



COMMONWEALTH OF PENNSYLVANIA  
PENNSYLVANIA PUBLIC UTILITY COMMISSION  
P.O. BOX 3265, HARRISBURG, PA 17105-3265

P 0096/036

IN REPLY PLEASE  
REFER TO OUR FILE

April 11, 1996

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APR 15 1996

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Mr. Eugene M. Fontana  
1803 Black Rock Lane  
Paoli, PA 19301

Dear Mr. Fontana:

Thank you for your April 4 letter to the Chairman concerning the application of the Philadelphia Suburban Water Company for a Distribution System Improvement Charge (DSIC).

This matter is now pending before the Public Utility Commission and we are precluded by statute from commenting on the merits of the issues raised in your letter. I can tell you that I anticipate this filing will be contested by both the Office of Consumer Advocate and the Office of Trial Staff.

I have forwarded a copy of your letter to the official file on the proceeding.

If I can be of any further assistance, please let me know.

Sincerely,

Kevin F. Cadden, Director  
Bureau of Public Liaison

BTL

cc: Secretary's Bureau ✓

**DOCUMENT  
FOLDER**



OFFICE OF CONSUMER ADVOCATE  
1425 Strawberry Square  
Harrisburg, Pennsylvania 17120

IRWIN A. POPOWSKY  
Consumer Advocate

(717) 783-5048

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April 15, 1996

John Alford, Secretary  
North Office Building, P.O. Box 3265  
Public Utility Commission  
Harrisburg PA 17105-3265

Re: Petition of Philadelphia Suburban Water Co.  
for Approval To Implement A Tariff  
Supplement Establishing A Distribution  
System Improvement Charge, Docket  
No. P-00961036.

Dear Secretary Alford:

Enclosed please find a copy of the Office of Consumer Advocate's (OCA) Notice of Intervention and Public Statement in the above-referenced proceeding.

The OCA will be filing a detailed response to the above-referenced Petition on or before May 6, 1996, the date established for responses in the Pennsylvania Bulletin Notice published April 6, 1996.

Sincerely,

Dianne E. Dusman  
Assistant Consumer Advocate

Enc.

cc: Robert Frazier, Prothonotary  
Susan T. Povilaitis, Law Bureau  
Office of Special Assistants  
Parties of Record

DOCUMENT  
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CERTIFICATE OF SERVICE

Re: Petition of Philadelphia Suburban Water Company For Approval to Implement A  
Tariff Supplement Establishing a Distribution System Improvement Charge  
Docket No. P-00961036

I hereby certify that I have this day served a true copy of the Office Of  
Consumer Advocate's Notice of Intervention, 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:

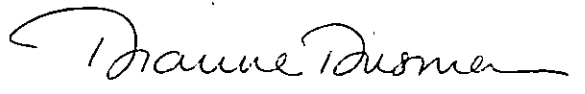
Dated this 15th day of April, 1996. SERVICE BY U.S. MAIL

Thomas P. Gadsden, Esq.  
Morgan, Lewis & Bockius  
2000 One Logan Square  
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Bernard A. Ryan, Jr., Esq.  
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Carol Pennington  
Office of Trial Staff  
PA Public Utility Commission  
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Harrisburg, PA 17120

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Dianne Dusman  
Assistant Consumer Advocates  
Counsel for:  
Office of Consumer Advocate  
1425 Strawberry Square  
Harrisburg, PA 17120  
(717) 783-5048

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Re: Petition of Philadelphia Suburban Water :  
Water Company for Approval To :  
Implement A Tariff Supplement : Docket No. P-00961036  
Establishing a Distribution System :  
Improvement Charge :

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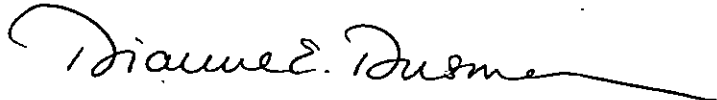
NOTICE OF INTERVENTION

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Pursuant to 52 Pa. Code §§ 5.71-5.74, the Office of Consumer Advocate hereby files this Notice of Intervention in the above-captioned proceeding. A copy of all correspondence, notices, documents, orders or other communications concerning the above-captioned proceeding should be addressed as follows:

Dianne E. Dusman  
Assistance Consumer Advocate  
Office of Consumer Advocate  
1425 Strawberry Square  
Harrisburg PA 17120

Respectfully submitted,



Dianne E. Dusman  
Assistant Consumer Advocate

Counsel for:  
Irwin A. Popowsky  
Consumer Advocate

Office of Consumer Advocate  
1425 Strawberry Square  
Harrisburg, PA 17120  
(717) 783-5048  
Dated: April 15, 1996

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PUBLIC STATEMENT OF THE CONSUMER ADVOCATE ISSUED IN  
ACCORDANCE WITH 71 P.S. SECTION 309-1

Act 161 of the Pennsylvania General Assembly, 71 P.S. § 309-2, as enacted July 9, 1976, authorizes the Consumer Advocate (OCA) to represent the interests of consumers before the Pennsylvania Public Utility Commission (PUC or Commission). In accordance with Act 161, the Consumer Advocate decided to intervene and participate in proceedings before the Commission involving the Petition of Philadelphia Suburban Water Company (PSWC) For Approval To Implement A Tariff Supplement Establishing A Distribution System Improvement Charge (Petition), Docket No. P-00961036.

Notice of this Petition was published in the Pennsylvania Bulletin on April 6, 1996, establishing a deadline of May 6, 1996 for responses by interested parties. The OCA will be submitting a detailed response to the PUC on or before that date.

The Petition seeks revenues for accelerated infrastructure improvements and company investment in main replacements between base rate proceedings. This revenue would be collected through a quarterly surcharge pursuant to Section 1307(a) of the Public Utility Code, 66 Pa.C.S. § 1307(a). The surcharge is projected to be 0.5% of non-public fire customer bills as of July 1, 1996, the requested effective date, but could increase to as much as 5%.

Rate recovery of expense related to utility plant is routinely considered in base rate proceedings, in which all changes in expenses are considered simultaneously. Use of Section 1307(a) of the Code has generally been limited to unique non-plant costs and those not within the control of utility management. Thus, this surcharge proposal departs from established ratemaking principles in Pennsylvania and the OCA does not believe its implementation is in the interest of ratepayers. The Company's request raises a variety of legal and factual issues which should be

explored in advance of Commission deliberation on this Petition.

For these reasons, the Consumer Advocate deemed it necessary to intervene in this proceeding and to fully participate in order to protect the interests of PAWC's ratepayers.

2000 One Logan Square  
Philadelphia, PA 19103-6993  
215-963-5000  
Fax: 215-963-5299

Morgan, Lewis  
& Bockius LLP  
COUNSELORS AT LAW

April 22, 1996

**VIA HAND DELIVERY**

Mr. John G. Alford, Secretary  
Pennsylvania Public Utility Commission  
New Filing Section, Room B-18  
North Office Building  
Commonwealth and North Streets  
P.O. Box 3265  
Harrisburg, PA 17120

RECEIVED  
96 APR 22 PM 4:18  
PA. P.U.C.  
INFO. CONTROL DIV.

Re: Petition of Philadelphia Suburban Water Company  
For Approval To Implement A Tariff Supplement  
Establishing A Distribution System Improvement Charge  
Pa. P.U.C. Docket No. P-00961036

Dear Secretary Alford:

Enclosed for filing in the above-captioned matter are an original and two (2) copies of Philadelphia Suburban Water Company's ("PSWC" or the "Company") Reply To The Answer Of The Office Of Trial Staff. Additional copies of this letter and the Company's Reply are enclosed, which we ask that you date-stamp and return as evidence of filing.

Copies of the Company's Reply have been served upon the Office of Trial Staff and the other persons indicated on the attached Certificate of Service.

Very truly yours,

*Thomas P. Gadsden*

Thomas P. Gadsden

TPG/lms

Encl.

cc: Per Certificate of Service

DOCUMENT  
FOLDER

BTL

ORIGINAL

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

RE: PETITION OF PHILADELPHIA SUBURBAN :  
WATER COMPANY FOR APPROVAL TO :  
IMPLEMENT A TARIFF SUPPLEMENT : Docket No. P-00961036  
ESTABLISHING A DISTRIBUTION :  
SYSTEM IMPROVEMENT CHARGE :

PHILADELPHIA SUBURBAN WATER COMPANY'S  
REPLY TO THE  
ANSWER OF THE OFFICE OF TRIAL STAFF

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96 APR 22 PM 4:18  
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INFO. CONTROL

Pursuant to 52 Pa. Code §§ 1.56(b) and 5.61-5.63,  
Philadelphia Suburban Water Company ("PSWC" or the "Company")  
hereby replies to the Answer of the Office of Trial Staff ("OTS")  
in the above-captioned matter.

INTRODUCTION

On March 20, 1996, PSWC filed the above-captioned Petition  
("Petition") requesting the Commission's approval to implement a  
Distribution System Improvement Charge ("DSIC") pursuant to  
Section 1307(a) of the Public Utility Code (66 Pa.C.S. §  
1307(a)). The DSIC would recover the fixed costs (depreciation  
and pre-tax return) of certain non-revenue producing, non-expense  
reducing distribution system improvement projects completed and  
placed in service between base rate cases. A complete  
explanation of the DSIC and the reasons why such a charge is  
necessary and proper for PSWC are set forth in the Petition.

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On April 9, 1996, the OTS filed an Answer opposing the Petition. In its Answer, the OTS has raised objections to the DSIC that it characterizes as "legal" and "technical." As fully explained below, none of the objections raised by the OTS is a valid basis for denying the Petition.

#### THE OTS'S "LEGAL" OBJECTIONS

The OTS contends that Section 1307 does not grant the Commission authority to approve an adjustment clause to recover the fixed costs of utility plant in service. In support of this interpretation, the OTS relies exclusively upon a single sentence from the Commonwealth Court's opinion in Pennsylvania Industrial Energy Coalition v. Pa. P.U.C., 653 A.2d 1336, 1347 (Pa. Cmwlth. 1995) (hereafter, "PIEC"). In that case, the appellant challenged, inter alia, the Commission's approval of a Section 1307 adjustment clause for recovery of electric utilities' costs to design and implement demand side management ("DSM") programs. Significantly, the Court affirmed the Commission's Order on that issue, finding that Section 1307 granted the Commission discretion to authorize the use of adjustment clauses to recover a wide variety of costs including the costs of "financing" DSM programs. 653 A.2d at 1349. For that reason, among others, the sentence the OTS has extracted from PIEC clearly should not be viewed as a per se prohibition against the use of a Section 1307 clause to recover the fixed costs of utility plant in service.

Section 1307(a) grants the Commission broad authority to approve adjustment clauses for the recovery of costs, subject to certain procedural safeguards:

Any public utility . . . may establish a sliding scale of rates or such other method for the automatic adjustment of rates of the public utility as shall provide a just and reasonable return on the rate base of such public utility, to be determined upon such equitable or reasonable basis as shall provide such fair return . . .

As evident from the language of Section 1307(a), the General Assembly did not impose any restrictions on the kinds of costs that could be recovered thereunder. In fact, in PIEC, the Commonwealth Court expressly rejected the appellant's argument that adjustment clauses should be restricted to the recovery of certain narrow categories of costs, such as fuel expenses and taxes:

Although we agree that Section 1307 should have limited application and the PUC should not use it to disassemble the traditional rate-making process, the General Assembly did not limit the allowance of automatic adjustment to only fuel costs and taxes which are generally beyond the control of the utility. Instead, the General Assembly specifically allowed the recovery of fuel costs and also allowed the PUC or the utilities to initiate the automatic adjustment of costs within specific procedures.

653 A.2d at 1349.

Significantly, in PIEC, the issue of whether the fixed costs of plant in service could be recovered under Section 1307 was not

presented, because all of the challenged costs were operating and maintenance or administrative expenses. See 653 A.2d at 1347. In fact, the single sentence from PIEC that the OTS gives paramount importance actually appears in the Court's discussion of Section 1315.<sup>1/</sup> Specifically, the appellant contended that recovery of DSM expenses under a Section 1307 clause would violate Section 1315 because those expenses could be recovered before they were "used and useful." See 653 A.2d at 1346. The Court stated that because Section 1315 and the "used and useful" concept apply only to "rate base" and not to expenses, the DSM expenses at issue in PIEC were not subject to a challenge under that section. This is the Court's holding, and nothing else said

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<sup>1/</sup> Section 1315 provides, in pertinent part, as follows:

Except for such nonrevenue producing, nonexpense reducing investments as may be reasonably shown to be necessary to improve environmental conditions at existing facilities . . . the cost of construction or expansion of a facility undertaken by a public utility producing, generating, transmitting, distributing or furnishing electricity shall not be made a part of the rate base nor otherwise included in the rates charged by the electric utility until such time as the facility is used and useful in service to the public. Except as stated in this section, no electric utility property shall be deemed used and useful until it is presently providing actual utility service to the customers.

Although Section 1315 is expressly applicable only to electric utilities, subsequent Commission decisions have applied the principles contained therein to all fixed utilities. See Final Policy Statement Re Ratemaking Treatment Of Construction Work In Progress (CWIP), Docket No. M-00930497 (January 19, 1995) (Order, p. 4).

by the Court was necessary for the resolution of this issue. However, the Court went on to add the sentence relied upon by the OTS, which is clearly discernible as dicta, when viewed in context:

As to the Industrial Coalition's argument that the costs are not related to used and useful expenses, Section 1315 expressly applies only to determine when the costs of construction or expansion of facilities may be included in the rate base. (Citations omitted.) Section 1315 is only applicable to the extent that DSM programs costs relate to physical facilities and is not relevant to determine whether the cost recovery methods approved by the PUC are violative of the Code. Because new physical facilities are appropriate costs only within the rate base under Section 1315, in the unlikely event that DSM programs require new physical facilities, those costs should be raised in a base rate case only, subject to the restrictions of Section 1315, and not through the surcharge mechanism.

653 A.2d at 1347.

From the portion of the PIEC opinion set forth above, it is clear that the focus of the Court's concern was whether the DSM adjustment clause would result in an electric utility recovering the costs of "physical facilities" before those facilities were "used and useful." PSWC was keenly aware of this issue and, chiefly for that reason, designed the DSIC to reflect the fixed costs of only those eligible plant additions that are actually placed in service "during the three-month periods ending one month prior to the effective date of each DSIC update." Petition, ¶ 33 at p. 23. Accordingly, the issue that

precipitated the Court's discussion of Section 1315 in PIEC could not arise with respect to the DSIC.

Additionally, and perhaps most importantly, the OTS has ignored this Commission's prior decisions approving the use of Section 1307 adjustment clauses to recover fixed costs associated with other utility plant investments, such as up-grades to coal-fired generating units<sup>2/</sup>, principal and interest on PennVest obligations<sup>3/</sup> and gas company costs "related to new facilities to implement restructuring brought about by FERC Order 636."<sup>4/</sup>

The OTS's position is completely contrary to the Commission's own, prior interpretation of Section 1307, as reflected in the decisions noted above. As Pennsylvania's Appellate Courts have repeatedly held, an agency's own interpretation of the statutes it administers is a legitimate and important indication of legislative intent and is entitled to

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<sup>2/</sup> 52 Pa. Code § 57.124. This provision was expressly approved in Investigation Into Demand Side Management By Electric Utilities: UNIFORM COST RECOVERY MECHANISM, 127 PUR4th 516, 522 (1991). See also Petition, ¶ 28 at pp. 19-20.

<sup>3/</sup> 52 Pa. Code § 69.363. See also Petition, ¶ 29 at p. 21. The interest on a PennVest obligation is the utility's capital cost associated with the plant funded by that loan. In addition, the principal payments on such obligations are also a fixed cost of utility plant, and their recovery under a Section 1307 clause represents a return of capital to the utility. In that respect, such principal payments are the same as the depreciation component of the fixed costs claimed for recovery under the DSIC.

<sup>4/</sup> 52 Pa. Code § 69.341(b)(4). See also Petition, ¶ 29 at p. 21.

"great weight."<sup>5/</sup> Under these circumstances, the OTS' reliance upon dicta from PIEC to reverse the Commission's own, well-founded interpretation of Section 1307 is unwarranted and unavailing.

Finally, the OTS's discussion of this Commission's decision in Re West Penn Power Co., 76 Pa. P.U.C. 183 (1992) requires a response. The OTS contends that West Penn has no bearing on the interpretation of Section 1307 because the Commission stated in that case that its decision "is principally related to the record evidence." However, that does not change the fact that the Commission did not accept the position, advanced by parties opposed to West Penn's proposal, that the Commission is legally prohibited from approving a Section 1307 clause to recover capital costs. And, as we know, this Commission has approved the use of Section 1307 clauses for such purposes in other contexts, as discussed above.

#### THE OTS'S "TECHNICAL" OBJECTIONS

The OTS has raised three "technical" objections to the Company's proposal (OTS Answer, pp. 3-6). Each objection is based upon the OTS's misperception or misunderstanding of the

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<sup>5/</sup> Chappell v. Pa. P.U.C., 57 Pa. Cmwlt. 17, 425 A.2d 873, 875-76 (1981). Accord Carol Lines, Inc. v. Pa. P.U.C., 83 Pa. Cmwlt. 393, 477 A.2d 601 (1984); Spicer v. Dept. of Public Welfare, 58 Pa. Cmwlt. 558, 428 A.2d 1608 (1981). See also Section 1921(c)(8) of the Statutory Construction Act, 1 Pa.C.S. § 1921(c)(8).

relevant facts or is incorrect in other fundamental respects, as explained below.

Reduction in maintenance and unaccounted-for water expense.

The OTS takes issue with the Company's general characterization of DSIC-eligible projects as "non-expense reducing" and specifically asserts as follows:

It is difficult to understand how the replacement of aging water distribution infrastructure could be non-expense reducing. OTS would expect that certain expenses, such as maintenance and unaccounted-for-water, would be reduced by these replacement projects.

OTS Answer, p. 3.

If PSWC were to replace all or substantially all of its distribution system tomorrow, one might justifiably expect to see a measurable impact on maintenance and unaccounted-for water expense. However, that is not going to happen overnight. Indeed, until the company is able to triple its current main replacement efforts, the average age of PSWC's distribution system would essentially remain the same. The best that can be said, therefore, is that approval of the DSIC might help the Company to stabilize and/or mitigate the rate of growth in these cost categories.

Two-year time horizon -- Commission's prior equity cost rate determination. The Petition provides that the equity return rate to be used in determining the Company's fixed costs for purposes of the DSIC will be:

. . . the equity return rate approved in the Company's last fully-litigated base rate proceeding for which a final order was entered not more than two years prior to the effective date of the DSIC.

If more than two years shall have elapsed between the entry of such a final order and the effective date of the DSIC update, then the equity return rate used in the calculation will be the equity return rate approved by the Commission in a final order entered at the conclusion of the most recent fully litigated proceeding for an investor-owned water utility having annual revenues in excess of \$10.0 million.

The OTS disagrees with this provision because "it is conceivable that the Company would achieve a two year old cost rate for common equity." The OTS objects to the use of a two-year time horizon because the DSIC: (1) " would fail to reflect any changes which might have occurred in the capital markets;" (2) provides no mechanism to account for "changes the Company might experience in its capital structure;" and (3) has no provision to account for the "reduction to the cost of common equity to reflect the lower risk of guaranteed recovery." OTS Answer, p. 4. None of these objections is valid and certainly none represents a fatal defect to the Company's proposal.

First, as should be obvious, "changes" in the "capital markets" are equally likely to yield equity return rates that are higher than the equity return awarded in a prior rate case. At the same time, it is unlikely that any dramatic changes would materialize during a two-year time frame. Indeed, the Commission

typically approves an equity return rate for utilities based on projections of the equity cost rates likely to prevail during the first year that new base rates will be in effect. Moreover, if a marked change -- either up or down -- were to occur, nothing would prohibit the Commission, on its own motion or upon the motion of any interested party, from ordering a change in the way the equity return component of the DSIC is determined. Simply to speculate that such a dramatic reduction in equity costs might occur, as the OTS has done, is no reason to find fault with the Company's proposal.

Second, the OTS is wrong in contending that the Company's proposal has no provision to account for changes in its capital structure. Rather, the Petition provides that the Company's return will always be the lesser of the return rate approved in its last litigated case or a pro forma calculation based upon:

. . . the Company's actual capital structure and actual cost rates for long-term debt and preferred stock as of the last day of the three-month period ending one month prior to the effective date of the surcharge.

Third, the OTS mischaracterizes the nature of the DSIC when it asserts that the DSIC provides "guaranteed recovery" of the Company's equity return. As addressed in detail below, the DSIC provides for the recovery of the fixed costs of only a portion of the Company's total annual plant additions. Moreover, the vast majority of the Company's fixed costs and expenses are unaffected by the DSIC, and the Company's risk of underrecovery of those

costs and expenses will continue even after the implementation of the DSIC.

"Guaranteed" Recovery. The OTS contends that the DSIC is a ratemaking method "greatly biased towards the Company" because it "[guarantees] that which [the Company] has never been guaranteed before." The OTS also characterizes the DSIC as "[guaranteeing] a dollar for dollar return without sufficient current justification of costs." OTS Answer, p. 5. None of these contentions is accurate.

First, it must be emphasized that the DSIC would provide for recovery of only a portion of the Company's total plant additions. For example, for calendar year 1996, the Company projects that, of total plant additions of approximately \$29.8 million, approximately \$14.4 million would be DSIC-eligible. As to property that is not eligible for DSIC recovery, the Company would continue to face the risk of underrecovery or non-recovery of fixed costs.

Second, in the Company's last rate case, the Company claimed a rate base of approximately \$382 million. As to the associated fixed costs of that plant, which are reflected in base rates, PSWC continues to be at risk of underrecovery based on the interplay of all of the factors that affect the margin between the Company's revenue and net income.

Third, the DSIC does not absolve the Company from the need to "justify its expenses." Other than depreciation expenses for new DSIC-eligible property, the DSIC would not apply to any of the Company's operating and maintenance expenses, which are -- and will remain -- elements of the Company's base rates. As a consequence, P<sup>S</sup>WC would need to seek a base rate increase to recover any increases in those expenses. The DSIC would not eliminate or reduce the requirement that the Company fully "justify its expenses" in the context of such a rate case.

Finally, the OTS errs in stating that the Commission's approval of the DSIC could "open the floodgates" with requests for adjustment clauses "to circumvent rate case scrutiny." As is evident from the Petition, the DSIC is designed to deal with a serious and unique problem faced by water utilities today. The Commission, in the exercise of its permissible discretion, is certainly capable of making distinctions between reasonable requests to establish adjustment clauses to deal with such problems -- such as the DSIC -- and other requests that do not have such a compelling justification.

Additionally, approval of the DSIC would in no way allow the Company to "circumvent rate case scrutiny" of the costs claimed for recovery. Under Section 1307 and the Commission's practices and procedures, there will be ample opportunity to review all of the costs claimed for recovery under the DSIC. Indeed, the end-of-period review and reconciliation procedures, periodic audits

and availability of complaint proceedings in all likelihood will result in a far greater degree of scrutiny of DSIC-eligible projects than they would receive within the time constraints of a Section 1308 base rate proceeding.

CONCLUSION

THEREFORE, for the reasons set forth above and in the PSWC's Petition, the Company's request to establish a DSIC should be granted.

Respectfully submitted,

Thomas P. Gadsden

Thomas P. Gadsden  
Anthony C. DeCusatis  
Morgan, Lewis & Bockius LLP  
2000 One Logan Square  
Philadelphia, PA 19103  
(215) 963-5234

Counsel for Philadelphia  
Suburban Water Company

OF COUNSEL:

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2000 One Logan Square  
Philadelphia, PA 19103  
(215) 963-5234

DATED: April 22, 1996

BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

RE: PETITION OF PHILADELPHIA SUBURBAN :  
WATER COMPANY FOR APPROVAL TO :  
IMPLEMENT A TARIFF SUPPLEMENT : Docket No. P-00961036  
ESTABLISHING A DISTRIBUTION :  
SYSTEM IMPROVEMENT CHARGE :

CERTIFICATE OF SERVICE

I hereby certify that I have, this day, served a true and correct copy of the aforementioned Reply upon the persons and in the manner indicated below:

BY HAND DELIVERY

Dianne E. Dusman, Esq.  
Office of Consumer Advocate  
1425 Strawberry Square  
Harrisburg, PA 17120

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Pennsylvania Public Utility  
Commission  
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DATED: April 22, 1996

Thomas P. Gadsden  
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Anthony C. DeCusatis  
Counsel for Philadelphia  
Suburban Water Company