



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

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JOHN G. ALFORD, SECRETARY
PA PUBLIC UTILITY COMMISSION
P. O. BOX 3265
HARRISBURG, PA 17105-3265

Re: Petition of Philadelphia Suburban Water
Company For Approval To Implement A
Tariff Supplement Establishing A
Distribution System Improvement Charge
Docket No. R-00963597

KJR

Dear Secretary, Alford:

Enclosed please find for filing an original and three (3) copies of **The Office of Trial Staff's Answer to Petition** in the above-referenced proceeding.

Sincerely,

Carol F. Pennington
Prosecutor
Office of Trial Staff

CFP:sjh

- cc: Chairman Quain
- Vice-Chairman Crutchfield
- Commissioner Rolka
- Commissioner Hanger
- Commissioner Bloom
- Cheryl Walker-Davis
- John Povilaitis
- Bernard A. Ryan, Jr.
- Irwin A. Popowsky

ORIGINAL
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NUMBER

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

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96 APR 10 AM 11:26

RE: PETITION OF PHILADELPHIA :
SUBURBAN WATER COMPANY :
FOR APPROVAL TO IMPLEMENT : Docket No. R-00963597
A TARIFF SUPPLEMENT :
ESTABLISHING A DISTRIBUTION :
SYSTEM IMPROVEMENT CHARGE :

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

On March 20, 1996, Philadelphia Suburban Water Company ("PSWC"), or ("Company") filed a Petition to implement a tariff supplement designed to establish a Distribution System Improvement Charge ("DSIC") pursuant to 66 Pa. C.S. Section 1307(a). The Company proposes to implement this charge for service rendered on and after July 1, 1996. The Office of Trial Staff's ("OTS") Answer to PSWC's Petition is filed pursuant to 52 Pa. Code §5.61. OTS respectfully opposes the proposed DSIC and recommends that the Commission deny the Company's Petition for the reasons set forth below.

DOCKETED

APR 10 1996

INTRODUCTION

DOCUMENT
FOLDER

PSWC is requesting the Commission's approval to establish the
Distribution System Improvement Charge for the purposes of recovering the fixed

costs of certain non-revenue producing, non-expense reducing distribution system improvement projects completed and placed in service between base rate cases.

According to the Company, the DSIC is designed to provide the Company with the resources it needs to accelerate its investment in new utility plant to replace aging water distribution systems. The Company states in this Petition that it must find a way to significantly increase the rate at which it will make improvements to its distribution system in order to prevent the degradation of water quality and reliability and to avoid deferring needed improvements. PSWC Petition, pp. 2-3.

The PSWC proposes that the DSIC become effective for bills rendered on and after July 1, 1996. Accordingly, the charge will be calculated to recover the fixed costs of eligible plant additions that have not previously been reflected in the Company's rate base and will have been placed in service between January 1, 1996 and May 31, 1996. Thereafter, the DSIC would be updated on a quarterly basis to reflect eligible plant additions placed in service during the three (3) month periods ending one month prior to the effective date of each DSIC update. PSWC Petition, pp. 3-4.

The Company proposes a 5% cap on the amount billed to customers under otherwise applicable rates and charges. When the cap is reached, no further increases in the DSIC would be permitted. Additionally, the DSIC would be subject to an annual reconciliation. PSWC Petition, pp. 4-5.

It is PSWC's position that the DSIC is needed so that the Company may

make system improvements at a more rapid pace than traditional base rate filings will permit. According to the Company, it has 3,180 miles of mains and it is currently rehabilitating approximately 15 miles of mains each year. At its current rate, total rehabilitation will require approximately 212 years which is substantially more than the average 66 year remaining life of these facilities. PSWC Petition, pp. 2-3.

The Company proposes to exclude from the DSIC those amounts billed for public fire protection service and the STAS, as projected for the prospective quarterly application period. PSWC Petition, p. 4.

After carefully reviewing PSWC's Petition, it is OTS's position that the Commission should deny the Company's Petition to implement the proposed Distribution System Improvement Charge. OTS's objections are based both on technical as well as legal grounds.

TECHNICAL OBJECTIONS

PSWC claims that the fixed costs to be collected through the DSIC would relate to ". . . certain non-revenue producing, non-expense reducing infrastructure rehabilitation projects. . ." See PSWC Petition, pp. 1-2. 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.

In its Petition, PSWC recommends that the Commission accept the cost rate of common equity in the Company's last fully litigated base rate proceeding if the

final order in such proceeding was entered not more than two years prior to the effective date of the DSIC. If, on the other hand, more than two years have elapsed between the entry of the final order and the effective date of the DSIC, the equity return rate which PSWC would use in the calculation of the DSIC would 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 \$10,000,000. PSWC Petition, pp. 24-25.

Under the Company's proposal, it is conceivable that the Company would achieve a two year old cost rate for common equity. OTS contends that this is clearly not in the public interest. To allow the possibility of the Company's effectuating a cost rate for common equity based on a rate case decided up to two years prior is certainly inappropriate since this rate would fail to reflect any changes which might have occurred in the capital markets. The DSIC fails to account for such changes in common equity rates as well as changes the Company might experience in its capital structure. Moreover, there is no reduction to the cost of common equity to reflect the lower risk of guaranteed recovery of these costs through the DSIC.

OTS submits that the Company would gain a greater advantage through the DSIC than it could achieve in a base rate proceeding. In a base rate proceeding the Company would be afforded the "opportunity" to recover its costs. In the instant Petition the Company is proposing dollar for dollar recovery of certain capital investments through the DSIC. OTS contends that there is no precedent for this

automatic recovery of plant additions which, in effect, guarantees a return on investment. This Commission has never guaranteed dollar for dollar recovery on plant investment. What this Commission has done is to provide a public utility the opportunity to recover its costs. OTS believes that PSWC's Petition is contrary to precedent and to the public interest because it seeks a guaranteed recovery which would serve to discourage the Company from operating in the most efficient and cost effective manner.

While Philadelphia Suburban refers to this Petition as innovative alternative ratemaking, OTS submits that, in reality, this is simply a variation on standard rate base/rate of return ratemaking which is greatly biased towards the Company. The DSIC would guarantee that which has never been guaranteed before by the Commission. This surcharge does not provide for the sharing of the risk/reward associated with alternative ratemaking. OTS submits that it is not in the public's best interest to guarantee a dollar for dollar return without sufficient current justification of costs by the Company.

Granting PSWC's Petition might also open the floodgates with requests for other surcharges and pass-throughs designed to circumvent rate case scrutiny. If the Commission allows this or any other company to entertain the possibility that rate case review and procedures can be avoided, it may well be lifting the lid on Pandora's Box. If utilities are permitted to surcharge for any and all types of costs, the Commonwealth's ratepayers would soon be subject to dollar for dollar ratemaking.

LEGAL OBJECTIONS

It is OTS's position that PSWC's proposed DSIC is not legally permissible under Section 1307(a) of the Public Utility Commission Code. 66 Pa. C.S. §1307(a). OTS contends that applicable case law prohibits the implementation of the proposed surcharge.

In an attempt to justify the legality of the Company's proposed DSIC, PSWC quotes that part of Section 1307(a) which provides that the Commission may establish a sliding scale of rates in certain instances. The Company also cites two cases which it interprets as supportive of its position.

In its Petition PSWC cites Re West Penn Power Company, 76 Pa. P.U.C. 183 (1992) ("West Penn"). According to the Company, in that case the Commission rejected efforts to restrict the use of a Section 1307(a) adjustment clause. The logical conclusion from the Company's analysis is that this case supports the legality of the proposed DSIC. OTS disagrees.

In the West Penn case, West Penn Power requested approval of a surcharge designed to recover, inter alia, taxes, depreciation and return on expenditures for certain Phase I/ Clean Air Act Amendments of 1990 compliance projects. The Administrative Law Judge recommended that the Commission deny West Penn's request on the grounds that Section 1307 does not authorize the surcharge for the purpose of a return on rate base. In its Petition, PSWC would have one

believe that the Commission specifically rejected the ALJ's reasoning. However, this is simply not the case. In the West Penn case at page 203, the Commission does not reject the ALJ's reasoning; it simply refuses to make a legal interpretation in that case. In fact, the Commission specifically states that:

Our decision is principally related to the record evidence, however, and not based on a legal interpretation of the Pennsylvania Public Utility Code.

See West Penn 76 Pa. P.U.C. at 203.

This excerpt from the West Penn decision clearly illustrates that the Commission rejected the surcharge without reaching the legal question of whether the Public Utility Code permits the implementation of such a surcharge. This decision can in no way be interpreted as supporting PSWC's position on this issue.

The Company also cites Investigation Into Demand Side Management by Electric Utilities: Uniform Cost Recovery Mechanism, 127 PUR 4th 516 (1991) "DSM Order". According to PSWC, this case supports the Company's position because it held that Section 1307(a) is not so restrictive and it may lawfully be used to recover a variety of costs, including rate of return on and of utility investments in Demand Side Management measures and improvements designed to upgrade coal fired generating units.

OTS submits that the Company's use and interpretation of the DSM Order is, to say the least, somewhat misleading. While it is true that the Commission

held that §1307(a) may be used to recover a variety of costs, what the Company fails to mention in its Petition is that on appeal Commonwealth Court stated that:

Because new 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 rate base case only subject to the restrictions of Section 1315, and not through the surcharge mechanism. [Emphasis added.]

See Pennsylvania Industrial Energy Coalition v. Pa. P.U.C. 65 A.2d 1336 (1995).

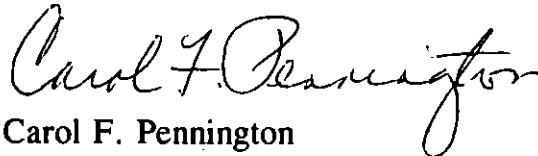
OTS submits that this language is directly on point. Philadelphia Suburban is attempting to put new physical plant into rate base through a surcharge, thus, circumventing a rate base case. Although the Commission held that Section 1307(a) may permit some costs to be recovered through a surcharge, and Commonwealth Court agreed, neither the Commission nor the Court identified these allowable costs. However, the Commonwealth Court did specify costs which cannot legally be recovered through a surcharge mechanism. Specifically, the Court stated that claims for new physical plant can be raised only in a rate base case and not through a surcharge mechanism. This language is clearly on point and specifically prohibits the implementation of the Company's proposed DSIC.

OTS is mindful of the problem which the Company is attempting to address through the DSIC. However, this problem must be addressed within the parameters of a lawful solution. The DSIC as proposed by Philadelphia Suburban Water Company in its Petition clearly does not meet this requirement.

CONCLUSION

For the reasons set forth above, OTS respectfully recommends that the Commission deny Philadelphia Suburban Water Company's Petition to enter an Order granting the Commission's approval to implement the proposed tariff supplement which establishes a Distribution System Improvement Charge.

Respectfully submitted,



Carol F. Pennington
Prosecutor
Office of Trial Staff

Date: April 9, 1996

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Re: Petition of Philadelphia Suburban :
Water Company For Approval To :
Implement A Tariff Supplement : Docket No. R-00963597
Establishing A Distribution :
System Improvement Charge :

CERTIFICATE OF SERVICE

I hereby certify that I am serving the foregoing, Answer To The Petition
Of Philadelphia Suburban Water Company of the Office of Trial Staff dated April 9,
1996, either personally, by first class mail or by fax upon the persons addressed
below:

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Carol F. Pennington

Carol F. Pennington
Prosecutor
Office of Trial Staff

Dated: April 9, 1996
R-00963597