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Pennsylvania Public     |
Utility Commission      |
     v.                 |Docket Nos.:
Aqua Pennsylvania, Inc.|R-2024-3047822 (Water)
                        |R-2024-3047824 (Wastewater)
In-Person Public Input |
Hearing                 |
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Pages 171 - 241

Curtis Hall Arboretum

1250 West Church Road

Wyncote, PA 19095

Monday, August 5, 2024

Commencing at 1:04 p.m.

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Docket Nos. R-2024-3047824, R-2024-3047822

Hearing Date: August 5, 2024

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EXHIBIT
Weiss - 1
8/5/24 EKS

Comment on Proposed Rate Increase

Aqua Pennsylvania, Inc Docket No. R-2024-3047822

Mark Weiss

8/4/2024

Over the past few years Aqua Pennsylvania, Inc. has requested and been granted rate increases substantially greater than the rate of inflation. A review of the annual reports for the past five years of Aqua Pennsylvania, Inc.'s parent company, Essential Utilities, shows a specific strategy being employed to increase real shareholder returns in the form of dividend growth and earnings per share. Below is a discussion of: a) Zone 1 Main Division residential (5/8" meter) water rate increases since 2019; b) comments regarding the changes to Essential Utilities; and c) their potential impact on residential water rates given the PUC's evaluation structure.

Pennsylvania Public Utility Commission (Pa PUC) Rate Review Issues

The PUC's rate review process is a book in itself.[1] However, there are a number of specific issues that apply to water companies and to water rates that must be considered in evaluating the fairness of the current rate increase being requested by Aqua Pennsylvania, Inc. (Aqua).

The stated purpose of rate regulation is to gain the efficiency of a natural monopoly while providing price and service regulation to benefit the consumer. In other words, allow the providing company to earn a fair return on invested capital, and guarantee consumers an adequate, safe, and reliable supply of the service or product, in this case water, at a reasonable rate.

In regulating water companies, several policy issues are taken into consideration, including:

- Consolidation of smaller systems into larger utility companies. The Public Utility Code has been updated to make it easier for larger companies to acquire smaller ones and include the cost, including goodwill and intangible assets, in rate cases. (Code §1327, §1311 amended in 2012, §1329 added in 2016)
- §1311 permits water and wastewater utilities to combine revenue requirements if "doing so is in the public interest". (Aqua is proposing this, however it artificially shifts the cost of wastewater systems to users who do not benefit from them.)
- Shareholders of utility companies are to receive a fair return on their investment. Historically utility companies were considered low risk investments, or "blue chip" investments due to the predictable nature of operating in a regulated environment. However, in recent years Essential Utilities and other companies in the "market basket" used to determine return on equity rates (ROE) have incurred greater risk to drive growth. For instance, Aqua's parent diversified from only water-related utilities into natural gas as well.

  Even the acquisition of smaller utilities, as encouraged by the PUC, increases the risk profile of the company, as it takes real management skill to integrate new companies into the larger entity, consolidate systems, train labor in standardized practices, integrate different corporate cultures, and make physical plants compatible.

  This changing risk profile does not benefit existing customers, and they should not have to pay for the implicit higher returns required by the marketplace to fund the business as it changes its risk profile. This would be reflected in increases in both debt and equity expenses.
- Using a market basket of regulated utilities that are operating under the same regulations creates a circularity, so increasing rates lead to more increasing rates.
- The PUC encourages companies to accelerate the maintenance or upgrading of the water and wastewater systems. Numerous incentives to provide for capital expansion exist to allow for the faster return of capital to the companies, while the cost goes into higher rates. In addition, normalization of tax expenses allows the companies to benefit from accelerated depreciation, while including higher tax expenses in the rates charged to customers. Overall, this provides an incentive for utilities to overinvest in new systems, as they are guaranteed a return even on

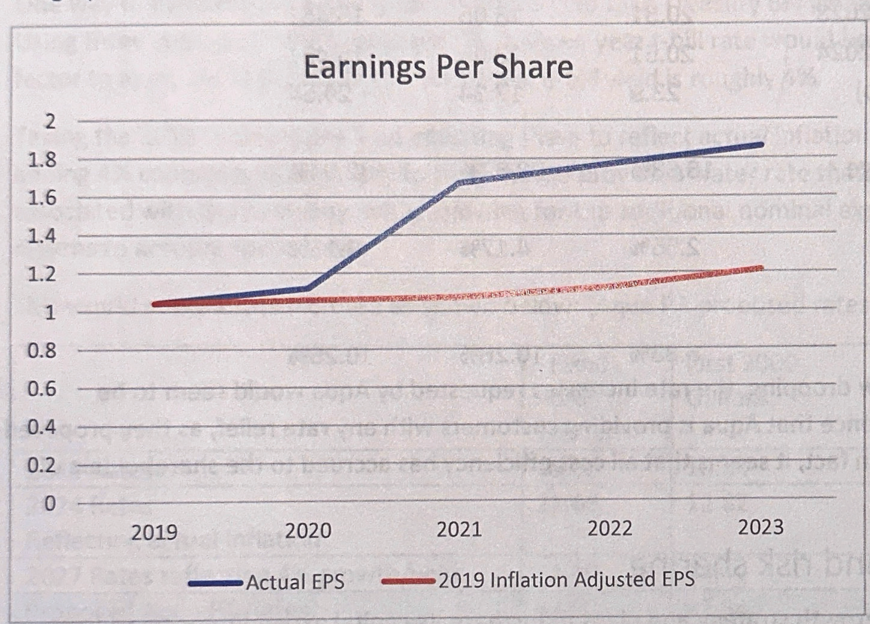
[1] James H. Cawley, Norman J. Kennard, "A Guide to Utility Ratemaking", 2018 Edition

inefficient investments. This return is spread over a relatively constant number of shares of stock, leading to higher real earnings per share over time.

Aqua Rate request and Shareholder returns

Drawing on information found in Essential Utilities Annual Reports, PUC Annual Reports, Aqua Tariff filings, and the US rate of inflation real returns and growth rates were computed.

Dealing first with inflation, Aqua should receive revenue to preserve real returns to shareholders and cover the nominal increase in costs due to inflation. However, the proposed rate increase, like previous increases, has exceeded the rate of inflation leading to real growth in shareholder earnings for providing roughly the same water services.



In this graph, the blue line represents actual earnings per share of Essential Utilities, while the orange line shows the 2019 earnings per share, adjusted for inflation. The gap is the additional earnings generated by the company, showing real growth.

Since the water business has not materially changed in the past five years, why should the earnings per share be growing at such a fast rate?

On page 6 of the 2020 Essential Utilities Annual Report the following is stated:

> "It is our intention to focus on growth opportunities in states where we have critical mass, which allows us to improve economies of scale through spreading our fixed costs over more customers – this cost efficiency should enable us to reduce the size of future rate increases."

For the time in question US inflation rose at a compound annual growth rate of 3.8% as shown in the following chart:

Year: 2018	2019	2020	2021	2022	2023
Nominal Value of $100	101.81	103.0623	107.9062	116.5387	120.501

CAGR Inflation	3.80%

Unfortunately for customers, while earnings per share grew faster than the rate of inflation, so did the cost of water. Where is the savings from consolidation and scale?

Water Rates

Aqua Rate Zone 1 Main Division

	Fixed 5/8" Meter	First 2000 Gal.	Over 2000 Gal.
2019	18	10.64	12.608
2020	18	10.64	12.608
2021	18	10.64	12.608
2022	20.51	13.05	15.451
2023	20.51	13.05	15.451
2024	20.51	13.05	15.451
Proposed 2024 Rates (2024p)	23.9	17.34	20.54
Proposed increase percentage	16.53%	32.87%	32.94%
CAGR (2020 – 2024)	2.65%	4.17%	4.15%
CAGR (2021-2024p) Rate Increase	5.83%	10.26%	10.25%

With the rate of inflation now dropping, the rate increases requested by Aqua would seem to be excessive. There is little evidence that Aqua is providing customers with any rate relief, as they proposed in their 2020 annual report. In fact, it seems that all cost efficiency has accrued to the shareholders of the parent company.

Aqua Rate request and risk sharing

Aqua continues to pursue a growth strategy and plans to increase its capital expenditures to address tightened regulation of PFAS and other chemicals in the water supply. The current rate increase request shows 100% of the capital cost being borne by customers, even though PFAS litigation is ongoing. By requiring the customers to bear 100% of the burden for meeting quality requirements, the company is disincentivized to push for the best settlement possible, as all costs are already covered. Shareholders should share the regulatory risk with customers, as in most unregulated industries, and not receive an extra return on their investment due to increased regulatory expense required to deliver a quality product or service. Cost recovery is not unreasonable for more stringent quality requirements, but it should be repaid in arrears, after improvements are made, and potential legal expense recoveries are completed.

Even the acceleration of water system improvements should not be included in the water rates. System life, incorporated into water rates when the initial capital investment is made, is predicated on sound engineering, management and maintenance practices. Retiring working assets prior to their expected life means that customers have paid for some inefficiency, unless the replacements drive down costs, in which case no rate increase would be needed. Rather, that cost and risk should be borne by the shareholders, who can influence the management of the company.

Limit increases to water rates to reflect expected inflation

A fair return to shareholders, cost of operations, and debt service are already included in the water rates being charged to Aqua Pennsylvania's customers. This has been the case since 2019, and prior to Essential Utilities acquiring additional wastewater systems and a natural gas company. Since meeting current clean drinking water regulations has also been a historic requirement for a regulated water utility, this expense was also incorporated into the rates, even as the requirements have changed over time. It therefore seems reasonable for water rates to rise, but only as fast as actual inflation for the time periods that are known and for the expected inflation for future time periods that the new rates anticipate covering.

One way to estimate expected future inflation is to take Treasury Bill yields for the time in question. Using three years as a rate's expected life, a three-year t-bill rate would be an appropriate inflation factor to apply. As of 8/1/2024 the three-year t-bill yield is roughly 4%.

Taking the 2019 Water Rates, and adjusting them to reflect actual inflation through 2023, and then adding 4% compounded annually to them would provide a water rate that reflects no change in the risk associated with the company, while allowing for the additional nominal expenses and shareholder returns to account for inflation.

This would imply a rate increase as shown below: (Aqua PA proposed rates shown for comparison)

	Fixed 5/8" Meter	First 2000 Gallons	Over 2000 Gal.
2019 Rates	18.00	10.64	12.61
2024 Rates Reflecting actual inflation	21.69	12.82	15.19
2027 Rates reflecting 4% growth/year	24.40	14.42	17.09
Proposed Aqua PA Rates	23.90	17.34	20.54

It seems unfair to consumers of Aqua Pennsylvania water to pay for expensive acquisitions made by the company by including an unlimited amount of goodwill in the rate calculation and shifting wastewater expenses to water customers. In addition, the company's increasing cost of capital, reflecting greater risk being taken by the parent company engaging in entirely new business lines should not be borne by the water customers either.

Water customers should pay a fair price for clean reliable water, and not a penny more. Since the regulated provision of water should not have materially changed since 2019, the rates should simply reflect the nominal increase in costs, and provide for the same nominal, but not real increase in profits and shareholder returns, as shown as the 2027 rates in the chart above.

Conclusion:

The Aqua rate increase should be adjusted downward to better reflect a stand-alone water business. Real return for a regulated water utility should be roughly constant over time since the risk profile of said business has not changed.

Further, water customers should not be required to subsidize wastewater customers, as currently proposed. This creates an incentive for smaller municipalities to not maintain their systems, and then sell them for above market rates to the larger utilities, which in-turn increase their capital base, and earnings, at the expense of customers who never benefited from artificially low wastewater treatment rates. This amounts to income redistribution in favor of irresponsible municipalities that failed to care for their systems.

Therefore, Aqua Pennsylvania's water rate increase should be limited to $24.40 for a fixed 5/8" residential water meter, plus $14.42 for the first 2000 gallons of water a month, and $17.09 for each additional 1000 gallons of water used per month.