 - 399.50, to represent the interests of small business consumers of utility services in matters before the Pennsylvania Public Utility Commission (“Commission”).

B. Procedural History

On November 8, 2023, Pennsylvania-American Water Company (“PAWC” or the “Company”) filed Supplement No. 45 to Tariff Water-PA P.U.C. No. 5 and Supplement No. 47 to Tariff Wastewater PA P.U.C. No. 16 with the Commission. The rates set forth in the two Tariff Supplements, if approved by the Commission, would increase PAWC’s annual water and wastewater revenues by \$203.9 million.

On November 20, 2023, the OSBA filed a Complaint in this proceeding.

On December 22, 2023, Administrative Law Judges (“ALJs”) Christopher P. Pell and John M. Coogan issued their Prehearing Conference Order.

On January 3, 2024, a Prehearing Conference was held before ALJs Pell and Coogan.

On January 5, 2024, ALJs Pell and Coogan issued their Prehearing Order #1.

On February 1, 2024, the OSBA served the Direct Testimony of Kevin Higgins.

On February 21, 2024, the OSBA served the Rebuttal Testimony of Mr. Higgins.

On March 4, 2024, the OSBA served the Surrebuttal Testimony of Mr. Higgins.

On March 7 and 8, 2024, Evidentiary Hearings were held before ALJs Pell and Coogan.

On March 11, 2024, ALJs Pell and Coogan issued their Order on Briefs and Closing of the Record.

The OSBA submits this Main Brief in accordance with the procedural schedule set forth in Prehearing Order #1.

C. Overview of PAWC’s Filing

In its Direct filing, PAWC proposes to increase its water and wastewater revenues by \$203.9 million, or 20.2% over current annualized revenues including projected Distribution System Improvement Charge (“DSIC”) revenue. The Company’s proposed revenue requirement is based on a fully projected future test year (“FPFTY”) ending June 30, 2025.¹

PAWC produced five separate revenue requirement studies, one for its water operations and four for its wastewater operations. These five studies are: Water Operations (“Water”), Wastewater Sanitary Sewer Systems General Operations (“WW SSS”), Butler Area Sewer Authority Wastewater Operations

¹ Direct Testimony of Ashley E. Everette (PAWC Statement No. 1), at 7-8.

(“BASA”), Brentwood Wastewater Operations (“Brentwood’) and Wastewater Combined Sewer System Operations (“WW CSS”).²

The Company also separately calculated five class cost-of-service studies corresponding to its respective revenue requirement studies.³

Of PAWC’s requested \$203.9 million revenue requirement increase, \$128.1 million is related to Water, \$31.8 million is related to WW SSS, \$26.3 million is related to BASA, \$1.9 million is related to Brentwood, and \$15.8 million is related to WW CSS, prior to accounting for PAWC’s proposed shift of a portion of the wastewater revenue requirement to water customers. On a percentage basis, PAWC’s calculated revenue requirements represent increases over present rates of 15.5% for Water, 33.3% for WW SSS, 221.9% for BASA, 106.1% for Brentwood, and 20.1% for WW CCS.⁴

PAWC is proposing to recover \$71.1 million of its wastewater revenue requirement from its water customers based on Act 11 of 2012 (“Act 11”).⁵ After accounting for the Company’s proposed Act 11 revenue shift, PAWC proposes to increase water revenues by \$199.2 million and wastewater revenues by \$4.7 million in total. The proposed wastewater revenue changes consist of a \$169 thousand decrease for WW SSS, a \$4.7 million increase for BASA, a \$369 thousand increase for Brentwood, and a \$227 thousand decrease for WW CSS.⁶

² The CSSs consist of the Scranton, McKeesport, and Kane combined sewer (wastewater and stormwater) systems. Direct Testimony of Ashley E. Everette (PAWC Statement No. 1), at 17-19.

³ Direct Testimony of Constance E. Heppenstall (PAWC Statement No. 12), at 3.

⁴ See Volume 03, Exhibit No. 3-A. See also, OSBA Statement No. 1, at 7.

⁵ Direct Testimony of Ashley E. Everette (PAWC Statement No. 1), at 20; 66 Pa. C.S. § 1311 (Valuation of and return on the property of a public utility).

⁶ Volume 03, Exhibit No. 3-A. See also, OSBA Statement No. 1, at 7.

PAWC also proposes to implement a Revenue Decoupling Mechanism (“RDM”), to implement an Environmental Compliance Investment Charge (“ECIC”), and requests deferred accounting for several items, including production expenses.⁷

D. Legal Standards

Section 1301 of the Public Utility Code, 66 Pa. C.S. § 1301, provides that “every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the commission.”

The burden of proof to establish the justness and reasonableness of every element of the utility’s rate increase rests solely upon the public utility. 66 Pa. C.S. § 315(a). “It is well-established that the evidence adduced by a utility to meet this burden must be substantial.” *Lower Frederick Township v. Pa. PUC*, 409 A.2d 505, 507 (Pa. Cmwlth. 1980).

Although the burden of proof remains with the public utility throughout the rate proceeding, when a party proposes an adjustment to a ratemaking claim of a utility, the proposing party bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment. *Pa. PUC v. Aqua Pennsylvania, Inc.*, Docket No. R-00072711 (Order entered July 17, 2008). “Section 315(a) of the Code, 66 Pa. C.S. § 315(a), applies since this is a proceeding on Commission Motion. However, after the utility establishes a prima facie case, the burden of going forward or the burden of persuasion shifts to the other parties to rebut the prima facie case.” *Pa. PUC v. Philadelphia Gas Works*, Docket No. R-00061931 (Order entered September 28, 2007), at 12.

Furthermore, Section 523 of the Public Utility Code, 66 Pa. C.S. § 523, requires the Commission to “consider . . . the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates.” In exchange for customers paying rates for service, which include the cost of

⁷ OSBA Statement No. 1, at 5.

utility plant in service and a rate of return, a public utility is obligated to provide safe, adequate, and reasonable service. “[I]n exchange for the utility’s provision of safe, adequate and reasonable service, the ratepayers are obligated to pay rates which cover the cost of service which includes reasonable operation and maintenance expenses, depreciation, taxes and a fair rate of return for the utility’s investors . . . In return for providing safe and adequate service, the utility is entitled to recover, through rates, these enumerated costs.” *Pa. PUC v. Pennsylvania Gas & Water Co.*, 61 Pa. PUC 409 (1986), at 415-16. *See also* 66 Pa. C.S. § 1501. As a result, the legislature has given the Commission discretionary authority to deny a proposed rate increase, in whole or in part, if the Commission finds “that the service rendered by the public utility is inadequate.” 66 Pa. C.S. § 526(a).

The Commonwealth Court in *Lloyd v. Pennsylvania Public Utility Commission*, 904 A.2d 1010 (Pa. Cmwlth. 2006), *appeal denied*, 591 Pa. 676 (2007) decided, as follows:

However, while permitted, gradualism is but one of many factors to be considered and weighed by the Commission in determining rate designs, and principles of gradualism cannot be allowed to trump all other valid ratemaking concerns and do not justify allowing one class of customers to subsidize the cost of service for another class of customers over an extended period of time.

* * *

[I]n effect, the Commission has determined that the principle of gradualism trumps all other ratemaking concerns - especially the polestar - cost of providing service.

Lloyd, at 1010.

The Commonwealth Court in *Lloyd* continued, as follows:

To allow the principle of gradualism to be applied on a total bill basis when each service is a stand-alone rate structure would be like saying that the Commission could apply the principle of gradualism in an electric case based on a customer's total utility bill, i.e., the amount a rate payer would pay for electric, gas, water and telecommunications services.

Lloyd, at 1020-1021.

II. Summary of Argument

Based upon the OSBA revenue adjustments, the OSBA proposes an overall revenue increase of \$109,088,498 for PAWC in this proceeding. The OSBA does not oppose other revenue adjustments presented by the non-Company parties.

PAWC's request to recover \$21.6 million in annual Act 11 revenues from water customers associated with the acquisition of the Butler Area Sewer Authority should be denied.

All costs related to PAWC's acquisition of Audubon Water Company's assets should be removed from the revenue requirement in this case.

50% of the Annual Performance Plan expense should be eliminated from PAWC's requested revenue requirement.

PAWC's proposal to have ratepayers fund the Company's Employee Stock Purchase Plan ("ESPP") should be rejected.

PAWC's Long-Term Performance Plan expense should be eliminated from PAWC's requested revenue requirement.

PAWC's request for deferred accounting treatment for its production expenses should be denied.

The OSBA recommends the adoption of the Water Cost of Service Study set forth in OSBA Statement No. 1-R, Schedule KCH-12. The OSBA's Water Cost of Service Study corrects for numerous, admitted errors in PAWC's originally filed Water Cost of Service Study, and employs maximum day and maximum hour allocators that more closely align with PAWC's system performance.

PAWC and the OSBA agree that all low-income residential customer assistance program costs should be exclusively recovered from the residential class.

The OSBA recommends the adoption of the water service revenue allocation to the Company’s various rate classes, which is based upon the Water Cost of Service Study set forth in OSBA Statement No. 1-R, Schedule KCH-12.

The OSBA recommends that the Act 11 wastewater subsidy allocation as set forth in PAWC’s response to OSBA 03-001.

PAWC’s proposed Revenue Decoupling Mechanism should be rejected.

PAWC’s proposed Environmental Compliance Investment Charge should be rejected.

III. Overall Position on the Rate Increase

The overall position of the OSBA on PAWC’s Direct requested revenue increase is set forth in the following table:⁸

	Total Company	
	Adjustment Impact	Increase
PAWC Direct Revenue Req. Increase		\$203,945,911
<u>OSBA Recommended Adjustments</u>		
Annual Performance Plan Expense	(\$5,153,394)	\$198,792,517
Long Term Performance Plan Expense	(\$5,230,156)	\$193,562,362
Employee Stock Purchase Plan Expense	(\$457,009)	\$193,105,353
Service Co. Executive Retirement Plan	(\$35,106)	\$193,070,247
External Board Expense	(\$126,792)	\$192,943,455
Proxy Return on Equity	(\$61,540,957)	\$131,402,498
BASA Mitigation Adjustment	(\$19,091,395)	\$112,311,103
Brentwood Mitigation Adjustment	(\$1,309,219)	\$111,001,884
Audubon Water Acquisition Adjustment	(\$1,913,386)	\$109,088,498
Total OSBA Adjustments	(\$94,857,413)	\$109,088,498

IV. Rate Base

The OSBA is not addressing this issue in its Main Brief.

V. Revenues

A. Butler Area Sewer Authority (“BASA”) Mitigation Adjustment

⁸ OSBA Statement No. 1-S, at 5, Table KCH-1-S.

A condition that the OSBA insisted on, and PAWC agreed to, in the Settlement Agreement approved at Docket No. A-2022-3037047 (“BASA Settlement”), is that the Company would move BASA rates to 1.40 times the current BASA rates *or* PAWC’s proposed Rate Zone 1 system-average wastewater rates, whichever is lower, upon the later of (a) the first anniversary of Closing or (b) January 1, 2025.⁹

PAWC has adhered to this condition, but in this proceeding the Company has proposed to recover \$21.6 million in annual Act 11 revenues from water customers associated with the acquisition of BASA. This recovery should be denied.

As set forth in the BASA Settlement, PAWC plans to include the \$228.0 million purchase price in rate base associated with the acquisition. The original cost of the BASA assets (as of June 30, 2024) is \$146.0 million, whereas the original cost less accumulated depreciation (“net book value”) is approximately \$90.1 million. Thus, the proposed rate base addition exceeds the original cost of the BASA assets by \$82.0 million and exceeds the net book value by \$137.9 million.¹⁰

In this proceeding, PAWC calculates that the cost-based increase related to BASA is \$26,288,308 (rather than the projected \$17,895,000) and proposes to shift \$21,552,699 of that increase to water customers¹¹.

It is unreasonable to shift this cost burden to water customers in this case. PAWC “negotiated” the BASA acquisition price¹², and negotiated with the OSBA and other parties to mitigate the impact on BASA customers in this rate case. Consequently, the OSBA recommends setting the BASA-related

⁹ OSBA Statement No. 1, at 20.

¹⁰ OSBA Statement No. 1, at 21.

¹¹ Volume 03, Exhibit No. 3-A. *See also*, OSBA Statement No. 1, at 22.

¹² As the Legislature is quickly becoming aware, a Section 1329 acquisition is not a typical negotiation between two parties. *See* OSBA Statement No. 1, at 23-25.

revenue requirement increase at the 40% capped increase for BASA wastewater customers, or \$4,735,610, with no Act 11 revenue shift to water customers. This adjustment would decrease PAWC's proposed revenue requirement by \$21.6 million, which is PAWC's proposed Act 11 revenue shift related to the BASA acquisition.¹³

Of course, the Commission did approve the BASA Settlement, which will allow PAWC (if the Commonwealth Court issues are resolved in its favor) to include \$228 million in rate base for the BASA acquisition. However, the Commission also approved the BASA rate mitigation plan, to which PAWC agreed, which limits the increase to BASA wastewater customers in this rate proceeding.

Therefore, the OSBA recommended revenue requirement adjustment related to BASA is simply holding PAWC to its commitment in the BASA Settlement. OSBA's adjustment is effectuated by temporarily imputing revenues to the BASA system in the amount necessary to recover the BASA revenue requirement without shifting costs to non-BASA customers. PAWC can revisit this issue in its next rate case.

B. Borough of Brentwood Wastewater Acquisition Mitigation Adjustment

On March 4, 2024, the Commission entered an Opinion and Order at Docket No. A-2021-3024058 denying PAWC's acquisition of the Borough of Brentwood's wastewater collection system assets.

Therefore, the Brentwood-related revenue requirement increase that PAWC proposes for Brentwood wastewater customers of \$369,405 must be eliminated. Furthermore, PAWC's proposed Act 11 revenue shift related to Brentwood of \$1.6 million must also be eliminated. The Company has agreed to remove the Brentwood revenue requirement from its claims in this case.¹⁴

¹³ OSBA Statement No. 1, at 25. The stated impact is based on PAWC's proposed cost of capital. The impact shown in the table above is calculated under a 9.65% proxy return on equity.

¹⁴ Hearing Transcript, page 1970, lines 16-19.

C. Audubon Water Company Acquisition

The Joint Application of Pennsylvania-American Water Company and Audubon Water Company, at Docket Nos. A-2023-3043194, A-2023-3043196, has scheduled evidentiary hearings for April 23 and 24, 2024.

PAWC is proposing to acquire Audubon’s water assets through a merger transaction valued at \$8.0 million, even though the net book value of the Audubon assets is only \$360,229 as of December 31, 2024.¹⁵ If the Audubon acquisition is rejected by the Commission, or if the Commission does not issue a final order in the Audubon acquisition proceeding prior to the record closing in the instant proceeding, all costs related to Audubon should be removed from the revenue requirement in this case. At a minimum, OSBA recommends removing the costs associated with the Audubon acquisition premium above net book value, which reduces the revenue requirement by approximately \$1,913,386.

VI. Expenses

B. Annual Performance Plan Expense (PAWC and Service Company)

PAWC provides performance-based compensation under two plans: the Annual Performance Plan (the “APP”), which is applicable to all full-time employees, and the Long-Term Performance Plan (the “LTPP”), which is limited to certain exempt employees.¹⁶

PAWC provides cash awards to employees for achievement of various business objectives under the APP. To calculate APP awards, the Company uses a “corporate performance multiplier.” The largest component (50%) of this multiplier is based on Adjusted Earnings Per Share (“EPS”). Every year, PAWC sets out the threshold, target, and maximum EPS levels that are used in the APP performance

¹⁵ OSBA Statement No. 1-S, at 14.

¹⁶ OSBA Statement No. 1, at 10.

calculation. If PAWC's corporate performance results in an EPS less than 90% of the *target*, no employees are given cash awards.

The OSBA recognizes that while rewarding employees for financial performance can, under certain specific circumstances, be appropriate, the responsibility for funding such awards rests mostly with the shareholders.

Therefore, the OSBA recommends that 50% of the APP expense be eliminated from the revenue requirement, based on the weight of the EPS goal included in the APP corporate performance calculation as well as placing more of the financial burden for the APP on the Company's shareholders.

This adjustment decreases the FPFTY revenue requirement by approximately \$5,153,394 in total, which includes the impact of removing 50% of the APP expense directly related to PAWC employees, as well as 50% of the APP expense allocated to PAWC by its Service Company from the revenue requirement. This amount also includes the estimated impact on payroll tax expense.¹⁷

D. Employee Stock Purchase Plan Expense

PAWC provides an Employee Stock Purchase Plan ("ESPP"), which gives a 15% discount on purchases of American Water Works' stock by employees who are enrolled in the ESPP.¹⁸ PAWC proposes to include the cost of providing this employee benefit in its revenue requirement.

OSBA recommends that PAWC's proposal that ratepayers should fund the stock purchase discount be rejected. It is not the job of ratepayers to incentivize employees to purchase American Water Works stock. Since the ESPP operates through payroll deductions, this stock purchase mechanism increases payroll costs for the portion of an employee's compensation that is used to purchase stock.¹⁹

¹⁷ OSBA Statement No. 1, at 11-12.

¹⁸ OSBA Statement No. 1, at 13.

¹⁹ OSBA Statement No. 1, at 13-14.

If PAWC wants to provide an incentive for employees to purchase the failing American Water Works stock, the ESPP should be funded by shareholders.

This adjustment decreases the FPFTY revenue requirement by approximately \$457,009 in total.²⁰

E. Stock-Based Compensation Expense - Long-Term Performance Plan Expense

PAWC provides stock-based compensation to eligible employees through its LTPP. Eligible employees are awarded restricted stock units (“RSUs”) and performance stock units (“PSUs”). RSU awards are based on a three-year vesting period if the participant remains employed with the Company, and PSU awards are based on “performance vesting conditions.”²¹

The PSUs are awarded based on a combination of compounded EPS growth and relative total shareholder return when compared to a peer group of stock over a three-year period. The LTPP awards for the historic test year ended June 30, 2023 was approximately 22% RSUs and 78% PSUs.²²

The OSBA recommends that the LTPP expense be removed from the revenue requirement – this is an award program that should be funded by shareholders. The majority of the LTPP cost is the PSU component, which is directly based on American Water Works’ financial performance.

The RSU component is simply based upon an employee continuing to work for PAWC, rather than any explicit work-related goals. Thus, the PAWC employee who simply shows up to work for 3 years obtains RSUs. This is an expense that is properly borne by the Company’s shareholders.

This adjustment decreases the FPFTY revenue requirement by approximately \$5,230,156 in total.²³ This amount includes the estimated impact on payroll tax expense.

G. Payroll Tax.

²⁰ OSBA Statement No. 1, at 14.

²¹ OSBA Statement No. 1, at 12.

²² OSBA Statement No. 1, at 12.

²³ OSBA Statement No. 1, at 13.

Payroll tax adjustments are appropriate if the Commission approves adjustments to compensation-related expenses that impact payroll taxes. The OSBA's recommended adjustment to APP and LTPP expenses include the estimated impact on payroll taxes.

Q. Production Expenses (and Request for Deferred Regulatory Accounting Treatment)

The OSBA recommends that PAWC's request for deferred accounting treatment for its production expenses be denied. Utility management should be expected to cope with normal business risks and the operation of economic forces, without resorting to single-issue ratemaking, such as the requested deferred accounting treatment, except in circumstances of compelling public interest.²⁴

R. Service Company Executive Retirement Plan Expense

OSBA recommended an adjustment to remove the Service Company Executive Retirement Plan (i.e., "SERP") expense, decreasing the FPFTY revenue requirement by approximately \$35,106 in total.²⁵ PAWC's rebuttal testimony stated that the Company would remove the SERP expense from the revenue requirement.

S. External Board Expense

OSBA recommended an adjustment to remove External Board expense based on PAWC's stated plans to eliminate its External Board. This adjustment decreases the FPFTY revenue requirement by approximately \$126,792 in total.²⁶ PAWC's rebuttal testimony stated that the Company would remove the External Board expense.²⁷

VII. Taxes

The OSBA is not addressing this issue in this Main Brief.

²⁴ OSBA Statement No. 1, at 47-48.

²⁵ OSBA Statement No. 1, at 15.

²⁶ OSBA Statement No. 1, at 16.

²⁷ OSBA Statement No. 1-S, at 6.

VIII. Rate of Return

E. Return on Equity (“ROE”)

For the purposes of this proceeding, OSBA expert witness Kevin Higgins utilized the 9.65% ROE authorized for PAWC’s distribution system improvement charge (“DSIC”) in the most recent Report of the Commission’s Bureau of Technical Utility Services on the Quarterly Earnings of Jurisdictional Utilities as a proxy for his revenue requirement.²⁸

Mr. Higgins’ use of the proxy ROE has implications for the adjustments when addressing PAWC’s acquisitions of other utilities. Use of the proxy ROE in the calculation of the revenue requirement impacts of his acquisition-related adjustments provides a more realistic measurement of the impact of those adjustments.²⁹

The OSBA has no objection, and would support, either the ROE of 8.45% proffered by the Bureau of Investigation and Enforcement (“I&E”), or the ROE of 9.1% and capital structure proffered by the Office of Consumer Advocate (“OCA”).

IX. Rate Structure and Rate Design

A. Cost of Service Studies

1. Water Operations

Various errors in PAWC’s original Water Cost of Service Study (“COSS”) were identified and acknowledged by the Company.

Cleveland-Cliffs Steel expert witness Richard A. Baudino observed that there has been a large shift in costs allocated to the Public class since the last rate case, Docket No. R-2022-3031672. Specifically, he noted that the Public class’s allocated share of meter and services costs increased

²⁸ OSBA Statement No. 1, at 17.

²⁹ OSBA Statement No. 1, at 18.

significantly since the last rate case. In response to PAWLUG 05-001, PAWC acknowledged that there was a “linking error” in the Public Authority meter count that was used as an input in the Water CCOSS. PAWC provided a revised Water CCOSS that corrected this error, as well as numerous other errors.³⁰

Mr. Baudino also observed that PAWC’s original Water CCOSS did not exclude interruptible usage from the extra capacity portion of Factors 2, 3, and 4. Specifically, the Company provides service under an Industrial Curtailment Rate that applies a reduced tail block rate to participating customers’ usage over 15,000,000 gallons a month. In exchange for this reduced tail block charge, participants must curtail usage of Company-supplied water for industrial purposes when requested by PAWC or be subject to penalties for failure to curtail.³¹ Interruptible usage was erroneously included in extra capacity components of the base-extra capacity allocators (Factors 2, 3, and 4), as well as the weighted maximum day / maximum hour allocators (Factors 5 and 8). The result was increased costs that were allocated to the industrial class.³²

PAWC admitted its error. In response to OCA 04-012, PAWC explained that it was a mistake to include interruptible usage in its extra capacity calculations. PAWC provided a corrected version of its Water CCOSS and fixed this error. As set forth above, PAWC also subsequently provided a further revision to its Water CCOSS in response to PAWLUG 05-001³³. This latest, revised Water CCOSS corrected the error related to interruptible usage identified by Mr. Baudino, as well as the Public class meter count error discussed by Mr. Baudino his Direct Testimony.³⁴

³⁰ OSBA Statement No. 1-R, at 5.

³¹ OSBA Statement No. 1-R, at 6.

³² OSBA Statement No. 1-R, 6.

³³ OSBA Statement No. 1-R, at 7.

³⁴ See OSBA Statement No. 1, at 35-37.

OCA expert witness Jerome D. Mierzwa observed that the maximum day and maximum hour weightings utilized by PAWC in its base-extra capacity allocation factors are outdated. PAWC utilizes a maximum day factor of 1.4, which is calculated using the ratio of the *maximum day* to the *average day* observed in 1988, 1995, 1996, 1999 and 2003. Mr. Mierzwa noted that that PAWC's maximum hour factor of 2.1 is based on a 1988 analysis of PAWC's three largest operating districts, and that PAWC does not have any recent actual hour data for its water system.³⁵

Mr. Higgins explained how PAWC uses the maximum day factor in its Water COSS, as follows:

In the base-maximum day extra capacity allocator, Factor 2, PAWC weights the average day by 1/1.4 (or 71.43%) and weights the maximum day extra capacity by 0.4/1.4 (or 28.57%). In this calculation, the maximum day component is intended to represent each class's share of the maximum day extra capacity, which is calculated using ratios from PAWC's Customer Class Demand Study conducted in 2013 to 2015. The Customer Class Demand Study identifies the highest maximum day to average day ratio for each customer class sample in 2013 to 2015, (*i.e.*, the class peaking factor). PAWC then applies each class's peaking factor to its pro forma future test year average daily consumption to develop an estimate of each class's noncoincident demand. Each class's maximum day extra capacity represents the difference between its noncoincident maximum daily demand and its average daily demand.

Factor 3 is another variation of the base-maximum day extra capacity factor which includes an additional weighting for Fire Protection.

Factors 2 and 3 are used to allocate a variety of costs in PAWC's water CCOSS, including Purification Buildings, Purification System plant, Other Water Source Structures, Mains 10-inches and over, and certain operations & maintenance ('O&M') expenses related to purification and Source of Supply.

OSBA Statement No. 1-R, at 9-10.

Mr. Mierzwa recommends utilizing a maximum day extra capacity factor of 1.2 based on the actual maximum day ratios since 2011. Moreover, PAWC's Schedule G demonstrates that the

³⁵ OSBA Statement No. 1-R, at 8-9.

Company's system-wide maximum day ratios have been trending downward over time. In the most recent ten-year period of data available, 2013-2022, the highest annual ratio is 1.16.

Consequently, the OSBA agrees with Mr. Mierzwa that a maximum day ratio of 1.2 is more appropriate for PAWC's system and should be adopted in this proceeding.

Mr. Higgins then explained how PAWC uses the maximum hour factor in its Water COSS, as follows:

PAWC utilizes a base-maximum hour extra capacity allocator, Factor 4, to allocate various cost items such as Mains under 10 inches and Distribution Reservoirs and Standpipes. This factor is calculated by weighting average hourly consumption, maximum hour extra capacity, and a Fire Protection component. PAWC uses a maximum hour factor of 2.1 to weight the average hourly usage and maximum hour extra capacity components.

In addition, PAWC utilizes Factors 5 and 8, which are weighted combinations Factors 3 and 4 to allocate certain pumping-related plant and mains-related O&M expenses.

OSBA Statement No. 1-R, at 12.

Mr. Mierzwa explains that the 2.1 maximum hour factor utilized by PAWC is based on a 1988 analysis and recommends that PAWC should be required to update its analysis of system-wide maximum hour extra capacity demands prior to its next base rate proceeding.³⁶ The OSBA agrees with this recommendation. Although Mr. Mierzwa recommends utilizing a maximum hour factor of 1.5 (using a study conducted by The York Water Company), the OSBA recommends the use of a maximum hour factor of 1.8. This maintains the same *proportionate relationship* between the maximum hour and the maximum day as the factors utilized by PAWC when adopting the OSBA's proposed maximum day factor of 1.2 (*i.e.*, $1.2 / 1.4$ and $1.8/2.1$).

4. Allocation of AMP Costs & Administrative Costs for H2O Programs

³⁶ OSBA Statement No. 1-R, at 13.

PAWC recovers the direct costs of the Company's residential low-income discounts from the residential class in the Company's rate design. However, in its original filing, PAWC allocated \$3,180,090 caused by the Company's Arrearage Management Plan ("AMP") and administrative costs associated with its low-income residential programs among *both* residential and non-residential customer classes in its cost-of-service studies.³⁷

For water service, PAWC allocates \$2,031,317 for its proposed AMP and \$416,569 in Dollar Energy administrative costs among its water classes based on the historical incurrence of bad debt. For wastewater service, PAWC allocates a total of \$345,883 in AMP expense and \$70,931 in Dollar Energy administrative costs among classes within its various wastewater cost-of-service studies.³⁸

PAWC also allocates \$315,390 in administrative costs for its H2O Grant and Discount program among water customer classes using an operations & maintenance ("O&M") factor.³⁹

Originally, PAWC initially claimed that costs associated with its AMP are recovered in base rates from residential customers. Later, the Company acknowledged that these costs are not directly assigned to the residential class in its cost-of-service studies.⁴⁰

The OSBA recommended that all the residential low-income program costs be directly assigned to the residential customer class, as these programs are not available to non-residential customers and only benefit the residential customer class.

PAWC adopted the OSBA's recommendation, and directly assigned AMP costs and residential low-income program administrative costs to the residential class.⁴¹

³⁷ OSBA Statement No.1, at 31.

³⁸ OSBA Statement No. 1, at 31.

³⁹ OSBA Statement No. 1, at 31.

⁴⁰ OSBA Statement No. 1, at 31-32.

⁴¹ OSBA Statement No. 1-S, at 19.

B. Revenue Allocation

1. Water Service Revenue Allocation

In his Direct Testimony, Mr. Higgins recommended a higher increase to the Public (Municipal) class and a lower increase to the Commercial class. In response, in his rebuttal testimony, PAWC witness Mr. Rea stated that PAWC is not opposed to higher increases for the Municipal class with offsetting decreases to other customer classes.⁴²

However, in his Rebuttal Testimony, OSBA expert Mr. Higgins revised his recommended Water COSS to incorporate corrections to significant errors in PAWC's originally filed Water COSS (as set forth above, the errors were admitted to by the Company), as well as using the OSBA's recommended maximum day and maximum hour weightings. Ultimately, Mr. Higgins recommended a reduction of PAWC's proposed revenue increases to *both* the Commercial and Residential classes.⁴³ OCA witness Mr. Mierzwa also agrees that the Public class should receive a greater increase, and that both the Residential and Commercial classes should receive lower increases.⁴⁴

Consequently, the OSBA's recommended revenue allocation is based upon Mr. Higgins' revised Water COSS and is set forth in Schedule KCH-12 of his Rebuttal Testimony.⁴⁵

2. Act 11 Allocation

As Mr. Higgins observed in his Direct Testimony, PAWC's methodology for allocating wastewater revenue responsibility among its water classes has evolved throughout the course of this

⁴² OSBA Statement No. 1-S, at 18.

⁴³ OSBA Statement No. 1-S, at 19.

⁴⁴ OSBA Statement No. 1-S, at 18.

⁴⁵ Schedule KCH-12 is attached to the Main Brief for the convenience of the reader.

proceeding. The Company’s Exhibit 12-A, Schedule A, spread the Act 11 revenue allocation among PAWC’s water classes, but provided no explanation how the revenue amounts were derived.⁴⁶

In response to discovery, PAWC provided a corrected allocation of Act 11 revenue among water classes in discovery response OSBA 03-001 that is based on the corresponding wastewater classes that give rise to the Act 11 revenue shortfall.⁴⁷

If, as expected, the Commission approves the recovery of a portion of the wastewater revenue requirement from PAWC’s water customers in this case, Mr. Higgins recommended utilizing the approach provided by PAWC in response to OSBA 03-001 as a reasonable means of allocating the Act 11 subsidy among water classes, as updated for the Act 11 subsidy level and cost-of-service studies ultimately approved in this case.⁴⁸

Other parties recommended different approaches to Act 11 subsidy allocation, with Mr. Mierzwa for the OCA⁴⁹ and Mr. Baudino for Cleveland-Cliffs Steel⁵⁰ recommending that the Act 11 subsidy be allocated among water classes based on the results of the water cost-of-service study. The legal problem with the OCA and Cleveland-Cliffs Steel methodology is that it transforms wastewater costs into water costs, and then those “transformed” wastewater costs are allocated based upon PAWC’s Water COSS. That “transformation” violates the plain language of the statute. Specifically, Section 1311(c) explicitly uses the word “allocate” – not “transform” or “change.” It is true that the Commission has latitude in interpreting its statutes. However, the Commission has no authority to change the words of those

⁴⁶ OSBA Statement No. 1, at 33.

⁴⁷ OSBA 03-001 is attached to this Main Brief for the convenience of the reader.

⁴⁸ OSBA Statement No. 1, at 33-34.

⁴⁹ OCA Statement 4, at 28.

⁵⁰ Cleveland-Cliffs Steel Statement No. 1, at 8-9.

statutes, and no definition of “allocate” includes the ability to perform alchemy by transforming wastewater costs into water costs.

Furthermore, such a transformation of wastewater costs into water costs so that a Water COSS can be applied violates the basic tenets of the *Lloyd* decision. The Commonwealth Court held, in 2006, that the cost of service was the polestar of setting rates. That is the law of the Commonwealth of Pennsylvania and must be followed by this Commission. If cost of service is the polestar, then diluting a Water COSS with wastewater costs is forbidden.

The allocation of any subsidy is, by its nature, imperfect, since it is a departure from cost causation. Unfortunately, the allocation of PAWC’s Act 11 subsidy is further complicated by the fact that PAWC’s non-residential wastewater class categories do not match those for its water system.⁵¹ If the Commission approves the recovery of a portion of the wastewater revenue requirement from water customers in this case, OSBA recommends that the allocation approach in PAWC’s response to OSBA 03-001 (as supported by Mr. Higgins) conforms to the requirements of Section 1311 of the Public Utility Code, and is a just and reasonable result for this issue.

D. Summary (Including Scale Back of Rates)

In the likely event that the Commission approves a lower revenue increase than that requested by PAWC, the OSBA recommends that the decrease be applied primarily to water rates. If the Commission approves a lower revenue requirement increase associated with PAWC’s wastewater systems than proposed by PAWC, the incremental revenue requirement reduction should not reduce PAWC’s proposed wastewater rates, so long as the cost-based wastewater revenue requirement is greater than

⁵¹ OSBA Statement No 1-R, at 15-16.

PAWC’s proposed wastewater rates. This means that a lower revenue requirement will reduce Act 11 revenues and PAWC’s proposed water rates generally.⁵²

Regarding water rates at a lower revenue requirement, the OSBA recommends scaling-back the revenue allocation to each customer class in proportion to each class’s share of the total non-Act 11 revenues shown in Mr. Higgins’ Schedule KCH-12, page 1. OSBA also recommends that each water class recover its allocated share of any approved Act 11 subsidy. The reasoning for this recommendation is straight-forward: it fixes the admitted errors in PAWC’s originally-filed Water COSS; it employs more reasonable and accurate maximum day and maximum hour allocators; and it will recover the Act 11 subsidy allocated to each water class.

X. Alternative Ratemaking Requests

A. Revenue Decoupling Mechanism

PAWC is requesting approval of a Revenue Decoupling Mechanism (“RDM”) for *both* water and wastewater service in this proceeding. If the Commission approved the proposed RDM, it would operate by comparing the difference between *actual revenue collected* and *hypothetical revenue collected* – which would be calculated by using a Straight Fixed Variable (“SFV”) rate design. If actual revenues are greater than hypothetical revenues, PAWC would credit the difference to customers in a subsequent year. If actual revenues are less than hypothetical revenues, PAWC would collect the difference from customers in a subsequent year.⁵³

⁵² OSBA Statement No. 1, at 36-37.

⁵³ OSBA Statement No. 1, at 37-38.

Moreover, if a larger small business, say an industrial facility, went out of business or moved to Kentucky, the remaining small businesses would have to pick up the revenue shortfall calculated by PAWC's RDM.⁵⁴

The OSBA opposes the PAWC's proposed RDM, and requests that the Commission reject it.

B. Environmental Compliance Investment Charge

In this proceeding, PAWC is asking Commission approval to impose an Environmental Compliance Investment Charge ("ECIC") on its water and wastewater ratepayers. The ECIC is purported to recover the costs of complying with "environmental standards" imposed upon PAWC by Federal, State, and Local governments *between* rate cases. PAWC's proposed ECIC would allow for recovery of capital costs and incremental O&M expenses for projects and activities that are set forth in the Company's "annual environmental compliance plan" that is to be filed with the Commission. Specifically, PAWC's proposed ECIC is designed as a percentage surcharge, calculated separately for water and wastewater, to be updated quarterly for the costs incurred in a preceding period. PAWC plans to impose the ECIC beginning in November 2025.⁵⁵

PAWC's proposed ECIC is the textbook example of single-issue ratemaking, a practice that runs afoul of traditional utility regulation before the PUC. It is true that PAWC's proposed ECIC might be considered alternative regulation. However, PAWC has shown a predilection for entering into costly expenditures – the acquisition of the Butler Area Sewer Authority being a prime example. Trusting PAWC to control its "environmental compliance costs" might be somewhat naive.

⁵⁴ OSBA Statement No. 1, at 39.

⁵⁵ OSBA Statement No. 1, at 45.

Furthermore, the entire point of rejecting single-issue ratemaking is that a traditional rate case allows all parties, including the Commission, to balance the expenses of, say, an ECIC, with possible savings created by a Company's environmental compliance projects.⁵⁶

The OSBA requests that the Commission reject PAWC's proposed ECIC.

XI. Low-Income Customer Assistance

The OSBA is not addressing this issue in its Main Brief.

XII. Service Quality and Customer Service Issues

The OSBA is not addressing this issue in its Main Brief.

XIII. Miscellaneous

The OSBA is not addressing this issue in its Main Brief.

XIV. Conclusion

Wherefore, the Office of Small Business Advocate respectfully requests that the ALJs and the Commission:

- Award PAWC an overall revenue increase of no more than \$109,088,498;
- Deny PAWC's request to recover \$21.6 million in annual Act 11 revenues from water customers associated with the acquisition of the Butler Area Sewer Authority;
- Remove all costs related to PAWC's acquisition of Audubon Water Company's assets from the revenue requirement in this case;
- Eliminate 50% of the Annual Performance Plan expense from PAWC's requested revenue requirement;
- Reject PAWC's proposal to have ratepayers fund the Company's Employee Stock Purchase Plan;

⁵⁶ OSBA Statement No. 1, at 46.

- Eliminate PAWC’s Long-Term Performance Plan expense from PAWC’s requested revenue requirement;
- Deny PAWC’s request for deferred accounting treatment for its production expenses;
- Adopt of the Water Cost of Service Study set forth in OSBA Statement No. 1-R, Schedule KCH-12;
- Order that all low-income residential customer assistance program costs shall be exclusively recovered from the residential class;
- Adopt the water service revenue allocation to the Company’s various rate classes as set forth in OSBA Statement No. 1-R, Schedule KCH-12;
- Adopt the Act 11 wastewater subsidy allocation as set forth in PAWC’s response to OSBA 03-001;
- Reject PAWC’s proposed Revenue Decoupling Mechanism; and
- Reject PAWC’s proposed Environmental Compliance Investment Charge.

Respectfully submitted,

/s/ Steven C. Gray

Steven C. Gray
Assistant Small Business Advocate
Attorney I.D. No. 77538

For:
NazAarah Sabree
Small Business Advocate

Date: March 26, 2024

Appendix A
Findings of Fact

Findings of Fact

- 1) On November 8, 2023, Pennsylvania-American Water Company (“PAWC” or the “Company”) filed Supplement No. 45 to Tariff Water-PA P.U.C. No. 5 and Supplement No. 47 to Tariff Wastewater PA P.U.C. No. 16 with the Commission. The rates set forth in the two Tariff Supplements, if approved by the Commission, would increase PAWC’s annual water and wastewater revenues by \$203.9 million.
- 2) On November 20, 2023, the OSBA filed a Complaint in this proceeding.
- 3) PAWC produced five separate revenue requirement studies, one for its water operations and four for its wastewater operations. These five studies are: Water Operations (“Water”), Wastewater Sanitary Sewer Systems General Operations (“WW SSS”), Butler Area Sewer Authority Wastewater Operations (“BASA”), Brentwood Wastewater Operations (“Brentwood”) and Wastewater Combined Sewer System Operations (“WW CSS”). PAWC Statement No. 1, at 17-19.
- 4) The Company also separately calculated five class cost-of-service studies corresponding to its respective revenue requirement studies. PAWC Statement No. 12, at 3.
- 5) Of PAWC’s requested \$203.9 million revenue requirement increase, \$128.1 million is related to Water, \$31.8 million is related to WW SSS, \$26.3 million is related to BASA, \$1.9 million is related to Brentwood, and \$15.8 million is related to WW CSS, prior to accounting for PAWC’s proposed shift of a portion of the wastewater revenue requirement to water customers. On a percentage basis, PAWC’s calculated revenue requirements represent increases over present rates of 15.5% for Water, 33.3% for WW SSS, 221.9% for BASA, 106.1% for Brentwood, and 20.1% for WW CCS. OSBA Statement No. 1, at 7.
- 6) PAWC proposed to recover \$71.1 million of its wastewater revenue requirement from its water customers based on Act 11 of 2012 (“Act 11”). After accounting for the Company’s proposed Act 11 revenue shift, PAWC proposes to increase water revenues by \$199.2 million and wastewater revenues by \$4.7 million in total. The proposed wastewater revenue changes consist of a \$169 thousand decrease for WW SSS, a \$4.7 million increase for BASA, a \$369 thousand increase for Brentwood, and a \$227 thousand decrease for WW CSS. OSBA Statement No. 1, at 7.
- 7) PAWC also proposes to implement a Revenue Decoupling Mechanism (“RDM”), to implement an Environmental Compliance Investment Charge (“ECIC”), and requests deferred accounting for several items, including production expenses. OSBA Statement No. 1, at 5.
- 8) The Settlement Agreement approved at Docket No. A-2022-3037047 (“BASA Settlement”) provides that the Company would move BASA rates to 1.40 times the current BASA rates or PAWC’s proposed Rate Zone 1 system-average wastewater rates, whichever is lower, upon the later of (a) the first anniversary of Closing or (b) January 1, 2025. OSBA Statement No. 1, at 20.

- 9) On March 4, 2024, the Commission entered an Opinion and Order at Docket No. A-2021-3024058 denying PAWC's acquisition of the Borough of Brentwood's wastewater collection system assets.
- 10) The Joint Application of Pennsylvania-American Water Company and Audubon Water Company, at Docket Nos. A-2023-3043194, A-2023-3043196, has scheduled evidentiary hearings for April 23 and 24, 2024.
- 11) The PAWC provides performance-based compensation under two plans: the Annual Plan (the "APP"), which is applicable to all full-time employees, and the Long-Term Performance Plan (the "LTPP"), which is limited to certain exempt employees. OSBA Statement No. 1, at 10.
- 12) PAWC provides cash awards to employees for achievement of various business objectives under the APP. To calculate APP awards, the Company uses a "corporate performance multiplier." The largest component (50%) of this multiplier is based on Adjusted Earnings Per Share ("EPS"). Every year, PAWC sets out the threshold, target, and maximum EPS levels that are used in the APP performance calculation. If PAWC's corporate performance results in an EPS less than 90% of the target, no employees are given cash awards. OSBA Statement No. 1, at 10.
- 13) PAWC provides an Employee Stock Purchase Plan ("ESPP"), which gives a 15% discount on purchases of American Water Works' stock by employees who are enrolled in the ESPP. PAWC proposes to include the cost of providing this employee benefit in its revenue requirement. OSBA Statement No. 1, at 13.
- 14) PAWC provides stock-based compensation to eligible employees through its LTPP. Eligible employees are awarded restricted stock units ("RSUs") and performance stock units ("PSUs"). RSU awards are based on a three-year vesting period if the participant remains employed with the Company, and PSU awards are based on "performance vesting conditions. OSBA Statement No. 1, at 12.
- 15) For the purposes of this proceeding, OSBA expert witness Kevin Higgins utilized the 9.65% ROE authorized for PAWC's distribution system improvement charge ("DSIC") in the most recent Report of the Commission's Bureau of Technical Utility Services on the Quarterly Earnings of Jurisdictional Utilities as a proxy for his revenue requirement. OSBA Statement No. 1, at 17.
- 16) Various errors in PAWC's original Water Cost of Service Study ("COSS") were identified and acknowledged by the Company. OSBA Statement No. 1-R, at 5-7, 8-9, 12; OSBA Statement No. 1, at 35-37.
- 17) In response to discovery, PAWC provided a corrected allocation of Act 11 revenue among water classes in discovery response OSBA 03-001 that is based on the corresponding wastewater classes that give rise to the Act 11 revenue shortfall. OSBA Statement No. 1, at 33-34.
- 18) PAWC is requesting approval of a Revenue Decoupling Mechanism ("RDM") for both water and wastewater service in this proceeding. If the Commission approved the proposed RDM, it would

operate by comparing the difference between actual revenue collected and hypothetical revenue collected – which would be calculated by using a Straight Fixed Variable (“SFV”) rate design. If actual revenues are greater than hypothetical revenues, PAWC would credit the difference to customers in a subsequent year. If actual revenues are less than hypothetical revenues, PAWC would collect the difference from customers in a subsequent year. OSBA Statement No. 1, at 37-38.

- 19) PAWC is asking Commission approval to impose an Environmental Compliance Investment Charge (“ECIC”) on its water and wastewater ratepayers. The ECIC is purported to recover the costs of complying with “environmental standards” imposed upon PAWC by Federal, State, and Local governments between rate cases. PAWC’s proposed ECIC would allow for recovery of capital costs and incremental O&M expenses for projects and activities that are set forth in the Company’s “annual environmental compliance plan” that is to be filed with the Commission. PAWC’s proposed ECIC is designed as a percentage surcharge, calculated separately for water and wastewater, to be updated quarterly for the costs incurred in a preceding period. PAWC plans to impose the ECIC beginning in November 2025. OSBA Statement No. 1, at 45.

Appendix B

Conclusions of Law

Conclusions of Law

- 1) Section 1301 of the Public Utility Code, 66 Pa. C.S. § 1301, provides that “every rate made, demanded, or received by any public utility, or by any two or more public utilities jointly, shall be just and reasonable, and in conformity with regulations or orders of the commission.”
- 2) The burden of proof to establish the justness and reasonableness of every element of the utility’s rate increase rests solely upon the public utility. 66 Pa. C.S. § 315(a). “It is well-established that the evidence adduced by a utility to meet this burden must be substantial.” *Lower Frederick Township. v. Pa. PUC*, 409 A.2d 505, 507 (Pa. Cmwlt. 1980).
- 3) Although the burden of proof remains with the public utility throughout the rate proceeding, when a party proposes an adjustment to a ratemaking claim of a utility, the proposing party bears the burden of presenting some evidence or analysis tending to demonstrate the reasonableness of the adjustment. *Pa. PUC v. Aqua Pennsylvania, Inc.*, Docket No. R-00072711 (Order entered July 17, 2008). “Section 315(a) of the Code, 66 Pa. C.S. § 315(a), applies since this is a proceeding on Commission Motion. However, after the utility establishes a prima facie case, the burden of going forward or the burden of persuasion shifts to the other parties to rebut the prima facie case.” *Pa. PUC v. Philadelphia Gas Works*, Docket No. R-00061931 (Order entered September 28, 2007), at 12.
- 4) Furthermore, Section 523 of the Public Utility Code, 66 Pa. C.S. § 523, requires the Commission to “consider . . . the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates.” In exchange for customers paying rates for service, which include the cost of utility plant in service and a rate of return, a public utility is obligated to provide safe, adequate, and reasonable service. “[I]n exchange for the utility’s provision of safe, adequate and reasonable service, the ratepayers are obligated to pay rates which cover the cost of service which includes reasonable operation and maintenance expenses, depreciation, taxes and a fair rate of return for the utility’s investors . . . In return for providing safe and adequate service, the utility is entitled to recover, through rates, these enumerated costs.” *Pa. PUC v. Pennsylvania Gas & Water Co.*, 61 Pa. PUC 409 (1986), at 415-16. See also 66 Pa. C.S. § 1501. As a result, the legislature has given the Commission discretionary authority to deny a proposed rate increase, in whole or in part, if the Commission finds “that the service rendered by the public utility is inadequate.” 66 Pa. C.S. § 526(a).
- 5) The Commonwealth Court in *Lloyd v. Pennsylvania Public Utility Commission*, 904 A.2d 1010 (Pa. Cmwlt. 2006), *appeal denied*, 591 Pa. 676 (2007) decided, as follows:

However, while permitted, gradualism is but one of many factors to be considered and weighed by the Commission in determining rate designs, and principles of gradualism cannot be allowed to trump all other valid ratemaking concerns and do not justify allowing one class of customers to subsidize the cost of service for another class of customers over an extended period of time.

* * *

[I]n effect, the Commission has determined that the principle of gradualism trumps all other ratemaking concerns - especially the polestar - cost of providing service.

Lloyd, at 1010.

The Commonwealth Court in *Lloyd* continued, as follows:

To allow the principle of gradualism to be applied on a total bill basis when each service is a stand-alone rate structure would be like saying that the Commission could apply the principle of gradualism in an electric case based on a customer's total utility bill, i.e., the amount a rate payer would pay for electric, gas, water and telecommunications services.

Lloyd, at 1020-1021.

Appendix C

Proposed Ordering Paragraphs

Proposed Ordering Paragraphs

- 1) PAWC shall increase its overall annual revenue by \$109,088,498.
- 2) PAWC's request to recover \$21.6 million in annual Act 11 revenues from water customers associated with the acquisition of the Butler Area Sewer Authority is hereby denied.
- 3) All costs related to PAWC's acquisition of Audubon Water Company's assets are hereby removed from the Company's revenue requirement.
- 4) 50% of the Annual Performance Plan expense is hereby removed from the Company's revenue requirement.
- 5) PAWC's proposal to have ratepayers fund the Company's Employee Stock Purchase Plan is hereby rejected.
- 6) All Long-Term Performance Plan expenses are hereby removed from the Company's revenue requirement.
- 7) PAWC's request for deferred accounting treatment for its production expenses is hereby denied.
- 8) The Water Cost of Service Study set forth in OSBA Statement No. 1-R, Schedule KCH-12 is just and reasonable and hereby adopted for purposes of this proceeding.
- 9) All low-income residential customer assistance program costs shall be exclusively recovered from the residential class.
- 10) The water service revenue allocation to PAWC's various rate classes as set forth in OSBA Statement No. 1-R, Schedule KCH-12 is just and reasonable and hereby adopted for purposes of this proceeding.
- 11) The Act 11 wastewater subsidy allocation, as set forth in PAWC's response to OSBA 03-001, is just and reasonable and hereby adopted for purposes of this proceeding.
- 12) PAWC's proposed Revenue Decoupling Mechanism is unjust and unreasonable and is hereby rejected.
- 13) PAWC's proposed Environmental Compliance Investment Charge is untimely, and therefore unjust and unreasonable, and hereby rejected.

Appendix D

OSBA Attachments for the Reader

Pennsylvania-American Water Company
Docket Nos. R-2023-3043189 (Water)
R-2023-3043190 (Wastewater)
Office of Small Business Advocate Set 3

OSBA 03-001

Responsible Witness: Charles Rea, Senior Director of Rates and Regulatory

Question:

Reference the Attachment provided in the Company's response to OSBA-I-018.

- a. Please reconcile the totals shown in the Act 11 column of the referenced attachment with the Act 11 subsidies shown in Exhibit 3-A, page A, by wastewater operating division.
- b. Please provide a detailed derivation of all figures shown in lines 9-12 of the referenced attachment. Include an electronic copy of all workpapers.

Response:

- a-b. Please see OSBA 03-001_Attachment for a corrected calculation of Act 11 revenues shown in Exhibit 3-A, page A, by wastewater operating division and customer class, including the derivation of all figures sourced to the applicable revenue and cost of service exhibits for each operating division. The data originally provided in OSBA-01-018 was not correct and did not tie to Exhibit 3-A, Page A.

Pennsylvania-American Company	\$ 603,126,055	\$ 232,115,036	\$ 45,115,631	\$ 35,175,459	\$ 5,777,625	\$ 921,309,806
Act 11 Water Allocation Worksheet	0.6546	0.2519	0.0490	0.0382	0.0063	
OSBA 03-001_Attachment						

Water Cost of Service Allocators	0.6546	0.2519	0.0490	0.0382	0.0063	(relative allocation of revenue requirements in water cost of service not including OWU and Public Fire
		0.7293	0.1419	0.1106	0.0182	(relative allocation of non-residential revenue requirements in water cost of service)
		0.8499	-	0.1289	0.0213	(relative allocation of non-residential revenue requirements in water cost of service excluding industrial

	Act 11	Residential	Nonresidential	Commercial	Industrial	Municipal	Fire	Other	Variance
SSS	\$ 31,962,404	\$ 12,870,804	\$ 6,827,101				\$ 12,264,499	\$ -	
CSS	\$ 16,007,049	\$ 6,723,694	\$ 8,639,969	\$ -	2,557,322		\$ (1,913,936)	\$ -	
Brentwood	\$ 1,565,232	\$ 1,308,466	\$ 256,766					\$ -	
BASA	\$ 21,552,699	\$ 18,185,956	\$ 3,366,743					\$ -	
Total	\$ 71,087,384								
Direct Allocation	\$ 39,088,920		\$ -	\$ -	2,557,322	\$ -			
SSS Non-Residential Reallocation			\$ 4,979,000	\$ 968,523	\$ 755,053	\$ 124,524			
CSS Non-Residential Reallocation			\$ 7,342,808	\$ -	\$ 1,113,518	\$ 183,643			
Brentwood Non-Residential Reallocation			\$ 187,259	\$ 36,426	\$ 28,397	\$ 4,683			
BASA Non-Residential Reallocation			\$ 2,455,364	\$ 477,621	\$ 372,350	\$ 61,408			
Other Reallocation	\$ 6,775,479		\$ 2,607,307	\$ 507,178	\$ 395,392	\$ 65,209			
Total	\$ 71,087,384	\$ 45,864,399	\$ 17,571,738	\$ 4,547,070	\$ 2,664,710	\$ 439,468		\$ -	

Pennsylvania-American Water Company
Act 11 Water Allocation Worksheet - SSS
OSBA 03-001_Attachment

SSS Act 11

Total Revenue Requirement	\$ 127,264,017	SSS Cost of Service - Total Cost of Service
SSS WW Total Revenue	\$ 95,301,613	Exhibit 10-B
<u>Total Act 11</u>	<u>\$ 31,962,404</u>	
Residential Cost of Service	\$ 73,148,161	SSS Cost of Service - Residential Cost of Service
Residential Proposed Revenue	\$ 60,277,357	Exhibit 10-B
<u>Residential Act 11</u>	<u>\$ 12,870,804</u>	
Non-Residential Cost of Service	\$ 27,532,034	SSS Cost of Service - Nonresidential Cost of Service
Non-Residential Proposed Revenue	\$ 20,704,933	Exhibit 10-B (Commercial + Industrial + Municipal less large industrial as reflected in SSS Cost of Service)
<u>Residential Act 11</u>	<u>\$ 6,827,101</u>	
Other Act 11	\$ 12,264,499	

Pennsylvania-American Water Company
Act 11 Water Allocation Worksheet - CSS
OSBA 03-001_Attachment

CSS Act 11

Total Revenue Requirement	\$	94,416,343
CSS WW Total Revenue	\$	78,409,294
Total Act 11	\$	16,007,049

CSS Cost of Service - Total Cost of Service
 Exhibit 10-C

Residential Cost of Service	\$	29,790,780
Residential CSO Reallocation	\$	23,280,396
Subtotal	\$	53,071,176
Residential Proposed Revenue	\$	46,347,482
Residential Act 11	\$	6,723,694

CSS Cost of Service - Residential Total Cost of Service
 CSS Cost of Service - Residential Reallocation of CSO Stormwater Costs

Exhibit 10-C

Nonresidential Cost of Service	\$	16,470,061
Nonresidential CSO Reallocation	\$	13,036,762
Subtotal	\$	29,506,823
Nonresidential Proposed Revenue	\$	20,866,854
Nonresidential Act 11	\$	8,639,969

CSS Cost of Service - Nonresidential Total Cost of Service
 CSS Cost of Service - Nonresidential Reallocation of CSO Stormwater Costs

Exhibit 10-C (commercial + Mkunicipal)

Industrial Cost of Service	\$	2,420,992
Industrial CSO Reallocation	\$	2,405,084
Subtotal	\$	4,826,076
Industrial Proposed Revenue	\$	2,268,754
Industrial Act 11	\$	2,557,322

CSS Cost of Service - Industrial Total Cost of Service
 CSS Cost of Service - Industrial Reallocation of CSO Stormwater Costs

Exhibit 10-C (commercial + Mkunicipal)

Other Act 11	\$	(1,913,936)
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Pennsylvania-American Water Company
Act 11 Water Allocation Worksheet - Brentwood
OSBA 03-001_Attachment

Brentwood Act 11

Total Revenue Requirement	\$	3,758,828
BASA WW Total Revenue	\$	2,193,596
<u>Total Act 11</u>	\$	<u>1,565,232</u>

Brentwood Cost of Service - Total Cost of Service
Exhibit 10-D

Residential Cost of Service	\$	3,021,924
Residential Proposed Revenue	\$	1,713,458
<u>Residential Act 11</u>	\$	<u>1,308,466</u>

Brentwood Cost of Service - Residential Cost of Service
Exhibit 10-D

Nonresidential Act 11	\$	256,766
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**Pennsylvania-American Water Company
Act 11 Water Allocation Worksheet - BASA
OSBA 03-001_Attachment**

BASA Act 11

Total Revenue Requirement	\$	38,135,710
BASA WW Total Revenue	\$	16,583,011
<hr/>		
Total Act 11	\$	21,552,699

BASA Cost of Service - Total Cost of Service
Exhibit 10-E

Residential Cost of Service	\$	30,356,662
Residential Proposed Revenue	\$	12,170,706
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Residential Act 11	\$	18,185,956

BASA Cost of Service - Residential Cost of Service
Exhibit 10-E

Nonresidential Act 11	\$	3,366,743
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WATER OPERATIONS
OSBA REBUTTAL CLASS COST-OF-SERVICE STUDY RESULTS AND RECOMMENDED REVENUE ALLOCATION
AT PAWC REQUESTED DIRECT REVENUE REQUIREMENT
FOR THE TWELVE MONTHS ENDED JUNE 30, 2025

Customer Classification (1)	OSBA Rebuttal Cost of Service at PAWC Direct Proposed Revenue Requirement as of June 30, 2025				Pro Forma Revenues Under Present Rates		OSBA Rebuttal Increase at Equalized COS + Act 11 Revenue		Pro Forma Revenues Under Proposed Rates		Proposed Increase	
	Cost of Service ¹	Allocation of Other COS ²	Total Amount	Percent of Total	Amount	Percent of Total	\$	%	Amount	Percent	\$	%
	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)
Residential	\$ 609,768,615	\$ 46,024,470	\$ 655,793,086	65.3%	\$ 528,290,043	65.5%	\$ 127,503,043	24.1%	\$ 655,793,086	65.3%	\$ 127,503,043	24.1%
Commercial	231,138,009	18,121,178	249,259,187	24.8%	202,779,636	25.1%	46,479,551	22.9%	249,259,187	24.8%	46,479,551	22.9%
Industrial	47,259,397	4,407,549	51,666,946	5.1%	37,580,738	4.7%	14,086,208	37.5%	51,573,520	5.1%	13,992,782	37.2%
Public (Municipal)	25,852,990	2,026,870	27,879,860	2.8%	22,559,539	2.8%	5,320,321	23.6%	27,829,447	2.8%	5,269,908	23.4%
Other Water Utilities - Group A	12,303	-	12,303	0.0%	51,822	0.0%	(39,520)	-76.3%	53,666	0.0%	1,844	3.6%
Other Water Utilities - Group B	494,510	-	494,510	0.0%	202,436	0.0%	292,073	144.3%	277,021	0.0%	74,585	36.8%
Private Fire Protection	6,470,881	507,316	6,978,197	0.7%	5,301,032	0.7%	1,677,165	31.6%	6,965,579	0.7%	1,664,547	31.4%
Public Fire Protection	12,796,616	-	12,796,616	1.3%	9,519,368	1.2%	3,277,249	34.4%	12,773,477	1.3%	3,254,109	34.2%
Total Sales of Water	\$ 933,793,321	\$ 71,087,383	\$ 1,004,880,705	100.0%	\$ 806,284,614	100.0%	\$ 198,596,091	24.6%	\$ 1,004,524,983	100.0%	\$ 198,240,369	24.6%
Other Water Revenues	10,675,369	-	10,675,369		10,034,383		640,986	6.4%	11,031,091		996,708	9.9%
Contract Sales - Industrial	4,482,099	-	4,482,099		4,482,099		-	0.0%	4,482,099		-	0.0%
Contract Sales - Resale	3,316,086	-	3,316,086		3,316,086		0	0.0%	3,316,086		0	0.0%
Total	\$ 952,266,876	\$ 71,087,383	\$ 1,023,354,259		\$ 824,117,182		199,237,077	24.2%	1,023,354,259		\$ 199,237,077	24.2%

Data Sources:

1. OSBA workpaper: Water CCOSS - OSBA Rebuttal WP, Sch A.
2. Includes unrecovered Wastewater Cost of Service (i.e., Act 11 revenue). Based on OSBA Act 11 WP - Rebuttal.

WATER OPERATIONS
OSBA REBUTTAL CLASS COST-OF-SERVICE STUDY RESULTS AND RECOMMENDED REVENUE ALLOCATION
AT OSBA RECOMMENDED REVENUE REQUIREMENT
FOR THE TWELVE MONTHS ENDED JUNE 30, 2025

Customer Classification (1)	OSBA Rebuttal Cost of Service - Scaled to OSBA Rev. Req. as of June 30, 2025				Pro Forma Revenues Under Present Rates		OSBA Rebuttal Increase at Equalized COS + Act 11 Revenue		Pro Forma Revenues Under Proposed Rates		Proposed Increase	
	Cost of Service ¹ (2)	Allocation of Other COS ² (3)	Total Amount (4)	Percent of Total (5)	Amount (6)	Percent of Total (7)	\$ (8)	% (9)	Amount (10)	Percent of Total (11)	\$ (12)	% (13)
	Residential	\$ 570,737,124	\$ 18,664,876	\$ 589,402,000	64.8%	\$ 528,290,043	65.5%	\$ 61,111,957	11.6%	\$ 589,619,501	64.8%	\$ 61,329,458
Commercial	216,342,789	12,436,411	228,779,200	25.1%	202,779,636	25.1%	25,999,564	12.8%	228,861,645	25.1%	26,082,009	12.9%
Industrial	44,234,307	3,282,317	47,516,624	5.2%	37,580,738	4.7%	9,935,886	26.4%	47,446,002	5.2%	9,865,264	26.3%
Public (Municipal)	24,198,132	1,391,024	25,589,155	2.8%	22,559,539	2.8%	3,029,616	13.4%	25,551,173	2.8%	2,991,634	13.3%
Other Water Utilities - Group A	11,515	-	11,515	0.0%	51,822	0.0%	(40,307)	-77.8%	50,250	0.0%	(1,572)	-3.0%
Other Water Utilities - Group B	462,856	-	462,856	0.1%	202,436	0.0%	260,420	128.6%	259,388	0.0%	56,951	28.1%
Private Fire Protection	6,056,678	348,167	6,404,845	0.7%	5,301,032	0.7%	1,103,813	20.8%	6,395,338	0.7%	1,094,306	20.6%
Public Fire Protection	11,977,501	-	11,977,501	1.3%	9,519,368	1.2%	2,458,133	25.8%	11,960,399	1.3%	2,441,031	25.6%
Total Sales of Water	\$ 874,020,901	\$ 36,122,794	\$ 910,143,695	100.0%	\$ 806,284,614	100.0%	\$ 103,859,081	12.9%	\$ 910,143,695	100.0%	\$ 103,859,081	12.9%
Other Water Revenues	10,373,375	181,589	10,554,964		10,034,383		520,581	5.2%	10,554,964		520,581	5.2%
Contract Sales - Industrial	4,482,099	-	4,482,099		4,482,099		-	0.0%	4,482,099		-	0.0%
Contract Sales - Resale	3,316,086	-	3,316,086		3,316,086		0	0.0%	3,316,086		0	0.0%
Total	\$ 892,192,462	\$ 36,304,383	\$ 928,496,845		\$ 824,117,182		104,379,663	12.7%	\$ 928,496,845		\$ 104,379,663	12.7%

Data Sources:

1. Based on Water CCOSS - OSBA Rebuttal WP, Sch A, scaled to OSBA recommended revenue requirement.
2. Includes unrecovered Wastewater Cost of Service (i.e., Act 11 revenue). Based on OSBA Act 11 WP - Rebuttal.

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY COMMISSION	:	
	:	
v.	:	Docket Nos. R-2023-3043189 (Water) R-2023-3043190 (Wastewater)
	:	
PENNSYLVANIA-AMERICAN WATER COMPANY	:	

CERTIFICATE OF SERVICE

I hereby certify that true and correct copies of the foregoing have been served via email (*unless otherwise noted below*) upon the following persons, in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant).

The Honorable Christopher P. Pell
Deputy Chief Administrative Law Judge
Pennsylvania Public Utility Commission
801 Market Street, Suite 4063
Philadelphia, PA 19107
cpell@pa.gov
pmcneal@pa.gov

Erin L. Gannon, Esquire
Melanie El Atieh, Esquire
David Evrard, Esquire
Andrew Zerby, Esquire
Office of Consumer Advocate
Forum Place
555 Walnut Street, 5th Floor
Harrisburg, PA 17101
OCAPAWC2023@paoca.org

Carrie B. Wright, Esquire
Bureau of Investigation & Enforcement
400 North Street
Commonwealth Keystone Building
Harrisburg, PA 17120
carwright@pa.gov

The Honorable John Coogan
Administrative Law Judge
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120
jcoogan@pa.gov

Kurt J. Boehm, Esquire
Jody Kyler Cohn, Esquire
Boehm, Kurtz, & Lowry
36 East Seventh Street, Suite 1510
Cincinnati, Ohio 45202
kboehm@bkllawfirm.com
jkylercohn@bkllawfirm.com

Kenneth M. Kulak, Esquire
Brooke E. McGlinn, Esquire
Catherine Vasudevan, Esquire
Mark A. Lazaroff, Esquire
Morgan, Lewis & Bockius, LLP
2222 Market Street
Philadelphia, PA 19103-2921
ken.kulak@morganlewis.com
brooke.mcglinn@morganlewis.com
catherine.vasudevan@morganlewis.com
mark.lazaroff@morganlewis.com

Joan E. London, Esquire
Kozloff Stoudt, P.C.
2640 Westview Drive
Wyomissing, PA 19610
jlondon@kozloffstoudt.com

Elizabeth Rose Triscari, Esquire
Teresa K. Harrold, Esquire
Erin K. Fure, Esquire
Pennsylvania-American Water Company
852 Wesley Drive
Mechanicsburg, PA 17055
elizabeth.triscari@amwater.com
erin.fure@amwater.com
teresa.harrold@amwater.com

Ria M. Pereira, Esquire
Lauren N. Berman, Esquire
John W. Sweet, Esquire
Elizabeth R. Marx, Esquire
Pennsylvania Utility Law Project
118 Locust Street
Harrisburg, PA 17101
pulp@pautilitylawproject.org

Sean M. Gallagher, Esquire
Gallagher law Group
110 East Diamond Street, Suite 101
Butler, PA 16001
smgallagher@gallagher.legal

Joseph L. Vullo, Esquire
Burke Vullo Reilly Roberts
1460 Wyoming Avenue
Forty Fort, PA 18704
jlvullo@bvrrlaw.com

Adeolu A. Bakare, Esquire
Charis Mincavage, Esquire
Ryan Block, Esquire
McNees Wallace & Nurick LLC
100 Pine Street
Harrisburg, PA 17101
abakare@mcneeslaw.com
rblock@mcneeslaw.com
cmincavage@mcneeslaw.com

J. Chadwick Schnee, Esquire
Schnee Legal Services, LLC
74 E. Main Street, #648
Lititz, PA 17543
chadwick@schneelegal.com

Robert Ralls (*W)
254 Red Haven Road
New Cumberland, PA 17070
rralls73@yahoo.com

Kyle Donahue
621 Gibbons Street
Scranton, PA 18505
Kyle.23.donahue@gmail.com

Karen O. Moury, Esquire
Lauren Burge, Esquire
Eckert Seamans Cherin & Mellott, LLC
213 Market St., 8th Floor
Harrisburg, PA 17101
kmoury@eckertseamans.com
lburge@eckertseamans.com

DATE: March 26, 2024

/s/ Steven C. Gray
Steven C. Gray
Assistant Small Business Advocate
Attorney ID No. 77538