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May 17, 2024

Via Electronic Filing
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:

Attached for electronic filing please find the Office of Consumer Advocate's Exceptions **PUBLIC** version in the above-referenced proceeding. Please note that the **CONFIDENTIAL** version of the OCA's Exceptions will only be sent to the parties that have executed the non-disclosure agreement as indicated on the Certificate of Service. The **CONFIDENTIAL** version of the OCA's Exceptions will be e-filed using the Commission's SharePoint file process.

Copies have been served on the parties as indicated on the enclosed Certificate of Service.

Respectfully submitted,

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cc: The Honorable John M. Coogan (**email only**: JCoogan@pa.gov)
The Honorable Christopher P. Pell (**email only**: CPell@pa.gov)
Certificate of Service

CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the following document, the Office of Consumer Advocate's Exceptions, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code § 1.54 (relating to service by a participant), in the manner and upon the persons listed below. This document was filed electronically on the Commission's electronic filing system.

Dated this 17th day of May 2024.

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Dated: May 17, 2024

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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

EXCEPTIONS
OF THE
OFFICE OF CONSUMER ADVOCATE

PUBLIC VERSION

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Dated: May 17, 2024

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I. INTRODUCTION AND OVERVIEW

On May 7, 2024, the Administrative Law Judges (ALJs) issued their Recommended Decision (Recommended Decision or R.D.). The OCA files these Exceptions.[1]

In the Recommended Decision, the ALJs recommend an overall rate increase of $104.1 million, comprised of a $92.6 million water revenue increase, or 11.3%, and a $11.5 million wastewater revenue increase, or 6.6%. The ALJs' recommendation is lower than the $203.9 amount requested by PAWC but remains unreasonably high given the facts of record. The OCA recommended a total increase of no more than $45.5 million or 4.49%, comprised of a $36.7 million water increase and a $8.8 million wastewater increase. Both the OCA's and the ALJs' recommended revenue requirements include the recovery of *all of PAWC's claimed $1.267 billion of capital improvements for its existing water and wastewater systems through the end of the FPFTY*. OCA St. 2 at 18-46; OCA St. 2, Exhs. LA-1, LA-2; OCA St. 2SR at 21-27. However, the main drivers of the ALJs' higher recommended increase are their recommendations on the depreciation expense/depreciation reserve issue ($15.5 million) (*see* OCA Exc. Nos. 3 and 9),[2] their award of an excessive return on equity (ROE) ($20.27 million) (*see* OCA Exc. Nos. 11 and 12),[3] and their failure to account for a reasonable capital structure for ratemaking purposes (*see* OCA Exc. No. 10).

From a big picture view, as argued by the OCA in its Briefs, PAWC's excessive and unnecessary $203.9 million rate relief request is based on three major drivers: (1) PAWC's

[1] The OCA notes that parties were only given ten (10) days to file Exceptions and five (5) days to file replies to exceptions in the Secretarial Letter accompanying the R.D. This contrasts with the twenty (20) and ten (10) days, respectively, provided in the Commission's regulations. 52 Pa. Code §§ 5.533, 5.535. Given the length and significance of the R.D., the OCA submits that the Commission should not have shortened the parties' ability to make effective arguments concerning a case of this magnitude, especially considering that the Commission set a very truncated litigation schedule from the beginning of this case given its June and July Public Meeting schedule.

[2] Direct Testimony of Ralph C. Smith, OCA St. 2 at 64-66. If the OCA's depreciation expense adjustment is adopted, it would decrease the ALJ's recommended revenue requirement to $88.6 million ($104.1 million - $15.5 million).

[3] *See infra* n. 8.

excessive rate of return claim, consisting of an unreasonably high ROE of 10.95%, inclusive of an arbitrary, unsupported, and unwarranted "management performance" adder of up to 25 basis points, and an unreasonable, equity-rich capital structure of 55.3% equity and 44.7% debt; (2) PAWC's sizeable ratemaking rate base claims related to aspirational and speculative utility plant in service claims in the FPFTY connected to six potential acquisitions; and (3) additional requests for deferred accounting treatment for production and OPEB expenses and alternative ratemaking mechanisms (*i.e.*, the Revenue Decoupling Mechanism (RDM) and Environmental Compliance Investment Charge (ECIC)) that would further increase consumers' rates in unknown quantities beyond PAWC's claimed revenue requirement in this case. OCA M.B. at 12-21.

On the first major driver of PAWC's $203.9 million increase request, the OCA's Exception Nos. 10-12 address the ALJs' recommendations. In the Recommended Decision, the ALJs recommend that the Commission adopt an ROE of 9.55%, inclusive of a 9.45% market-based return and .10% upward adjustment for management performance, and a capital structure of 55.3% equity and 44.7% debt. R.D. at 150, 167-69, 183-84. The OCA's Exceptions urge the Commission to reject the ALJs' recommendations regarding ROE, management performance adder, and capital structure and to adopt the OCA's recommendations of a market-based ROE of 9.10%, with no management performance adder, and a reasonable ratemaking capital structure of 51% equity and 49% debt, as discussed more extensively below. OCA M.B. at 16, 46-60; OCA R.B. at 29-39. The adoption of the OCA's ROE alone would save ratepayers $20.27 million[4] per year without jeopardizing safe and reliable service by PAWC and while providing its shareholders the opportunity to earn a reasonable return on their investment.

[4] *See infra* n.8.

At the same time, the OCA believes there are *many* important things the ALJs got right in the Recommended Decision, especially regarding the second and third major drivers of PAWC's requested rate increase and on the Act 11 subsidy issue. More specifically, on the second major driver of PAWC's requested rate increase, the ALJs agreed with the OCA's and other parties' recommended exclusion of PAWC's sizeable ratemaking rate base claims related to aspirational and speculative utility plant in service claims in the FPFTY because PAWC failed to demonstrate by a preponderance of evidence that there is reasonable certainty that the property will be acquired and used and useful by PAWC by the end of the FPFTY.[5] R.D. at 73-77; OCA M.B. at 13-14, 22-32; OCA R.B. at 16-27. On the third major driver, the ALJs agreed with the OCA's and the other parties' recommendation to reject the Company's requests for deferred accounting treatment for Pension and OPEB Expense and Production Expense, the RDM and ECIC alternative ratemaking mechanisms, and the wastewater winter averaging rate design. In the R.D., the ALJs agreed with the OCA and other parties and recommended that these proposals be denied. R.D. at 131, 135, 290-93, 306-07. The Commission should adopt the ALJs' recommendations without modification.

PAWC proposed an Act 11 subsidy that would result in its existing wastewater customers bearing no rate increase burden, which is unreasonable, unduly discriminatory to water customers, and not in the public interest. In contrast, the OCA proposed a reasonable and equitable shift of 75% of the Wastewater SSS and 50% of the CSS Wastewater revenue requirement increase to Water customers. OCA St. 4 at 28. App. A, OCA Table Summary; OCA St. 2, Exh. LA-1, Sch. A; OCA St. 4 at 9, 28; OCA St. 4R at 7. In the R.D., the ALJs accepted the OCA's recommendation for allocation of the Act 11 subsidy. R.D. at 224-27. The OCA believes the ALJs got the Act 11 shift right and that the Commission should adopt their recommendation without modification.

[5] 66 Pa.C.S. §§ 1301, 315(e); *Pa. PUC v. UGI Utils., Inc. - Elec. Div.*, R-2017-2640058 (Oct. 25, 2018), Order at 27-31, www.puc.pa.gov/pcdocs/1591254.docx, *aff'd by McCloskey v. Pa. PUC*, 225 A.3d 192 (Pa. Cmwlth. 2020).

Finally, the OCA's Exceptions below address certain recommendations of the ALJs including, but not limited to, executive compensation, affordability, low-income customer programs, customer service performance, and American Water Resources (AWR).

II. FINDINGS OF FACT

Exception No. 1: The ALJs erred in Finding of Fact No. 44 by failing to identify the specific acquisitions. R.D. at 12.

In the Recommended Decision, Finding of Fact No. 44 states: "In the last ten years the Company has completed sixteen acquisitions of very small, less-viable water and wastewater systems with less than 1,000 customers each. PAWC St. 1, p. 42-43." R.D. at 12.

The ALJs rely on this Finding of Fact to conclude that PAWC is deserving of a 10-basis point adder to its ROE. R.D. at 183-84. The ALJs erred in making this finding of fact because it does not specify or identify the sixteen acquisitions that are being referred to and, as such, as discussed *infra* in Exception No. 12, there is no evidentiary basis to conclude based that a 10-basis point adder is supported.

Exception No. 2: The ALJs erred in Finding of Fact 176 by stating PAWC's relationship with AWR has remained unchanged over the last two decades. R.D. at 32.

In Finding of Fact No. 176, the ALJs found that "PAWC's relationship with AWR as a partner who provides optional warranty products and services to its customers has remained unchanged over the last two decades." R.D. at 32.

This finding is not supported by the record and the ALJs erred in their conclusion that PAWC's relationship with AWR has remained unchanged for two decades, when in 2021 AWR was sold and is no longer part of the same corporate family as PAWC. OCA St. 6 (Confidential) at 31-42, Exh. BA-6 through BA-9 (Confidential); OCA St. 6-Supp at 1-6; OCA St. 6SR (Confidential) at 19-24. The relationship between AWR and PAWC is now dictated by a Utility

Agreement, which was not in existence prior to 2021. CONFIDENTIAL Exh. BA-8. These changes are material and significant and support the recommendation that the OCA made in its case that PAWC should be required to cease it marketing and billing arrangements prospectively and the Commission should open an investigation into the relationship between these companies.

III. RATE BASE

A. Depreciation Reserve

Exception No. 3: The ALJs erred in their rejection of the OCA's adjustment to depreciation expense and, in the interests of appropriately considering the consumer and public interest, the Commission should adopt the OCA's $15.5 million downward adjustment to depreciation expense and postpone examination of the 2021 Service Life Study to PAWC's next rate case. R.D. at 79-80; OCA M.B. at 43-44; OCA R.B. at 27.

In the R.D., the ALJs rejected the OCA's recommendation that for purposes of calculating accrued depreciation, the Company utilize the service lives for three specific plant accounts – Mains and Accessories, Other Water Source Structures, and Fire Hydrants – that were used in PAWC's 2022 rate case. The ALJs determined that the service lives used by PAWC, based on a 2021 Service Life Study were appropriate and recommended that the Commission adopt PAWC's claim for accrued depreciation related to its plant-in-service. R.D. at 79-80.

In reaching this conclusion, the ALJs increased the annual revenue requirement that consumers are required to pay by $15.5 million. OCA St. 2 at 64-66; *see* OCA Exc. No. 9 below. The ALJ's recommendation should not be adopted as to this issue. The record reflects and the OCA argued that the service lives that PAWC chose for each of these components was significantly shortened from the service lives used in PAWC's 2022 base rate case, the impact of which was to increase the annual revenue requirement. For Mains and Accessories, the useful life was reduced from 110 years to 90 years. For Other Water Source Structures, the reduction was from 60 to 50 years. For Fire Hydrants, the useful life was lowered from 75 to 60 years. OCA witness Smith

correctly pointed out that PAWC's decision to shorten the service lives of these assets had the effect of increasing PAWC's depreciation expense by nearly $15.5 million. OCA St. 2 at 64-66. Observing the relatively short time interval between PAWC's 2022 rate case and the current case, Mr. Smith stated that such a significant reduction of the useful lives for these three utility plant accounts was not justified and should not be accepted. Instead, the OCA recommended that the service lives from the 2022 rate case be used. OCA St. 2 at 64-66.

In rebuttal, PAWC witness Spanos explained that the service lives used were from the Company's 2021 Service Life Study, a study that was not available at the time PAWC's 2022 rate case was prepared but was available for the current case. Mr. Spanos noted that the Company's previous study was performed in 2016 and that it is standard practice in Pennsylvania to conduct a new service life study every five years. PAWC St. 11-R at 1-10.

The OCA acknowledges the 2021 Service Life Study but maintains that due to the short period of time between rate cases, the significant reduction in the service life used for the three plant accounts identified by Mr. Smith was abrupt and, on balance, unnecessary. The OCA submits that another approach may be more appropriate – to utilize the service lives from the 2022 rate case for the current case and allow the service lives from the 2021 Service Life Study, or its replacement study, to be examined in PAWC's next base rate case. The OCA submits that the service lives used in the 2022 rate case provide a more rational balancing of interests between accuracy of depreciation schedules and the consumer interests of ensuring that rates remain reasonable and affordable. This choice has real economic consequences as the difference in the OCA's position and that adopted by the ALJs is $15.5 million per year in depreciation expense. When faced with this balance, the OCA submits that the Commission should adopt the service lives that were in place at the end of the 2022 rate case. *See* OCA Exc. No. 9.

B. Cash Working Capital

Exception No. 4: The ALJs' recommended cash working capital adjustment fails to take into account the proper adjustment based on a capital structure of 51% equity and 49% debt. R.D. at 80- 82; OCA M.B. at 33; OCA R.B. at 27.

In the R.D., the ALJs recognized certain adjustments would need to be made based on other recommendations within the decision. R.D. at 82. The ALJs recommended that Cash Working Capital Be adjusted for Interest and Dividends, Taxes, and O&M Expenses. *Id*. at 82.

The capital structure adjustment proposed by the OCA in Exception 10, if accepted by this Commission, will necessitate an additional adjustment to the cash working capital. If the OCA's capital structure adjustment is accepted, the ALJ's recommendation regarding cash working capital must be updated to reflect the change.

IV. REVENUES

A. American Water Resources (AWR) – Miscellaneous Revenues

Exception No. 5: The ALJs erred in their reasons for not adjusting PAWC's miscellaneous revenues related to AWR. R.D. at 93; OCA M.B. at 34-35; OCA R.B. at 69-74.

In the Recommended Decision, the ALJs recommended no adjustments to the miscellaneous revenues related to AWR because the ALJs "do not recommend adoption of the OCA's position to open an investigation into PAWC's relationship with AWR." R.D. at 93.

While the OCA agrees with the recommendation to not adjust the miscellaneous revenues related to AWR, the OCA disagrees with the ALJs' reasoning. As explained in its Main Brief, the OCA has not challenged PAWC's $659,624 miscellaneous revenue claim related to AWR because it is fully substantiated, and it benefits consumers in this rate case by offsetting proposed revenue requirement. OCA St. 2SR at 49-50. The OCA has recommended an investigation and a pause on any new enrollments pending such an investigation. OCA St. 6 at 41; OCA St. 6SR at 23-24. If the Commission adopts the OCA's recommendation to open an investigation, it would be speculative

to say what the outcome would be. Given this uncertainty, no adjustment is necessary to miscellaneous revenue claim. OCA St. 2SR at 50.

V. EXPENSES

A. Stock-Based Compensation Expenses – American Water Executives

Exception No. 6: The ALJs erred in concluding that executive compensation that is tied to stock price performance benefits consumers. R.D. at 106; OCA M.B. at 36-37.

In the Recommend Decision, the ALJs rejected the OCA's recommendation to remove certain expenses related to the stock-based compensation associated with the Long-Term Performance Plan (LTPP) of American Water Works, Inc. (AWK) for its top executives. The ALJs found that PAWC had sufficiently demonstrated that the stock-based compensation claim benefits customers. They stated that "improved financial performance can benefit customers by encouraging operational efficiency." R.D. at 106.

The ALJs' conclusion is too illusory and conditional to form the basis of a decision to require that these expenses be paid for by consumers. As argued in the OCA's Main Brief, this expense is distinguishable form the allowed expense in *Pa. PUC v. Aqua Pa., Inc.*, 2022 Pa. PUC LEXIS 161, *112 (Order May 16, 2022) (*Aqua 2022*), where the Commission found that stock-based compensation benefits ratepayers where the compensation is linked to performance objectives that benefit consumers, including controlling costs and compliance initiatives. *Aqua 2022* at *60-61. Here, the OCA recommended removing that portion of the expense claim projected to be paid to the top executives of AWK and charged to PAWC for the FPFTY that are linked to shareholder interests rather than consumer interests. The stock-based compensation for those executives consists of (1) performance stock units (PSU), and (2) restricted stock units (RSU). Effecting this removal would reduce PAWC's operating expenses by $1.722 million. OCA St. 2 at 66-67. This adjustment is necessary because customers should not be required to pay for a

portion of the expense for stock-based compensation paid to AWK's top executives, where such compensation is linked to the performance of *AWK's stock price* and has the primary purpose of *benefitting AWK's stockholders* and aligning the interests of LTPP participants with those of the stockholders. Recovering the portion of stock-based compensation expense tied to shareholder interests from PAWC's customers is not reasonable nor does it promote reasonable, adequate, or efficient public utility service. OCA St. 2 at 67; OCA St. 2SR at 67.

The OCA submits that while operational efficiency or achieving other operational results may be byproducts of achieving financial performance goals, those operational goals are not the primary driver of the LTPP, particularly the PSUs. The PSU component of the LTPP is determined based on a combination of compounded Earnings Per Share growth and relative total shareholder return compared to a peer group over a three-year performance period. PAWC St. 2 at 41. These are purely financial results-oriented goals. There is no component related to operational results. Further, as discussed in the testimony of OSBA witness Higgins, LTPP awards are generally allocated 30% to RSUs and 70% to PSUs. OSBA St. 1 at 12. Thus, the bulk of LTPP compensation consists of awards based entirely on achieving AWK financial goals, which benefit AWK shareholders, but not necessarily PAWC customers. Accordingly, PAWC's captive customers who have no choice but to purchase water or wastewater from PAWC should not be required to bear this expense to reward PAWC's parent company executives' actions that increase stock price for the benefit of shareholders. Shareholders may well want to encourage their employees to take this action, but then shareholders, and not ratepayers, should pay for this incentive. The record does not support the conclusion drawn by the ALJs and there is no substantial evidence the supports the finding that stock-based compensation associated with LTPP benefits customers. The OCA's proposed reduction of $1.722 million in operating expense should be adopted.

B. Executive Perquisites (AWW Executives Dividend Equivalents)

Exception No. 7: The ALJs erred in concluding that this parent company executive compensation benefits PAWC's consumers. R.D. at 107; OCA M.B. at 38.

In the Recommended Decision, the ALJs rejected the OCA's recommendation to remove expenses related to the executive perquisites associated with Dividend Equivalents for top AWK executives. The ALJs noted that the executive perquisites associated with dividend equivalents are paid in cash with respect to PSUs and RSUs if the PSUs or RSUs are converted to common stock. They stated that for the same reasons approved the stock-based compensation expense, they recommend approval of PAWC's Executive Perquisites claim. R.D. at 107.

The OCA submits that the ALJs are incorrect, and the record does not support their conclusion, and that again, this expense is distinguishable from the allowed expense in *Aqua 2022*. The OCA maintains that charging the Dividend Equivalents portion of all Other Compensation received by AWW's top executives to PAWC's revenue requirement, and ultimately its customers, is not reasonable. Like the LTPP, this additional executive perquisite relates to stock-based compensation and, as such, it is linked to the Company's financial performance and not to activity that necessarily benefits customers. It is not appropriate to charge such parent company executive perquisites to PAWC customers. OCA witness Smith estimated that removing the Dividend Equivalents expense would reduce PAWC's FPFTY operating expenses by $31,371. OCA St. 2 at 70. Because the Dividend Equivalents expense yields little to no benefit to customers, the Commission should adopt the OCA's adjustment.

C. Call Center Expenses

Exception No. 8: The Commission should exercise its discretion to disallow the imprudently incurred costs associated with the third-party call centers that have continually performed below an acceptable level. R.D. at 120-22; OCA M.B. at 42; OCA R.B. at 38-39, 63-65.

In the Recommended Decision, the ALJs recommended the rejection of the OCA's adjustment to third party Call Center Expenses. R.D. at 121. The ALJs' stated that they were not persuaded an adjustment was merited, and that "it is not clear to us from the evidence cited by the OCA that the performance of the third-party call centers is so egregious compared to the performance by the Service Company to merit disallowance of the associated expense claim." R.D. at 122. The ALJs further stated that "it is unclear how eliminating PAWC's claim related to third-party call centers will provide the improved service sought by the OCA if PAWC's own call centers are managed similarly." *Id.*

Respectfully, the ALJs did not accurately assess or account for the evidence in the record or the arguments of the OCA. In reaching the recommendation to reject the disallowance of third-party call center costs, the ALJs not only overlooked the evidence provided by OCA Witness Barbara Alexander[6] regarding the discrepancies in the call center performance by third party call centers as compared to internal call centers, but also did not give proper weight to the Company's failure to take any sort of corrective action to improve this service. OCA M.B. at 43; OCA R.B. at 39; OCA St. 6SR at 9-10. As shown in Exhibit BA-3 of Ms. Alexander's testimony, the call center performance for Transworld Systems and Intelogix has been *noticeably worse* than the call center performance indicated within the Customer Care table of Exhibit BA-3 which is a combined total for American Water agents as well as third-party contractors. Exh. BA-3. Despite this documented discrepancy in poor performance, the Service Company has failed to utilize any of its contractual

[6] Ms. Alexander was erroneously referred to as a PAWC witness within this section of the R.D. as well as citations to her testimony being referred to as PAWC St. 6.

remedies for this continual failure of the third parties to meet performance standards. OCA St. 6 at 20. That is, PAWC specifically failed in its management function and responsibilities to exercise contractual remedies designed to incent performance and, as a result of this failure to enforce contractual standards, the Company's captive ratepayers are being forced to pay for third party call centers that are not performing to the standards set forth in the contracts. This mismanagement by PAWC and through the Company's failure to even attempt to rectify this poor performance is the reason for the disallowance of this expense as the expense is neither justified nor prudently incurred given the facts presented. PAWC has a duty and obligation to its ratepayers to manage the contracts and exercise the remedies in those contracts to only prudently incur costs. When it fails in this responsibility, cost recovery should be denied.

D. Depreciation Expense

Exception No. 9: In the interests of consumers, the Commission should adopt the OCA's $15.5 million downward adjustment to depreciation expense. R.D. at 79-80; OCA M.B. at 43-44; OCA R.B. at 27.

As explained in OCA Exception No. 3, *supra*, the Company choice to shorten useful lives to certain water plant accounts increases the revenue requirement by $15.5 million in depreciation expense each year.[7] The OCA has proposed a reasonable alternative in Exception No. 3 to utilize the service lives from the 2022 rate case for the current case and allow the service lives from the 2021 Service Life Study, or its replacement study, to be deferred to and examined in PAWC's next base rate case. Given that expense items are a direct input into the revenue requirement amount, adoption of this adjustment alone would reduce the ALJs' recommended increase to $88.6 million ($104.1 million - $15.5 million).

[7] Direct Testimony of Ralph C. Smith, OCA St. 2 at 64-66. If the OCA's depreciation expense adjustment is adopted, it would decrease the ALJ's recommended revenue requirement to approximately $88.6 million ($104.1 million - $15.5 million).

VI. RATE OF RETURN

The OCA's recommendations on ROE[8] and capital structure present the Commission with an option that is well within the zone of reasonableness and that would reduce the overall revenue requirement in the interest of consumers. OCA St. 3 at 58, 61, Exh. DJG-13, 20-61; OCA St. 3SR at 2-11; OCA St. 2, Exh. LA-1, Sch. D, Exh. LA-6. The OCA submits that the record reflects that the OCA's proposed return and capital structure better shape to the balance that is required between consumer and public interest and investor and utility need. OCA M.B. at 15-17, 46-60; OCA R.B. at 29-39; *Permian Basin Area Rate Cases*, 390 U.S. 747, 770, 797 (1968) (*Permian Basin*).

A. Capital Structure

Exception No. 10: The record supports the Commission choosing to exercise its discretion in utilizing a hypothetical capital structure to protect consumers from excessive costs. R.D. at 146-51; OCA M.B. at 48-51; OCA R.B. at 29-32.

In the Recommended Decision, the ALJs reasoned that the Company's capital structure consisting of 44.7% debt and 55.3% equity should be adopted based on PAWC's proxy group equity rations and because that capital structure recognized the actual composition of financing that PAWC was utilizing. R.D. at 149-150. The ALJs believed that the cases cited by the OCA were factually different from this case. R.D. at 150-51. The ALJs' also noted that I&E accepted the Company's claimed capital structure. *Id.* at 151.

[8] The OCA notes that no expert testified to the amount of the ROE and management performance adder recommended by the ALJs. Accordingly, the ALJs in the Recommended Decision do not include a finding of fact to show the values of their recommendations on the ROE and management performance adder. However, this leaves the record unclear as to the values of the ALJs recommendations and creates a potential blind spot for the Commission in considering the ALJs' recommendations. To fill that gap, and for illustrative purposes, based on the numbers adopted by the ALJs and at the capital structure adopted by the ALJs in the R.D., the OCA's experts calculate that 10 basis points in ROE is worth approximately $4.52 million. The difference between adopting the OCA's recommended ROE of 9.1% and the ALJs' recommended ROE of 9.45% is 35 basis points, which is worth approximately $15.75 million ($4.52 million x 3.5). When adding the additional 10 basis points related to the ALJs' recommended management adder, it is worth an additional $4.52 million, for a total of $20.27 million ($15.75 million + $4.52 million). Thus, if the Commission adopts all of the ALJs' recommendations except for the 9.55% ROE and instead adopts the OCA's recommended ROE of 9.1%, it will reduce the overall revenue requirement increase to approximately $83.83 million ($104.1 million - $15.75 million - $4.52 million).

The Commission can and should exercise its discretion to impute a capital structure for ratemaking purposes in this case. The use of the hypothetical capital structure is appropriate in cases like this one to reduce costs to ratepayers, as opposed to increasing costs, where the utility's management proposes an actual capital structure that imposes an unfair cost burden on ratepayers. *See, e.g.*, *T.W. Phillips Gas and Oil Co. v. Pa. PUC*, 474 A.2d 355, 362 (Pa. Cmwlth. 1984); *Carnegie Natural Gas Co. v. Pa. PUC*, 433 A.2d 938 (Pa. Cmwlth. 1981) (*Carnegie*) (100% equity actual capital structure). The Commission has explained its rationale:

> [T]he Commission has the duty to regulate utilities in a manner which provides customers with reliable service at reasonable cost. This is not to say that we may mandate to regulated utilities the proportions of debt and equity contained in their capital structures. Rather, the actual capital structure is a matter within the discretion of corporate management; *however, this does not preclude the commission from determining that a particular utility's capital structure is unreasonable or uneconomical when balancing the goals of safety, prudent management, and economy and utilize a hypothetical capital structure for rate-making purposes.*

Pa. PUC v. Carnegie Natural Gas Co., 54 Pa. PUC 381, 393 (1980), *aff'd by Carnegie*. *See* OCA M.B. at 50-51. [9]

As stated in the OCA's Main Brief, at the Company's proposed rate base, the Company's proposed capital structure would cost ratepayers an additional $30.7 million per year. OCA M.B. at 49. While this number would be reduced, should this Commission choose to adopt the ALJs' recommended reductions to rate base and those that are contained in these Exceptions, it still represents an excessive return granted to the Company that results in an overall unreasonable revenue requirement. PAWC's customers have no choice except to purchase their water and

[9] The underlying theme is an equitable one, in which the Commission and Pennsylvania courts do not allow the utility's financial interests to outweigh the public interest. *Pa. PUC v. Pa. Gas and Water*, 424 A.2d 1213, 1217 (Pa. 1980) (such property must be regulated in the interest of the public no less than in the interest of the utility*)*; *see also Arrowhead Pub. Serv. Corp. v. Pa. PUC*, 600 A.2d 251, 257 (Pa. Cmwlth. 1991) (supporting the PUC's use of the utility's actual cost of debt where the cost is clearly identifiable); *Big Run Tel. Co. v. Pa. PUC*, 449 A.2d 86, 89 (Pa. Cmwlth. 1982) (a hypothetical capital structure is justified in the event actual capital structure is disproportionate, meaning, the actual capital structure "imposes an unfair tax burden on ratepayers"). *See* OCA M.B. at 50-51.

wastewater from PAWC and do not benefit from an equity-heavy capital structure; it exclusively benefits shareholders. OCA M.B. at 49. To be clear, the OCA takes no position on how PAWC can finance its operations, that is for its management to decide. However, when it comes to determining what ratepayers are forced to pay, the Commission must step in to ensure that they are not overpaying for imprudent or unreasonable decisions. The OCA's recommended capital structure of 51% equity would more closely match the capital structure to that of the Proxy Group as well as to PAWC's parent company, AWK. OCA M.B. at 49. As shown in the OCA's Main Brief and Reply Brief, the Commission has the authority to utilize a hypothetical capital structure, and the OCA respectfully requests that the Commission utilize this authority to set a hypothetical capital structure for ratemaking that will protect consumers from and equity rich capital structure that only benefits shareholders. OCA M.B. at 50-51; OCA R.B. at 30.

B. Return on Equity (ROE)

Exception No. 11: The ALJs recommended a ROE that was too high based on the record and should have accepted the OCA's market-based ROE. R.D. at 152-69; OCA M.B. at 6-8, 48, 51-55; OCA R.B. at 32-34.

In the Recommended Decision, the ALJs recommend a modified version of I&E's analysis that results in a ROE of 9.45%. R.D. at 167. The ALJs reached this number by modifying I&E witness Patel's recommendation by averaging the results of his CAPM and DCF calculation, notwithstanding that Mr. Patel did not recommend this result or method. *Id*. In utilizing the modified I&E ROE, the ALJs determined that they agreed with Mr. Patel's decision to include Middlesex Water in the proxy group for DCF calculations as well as his use of 10-year Treasury notes. R.D. at 169. The ALJs were also persuaded by I&E witness Patel's DCF analysis. *Id.* at 168.

The decision of the ALJs to pick and choose what parts of I&E's analysis to use and what parts to ignore, while simultaneously ignoring the other evidence presented, resulted in an ROE

that was excessive by 35-basis points. The OCA's recommendations,[10] on the other hand, will enable the Commission to exercise its discretion in a manner that gives "due consideration to" and protects the interests of consumer interests from paying excessive rates. 71 P.S. § 309.5; *see also Permian Basin* at 770, 797. At the same time, the OCA's recommendations will allow PAWC to have an opportunity to earn a fair rate of return within the zone of reasonableness and maintain its financial integrity and stability to provide safe and adequate water and wastewater service to consumers. *Bluefield Water Works and Improvement Co. v. Public Serv. Comm'n of W.Va.*, 262 U.S. 679, 692-93 (1923) (*Bluefield*); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (*Hope*); *Duquesne Light Co. v. Barasch,* 488 U.S. 299, 310, 312 (1989), *aff'g Barasch v. Pa. PUC*, 532 A.2d 325 (Pa. 1987); *Permian Basin* at 797. Accordingly, the OCA' recommendation falls within the zone of reasonableness that protect both consumers and shareholder interests and thus will produce just and reasonable rates. *See* OCA M.B. at 6-8, 48.

OCA witness Garrett's DCF and CAPM models point to a ROE of 9.1%, or 8.7% depending on whether the alternative ratemaking requests or equity rich capital structure was granted. OCA M.B. at 51. In the Recommended Decision, the ALJs erred and recommended granting the Company's equity rich capital structure, and, as such, the proper and record-supported ROE would be 8.7%, not 9.45%.

OCA witness Garrett is the witness in this case that testified to a ROE based on the average of his DCF and CAPM results. OCA witness Garrett presented an accurate DCF that utilized a sustainable realistic growth rate that produced a cost of equity result of 9.4%, using the following the three primary inputs:

[10] The OCA's recommendations are based on fully substantiated cost of capital analyses, as required by law. *Pa. PUC v. Pa. Power Co*., 55 Pa. PUC 552, 579 (1982); *Pa. PUC v. Nat'l Fuel Gas Dist. Corp*., 73 Pa. PUC 552, 603-05 (1990); *Pa. PUC v. Philadelphia Suburban Water Co.*, 71 Pa. PUC 593, 622-23 (1989).

- Stock price – Mr. Garrett used 30-day averages of adjusted closing stock prices for each company in the proxy group; OCA St. 3 at 20-22, Exh. DJG-3;

- Dividend – Mr. Garrett used forward-looking annualized dividends published by Yahoo! Finance; OCA St. 3 at 22, Exh. DJG-3; and

- Long-term growth rate – Mr. Garrett gave more weight to the results on the analyst growth variation because of the unique growth opportunities for water utilities; average long-term growth rate of 6.9% for the water proxy group; OCA St. 3 at 27-28; OCA St. 3SR at 3.

OCA M.B. at 52. Additionally, OCA Witness Garrett's CAPM Model, utilizes a realistic Equity Risk Premium that is in line with multiple independent experts that produced a cost of equity result of 8.7%, using the following three inputs:

- Risk-free rate – Mr. Garrett used 4.42% based on the 30-day average of daily Treasury yield curve rates on 30-year Treasury Bonds, OCA St. 3 at 34-35, Exh. DJG-7;

- Beta coefficient – Mr. Garrett used betas published by Value Line, OCA St. 35-36, Exh. DJG-8;

- Equity risk premium (ERP) – Mr. Garrett started by using an implied ERP of 5.0%, using the implied ERP approach, pursuant to which he collected data for the index value, operating earnings, dividends, and buybacks for the S&P 500 over the past six years; he calculated the dividend yield, buyback yield, and gross cash yield for each year, and the component annual growth rate from operating earnings. OCA St. 41, Exh. DJG-9. He used a final ERP estimate of 5.3% after considering the results of ERP surveys along with the implied ERP calculations and the ERP reported by Kroll (Duff & Phelps). OCA St. 3 at 41-46.

OCA M.B. at 54; OCA R.B. at 33-34. Mr. Garrett testified that in order to get an accurate assessment of the cost of equity, a model that measures market risk and its impact on individual companies must be used, he used both the DCF and CAPM Model. OCA St. 3 at 28; OCA M.B. at 52. Notably, the OCA's proposed ROE for PAWC of 9.1% falls within PAWC witness Bulkley's overall DCF Model range. OCA St. 3 at 29; *see* OCA M.B. at 52-53.

C. Business Risks and Management Performance Adder

Exception No. 12: The ALJs erred in awarding a 10-basis point management adder to PAWC's ROE based on this record. R.D. at 183-84; OCA M.B. at 17-20, 55-60; OCA R.B. at 35-39.

In the Recommended Decision, the ALJs recommended to not award a 25-basis point adder requested by PAWC while simultaneously recommending the Commission award a 10-basis point upward adjustment for PAWC's acquisitions of "very small, less-viable" water and wastewater systems. R.D. at 183-84.

On the one hand, the ALJs correctly agreed with the OCA that PAWC's testimony of activities supporting a 25-basis point adder to the ROE better reflect PAWC complying with its public service obligations under the law, rather than providing extraordinary service. The ALJs further found that the OCA also convincingly demonstrated that the Company did not show its service was exemplary in all areas. Additionally, the ALJs also correctly found that the significant amount of criticism voiced by PAWC customers, whether through filing of complaints or participation at public input hearings, merit against finding a full award of PAWC's requested 25 basis point adjustment. R.D. at 184 (citations omitted). The ALJs' got it right in their recommendation to not award the 25-basis point adder requested by PAWC based on a coherent rationale. As the OCA argued, based on this record the Commission should exercise its discretion not to award an adder as PAWC has mainly shown that it is complying with its public service obligations and has not demonstrated that its performance is exemplary in all areas. OCA R.B. at 35-39; OCA M.B. at 17-20, 55-60; OCA R.B. at 35-39.

On the other hand, the ALJs erred in recommending that the Commission award 10 basis points to the ROE on the basis of the Commission's "explicit endorsement" of rate return premiums in the Commission's Policy Statement at 52 Pa. Code § 69.711(b). The error is the result of the ALJs' failure to make any of the specific findings of facts required under 52 Pa. Code § 69.711(a)

for the acquisitions. Subsection (a) of the Policy Statement requires demonstration of the criteria set forth in (a)(1)-(6) for each acquisition. Specifically, Section 69.711(a) requires that the listed parameters "*shall first be met in order for Commission consideration of a utility's proposed acquisition incentive."* 52 Pa. Code § 69.711(a) (emphasis added). There is no record in this case demonstrating that the subsection (a) factors were met by the Company. The Company (and ALJs) did not even identify the names of any of the sixteen acquisitions. *See* PAWC St. 1 at 42-43; PAWC St. 1R at 14; PAWC R.B. at 44. PAWC bears the burden of proof to support its ROE claims, including its adder request, with substantial evidence. 66 Pa.C.S § 315(a). PAWC failed to develop the record with substantial evidence to, at a minimum, identify the sixteen acquisitions and to demonstrate that each acquisition has met the criteria under subsection (a)(1)-(6) to qualify for the rate of return premium under subsection (b)(1) of the Commission's Policy Statement. It is possible that some or all of the acquisitions would not meet the criteria of subsection (a). Thus, there is no basis to conclude that an additional 10-basis points, which is the equivalent of charging customers $4.52 million[11] more each year, is warranted.

Additionally, the ALJs referenced PAWC's acquisitions of Delaware Sewer Company (Delaware Sewer) and Winola Water Company (Winola Water) and the Commission's Policy Statement at 52 Pa. Code § 69.711. Again, PAWC failed to develop the record to show how these two acquisitions would meet the criteria of subsection (a)(1)-(6) of the Commission's Policy Statement. PAWC did not voluntarily acquire the Delaware Sewer and Winola Water systems as envisioned by the arms-length requirement of subsection (a)(5) of the Commission's Policy Statement; rather, PAWC was directed by the Commission to acquire these systems under Section 529 of the Public Utility Code. The ALJs failed to acknowledge that PAWC was directed to acquire

[11] *See supra* n. 8.

these systems by the Commission pursuant to Section 529. PAWC St. 1 at 42-43; *see* R.D. at 174, n. 516 (citing PAWC St. 1 at 42-43). Furthermore, Section 529 makes it the ***public service obligation*** of a "capable public utility", like PAWC, to acquire a "small water or sewer utility" pursuant to Commission order when certain conditions exist. 66 Pa.C.S. § 529. In such event, Sections 529(j), (k), and (l) plainly and expressly extend certain protections to the acquiring capable public utility (including any prior receivership) by providing for cost recovery of reasonable and prudent costs, limitations on liability, and limitations on enforcement actions. 66 Pa.C.S. §§ 529(j), (k), (l). Hence, PAWC's fulfillment of its public service obligations under Section 529, especially given that PAWC was adequately protected and compensated for these acquisitions pursuant to the provisions of Section 529, should not alone be used as a basis to award 10 basis points to the ROE.

In this sense, the OCA submits that for PAWC, with the privilege and benefit of operating as the Commonwealth's largest Class A public utility (companies with jurisdictional gross operating revenues over $750,000), comes the responsibility of aiding other water systems within the state in time of need or crisis, provided that PAWC has the opportunity to recover its reasonably and prudently incurred costs related thereto. The privileges and benefits enjoyed by PAWC include a growing captive customer base and a reasonable opportunity to earn a fair return on a sizeable rate base. Regarding PAWC's involvement in (1) serving as the appointed receiver of the East Dunkard Water Authority under the protection of receivership orders, and (2) extending mains to the Dimock properties under the protection of well-negotiated agreements (and as fully funded by a third party, Cabot Oil), PAWC is technically, managerially, and financially fit to render such assistance, and, therefore, it should render that assistance where rate recovery protections are put in place. Indeed, in acquisition proceedings under Sections 1102/1103, PAWC's fitness as a large

and capable water and wastewater utility it is routinely asserted by PAWC, unopposed by OCA, and found by the Commission to be a "benefit" that is then considered under the "affirmative public benefits" legal standard. Accordingly, the ALJs' emphasis on PAWC's "willingness to answer calls for aid to other water and wastewater providers" is not in and of itself a showing of extraordinary service or commitment deserving of a management performance adder to the ROE. It simply comes with the territory of being a fit, Class A water public utility in the Commonwealth.

Along these lines, the OCA submits that the Commission's Policy Statement at 52 Pa. Code § 69.711(a)(4) requires a demonstration that "the acquired system's ratepayers should be provided with improved service in the future, with the necessary plant improvements being completed within a reasonable period of time" in order to qualify for the rate premium adder. PAWC has not met its burden of showing it has provided the customers of EDWA or Dimock with improved service or that the necessary plant improvements will be completed within a reasonable period of time. PAWC cites to the direct testimony of PAWC witness Everette, who testified that the new drinking water system to the Dimock properties will be fully funded (by Cabot Oil and Gas) and in service by the end of 2026, which is outside of the FPFTY in this case. PAWC R.B. at 44-45 (citing PAWC St. 1 at 42-43, 45-46). As for EDWA, the proceedings are presumably too nascent for PAWC to have developed the record in this case as to any improvements it has made to that system. PAWC R.B. at 44, n. 159, 160. At a minimum, the Commission should follow its own criteria for determining when a return premium is warranted.

Furthermore, the Commission should not adopt the ALJs' reasoning that PAWC deserves an upward adjustment management adder on the basis that PAWC could have pursued certain acquisitions under Section 1329 for a fair market value rate base but chose not to. This argument asserted by PAWC, as adopted by the ALJs, is meritless. There is absolutely no guarantee or any

reasonable degree of certainty that an acquisition pursued under Section 1329 would have been approved under the accompanying "affirmative public benefits" legal standard of Sections 1102/1103. Hence, giving credit to PAWC for not pursuing certain types of litigation authorized by the Public Utility Code hardly constitutes good reason to award PAWC with a bump to its ROE.

To be clear, under no circumstances is the Commission obliged to grant a management performance adder in determining the authorized ROE under the constitutional standards because a reward for management performance is not commensurate with returns on investments in other enterprises having corresponding risks. Under the constitutional standards, the return need only be "equal to that being made at the same time on investments in other business undertakings which are attended by corresponding risks and uncertainties," *Bluefield* at 692, and "commensurate with returns on investments in other enterprises having corresponding risks" while being sufficient "to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital." *Hope* at 603. As OCA witness Garrett testified, investors cannot expect an additional ROE simply due to prudent managerial performance when they invest in competitive firms in the marketplace.[12] OCA M.B. at 55-56; OCA St. 3 at 49. Importantly, the legal standards of *Bluefield* and *Hope* do not establish the fair rate of return as a "quid-pro-quo" concept where non-market-based increments to cost of equity are awarded to a utility's shareholders in return for a utility's management operating the public utility company in a prudent manner as required by law. OCA M.B. at 59; OCA St. 3 at 49; OCA St. 3SR at 11.

[12] The primary driver of the cost of equity and required rate of return is how market risk impacts individual firms; thus, managerial performance does not have an increasing effect on a utility's market-based ROE. OCA St. 3 at 48; OCA St. 3SR at 8. Specifically, managerial performance and the risk of imprudent management is related to firm-specific risks, which are not rewarded by the market because investors can eliminate such risk through diversification of portfolio, and do not have a material effect on the cost of equity. *Id*.; OCA M.B. at 56. As investors in competitive firms in the marketplace cannot expect an additional ROE simply due to a firm's prudent managerial performance, shareholders of a regulated utility should not receive any premium in addition to an authorized market-based ROE due to the utility's prudent managerial performance. *Id*.

Given that there is no constitutional requirement to award a public utility with an upward management adder, the Company's adder request thus becomes a question of whether it is an appropriate exercise of Commission discretion to grant the adder. However, as stated above, PAWC has *not* demonstrated in this record that its performance overall or that its performance related to the sixteen acquisitions or the Delaware Sewer or Winola Water acquisitions or the special projects of EDWA and Dimock is exemplary and deserving of a management performance adder. Given this lack of record support, the Commission should exercise its discretion to reject the claim. Doing so will send a clear signal to water public utilities that they must demonstrate exemplary service related to the acquisition of and improvements to small, non-viable systems.

In summary, and as argued in the OCA's Main Brief, the record does not support granting the requested adder in any amount. By not awarding an adder, the Commission would be acting within the zone of reasonableness and protecting future and present interests of consumers from unsupported, excessive rates. *See* 71 P.S. § 309-5; *see also Permian Basin* at 794-95, 797; OCA M.B. at 56-57.

VII. RATE STRUCTURE AND RATE DESIGN

A. Cost of Service Studies – Water Operations

Exception No. 13: The ALJs erred in not adopting the OCA's adjustment to PAWC's water cost of service study to include interruptible usage in the extra capacity factor allocations. R.D. at 195; OCA M.B. at 65-66; OCA R.B. at 41-43.

In the Recommended Decision, the ALJs found that the cost-of-service study methods and factors used by PAWC for its water operation are reasonable and consistent with past practice and recommended that the Commission adopt the Company's cost of service study without modification. R.D. at 195.

The ALJs' erred in this finding and recommendation. That error is the result of the ALJs ignoring unrebutted substantial evidence of record showing that interruptible Industrial customers have not been interrupted in the last 20 years. OCA M.B. at 65-66; OCA St. 4SR at 9 (citing PAWC response to OCA-35-9). Based on the record in this case, there is no factual premise for excluding interruptible Industrial usage in the extra capacity factor allocations. OCA M.B. at 65-66; OCA R.B. at 41-43. As the OCA advocated in its Briefs, the Company's water cost of service study should be modified to include interruptible Industrial usage in the extra capacity factor allocations because interruptible Industrial customers are regularly served during periods of peak demand. OCA M.B. at 65-66; OCA R.B. at 41-43.

This is consistent with PAWC witness Heppenstall's testimony in a recent rate proceeding for a gas utility, where she opined that interruptible customers that had not been interrupted in nearly 20 years should be treated the same as firm customers in the cost of service study:

> Ms. Heppenstall continued, "[e]ven though PGW does not include interruptible load in calculating its peak design day demand, PGW does provide gas during the period of Interruptible classes' peak day demand. Therefore, the cost allocation should reflect that service."

Pa. PUC v. Philadelphia Gas Works, 2023 Pa. PUC LEXIS 298 (Nov. 9, 2023), Order at *75 (*PGW 2023*). In *PGW 2023,* the Commission was persuaded by the OCA that, as there has been no interruption in the past 20 years, the interruptible class of customers is using the utility's distribution system during peak periods, and, therefore, treating those customers as receiving firm service for cost allocation purposes more closely aligns with cost causation. *Id*. This is the same reasoning advanced by OCA witness Mierzwa in the current proceeding. OCA St. 4 at 14; OCA St. 4SR at 9.

PAWLUG has argued in its Main Brief that *PGW 2023* should be distinguished because the interruptible customers here are not a separate class, they are part of the larger Industrial class,

which is mostly made up of firm customers. As such, PAWLUG argued that including interruptible usage as firm would cause firm Industrial customers to subsidize costs. PAWLUG M.B. at 16-17. This argument is incorrect and misleading,[13] and importantly, in *PGW 2023,* the same arguments were also made by parties representing industrial and commercial customers, which were not accepted by the Commission. *PGW 2023* at *70-71, 75. While the Commission is not bound by the rule of *stare decisis,* it must render consistent opinions and should either follow, distinguish, or overrule its prior precedent. *Bell Atlantic v. Pa. PUC,* 672 A.2d 352, 354 (Pa. Cmwlth. 1994). In summary, based on the facts of this record, and to be consistent with *PGW 2023,* the Commission should modify the ALJs' recommendation to adopt the Company's water cost of service study as adjusted in conformity with the OCA's recommendation to include interruptible Industrial usage in the extra capacity factor allocations.

B. Cost of Service Studies – Allocation of AMP Costs and Administrative Costs for H2O Programs

Exception No. 14: The OCA urges the Commission to assign AMP Costs and H2O Programs administrative costs among all customer classes, not just residential. R.D. at 209-10; OCA M.B. at 68-70; OCA R.B. at 45-46.

In the Recommended Decision, the ALJs recommended that the AMP costs and administrative costs for H2O programs be assigned to the residential class only. R.D. at 209-10.

The Commission should decline to follow the ALJs' recommendation and instead require that the costs for PAWC's Arrearage Management Program (AMP) and administration of its H2O Grant and Discount programs be properly allocated consistent with the allocation of uncollectible

[13] Indeed, the failure to include the maximum day and hour demands of interruptible customers in determining the cost of serving Industrial customers subsidizes the entire Industrial class (since the same rates are generally applicable to all Industrial customers), by increasing the rates of all other customer classes. Industrial customers are being subsidized by all other firm customers because PAWC's interruptible maximum day and maximum hour extra capacity factor allocations have not been aligned with cost causation, *i.e.*, have not been based on those customers' actual usage of the system Please see the OCA's Main Brief for further discussion responsive to PAWLUG, OSBA, Cleveland Cliffs, and PAWC on this issue. OCA M.B. at 65-66.

costs generally – *i.e.*, to all customer classes. The AMP does not *cause* new costs that would not have existed in the absence of the program. It trades off a more immediate write-off of *pre-program* arrears in exchange for future in-full BDP payments. Thus, PAWC's AMP will, if anything, serve to reduce the dollars ultimately found to be uncollectible. OCA M.B. at 67; OCA R.B. at 45-46; OCA St. 5R at 4, 12. Both OSBA and PAWLUG agree, to the extent that:

> [I]f the AMP expense is not truly incremental to the general uncollectible expense, then it should be removed from the revenue requirement rather than directly assigned to the residential class. PAWC should not be permitted to recover the same uncollectible "dollar" twice: once through uncollectible expense and again through AMP expense. OSBA St. 1SR at 17; *see also* PAWLUG M.B. at 22.

Likewise, the administration of the H2O Grant and Discount programs is expected to result in a corresponding decrease in PAWC's administrative costs associated with addressing the nonpayment of bills. OCA M.B. at 70; OCA St. 5R at 5-6. The only way to appropriately capture, and to allocate, both the costs and the cost reductions, is to allocate the costs as PAWC initially proposed to do in this case – based on an O&M composite factor.[14] *Id*.

C. Tariff Structure – Residential Customer Charge

Exception No. 15: The ALJs erred by adopting the Company's direct cost analysis for the water customer charge. R.D. at 234-36; OCA M.B. at 77-78; OCA R.B. at 52-54.

In the R.D., the ALJs recommended that the water customer charge increase from $17.50 to $20 based on the Company's proposal. R.D. at 234-36. PAWC's proposal to increase the Residential customer charge to $20.00 (by 14.3%) for customers in Rate Zones 1 through 5 with 5/8-inch, 3/4-inch, 1-inch, and 1½-inch meters is not reasonable. First, PAWC's analysis of customer charges, which it claims only reflects direct costs, indicates a cost-based charge of

[14] OCA's adjustment to PAWC's claim for the amount of FPFTY uncollectible expense related to AMP credits is shown in Appendix A to the OCA's Main Brief, OCA Table II, ln. 42 (Water); Table II, ln. 17 (SSS); Table II, ln. 9 (CSS); OCA St. 2 at 73-74; OCA St. 2SR at 48.

$19.31, which is less than its proposed charge of $20. PAWC Exh. 12-A, Att. RS1j, 2-3. Next, PAWC's analysis includes costs that are not direct customer costs and do not change with the addition or subtraction of a customer, including office building and furniture expenses.[15] OCA St. 4 at 35-36. These costs relate to PAWC's general operation as a utility. Not all of a utility's fixed expenses for operation are properly included in a customer cost analysis and the Commission has generally permitted only expenses directly related to meter reading, customer service, accounting and customer records and collections. *See, e.g., Pa. PUC v. Metropolitan Edison Co.*, 60 Pa. PUC 349 (1985); *Pa. PUC v. Nat'l Fuel Gas Dist. Corp.*, 83 Pa. PUC 262, 371 (1994); *Pa. PUC v. PPL Elec. Util. Corp*., 237 PUR4th 419, 461 (2004). Only those costs that vary directly with the addition or subtraction of a customer should be included in the calculation of a customer charge. OCA St. 4 at 35. Where the Commission has permitted allocated portions of indirect costs, on a case-by-case basis, it has allowed costs associated with direct labor costs, including employee benefits, workers compensation insurance and payroll taxes. *Pa. PUC v. Aqua Pa., Inc*., 236 PUR4th 218 at 251 (Pa. PUC 2004) (*PSW 2004*). Significantly, the Commission stated: "We caution that these are costs which may be considered for inclusion in the customer charge, but such claims are subject to scrutiny on a case-by-case basis." *Id.* Furthermore, since *PSW 2004,* the Commission has rejected a utility's proposed customer charge increase based on a cost analysis that included indirect costs. *Pa. PUC v. PPL Gas Util. Corp.*, 2007 Pa. PUC LEXIS 2 (Feb. 8, 2007), Order at *210. The OCA presented adjustments to remove the improperly included office building and furniture costs. Based on the OCA's overall position on revenue requirement, the OCA recommends the existing $17.50 monthly charge for Residential customers should be maintained. Maintaining the existing charge is further supported by the fact that PAWC's own calculation of

[15] I&E witness Cline recommends a customer charge of $19.50 based on his adoption of PAWC's cost analysis rounded to the nearest half dollar (I&E St. 4 at 33); this charge should not be adopted for the same reasons.

direct customer costs uses its filed-for pre-tax return and if the Commission allows a lesser return, PAWC's calculation indicates a lesser water customer charge. *See* OCA Exc. No. 17 below.

Exception No. 16: The ALJs erred by adopting I&E's proposed wastewater customer charge as it included I&I costs, which are not direct costs. R.D. at 234-36; OCA M.B. at 78-79; OCA R.B. at 52-55.

In the Recommended Decision, the ALJs recommended that the wastewater customer charge increase from $14.30 to $15 based on I&E's proposal. R.D. at 234-36. The ALJs erred by adopting I&E's $15 proposal because that proposal is not supported by substantial evidence and is the result of I&E witness Kubas arbitrarily assigning a small portion of certain indirect costs – Inflow and Infiltration (I&I) costs – to the customer charge even though witness Kubas testified that such costs do not vary with the number of customers. I&E St. 3 at 19; I&E M.B. at 75.

PAWC's direct customer charge calculation improperly included the costs associated with collecting and treating I&I; however, I&I cannot reasonably be considered a direct cost because it is largely a function of precipitation and, therefore, does not vary directly with the addition or subtraction of a customer. Without I&I costs, the Company's calculation of customer costs indicates a direct cost of $13.87 at PAWC's proposed revenue requirement. I&E M.B. at 75-76; OCA M.B. at 78.

I&E witness Kubas agreed with the OCA that I&I costs should be excluded from the calculation of the wastewater customer charge as it is not a direct cost. Nevertheless, Mr. Kubas proposed a $15 customer charge that started from the direct customer cost of $13.87 plus adding a "small portion of the I&I costs." I&E St. 3 at 19; I&E M.B. at 75. Mr. Kubas' recommendation is not supported by his own rationale in his testimony, and thus his inclusion of a small portion of I&I costs is arbitrary.

As such, Residential customer charges in Wastewater SSS Rate Zones 1, 2, 5 and 6 should be maintained at $14.30 to recognize the full exclusion of the I&I costs. Again, these are calculated at the Company's claimed revenue requirement, which means that if the Commission does not adopt PAWC's filed-for rate of return, for example, that adjustment has to be flowed through the customer cost calculation. That will provide more support for maintaining the current SSS Wastewater Residential customer charges at no more than $14.30. *See* OCA Exc. No. 17 below.

Furthermore, PAWC provided no customer cost analysis for CSS operations. I&E M.B. at 82. For Wastewater CSS Rate Zones 3, 4, 7 and 9, the OCA recommended that Residential customer charges should be reduced to $14.30 consistent with its recommendation for the SSS customers. OCA M.B. at 79; OCA St. 4 at 47. I&E's recommended $20 Residential CSS charge is not cost-based, whereas the OCA's recommended $14.30 charge would set the charge for CSS customers at the same amount as SSS customers (whose rate is cost-based). OCA St. 4SR at 40.

Exception No. 17: <u>The ALJs erred to the extent the ALJs' adoption of the $20 water customer charge and $15 wastewater customer charge do not account for a scale back/reduction based on the authorized revenue requirement</u>. R.D. at 234-36, 271-72; OCA M.B. at 77-79; OCA R.B. at 52-55.

In the Recommended Decision, the ALJs recommended that the water customer charge increase from $17.50 to $20 based on the Company's proposal, and that the wastewater customer charge increase from $14.30 to $15 based on I&E's proposal. R.D. at 234-36. Additionally, the ALJs agreed with the Company's position on the scale back of rates, explaining that the proposal to proportionately reduce the water and wastewater revenue requirements and the proposed amount of reallocation from wastewater to water under Act 11 would be an equitable scale back while still allowing for some rate relief for wastewater customers under Act 11. R.D. at 271-72.

The OCA takes exception with these recommendations to the extent it is construed to mean that the ALJs' adoption of the $20 water customer charge and $15 wastewater customer charge

will not be scaled back or reduced based on the overall revenue requirement authorized by the Commission. PAWC's direct customer charge analyses for both water and wastewater were calculated at PAWC's filed-for revenue requirement increase and pre-tax rate of return. PAWC Exh. 12-B, Sch. RS1 j. Responses at 2). Adjustments that the Commission makes to the allowed revenue requirement, including pre-tax rate of return, impact those calculations and should be flowed through to reduce the indicated customer charges. *See* OCA St. 4 at 36; OCA St 4SR at 14. Likewise, I&E's recommendation for the $15 wastewater customer charge was made at the Company's requested revenue requirement and where adjustments to that revenue requirement impact I&E's analysis and calculation, they should be flowed through. OCA St. 4R at 6.

VIII. LOW-INCOME CUSTOMER ASSISTANCE

A. Affordability Analysis

Exception No. 18: The ALJs erred in not adopting the OCA's adjustments to the Company's affordability analysis based on the fully substantiated evidence of record. R.D. at 315-16; OCA M.B. at 95-96; OCA R.B. at 60.

In the Recommended Decision, the ALJs found both PAWC's Enterprise Level Analysis and its Community-Level Analysis to be reasonable methods to determine customer affordability. R.D. at 315-16.

To determine if rates are affordable for PAWC's customers, PAWC and the OCA generally agree that a consumer's water/wastewater burden, or the proportion of income dedicated to paying the consumer's bill for water and wastewater service, or the bills-to-income (BTI) ratio (BTI Ratio), should not exceed 2%. PAWC St. 10 at 4-23; OCA St. 5 at 7-39. Where PAWC and the OCA disagree, however, is on the affordability analysis that is used to determine those customers who have a water burden exceeding the affordable 2% BTI Ratio. This disagreement is significant because the affordability analysis that is used to determine how many and which customers have

water burdens that exceed the 2% BTI Ratio ultimately supports the development and design of low-income customer assistance programs, including, but not limited to, the Company's H2O BDP. PAWC has not met its burden of proof in demonstrating with substantial evidence that its affordability analysis will lead to affordable and just and reasonable rates. The OCA has presented fully substantiated adjustments to PAWC's affordability analysis that would lead to affordable and just and reasonable rates for low-income customers. OCA St. 5 at 7-39.

As identified in Mr. Colton's testimony, the affordability analysis presented by PAWC witness Rea at the enterprise level and community level is inadequate and unreasonable and, therefore, Mr. Rea's conclusion that PAWC bills are generally affordable when viewed from both the community level and the household level is unreasonable and unsupported. OCA witness Colton corrects the flaws in the Company's analyses and presents a fully substantiated and accurate analysis that should be adopted by the Commission. OCA St. 5 at 7-39. Mr. Colton's recommended affordability analysis, at a high level, is as follows:

- *Enterprise level*: First, reject Mr. Rea's recommendations to measure affordability using Median Household Income (MHI) and the Median Household Income of Homeowners (MHI-HO). Second, examine BTI Ratios at the average income in the First Quintile and Second Quintile given a constant usage over the years. Third, determine what income would be needed in order to achieve a BTI Ratio of 2.0% each year and examine the number of zip codes within the PAWC service territory that have those incomes at the average Q1 and average Q2 income levels. OCA St. 5 at 7-22.

- *Community level*: First, reject the limitation of any "affordability analysis" to use of a minimal "Basic Water Service." Second, do not examine affordability only for the PAWC population as whole. Third, measure affordability at different income levels. Finally, do not consider only the ***breadth*** of affordability (*i.e.*, the number of customers with BTI Ratios exceeding 2% of income), but also consider the ***depth*** of affordability (*i.e.*, recognizing that a substantial number of the customers with unaffordable bills, do not merely have a BTI Ratio "over 2%," but have a BTI Ratio of over 20%). OCA St. 22-39

OCA St. 5SR at 8-9. Mr. Rea in his rebuttal did not credibly respond to the affordability analysis that Mr. Colton recommended be adopted.

B. H2O Bill Discount Program Design

Exception No. 19: The ALJs erred by imposing an effective date that is uncertain and too far into the future for PAWC to increase the discount percentage for each tier of the Bill Discount Program. R.D. at 316-21; OCA M.B. at 97-98; OCA R.B. at 60-61.

PAWC proposed to add a fourth tier to the existing Bill Discount Program for customers whose household incomes are 150%-200% of the federal poverty line. R.D. at 316-17. No party opposed, and the ALJs recommended approving the fourth tier as an additional measure to assist PAWC's customers to afford their bills. *Id*. at 320. Further, the ALJs recommended that the percentage discount applicable to each tier be increased. R.D. at 320-21. While the fourth tier would go into effect with new rates, the ALJs recommended that the percentage discounts would change "no later than the effective date of rates resulting from PAWC's next general rate increase filed with the Commission." R.D. at 320-21.

While the OCA agrees with these proposals, the OCA does not agree with delaying the percentage increases. No party advocated for the timeline that the ALJs selected for implementation. Furthermore, the timeline chosen by the ALJs is uncertain, and places the entire schedule within PAWC's control in terms of deciding when to file for a next rate case. There is no certainty when the Company will next file a general rate increase or when the effective dates of that increase will be. As such, the Commission should reject the ALJs' uncertain timeline and, if the increases are not put into effect now (i.e. at the same time the fourth tier is added), instead adopt a more fitting timeline of 1-year after the effective date of the rates set in this case.

C. Hardship Fund

Exception No. 20: The ALJs erred by imposing an effective date that is uncertain and too far into the future for PAWC to implement the allowance of multiple customer grants and the elimination of the good faith payment requirement. R.D. at 321-27; OCA M.B. at 98-99; OCA R.B. at 62.

In the Recommended Decision, the ALJs recommended the adoption of the proposal for the allowance of multiple customer grants per year. R.D. at 327. Furthermore, the ALJs recommended that the Commission remove the $50 good faith payment required to receive a hardship fund grant. R.D. at 328. However, the ALJs recommended that both of these proposals take effect "no later than the effective date of rates resulting from PAWC's next general rate increase filed with the Commission." R.D. at 327-28.

While the OCA agrees with these proposals, the OCA does not agree with the timeline put forth by the ALJs. No party advocated for the timeline that the ALJs selected for implementation. Furthermore, the timeline chosen by the ALJs is uncertain, and places the entire schedule within the Company's control in terms of deciding when to file for a next rate case. There is no certainty when the Company will next file a general rate increase or when the effective dates of that increase will be. As such, the Commission should reject the ALJs uncertain timeline and instead adopt a more fitting timeline of 1 year after the effective date of the rates set in this case. The OCA proposes this timeline in recognition of Dollar Energy Fund's work developing software to allow for multiple hardship grants. R.D. at 322 n. 1124. This software is anticipated to deploy at the start of the 2024-2025 grant year, which will be within one year of the effective date of the rates set in this case. *Id.*

D. Low-Income Customer Outreach, Screening, and Intake

Exception No. 21: The Commission should consider the concerning evidence of low enrollment in the Company's BDP and adopt the recommendations offered by the OCA. R.D. at 341; OCA M.B. at 99-100; OCA R.B. at 63.

In the Recommended Decision, the ALJs rejected the OCA's recommendations for increasing customer enrollment in PAWC's universal service programs and providing additional protections to customers facing termination of service. They found that the Company is adhering to the requirements of Chapter 14 of the Public Utility Code for making customers and prospective customers aware of the availability of its universal service programs when they contact the Company about a payment arrangement. R.D. at 341.

While the Company may indeed be adhering to the statutory standards, OCA witness Colton brought forward some concerning statistics related to the level of low-income customer enrollment in the Company's BDP program. Specifically, he found that from November 2021 to October 2023, of the 60,660 confirmed low-income customers, PAWC has enrolled fewer than 13,700 or 17.7% of those customers into its BDP. OCA St. 5 at 57. This number is in stark contrast to PAWC's disconnection count of confirmed low-income customers from January 2021 to October 2023, which was 35,488, and the disconnection notice count of 412,518 sent to confirmed low-income customers. OCA St. 5 at 57. These confirmed low-income customers disconnections represent a total arrearage of $14,550,181 at the time of disconnection. OCA St. 5 at 57. In no month from January 2023-October 2023 did PAWC enroll more confirmed low-income customers than it disconnected. OCA St. 5 at 69. These figures strongly suggest that there is room for improvement in the Company's universal service program enrollment efforts. The OCA submits that the four recommendations listed at p. 100 of its Main Brief should be adopted.

E. Data Collection, Reporting, and Monitoring of Low-Income Programs

Exception No. 22: The OCA urges the Commission to approve the use of the surveys recommended by the OCA. R.D. at 345; OCA M.B. at 101; OCA R.B. at 63.

In the Recommended Decision, the ALJs rejected the OCA's recommendation that PAWC conduct customer satisfaction surveys targeted to certain types of low-income customers: (1) those seeking to enroll in the BDP and/or AMP; (2) those seeking a deferred payment arrangement; (3) those expressing difficulty or inability-to-pay their bills in a full and timely manner; and (4) those responding to the pending or executed disconnection of service for nonpayment. The ALJs found that these surveys were unnecessary. They noted that the Company was already identifying trends from customer feedback in connection with transaction surveys. R.D. at 345.

The OCA recommended the surveys to assist in improving the performance of PAWC's low-income customer assistance programs. It proposed that the survey results be compiled and provided to the Low-Income Advisory Group (LIAG) for possible discussion by the LIAG with the objective of improving customer satisfaction and collections outcomes thereby improving management's control of costs and revenues. OCA St. 5 at 123-24. OCA witness Colton observed that the quarterly and targeted surveys referred to in Company witness Degillio's testimony (PAWC St. 2 at 8), have not been used to assess how PAWC might improve customer satisfaction and collections outcomes. OCA St. 5 at 120. Therefore, the OCA submits that despite the ALJs position, there remains a need for the type of surveys recommended by the OCA and the Commission should approve their use.

F. Comprehensive Written Plan

Exception No. 23: The OCA urges the Commission to prioritize a comprehensive written plan as part of prudent and adequate customer assistance programming management and planning. R.D. at 350; OCA M.B. at 101; OCA R.B. at 63.

The ALJs rejected a recommendation by the OCA and CAUSE-PA that PAWC be required to file a comprehensive Universal Service Plan with the Commission. The ALJs noted that only electric and natural gas utilities are currently required to file such plans. No such requirement applies to water and wastewater utilities. Nevertheless, the ALJs commented that if the Commission finds merit in the OCA and CAUSE-PA recommendation, the Commission should pursue such a requirement on a statewide basis rather than a utility-by-utility approach. R.D. at 350.

The OCA recommended the comprehensive plan as a fundamental element of prudent and adequate program planning and management of its low-income customer assistance programs. While the OCA recognizes that PAWC is not required to prepare and file a written plan, the need to prepare and file such a plan is based on the need for efficient and adequate service to low-income customers and planning of expenditures for related programs. OCA MB at 101; OCA RB at 63.

Mindful of the ALJs' recommendation that any requirement for filing comprehensive universal service plans for water and wastewater utilities be carried out on statewide basis, the OCA encourages the Commission to consider this option. The OCA would actively participate in such a proceeding.

IX. SERVICE QUALITY AND CUSTOMER SERVICE ISSUES

A. Customer Service Performance

Exception No. 24: The ALJs erred in rejecting the OCA's recommendations to improve customer service performance. R.D. at 355-64; OCA M.B. at 102-05; OCA R.B. at 64-66.

In the Recommended Decision, the ALJs recommended rejection of the OCA's proposed improvements to customer service performance. R.D. at 363-64. In this recommendation of rejection, the ALJs noted that only a handful of public input hearing witnesses raised customer service issues, and that the majority of the testimony concerned affordability. R.D. at 363. The ALJs further stated "Although there were several customers who offered testimony during the public input hearings regarding issues they experienced contacting PAWC to report various issues, we don't believe that is a sufficient showing to warrant directing PAWC to implement changes to its call-handling procedures." R.D. at 364. The ALJs recognized that Section 1501, 66 Pa.C.S. § 1501, requires PAWC to provide adequate and reasonable service but stated it does not require perfect service. R.D. at 364.

In reaching the recommendation, the ALJs placed too much weight on the fact that few people testified regarding customer service issues at public input hearings. When consumers are faced with yet another rate increase to their water and wastewater bills that threatens affordability, or are given the opportunity to testify regarding the service quality issues they have dealt with, they are unlikely to use their very limited time allowed for testimony to discuss customer service when they are concerned about being able to drink safe water or afford their water bill. The fact that consumers prioritized their issues in a manner that focused on things like affordability and service quality first, should not be used against them. Furthermore, the OCA is the statutory advocate that represents the interests of consumers in these proceedings, the fact that few consumers testified at public input hearings regarding these issues is not determinative where the

OCA – after conducting extensive discovery – provided substantial evidence of the customer service issues in the testimony of Ms. Alexander. OCA St. 6 at 21-23. This substantial evidence was also shown in the management audit as highlighted on page 22 of OCA St. 6. The ALJs did not give adequate weight to Ms. Alexander's testimony regarding customer service, and instead focused on the lack of public input testimony regarding this issue. For this reason, the ALJs erred and their recommendation to reject the OCA's proposed measures should not be adopted.

B. American Water Resources (AWR)

Exception No. 25: The ALJs erred in finding that PAWC's relationship with AWR has remained unchanged for over 20 years and that it is not deceptive and discriminatory to the detriment of PAWC's captive consumers. R.D. at 375-82; OCA M.B. at 106; OCA R.B. at 69-75.

In the Recommended Decision, the ALJs found it "important to consider that PAWC's relationship with AWR has remained unchanged for over 20 years." R.D. at 381. The ALJs also found that the billing relationship between AWR and PAWC is not exclusive, and that no other entity is seeking access to PAWC bills. *Id.* at 382. These findings were noted as some of the reasons for rejecting the OCA's request for an investigation. *Id.* at 382.

The OCA takes exception to the ALJs' conclusion. First, the ALJs' finding of fact that the relationship between PAWC and AWR has remained unchanged for over 20 years is simply incorrect. AWK sold its interest in AWR ending the affiliate relationship between AWR and PAWC in December 2021. OCA M.B. at 106; OCA R.B. at 69-70. Concurrent with the sale was the signing of a Licensing Agreement that gives this unaffiliated company the right to use the American Water name, logo, and branding and a Utility Billing Agreement that gives this unaffiliated company direct access to PAWC's customers for billing and marketing purposes. OCA R.B. at 70. This change in ownership is what lead to the deceptive practice and the unreasonable utility service under Section 1501 of AWR appearing on customer bills under the American Water name and logo

and AWR's marketing materials being sent to PAWC's customers as bill inserts under the American Water name and logo. This practice, undoubtedly, would lead the average consumer to believe an affiliated relationship exists between PAWC and AWR, when in fact none does. Indeed, as documented by the OCA, customers testified to having originally assumed these entities were connected legally. OCA St. 6 Supp at 2-5. AWR and PAWC both stand to benefit from the false impression given to PAWC's captive customers. OCA St. 6 at 39-40.

The ALJs also erred by finding that this practice is not discriminatory to other providers of these services. R.D. at 381-82. In finding that this practice is not discriminatory, the ALJs state **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL].** Thus, while the Public Utility Code and Commission orders require that a utility provide on-bill billing to third parties for third party services on a non-discriminatory

basis,[16] this provision of the Utility Billing Agreement **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL].** Therefore, for these reasons, and for the reasons set forth in the OCA's Main Brief and Reply Brief, the OCA requests that in the interests of consumers, the Commission order an investigation into this program.

X. CONCLUSION

Based on the foregoing and for the reasons articulated in the OCA's Main and Reply Briefs, the OCA respectfully requests that the Commission grant the OCA's Exceptions and adopt the OCA's positions as discussed above.

Respectfully submitted,

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[16] *See* 66 Pa.C.S. § 1502; *see also Pa. PUC v. Columbia Gas of Pa., Inc.*, 2018 Pa. PUC LEXIS 431 (Dec. 6, 2018), Order (stating that Section 1502 requires that where a utility provides utility billing services to a third party, the same service must be provided in a nondiscriminatory, or not unreasonably discriminator manner, to other parties).