

COMMONWEALTH OF PENNSYLVANIA



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April 6, 2026

**Via Electronic Filing**

Matthew L. Homsher, 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-2025-3057983 (W)  
R-2025-3058051 (WW)

Dear Secretary Homsher:

Attached for electronic filing please find the Office of Consumer Advocate's Main Brief in the above-referenced proceeding.

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

Respectfully submitted,

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Certificate of Service

CERTIFICATE OF SERVICE

Pennsylvania Public Utility Commission :  
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 v. : Docket Nos. R-2025-3057983 (W)  
 : R-2025-3058051 (WW)  
 Pennsylvania-American Water Company :  
 :

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

Dated this 6th day of April 2026.

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BEFORE THE  
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	Docket Nos.
v.	:	R-2025-3057983 (Water)
	:	R-2025-3058051 (Wastewater)
Pennsylvania-American Water Company	:	

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MAIN BRIEF  
OF THE  
OFFICE OF CONSUMER ADVOCATE

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## **I. INTRODUCTION**

### **A. Procedural History**

On November 14, 2025, Pennsylvania-American Water Company (PAWC or Company) filed its direct case. On November 17, 2025, the OCA filed a Formal Complaint and Public Statement challenging the lawfulness of the proposed rate increase. Current and prospective customers filed approximately 159 formal complaints and 572 informal complaints. There were 12 Public Input Hearings at which hundreds of individuals testified under oath in opposition to PAWC's rate relief request.

On March 23, 2026, the Administrative Law Judges (ALJs) presided over evidentiary hearings and admitted the OCA's written direct, supplemental direct, rebuttal, and surrebuttal testimonies, and accompanying exhibits into the record.

### **B. Legal Standards (Burden of Proof)**

PAWC bears the burden of proof to establish the justness and reasonableness of every element of its requested rate increase:

Reasonableness of rates – In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceedings upon the complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.<sup>1</sup>

The evidence necessary to meet that burden must be substantial, legally credible, and cannot be mere "suspicion" or "scintilla" of evidence.<sup>2</sup>

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<sup>1</sup> 66 Pa. C.S. § 315(a).

<sup>2</sup> *Lower Frederick Twp. Water Co. v. Pa. PUC*, 409 A.2d 505, 507 (Pa. Cmwlth. 1980); *Lansberry v. Pa. PUC*, 578 A.2d 600, 602 (Pa. Cmwlth. 1990) (*Lansberry*).

The party with the burden of proof has a formidable task to show that the Commission may lawfully adopt its position.<sup>3</sup> Even where a party has established a *prima facie* case, the party with the burden must establish that “the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary.”<sup>4</sup> Furthermore, it is well-established that the “degree of proof before administrative tribunals...is satisfied by establishing a preponderance of the evidence.”<sup>5</sup>

The utility’s burden of proof does not shift to parties challenging the rate increase:

It is well-established that in general rate increase proceedings, the burden of proof does not shift to parties challenging a requested rate increase. Rather, the utility’s burden of establishing the justness and reasonableness of every component of its rate request is an affirmative one and that burden remains with the public utility throughout the course of the rate proceeding. It has been held that there is no similar burden placed on other parties to justify a proposed adjustment to the utility’s filing.<sup>6</sup>

In *Berner*, the Pennsylvania Supreme Court stated:

[T]he appellants did not have the burden of proving that the plant additions were improper, unnecessary or too costly; on the contrary, that burden is, by statute, on the utility to demonstrate the reasonable necessity and cost of the installations and that is the burden which the utility patently failed to carry.<sup>7</sup>

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<sup>3</sup> *Burleson v. Pa. PUC*, 461 A.2d 1234, 1236 (Pa. 1983) (*Burleson*).

<sup>4</sup> *Id.*

<sup>5</sup> *Lansberry* at 602.

<sup>6</sup> *Pa. PUC v. Pa. American Water Co.*, 2004 Pa. PUC LEXIS 29 at \*16-18 (Order Jan. 29, 2004) (*PAWC 2004*) citing *Berner v. Pa. PUC*, 116 A.2d 738 (Pa. 1955) (*Berner*).

<sup>7</sup> *Id.* at 744.

The Commission recognizes in its rate determinations that the burden of proof will not shift to a complainant or intervener that is challenging the requested rate increase.<sup>8</sup>

## II. SUMMARY OF ARGUMENT

Overall Position: PAWC's proposed rate increase results in unaffordable rates. PAWC's customers have experienced base rate increases in 2021, 2022, and 2023 resulting from a two-stage rate increase from PAWC's 2020 base rate case, an increase that just took effect in January 2023 from the 2022 rate case, and a rate increase authorized in 2024 because of PAWC most recent base rate case filed in 2023. Since PAWC's 2020 rate case, the average residential customer in Rate Zone 1 has seen a nearly 25% increase in rates.

Due to the compounding affordability issues posed by PAWC's frequent base rate cases to its ratepayers, and PAWC's failure to meet its burden of proof, the Commission should deny PAWC's proposed rate increase.

Revenue Requirement: PAWC has not met its burden of proof in demonstrating that its requested overall revenue increase of \$159,597,595<sup>9</sup> million will produce rates that are just and reasonable, equitable among customer groups, or in the public interest.

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<sup>8</sup> See e.g., *Pa. PUC v. Equitable Gas Co.*, 57 Pa. PUC 423, 471 (1983); *Univ. of Pa. v. Pa. PUC*, 485 A.2d 1217 (Pa. Cmwlth. 1984); *Pa. PUC v. PPL Elec. Util. Corp.*, 237 PUR4th 419, 426 (2004) (*PPL 2004*).

<sup>9</sup> PAWC originally requested a \$168.7 million rate increase, however, on March 13, 2026, PAWC submitted supplemental direct testimony of Linda Schlessman who recommended a \$35,620,052 reduction in rate base resulting in PAWC's updated requested revenue increase of \$159,597,595. PAWC St. 8 Supp. at 4; PAWC Ex. 3-A Revised at 2.

The OCA did not challenge PAWC's claimed capital spend of \$1.2 billion<sup>10</sup> for its Water and Wastewater utility plant through the end of the FPFTY. Apart from the \$1.2 billion for infrastructure improvement projects, PAWC's \$159.6 million rate increase request (\$90.4 million for Water and \$69.2 million for Wastewater) is excessive and unnecessary based on three major drivers. First, PAWC's unreasonable 10.95% return on equity (ROE) proposal. Second, PAWC's continued use of the ELG procedure, which is an accelerated form of depreciation recovery. Third, PAWC's attempt to transfer risks from itself to its ratepayers through riders.

If the Commission does not deny PAWC's rate increase, the OCA recommends that the Commission authorize a revenue requirement decrease of no less than \$12,303,325, or \$171,900,920 lower than PAWC's requested revenue requirement increase of \$159,597,595.

Rate of Return: The primary driver of PAWC's rate increase is the return on equity. PAWC proposed an excessive 10.95% return on equity. The OCA recommends the Commission adopt an overall weighted Rate of Return of 6.96% for water operations and 6.59% for wastewater operations with no adjustments to PAWC's proposed capital structure, and a return on equity of 8.7%.

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<sup>10</sup> The \$1.2 billion of investment is for new or replacement utility plant and equipment during the future test year (FTY) ending June 30, 2026, and its FPFTY ending June 30, 2027, the majority of which is and will be in source of supply, treatment, distribution, and collection assets. PAWC St. of Reasons at 1; PAWC St. 1 at 7.

The revenue requirement impact of the OCA's change in PAWC's ROE accounts for \$113.9m, which is significant compared to PAWC's \$159.59m rate increase request. Record evidence supports the finding that PAWC's authorized ROE should be lower than PAWC's current authorized ROE of 9.45%, as opposed to 150 basis points higher as proposed by PAWC. If PAWC were awarded a 9.45% ROE in this proceeding, it would reduce PAWC's revenue requirement increase to \$17.3 million if the OCA's other adjustments were adopted.

The OCA's DCF analysis resulted in a 6.8% to 9.3% range. PAWC's requested 10.95% return on equity is inflated beyond the cost of equity for the proxy group studied, beyond PAWC's own DCF, and includes unnecessary, non-market-based adjustments related to PAWC's claim of superior management performance. Further, PAWC's claim of superior management performance is belied by the evidence presented in this case in relation to its assistance programs and call center performance.

Depreciation: PAWC's proposed depreciation procedure results in ratepayers paying over \$50 million annually. The OCA carried its burden of production to show that use of the Average Life Group (ALG) procedure over PAWC's claimed Equal Life Group (ELG) procedure will produce just and reasonable rates. Adopting the ALG procedure is squarely within the Commission's ratemaking discretion, as no state or federal law prohibits the Commission's adoption of the ALG procedure in this proceeding.

Substantial record evidence demonstrates that the use of the ALG procedure will permit PAWC's recovery of reasonable amounts charged to operating expenses for

depreciation so that PAWC is whole and the integrity of its investments maintained. Substantial record evidence further demonstrates that use of the ALG procedure will allow PAWC's accumulated depreciation and annual depreciation to be calculated on a reasonably consistent basis. Use of the ALG procedure would also remove the excess amounts charged in rates for depreciation expense. Furthermore, substantial record evidence demonstrates that the use of the ELG procedure unreasonably accelerates the recovery of depreciation expense, violates the matching principle, and creates intergenerational inequity among consumers paying utility rates. A significant majority of state commissions require the ALG procedure, leaving Pennsylvania in the small minority of jurisdictions that allows the ELG procedure.

Cost of Service, Revenue Allocation, and Rate Design: The cost of service, revenue allocation, and rate design proposals by PAWC must be modified to be just and reasonable. The system-wide maximum day and maximum hour demand factors used by PAWC's water COSS are outdated as they are based on data from 2003. Additionally, PAWC's peak hour analysis was conducted in 1988. OCA witness Mierzwa's updated COSS is more accurate as it relies on recent data, and should be adopted by the Commission.

Further, the Commission should continue to order PAWC to provide separate COSS studies for its frequent Section 1329 acquisitions for transparency. The Commission should also reject PAWC's Act 11 wastewater revenue shift as PAWC's current proposal results in unjust and unreasonable rates.

Fixed charges for Residential customers are properly maintained at current levels to recover PAWC's costs that do not vary directly with the addition or subtraction of a customer. PAWC's "deduct adjustment" should be rejected.

Customer / Quality of Service: PAWC's call center performance is inadequate based on (1) high call-answer times, (2) high call abandonment rates, and (3) and customer complaints. PAWC's call centers perform at a dramatically lower level of performance than should be tolerated.

OCA witness Alexander reviewed the service quality and customer service issues in this matter. Generally, Ms. Alexander testified that PAWC's customer service is lacking and does not demonstrate exemplary service worthy of an increased ROE. Ms. Alexander made several recommendations for improving the quality of service to PAWC customers and improving the arrangement with PAWC and ex-affiliate American Water Resources.

The Commission should disallow certain call center expenses, reject PAWC's request for an enhanced ROE due to extraordinary management, and require PAWC to adopt the OCA's recommendations to improve service and transparency.

Low-Income Customer Assistance: Due to the frequency and magnitude of PAWC's rate increase requests, PAWC's customers are struggling with increasingly unaffordable water and wastewater bills. The Commission should consider PAWC's customers' ability to afford the rate increase authorized in this proceeding when authorizing PAWC's revenue requirement increase or decrease which has a profound effect

on PAWC's customer base, especially its low- and moderate-income customers when evaluating whether PAWC's rates are just and reasonable.

PAWC should improve its low-income customer identification and notice procedures. Due to the significant affordability concerns presented by PAWC's rates, PAWC should allow customers to earn a monthly arrearage forgiveness credit for each complete payment, expand the monthly credit that PAWC provides for a payments towards arrearage forgiveness, tie enrollment of low-income customers into its arrearage forgiveness program to enrollment in PAWC's bill discount program. PAWC's request to be the only PA water and wastewater company with a CAP Rider should be denied. PAWC's request for cost recovery of its arrearage forgiveness credits and proposal for a deduct adjustment should also be denied due to the impact on low-income customers.

The OCA's recommendations significantly benefit PAWC and its customers by reducing costs associated with uncollectibles and terminations and by ensuring that as many PAWC's customers retain vital water and wastewater service.

### **III. OVERALL POSITION ON RATE INCREASE**

The Commission should not grant PAWC's general rate increase request because PAWC has not met its burden of proof in demonstrating that its requested overall revenue increase of \$159,597,595<sup>11</sup> will produce rates that are just and reasonable, equitable among

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<sup>11</sup> PAWC originally requested a \$168.7 million rate increase, however, on March 13, 2026, PAWC submitted supplemental direct testimony of Linda Schlessman who recommended a \$35,620,052 reduction in rate base resulting in PAWC's updated requested revenue increase of \$159,597,595. PAWC St. 8 Supp. at 4; PAWC Ex. 3-A Revised at 2.

customer groups, or in the public interest.<sup>12</sup> In the event that the Commission does not deny PAWC's rate increase, the OCA recommends that the Commission authorize a revenue requirement decrease of no less than \$12,303,325, or \$171,900,920 lower than PAWC's requested revenue requirement increase of \$159,597,595.<sup>13</sup>

This rate increase request was filed less than two years after the Commission granted PAWC a combined \$99,329,013 (\$88,121,069 for water and \$11,207,944 for wastewater) increase on July 11, 2024, in a case where PAWC requested a \$203.9 million increase based on a FPFTY ending June 30, 2025.<sup>14</sup>

The OCA did not challenge PAWC's claimed capital spend of \$1.2 billion<sup>15</sup> for its Water and Wastewater utility plant through the end of the FPFTY. Apart from the \$1.2 billion for infrastructure improvement projects, PAWC's \$159.6 million rate relief request (\$90.4 million for Water and \$69.2 million for Wastewater) *is excessive and unnecessary* based on *three major drivers*, and PAWC's need for rate relief is dispelled by the OCA's recommendation, based on substantial evidence, supporting an annual decrease of \$12,303,325 (\$42,421,682 million decrease for Water and \$27,758,357 million increase for Wastewater (pre-Act 11 shift)).<sup>16</sup>

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<sup>12</sup> 66 Pa. C.S. § 315(e); *Pa. PUC v. Pa. American Water Co.*, 2004 Pa. PUC LEXIS 29, \*16-18 (Order Jan. 29, 2004); *Burleson* at 1236; *Lansberry* at 602.

<sup>13</sup> App. A, OCA Tables; OCA St. 1SR at 2.

<sup>14</sup> *Pa. PUC v. PAWC*, R-2023-3043189, Order at 5, 26, 391 (July 11, 2024) (PAWC 2023).

<sup>15</sup> The \$1.2 billion of investment is for new or replacement utility plant and equipment during the future test year (FTY) ending June 30, 2026, and its FPFTY ending June 30, 2027, the majority of which is and will be in source of supply, treatment, distribution, and collection assets. PAWC St. of Reasons at 1; PAWC St. 1 at 7.

<sup>16</sup> App. A, OCA Tables; OCA St. 1 at 2-3.

The first major driver is PAWC’s unreasonable rate of return claim, consisting of an unreasonably high ROE of 10.95%, partially based on an arbitrary, unsupported, and unreasonable consideration of management performance.<sup>17</sup> As discussed further below in Section IX, PAWC has not affirmatively demonstrated with substantial evidence the reasonableness of its claims for its ROE.<sup>18</sup>

The second major driver is PAWC’s continued use of the ELG method, instead of the widely applied ALG method, to calculate depreciation rates. “PAWC’s use of the ELG method... increases the annual depreciation accrual charged to customers by \$50.1 million in the 2025 Study, \$50.2 million in the 2026 Study, and by \$49.9 million in the 2027 Study.”<sup>19</sup> Use of the majority-view ALG procedure alone will result in a \$52.2 million reduction of PAWC’s requested revenue increase.<sup>20</sup>

The third major driver is PAWC’s request for approval of various mechanisms that will (1) unreasonably transfer risk from PAWC to consumers, and (2) further increase consumers’ rates in unknown quantities beyond PAWC’s claimed revenue requirement in this case following the effective date of base rates approved in this case and in future rate cases. In particular, PAWC seeks deferred accounting treatment for pension and other post-

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<sup>17</sup> See OCA St. 2 at 2-3, 40-42; PAWC St. 3 at 65.

<sup>18</sup> 66 Pa. C.S. § 1301; *Bluefield Water Works and Improvement Co. v. Public Serv. Comm’n of W.Va.*, 262 U.S. 679 (1923) (*Bluefield*); *Federal Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (*Hope*); *Permian Basin Area Rate Cases*, 390 U.S. 747, 794-95 (1968).

<sup>19</sup> OCA St. 2 at 4.

<sup>20</sup> App. A, OCA Tables; OCA St. 2 at 4; OCA St. 1SR at 2.

employment benefit (OPEB) expenses for tracking and recovery in future rate cases; however, this proposal is an unnecessary, unlawful single issue ratemaking request.<sup>21</sup>

**IV. RATE BASE**

**A. Plant In-Service**

The OCA has no adjustments to PAWC’s plant in-service as the OCA has made no adjustments to any of PAWC’s expenditures on utility infrastructure or maintenance.

**B. Additions to Rate Base**

**1. Utility System Acquisitions**

**a. New Systems Added to Rate Base**

As a result of acquisitions since PAWC’s last base rate case, PAWC proposes to include the following systems in rate base for the first time:<sup>22</sup>

Water	Wastewater
Farmington Township	Farmington Township
Audubon Water Company	Butler Area Sewer Authority
East Dunkard Water Authority	Elizabeth Borough Municipal Authority
Manwalamink Water Company	Manwalamink Sewer Company
Appalachian Utilities, Inc.	Sadsbury Township Municipal Authority
Corner Water Supply and Service Corporation	

All of the above systems were acquired pursuant to 66 Pa. C.S. Sections 1329 or 1102.<sup>23</sup> None were acquired under Section 529.

The only instance in which PAWC was a receiver of a troubled system among the above transactions was with the East Dunkard Water Authority (EDWA).<sup>24</sup> However, PAWC and EDWA had already made plans for PAWC to acquire the EDWA system and executed the acquisition agreement when, in an unrelated development, the system

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<sup>21</sup> OCA St. 1 at 25-26; OCA St. 1SR at 3-7.

<sup>22</sup> OCA St 1 at 6.

<sup>23</sup> PAWC St. 7 at 3-13.

<sup>24</sup> PAWC St. 1 at 11-13.

experienced an operational failure.<sup>25</sup> Because EDWA lacked the funds to address the issue, PAWC was appointed as receiver for the EDWA system.<sup>26</sup> Aside from that one instance, the system acquisitions PAWC seeks to include in rate base in this case did not involve troubled systems. The OCA does not oppose the addition of the above systems to rate base.

**b. Acquisition Adjustments**

PAWC is seeking to recover acquisition costs for the following systems: Audubon Water Company (AWC), Farmington Township water system (Farmington), and Manwalamink Water Company (MWC) and Manwalamink Sewer Company (MSC) (together, Manwalamink).<sup>27</sup>

The Public Utility Code provides a recovery method for the amounts that a utility spends to acquire a water or sewer system that exceeds the acquired system's original cost, minus accrued depreciation.<sup>28</sup> Under Section 1327, a utility must satisfy nine requirements in order to include a positive acquisition adjustment in a rate base.<sup>29</sup>

**i. Audubon Water Company**

As part of the AWC acquisition proceeding, the parties, including the OCA, waived their rights to challenge PAWC's request to recover the acquisition premium.<sup>30</sup> The OCA does not oppose PAWC's request to recover the acquisition costs for AWC.

**ii. Manwalamink**

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<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> OCA St. 1 at 9.

<sup>28</sup> 66 Pa. C.S. § 1327.

<sup>29</sup> 66 Pa. C.S. § 1327(a)(1-9).

<sup>30</sup> OCA St. 1SR at 13-14.

On March 27, 2025, the Commission approved PAWC's acquisition of Manwalamink's water and wastewater systems.<sup>31</sup> The purchase price allocated \$1,809,000 for the water system and \$2,191,000 for the wastewater system.<sup>32</sup> The application for PAWC's acquisition of Manwalamink was filed under Section 1102(a) of the Pennsylvania Public Utility Code (the Code), 66 Pa. C.S. Section 1102(a).<sup>33</sup>

PAWC's proposed acquisition adjustment for the Manwalamink systems should be removed from PAWC's rate base as PAWC has not met the criteria under Section 1327(a)(3) necessary to support its inclusion.

PAWC did not demonstrate that Manwalamink was providing inadequate, inefficient, unsafe or unreasonable service at the time of acquisition when it made a generalized claim that the system's elderly owners were unable to maintain operations.<sup>34</sup> This assertion is contradicted by the acquisition record, where no party, including PAWC, alleged deficient service.<sup>35</sup> Testimony instead showed that day-to-day operations were handled by a third-party operator, and that the sale was motivated by the owners' age rather than any service failure.<sup>36</sup> While the Manwalamink systems had a number of violations of the Safe Drinking Water Act (SDWA), these violations were largely monitoring and

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<sup>31</sup> *Application of Pennsylvania-American Water Co., pursuant to Section 1102 of the Public Utility Code to Acquire Manwalamink Water Company and Manwalamink Sewer Company Assets*, Docket Nos. A-2023-3044418 et al., Order (Mar. 27, 2025).

<sup>32</sup> OCA St. 1 at 8.

<sup>33</sup> *Id.*

<sup>34</sup> OCA St. 1 at 18.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* at 19.

reporting issues, Manwalamink showed improvement overtime, with 5 violations in 2023 down from 17 in 2021, and they were not tied to customer harm or service degradation.<sup>37</sup> By the time of PAWC's Application to acquire Manwalawink's assets, Manwalawink's compliance vastly improved.<sup>38</sup> As such, the evidence does not meet the statutory threshold required for an acquisition adjustment.

Additionally, PAWC failed to establish that the purchase price was reasonable and the product of an arm's length negotiation as required under 66 Pa. C.S. Sections 1327(a)(5) and (6). The purchase price of the Manwalamink systems was derived from a pre-existing agreement negotiated by a previous potential buyer, which PAWC merely adopted.<sup>39</sup> Moreover, PAWC paid an 111% premium over book value for a system it now claims was deficient, yet failed to demonstrate any corresponding benefits such as increased earnings or growth.<sup>40</sup> Its own projections showed revenue deficiencies post-acquisition, undermining any claim that the premium was justified.<sup>41</sup>

Since PAWC cannot demonstrate that Manwalamink was not providing adequate service at the time of the acquisition and failed to establish that the purchase price was reasonable and the result of an arm's length negotiation, the requirements of Section 1327 have not been met. PAWC's proposal for a positive acquisition adjustment should be rejected, and its rate base claim should be decreased by \$380,725.

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<sup>37</sup> OCA St. 1SR at 15, 17-19.

<sup>38</sup> *Id.*

<sup>39</sup> OCA St. 1 at 19.

<sup>40</sup> OCA St. 1SR at 14-15.

<sup>41</sup> *Id.*

### iii. Farmington

On September 26, 2024, the Commission approved PAWC's acquisition of Farmington's water and wastewater systems.<sup>42</sup> The purchase price allocated \$2,621,312 for the water system and \$2,923,688 for the wastewater system.<sup>43</sup> The application for PAWC's acquisition of Farmington was filed under Section 1102(a).<sup>44</sup> PAWC is only seeking inclusion of an acquisition adjustment for Farmington's water system in this case.<sup>45</sup>

PAWC's proposed acquisition adjustment for Farmington should be removed from PAWC's rate base as PAWC has not met the criteria under Section 1327(a)(3) necessary to support its inclusion. PAWC did not demonstrate that Farmington was providing inadequate, inefficient, unsafe or unreasonable service at the time of acquisition when it claimed that Farmington's SDWA violations for failure to collect weekly water samples constituted inadequate and unreliable service.<sup>46</sup> OCA witness Morgan explained that:

[T]he violations were not critical, nor did they result in releasing a serious public health crisis. Rectifying the violations appears to be a matter that PAWC could easily resolve by changing sampling collection protocols. Moreover, PAWC's proposal would hurt the same customers it claims to be concerned about. In fact, PAWC's proposal is punitive towards those customers. Essentially, PAWC is proposing to increase rate base and charge customers more for service because the former system operator did not consistently collect testing samples. Viewed differently, the nature of the violations was not so critical as to require PAWC to pay the acquisition

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<sup>42</sup> *Application of Pennsylvania-American Water Co., pursuant to Section 1102 of the Public Utility Code to Acquire Township of Farmington Water and Wastewater Assets*, Docket Nos. A-2023-3042587 et al., Order (Sep. 26, 2024).

<sup>43</sup> OCA St. 1 at 7.

<sup>44</sup> *Id.*

<sup>45</sup> OCA St. 1SR at 18.

<sup>46</sup> OCA St. 1 at 13.

adjustment in order to take over the system to immediately eliminate a critical health, safety and reliability threat.<sup>47</sup>

Since PAWC cannot demonstrate that Farmington was not providing adequate service at the time of the acquisition, the requirements of Section 1327 have not been met. PAWC's proposal for a positive acquisition adjustment should be rejected, and its rate base should be decreased by \$23,586.

**C. Deductions from Rate Base**

The OCA did not address this issue in its testimony.

**D. Conclusion**

PAWC has not met its burden of proof on all of its rate base claims, and the OCA's adjustments are reasonable.

**V. REVENUES**

The OCA did not address this issue in its testimony.

**VI. EXPENSES**

PAWC has not affirmatively demonstrated by a preponderance of evidence that the expenses the OCA challenges are reasonably necessary to provide services, or prudently incurred.<sup>48</sup> For the expenses challenged by the OCA, the Commission should exclude PAWC's claimed expenses as unreasonable and adopt the OCA's adjustments to the expenses.

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<sup>47</sup> OCA St. 1 at 13-14.

<sup>48</sup> *City of Lancaster Sewer Fund v. Pa. PUC*, 793 A.2d 978, 982 (Pa. Cmwlth. 2002); *Popowsky v. Pa. PUC*, 674 A.2d 1149, 1154 (Pa. Cmwlth. 1996).

**A. Labor-Related Expense (Salaries and Wages, Employee Benefits, and Related Payroll Taxes)**

PAWC originally calculated its payroll expense assuming a full complement of employees without consideration of vacant positions.<sup>49</sup> Since then, PAWC has accepted the adjustment proposed by I&E witness Okum to reflect a vacancy rate of 1.25% using the average vacancy of the three years ended June 30, 2025.<sup>50</sup> The OCA does not oppose this adjustment.

**B. Performance Compensation (PAWC)**

PAWC has implemented a compensation policy under which a portion of employee pay is tied to performance metrics.<sup>51</sup> One aspect of the compensation policy emphasizes the achievement of earnings goals, and it is primarily aimed at enhancing shareholder value and conferring benefits to shareholders.<sup>52</sup>

In Columbia’s 2025 rate case, the ALJs recommended disallowing the portion of incentive compensation tied to shareholder earnings goals, finding that such metrics lacked a sufficient nexus to ratepayer benefits and instead primarily advanced shareholder interests.<sup>53</sup> Only where an incentive compensation plan is reasonable, prudently incurred, not excessive, and there is a benefit to ratepayers, a Company may recover the expense of that program.<sup>54</sup> In *PPL 2012*, the Commission allowed incentive compensation expense because it was consistent with the Commission’s “prior decisions approving incentive

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<sup>49</sup> OCA St. 1 at 20.

<sup>50</sup> PAWC St. 6R at 2.

<sup>51</sup> OCA St. 1 at 20.

<sup>52</sup> *Id.*

<sup>53</sup> *Pa. PUC v. Columbia Gas of PA, Inc.*, R-2025-3053499 Order at 204-05 (Oct. 3, 2025).

<sup>54</sup> *Pa. PUC v. PPL Elec. Util. Corp.*, R-2012-2290597, Order (Dec. 28, 2012) (*PPL 2012*).

compensation programs that are focused on improving operational effectiveness.”<sup>55</sup> Similarly, the Commission has approved incentive compensation plans where employees eligible for the compensation “have direct responsibilities for customer service and regulatory compliance or are otherwise responsible for ensuring safe and reliable service to customers.”<sup>56</sup> Having a financial metric component to the incentive compensation plan does not disqualify it from inclusion in the utility’s revenue requirement, if the incentive plan establishes that eligibility for the incentive “is based on performance duties and metrics directly related to the provision of service.”<sup>57</sup>

OCA witness Morgan testified that PAWC’s performance pay related to achievement of earnings goals should not be recoverable from ratepayers for several reasons. First, Mr. Morgan explained that such incentives should be self-funding:

First, if the financial targets are set properly, achieving the necessary performance should be self-supporting. This means that the measures that achieve additional cost savings, increase revenue, or otherwise improve financial results should generate the necessary income to cover the incentive plan payments.<sup>58</sup>

Mr. Morgan further testified that these incentives lack a sufficient nexus to ratepayer benefits and instead primarily benefit shareholders:

Second, these payments are not tied to ratepayer benefits such as meeting quality of service, operational efficiency, or conservation goals. Finally, the incentive to improve financial performance is not necessarily consistent with the interests of PAWC’s ratepayers, but, instead, is more aligned with

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<sup>55</sup> *PPL 2012* at 26 citing *Pa. PUC v. Aqua Pa., Inc.*, 2008 Pa. PUC LEXIS 50, \*24; *Pa. PUC v. Duquesne Light Co.*, 1987 Pa. PUC LEXIS 342 at \*99-100.

<sup>56</sup> *Pa. PUC v. PAWC*, 2021 PA. PUC LEXIS 55 at \*59 (Feb. 25, 2021) (*PAWC 2021*).

<sup>57</sup> *Id.* at \*60.

<sup>58</sup> OCA St. 1 at 20.

shareholders' interests. Shareholder value has a correlation to earnings, so when improved earnings are reported, shareholder value improves but rates do not go down. Thus, the beneficiaries of the improved earnings are the shareholders.<sup>59</sup>

As such, OCA witness Morgan recommended that the component of PAWC's performance pay related to achievement of earnings goals be removed from rates.<sup>60</sup> PAWC contends that performance-based compensation is market-driven and necessary to attract, motivate, and retain employees, and that it benefits customers by promoting efficiency.<sup>61</sup> However, the issue is not the existence or overall level of compensation, but how its costs are allocated to ratepayers and to shareholders among stakeholders.<sup>62</sup> The portion of performance-based compensation tied to earnings goals primarily and disproportionately benefits shareholders.<sup>63</sup> OCA witness Morgan testified to the following:

The justification for the performance-based compensation is the achievement of earnings goals by getting employees to work towards managing the Company's costs. If savings are achieved, earnings will increase (assuming all else remains constant). Share prices are linked to earnings, therefore higher earnings drive up share prices. When share prices increase, the value of the shareholders' investment in the Company increases. In short, shareholders' wealth is impacted by the achievement of performance-based compensation. In contrast, rates paid by customers are fixed until changed by the Commission. If the performance-based compensation plan results in higher earnings, i.e., ROR, customers do not receive a rebate or a rate reduction. Hence, because of the additional benefit received by shareholders, it is appropriate for a portion of the cost of the performance-based compensation plan to be absorbed by the Company.

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<sup>59</sup> *Id.* at 20-21.

<sup>60</sup> *Id.* at 20.

<sup>61</sup> OCA St. 1SR at 7.

<sup>62</sup> *Id.* at 7-8.

<sup>63</sup> *Id.*

Another benefit received by shareholders resulting from the performance-based compensation plan relates to dividends. Consistency in achieving higher earnings could lead to higher dividends. This does not only increase current dividends (shareholder income), it also positively impacts share prices which could lead to an increase in shareholders' wealth. This is another reason it is appropriate for shareholders to absorb a portion of the performance-based compensation costs.<sup>64</sup>

PAWC argues that the performance compensation plan in this case is fundamentally the same as PAWC's last base rate case, which was approved by the Commission.<sup>65</sup> However, OCA witness Morgan testified that PAWC's reliance on prior Commission approval is misplaced, as the continued use of these compensation structures has not produced sustained, tangible benefits for customers, as evidenced by the need for another rate increase shortly after the last case.<sup>66</sup> Renewed scrutiny is warranted, instead of a continuation of past practice that unfairly disadvantages ratepayers.

Accordingly, the OCA recommends a \$3,325,873 adjustment to PAWC's claimed incentive compensation expense.<sup>67</sup>

### **C. Group Insurance Expense**

PAWC's adjustment of its group insurance cost is "based on the January 2026 premiums annualized for the future test year number of employees, less the annualized employee contribution, and adjusted for the portion not charged to operations. The fully projected future test year was developed by adjusting the annualized 2026 amount by a 3

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<sup>64</sup> OCA St. 1SR at 9-10.

<sup>65</sup> PAWC St. 3R at 7.

<sup>66</sup> OCA St. 1SR at 9.

<sup>67</sup> App. A, OCA Tables; OCA St. 1SR at 2.

year average of 3.74%.”<sup>68</sup> The 3.74% average was applied as a growth rate instead of a normalization adjustment.<sup>69</sup> PAWC’s characterization of its method as a “normalizing” adjustment is inaccurate.<sup>70</sup> Rather than smoothing fluctuations, PAWC applies the historical average as a growth factor to increase projected costs.<sup>71</sup> OCA witness Morgan testified that this is not a normalization technique, but a forecasting method that compounds historical changes without demonstrating that those changes will persist into the FPFTY. *Id.* As such, it introduces unnecessary speculation into the ratemaking process.

This is different from the recommendation the OCA made in PAWC’s last base rate case, adopted by the Commission in its Opinion and Order, that a three-year average percentage change should be used to normalize the group insurance expense.<sup>72</sup>

Here, OCA witness Morgan recommends an adjustment to the group insurance expense to reflect the 2026 group insurance rates because they are the most recent, known rates, and are more aligned with current actuarial considerations.<sup>73</sup> He explained,

[I]t is inappropriate to use the historical change in insurance costs as a basis for insurance projections because insurance projections should be based on actuarial methods. The past historical changes in costs could have been affected by the population size of the group, demographics, or events in the economy. As a result, I maintain that FPFTY group insurance expense should be based on the most recent, actual insurance rates.<sup>74</sup>

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<sup>68</sup> PAWC Workpaper 4d Group Insurance Adjustment Revised.

<sup>69</sup> OCA St. 1SR at 19.

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> OCA St. 1 SR at 19.

<sup>73</sup> OCA St. 1 at 23.

<sup>74</sup> OCA St. 1SR at 19-20.

Accordingly, the Commission should reject PAWC's proposed group insurance expense calculation and instead calculate group insurance expense based solely on the 2026 rates, resulting in a recommended adjustment of \$566,573.<sup>75</sup>

**D. Service Company Expense**

The OCA did not address this issue in its testimony.

**E. Waste Disposal Expense**

The OCA did not address this issue in its testimony.

**F. Transportation Expense**

PAWC derived its FPFTY transportation expense from the number of units in PAWC's fleet, the average monthly leasing fees, and the inclusion of other transportation expenses.<sup>76</sup> PAWC also applied a 6.94% inflation factor to certain expenses based on a three-year average (2023-2025) of the Consumer Price Index (CPI) for transportation services.<sup>77</sup>

OCA witness Morgan recommends an adjustment that removes the inflation escalation effect from the projected FPFTY for the following reasons:

First, historical inflation rates are not good predictors of future inflation, as demonstrated by current inflation rates compared to rates during 2023. For example, using the data presented by the Company between December 2023 and December 2024, the transportation CPI increased by an annual rate of 7.47%. However, between December 2024 and December 2025 the transportation CPI increased by an annual rate of 1.72%. Clearly the rate of inflation has decreased when compared to the three-year average used by the Company. Second, the Company's historical data reveals that these expenses, to which the inflation rate was applied, did not follow the inflation trend. For example, fuel expenses decreased from the historical period to

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<sup>75</sup> App. A, OCA Tables; OCA St. 1SR at 2.

<sup>76</sup> OCA St. 1 at 23.

<sup>77</sup> *Id.*

2025. Additionally, titling and registration fees are generally fixed until changed by jurisdictional authority.<sup>78</sup>

In PAWC witness O'Malley's rebuttal testimony, she acknowledged the change in inflation factor pointed out by Mr. Morgan and recommended applying the June 2025 inflation rate of 3.11% instead of the three-year average of 6.94%.<sup>79</sup>

The OCA maintains that PAWC should remove the inflation escalation because past inflation is not a good predictor of future inflation rates, and PAWC's historical data does not follow the inflation trend.<sup>80</sup> Therefore, the Commission should deny the inflation adjustment included in PAWC's transportation expense adjustment, resulting in a \$217,216 reduction.<sup>81</sup>

#### **G. Towamencin Transaction Costs**

On May 15, 2023, PAWC filed an application with the Commission under Sections 1102(a) and 1329 of the Code, for approval of the right to acquire substantially all of the wastewater system assets of Towamencin.<sup>82</sup> On September 12, 2024, PAWC and Towamencin filed a letter with the Commission indicating that the Applicants had mutually agreed to terminate the underlying transaction of the Joint Application and requested leave to withdraw the Joint Application.<sup>83</sup>

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<sup>78</sup> *Id.* at 23-24.

<sup>79</sup> PAWC St. 6R at 21.

<sup>80</sup> OCA St. 1SR at 20.

<sup>81</sup> *Id.* at 2; App. A, OCA Tables.

<sup>82</sup> OCA St. 1 at 21 *citing Commission Letter to the Joint Applicants legal representatives*, Docket Nos. A-2023-3039900 & A-2024-3050135 (Sept. 24, 2024).

<sup>83</sup> *Id.* at 22.

What constitutes “used and useful property” is committed to the wide discretion of the Commission, and if the Commission reasonably finds that the property will not be used and useful in serving the public, it may make adjustments to exclude the value of the property from rate base and disallow the utility’s return on that property.<sup>84</sup> The adjustments must be supported with a reasonable degree of specificity in findings and reasoning.<sup>85</sup>

To determine whether property will be “used and useful” in the FPFTY, a utility must sufficiently demonstrate by the close of the record that the utility property is reasonably certain to be used and useful in the FPFTY.<sup>86</sup> In *UGI 2018*, the Commission agreed with the ALJ’s recommendation to reject the utility’s \$17.3 million utility plant in service claim and related expenses associated with the planned construction of a new operations center by the end of the FPFTY because: (1) the utility did not demonstrate that its planned operations center would be in operation by the end of the FPFTY; and (2) there was no “reasonable certainty that it [would] be in operation in the FPFTY.”<sup>87</sup> In affirming the Commission’s decision in *UGI 2018*, the Commonwealth Court in *McCloskey 2020* observed that the Commission properly excluded the proposed operations center and

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<sup>84</sup> *Pa. Power & Light Co. v. Pa. PUC*, 516 A.2d 426, 430 (Pa. Cmwlth. 1985) (citations omitted); *see also UGI Corp. v. Pa. PUC*, 410 A.2d 923, 929 (Pa. Cmwlth. 1980) (*UGI 1980*).

<sup>85</sup> *Phila. Suburban Water Co. v. Pa. PUC*, 394 A.2d 1063, 1066-67 (Pa. Cmwlth. 1978).

<sup>86</sup> *Pa. PUC v. UGI Utils., Inc. – Elec. Div.*, Docket No. R-2017-2640058, Order (Oct. 25, 2018) (*UGI 2018*).

<sup>87</sup> *UGI 2018* at 27-31 *citing* R.D. at 22-24, 79.

reduced the utility's rate base by over \$17.3 million "on the basis that there was insufficient evidence to support that it would be in service during the FPFTY."<sup>88</sup>

In PAWC's last base rate case, the Commission adopted the ALJs' Recommended Decision with regards to utility plant-in-service, agreeing with the OCA's and I&E's arguments that proposed system acquisitions that were not finalized should not be included in rate base because "there must be reasonable certainty by the close of the record in the rate case that the property claimed in rate base will be used and useful by the end of the FPFTY."<sup>89</sup> As the Towamencin acquisition was abandoned, the associated transaction costs did not and will not contribute to the provision of utility service, either presently or during the forecast test year. Accordingly, these costs fail the threshold "used and useful" standard and must be excluded.

PAWC claims "[t]here were two unforeseen and extraordinary circumstances that occurred while the acquisition application was pending that caused the transaction to fail" that "were outside any business risk that PAWC assumed in deciding to pursue the acquisition."<sup>90</sup> PAWC claims these circumstances justify recover of the acquisition costs incurred during the acquisition proceeding, despite PAWC not consummating the transaction.<sup>91</sup>

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<sup>88</sup> *McCloskey 2020* at 207, n.9.

<sup>89</sup> *PAWC 2023* at 37.

<sup>90</sup> *PAWC St. 7R* at 15.

<sup>91</sup> *Id.*

PAWC claims that the first “extraordinary circumstance” is the Commission’s Final Supplemental Implementation Order, which adopted the use of a Reasonableness Review Ratio (RRR) for reviewing acquisitions pursuant to Section 1329, which is used to determine the reasonableness of the transaction price.<sup>92</sup> The Commission approved the use of a revised RRR in a Final Supplemental Implementation Order (*2024 FSIO*) issued on July 2, 2024, which was after PAWC filed its Application, but before the transaction was finalized.<sup>93</sup>

PAWC’s claim that the Commission’s adoption of the RRR affected its ability to consummate the transaction is unfounded because the Commission in its *2024 FSIO* explained the following:

To be clear, the provisions of this Order are not retroactive. The public hearing, rate impact notice, and default appraisal weight provisions of the 2024 FSIO will go into effect 30 days after the entry of this Order with respect to all acquisitions where an APA has not been executed. For acquisitions where an APA has been executed, including those for which a Section 1329 application has been filed, but not finally accepted, we will consider the unique facts and circumstances of each acquisition and take into account the dates on which the APAs were executed and applications were filed.<sup>94</sup>

As PAWC had already executed its Asset Purchase Agreement (APA) and filed its Section 1329 before the issuance of the FSIO, the *2024 FSIO* would not have applied retroactively

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<sup>92</sup> *Id.* at 15-16.

<sup>93</sup> *Id.* at 15 (internal citations omitted).

<sup>94</sup> *Valuation of Acquired Municipal Water and Wastewater Systems Act 126 of 2016*, M-2016-2543193 Order at 114 (July 2, 2024) (*2024 FSIO*).

to the Towamencin acquisition proceeding. PAWC’s classification of the 2024 FSIO as an “extraordinary circumstance” that led to the failure of the transaction is unsupported.

The second “extraordinary circumstance” was a local referendum that was effective July 1, 2023, that prohibited the privatization of Towamencin assets through the adoption of a Home Rule Charter.<sup>95</sup> According to PAWC, this “Home Rule Charter arguably could not have retroactively negated an existing contract,” but PAWC and Towamencin chose not to litigate the issue.<sup>96</sup>

OCA witness Morgan testified to the following in response to PAWC:

As I have said, virtually all business decisions contain an aspect of risk. The nature of risks is that they are not always known prior to the decision making. When the decision was made to pursue the acquisition of the Towamencin System, the ultimate risk of not succeeding should have been contemplated. I do not believe the management of PAWC is so overly confident that it did not contemplate failure when often there are stories in the financial press about mergers and acquisitions falling apart. Allowing cost recovery here would set a dangerous precedent. It would signal to PAWC, a company with an extensive history of acquisitions, and other utilities that the Commission will insulate them from the financial risks of failed utility acquisitions.<sup>97</sup>

The risk of a failed transaction is an ordinary business risk that utilities and their shareholders, not ratepayers, must bear, particularly where that risk never results in property that will be used and useful in providing service to ratepayers.<sup>98</sup> The Application

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<sup>95</sup> PAWC St. 7R at 16.

<sup>96</sup> *Id.*

<sup>97</sup> OCA St. 1SR at 13.

<sup>98</sup> *Id.*

was withdrawn, no assets were acquired, and no service benefits were ever realized or will be realized by PAWC customers for the foreseeable future.

For all of these reasons, the Commission should deny PAWC's request to include Towamencin transaction costs in rates, thus reducing PAWC's requested rate base by \$61,638.

#### **H. Interest Synchronization**

Interest synchronization is used in ratemaking to determine the amount of interest expense to be used in the calculation of income tax. The adjustment ensures the tax-deductible interest expense for ratemaking is properly matched with the rate base and weighted cost of debt. OCA witness Morgan multiplied the OCA's adjusted rate base by the weighted cost of debt included in the OCA recommended capital structure.<sup>99</sup> The interest synchronization adjustment is necessary to ensure that the amount of income taxes claimed by PAWC is properly matched to its rate base and weighted cost of debt.<sup>100</sup>

#### **I. Amortization Expense**

The OCA did not address this issue in its testimony.

#### **J. Third-Party Call Center Expense**

Please see Section XIII.

#### **K. Pension and Other Post Employment Benefits ("OPEB") Expense (Request for Deferred Regulatory Accounting Treatment)**

PAWC requested deferred accounting treatment for Pension and OPEB expenses, claiming that pension and OPEB expenses "are difficult to predict and can materially increase or decrease from year-to-year because pension and OPEB costs are based on

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<sup>99</sup> OCA St. 1 at 24-25.

<sup>100</sup> *Id.*

actuarial forecasts that take into account a number of economic and demographic factors.”<sup>101</sup> Additionally, PAWC witnesses Chard and Popiolek stated that the use of a three-year historical average of pension and OPEB expenses is not an appropriate method for determining projected costs.<sup>102</sup>

This same issue arose with PAWC’s last base rate case. In its Order dated July 11, 2024, the Commission rejected similar requests for pension/OPEB trackers that were made by PAWC.<sup>103</sup> Pertaining these requests, the Commission stated as follows:

We agree with the ALJs and I&E that pension and OPEB costs are not extraordinary, unanticipated, or non-recurring. R.D. at 131 (citing I&E M.B. at 31-32). As discussed by I&E, pension and OPEB costs are routine expenses that can be forecasted on an annual basis and are part of contractual agreements with past employees. *See*, I&E M.B. at 32. Therefore, costs for pension and OPEB expense do not qualify for deferred accounting treatment. Indeed, as noted by the ALJs, the OCA, and PAWLUG, to allow deferred recovery for such routine costs would raise concerns of single-issue ratemaking.<sup>104</sup>

To the extent that PAWC argues that the ALJs’ adjustment of PAWC’s pension and OPEB expense claim using a three-year average is improper, we disagree. As noted by I&E, adopting three-year averaging in calculating pension and OPEB expenses is consistent with recent Commission determinations.<sup>105</sup> Furthermore, we agree with the ALJs

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<sup>101</sup> PAWC St. 2 at 27.

<sup>102</sup> OCA St. 1SR at 5 (internal citations omitted).

<sup>103</sup> *PAWC 2023* at 128.

<sup>104</sup> *See*, R.D. at 131 (citing OCA M.B. at 44-45; PAWLUG M.B. at 7-8).

<sup>105</sup> *See*, I&E M.B. at 36 (citing *PGW 2023* at 86; *PECO 2021* at 90).

that I&E adequately demonstrated that PAWC's claims for pension and OPEB costs should be based on averaging.<sup>106</sup>

The OCA opposes PAWC's ancillary requests for Commission approval of deferred regulatory accounting treatment for pension and OPEB expenses. PAWC has not met its burden to demonstrate that these accounting mechanisms are necessary or just and reasonable. Moreover, the requested treatments of isolated expenses for deferred recovery in future base rate cases are squarely impermissible single-issue ratemaking.<sup>107</sup> Single-issue ratemaking is similar to retroactive ratemaking and, in general, is prohibited if it impacts on a matter that is normally considered in a base rate case.<sup>108</sup> Here, PAWC's requests are distinguishable from that approved in *PIEC* which affirmed the Commission's authority to allow a Section 1307 surcharge, because this is a base rate case and PAWC is asking for specific deferred accounting treatment and future recovery of line-item expenses that get addressed in base rate cases.<sup>109</sup>

Although a utility's "cost of service" is made up of dozens of individual cost components, which can and will vary from expected values, single-issue ratemaking

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<sup>106</sup> R.D. at 131 (citing I&E St. 1-SR at 20-26; I&E St. 1 at 21-25).

<sup>107</sup> See *Nat'l Fuel Gas Dist. Corp. v. Pa. PUC*, 464 A.2d 546, 567 (Pa. Cmwlth. 1983) (in the context of tariff supplements, the consideration of expense and revenue items in isolation could result in confiscatory rates); see also *Phila. Elec. Co. v. Pa. PUC*, 502 A.2d 722, 727-28 (Pa. Cmwlth. 1985) (holding that there should be no line-by-line examination of items in a rate case and an isolated item of revenue or expense may not be, without more, the subject of a refund or recovery).

<sup>108</sup> *Pa. Indus. Energy Coalition v. Pa. PUC*, 653 A.2d 1336, 1350 (Pa. Cmwlth. 1995), *aff'd*, 543 Pa. 307, 670 A.2d 1152 (1996) (*PIEC*).

<sup>109</sup> *Id.*

ignores the fact that as a single cost component changes in one direction, other components may change in the opposite direction.<sup>110</sup> Single-issue ratemaking denies customers the benefit of these offsetting cost reductions.<sup>111</sup> It shifts the risk of fluctuations of a specific expense item away from investors where the risk is currently borne and puts that risk squarely onto customers. Additionally, isolating and tracking the Pension and OPEB expenses for eventual recovery, runs counter to a fundamental principle of ratemaking that a utility should be afforded the opportunity to recover its costs of providing service but not guaranteed such recovery.<sup>112</sup>

Accordingly, as PAWC has not presented any new arguments or asserted materially different facts in this base rate case, the Commission should, consistent with its determination in the prior base rate proceeding, disallow PAWC's ancillary requests for approval of deferred regulatory accounting treatment for pension and OPEB expenses for recovery in a future rate case.

## **VII. TAXES**

The OCA did not address this issue in its testimony.

## **VIII. DEPRECIATION**

### **A. Introduction**

The primary issue before the Commission in this case regarding depreciation is the amounts to be recovered in operating expenses and whether the Average Life Group (ALG)<sup>113</sup> versus the Equal Life Group (ELG) procedure should be used to determine those

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<sup>110</sup> OCA St. 1 at 26.

<sup>111</sup> *Id.*

<sup>112</sup> *Id.*

<sup>113</sup> The average life group procedure is also referred to as the average service life procedure.

amounts. Currently, PAWC uses the ELG.<sup>114</sup> PAWC's use of the nationally atypical ELG depreciation procedure instead of the ALG procedure will result in current customers paying nearly \$60 million per year more than they otherwise would.<sup>115</sup> If the Commission authorizes the ALG, which is used by the vast majority of jurisdictions and public utilities nationally, the Commission can provide customers who are struggling with affordability issues with significant financial relief.

PAWC's proposed depreciation rates amount to a total annual depreciation accrual of \$263 million based on plant balances at June 30, 2027.<sup>116</sup> If the Commission adopts Mr. Garrett's recommendation to use the Average Life Group Procedure or ALG it will reduce the annual depreciation accrual charged to customers by \$50.1 million in 2025 by \$50.2 million in 2026, and by \$49.9 million in the 2027.<sup>117</sup>

OCA witness Garrett recommended that the Commission reject PAWC's use of the ELG procedure.<sup>118</sup> First, the ELG procedure results in an accelerated form of cost recovery from consumers.<sup>119</sup> Under the ELG procedure, property is divided into subgroups, called vintages, that each have a common life.<sup>120</sup> Using ELG results in higher depreciation rates in the early years of a vintage's life.<sup>121</sup> By contrast the ALG procedure results in the same

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<sup>114</sup> OCA St. 2 at 46

<sup>115</sup> OCA St. 2 SR at 14.

<sup>116</sup> OCA St. 2 at 3.

<sup>117</sup> OCA St. 2 at 4.

<sup>118</sup> OCA St. 2.

<sup>119</sup> OCA St. 2 at 4.

<sup>120</sup> OCA St. 2 at 46.

<sup>121</sup> *Id.*

depreciation rate applied to each age interval.<sup>122</sup> Mr. Garrett testified that use of the ELG procedure results in current customers overpaying.<sup>123</sup> Second, Mr. Garrett testified that the ELG procedure can result in unreasonably high depreciation rates as it results in higher present cash flow to PAWC, which is likely the primary motivation for PAWC proposing the ELG procedure.<sup>124</sup> A significant majority of state commissions require ALG, leaving Pennsylvania in the small minority of jurisdictions that approve and utilize ELG.<sup>125</sup>

This issue is squarely within the Commission’s ratemaking discretion, as no state or federal law prohibits the Commission’s adoption of the ALG procedure. Adopting the use of the ALG procedure will permit PAWC to recover reasonable amounts charged to operating expenses for depreciation so that it is fully recovered, and the integrity of its investments maintained while ensuring that consumers pay no more than necessary. Through adoption of the ALG procedure, the excess amounts charged in rates for depreciation expense will be removed.

**B. Adopting the ALG procedure results in fairer rates to consumers.**

Under Pennsylvania Court precedent, annual depreciation is defined as follows:

“Annual depreciation is an operating expense representing the consumption of assets in rendering service.”<sup>126</sup> “A utility is entitled under the law to recover from the rate payers

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<sup>122</sup> OCA St. 2 at 47.

<sup>123</sup> OCA St. 2SR at 18.

<sup>124</sup> OCA St. 2 at 49; OCA St. 2SR at 17.

<sup>125</sup> OCA St. 2 at 48.

<sup>126</sup> *Penn Sheraton Hotel v. Pa. PUC*, 198 Pa. Super. 618, 627 (Pa. Super. 1962) (*Penn Sheraton*).

the original cost of construction of its depreciable plant.”<sup>127</sup> Additionally, “it is clear in our law that ‘[i]n no event will a utility be permitted to recover by annual allowances for depreciation a total amount in excess of the original cost, since annual depreciation is computed on original cost and not upon fair value or reproduction cost.’”<sup>128</sup> In other words, annual depreciation is the return *of* the investment, which is returned through the depreciation O&M expense over the life of the plant.

The Pennsylvania Superior Court defined accrued depreciation (also referred to as accumulated depreciation) as follows: “[a]ccrued depreciation for rate purposes means ‘the actual depreciation of the utility’s property as it has accrued to the date that fair value is in issue.’”<sup>129</sup> The Superior Court further noted that “accrued depreciation properly determined ‘should disclose the consumption of property to date.’”<sup>130</sup>

Current legal standards do not mandate a specific procedure when conducting depreciation analysis.<sup>131</sup> The standards direct that analysts use a system for estimating depreciation rates that will result in the systematic and rational allocation of capital recovery for the utility.<sup>132</sup> A depreciation study may be defined by several primary parameters, including 1) method of allocation; 2) a procedure for applying the method; 3) a technique of applying the depreciation rate; and 4) a model for analyzing the

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<sup>127</sup> *Id.*

<sup>128</sup> *Penn Sheraton* at 627.

<sup>129</sup> *Penn Sheraton* at 624.

<sup>130</sup> *Id.*

<sup>131</sup> OCA St. 2 at 45.

<sup>132</sup> *Id.*

characteristics of vintage property groups.<sup>133</sup> OCA witness Garrett used the straight-line method, ALG procedure, the remaining life technique, and the broad group model.<sup>134</sup>

As OCA witness Garrett testified:

The ‘procedure’ refers to the way the allocation method is applied through subdividing the total property into groups. While single units may be analyzed for depreciation, a group plan of depreciation is particularly adaptable to utility property. Employing a grouping procedure allows for a composite application of depreciation rates to groups of similar property, rather than excessively conducting calculations for each unit.<sup>135</sup>

Mr. Garrett testified that “[w]hile single units may be analyzed for depreciation, employing a grouping procedure allows for composite application of depreciation rates to groups of similar property as opposed to excessively conducting calculations for each unit of property.”<sup>136</sup>

OCA witness Garrett testified that “[i]n the ALG procedure, a constant accrual rate is based on the average life of all property in the group is applied to the surviving property.”<sup>137</sup> As such, “use of the average life results in the same depreciation rate applied to each age interval.”<sup>138</sup> OCA witness Garrett further testified that “[i]n the ELG method, property is divided into subgroups, called vintages that each have a common life.”<sup>139</sup> Under

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<sup>133</sup> OCA St. 2 at 45-46.

<sup>134</sup> *Id.* at 46

<sup>135</sup> OCA St. 2, App. C at 3.

<sup>136</sup> *Id.*

<sup>137</sup> OCA St. 2 at 46.

<sup>138</sup> *Id.* at 47

<sup>139</sup> *Id.* at 46.

the ELG procedure, depreciation expense will always be higher in early years when utilities make recent capital investments.<sup>140</sup> OCA witness Garret testified as follows:

Also, in Mr. Spanos’s rebuttal testimony, I did not see him rebut the fact that compared with the ALG procedure, the ELG procedure will result in higher depreciation rates for current customers. Likewise, the ELG procedure will result in higher cash flows for the Company relative to the ALG procedure.<sup>141</sup>

PAWC’s use of ELG instead of ALG results in current customers paying nearly \$60 million per year more than they otherwise would.<sup>142</sup> If the Commission authorizes the depreciation methodology used by the vast majority of jurisdictions, the Commission can provide current customers significant financial relief. OCA witness Garrett summarized his application of the ALG procedure to PAWC’s depreciation studies as follows:

Figure 1:  
Summary Depreciation Accrual Adjustment – 2025 Study

Plant Operations	PAWC Accrual	OCA Accrual	OCA Adjustment
Water Operations	\$ 190,896,455	\$ 154,040,446	\$ (36,856,009)
Wastewater Sanitary Sewer System (SSS)	26,745,064	20,638,871	(6,106,193)
Butler Area Sewer Authority (BASA)	10,875,378	7,071,721	(3,803,657)
Wastewater Combined Sewer System (CSS)	19,043,262	15,662,376	(3,380,886)
<b>TOTAL PLANT STUDIED</b>	<b>\$ 247,560,159</b>	<b>\$ 197,413,414</b>	<b>\$ (50,146,745)</b>

Figure 2:  
Summary Depreciation Accrual Adjustment – 2026 Study

<sup>140</sup> OCA St. 2 at 50.

<sup>141</sup> OCA St. 2SR at 15.

<sup>142</sup> *Id.* at 14.

Plant Operations	PAWC Accrual	OCA Accrual	OCA Adjustment
Water Operations	\$ 194,622,280	\$ 157,589,083	\$ (37,033,197)
Wastewater Sanitary Sewer System (SSS)	26,421,463	20,632,278	(5,789,185)
Butler Area Sewer Authority (BASA)	10,716,015	6,833,684	(3,882,331)
Wastewater Combined Sewer System (CSS)	18,983,484	15,870,260	(3,113,224)
Elizabeth Borough Wastewater	1,064,881	732,425	(332,456)
<b>TOTAL PLANT STUDIED</b>	<b>\$ 251,808,123</b>	<b>\$ 201,657,731</b>	<b>\$ (50,150,392)</b>

Figure 3  
Summary Depreciation Accrual Adjustment – 2027 Study

Plant Operations	PAWC Accrual	OCA Accrual	OCA Adjustment
Water Operations	\$ 204,148,039	\$ 167,195,229	\$ (36,952,810)
Wastewater Sanitary Sewer System (SSS)	26,943,479	21,141,801	(5,801,678)
Butler Area Sewer Authority (BASA)	11,299,118	7,431,909	(3,867,209)
Wastewater Combined Sewer System (CSS)	19,602,347	16,619,156	(2,983,191)
Elizabeth Borough Wastewater	1,035,500	742,790	(292,710)
<b>TOTAL PLANT STUDIED</b>	<b>\$ 263,028,483</b>	<b>\$ 213,130,885</b>	<b>\$ (49,897,598)</b>

**C. Case law does not prohibit the adoption of the ALG procedure.**

While PAWC is entitled to recover depreciation expense to ensure the utility is whole and the integrity of its investment maintained, the utility bears the burden of demonstrating that its claimed amounts to recover in in expenses are not excessive.<sup>143</sup> The U.S. Supreme court Stated:

[T]he company has the burden of making a convincing showing that the amounts it has charged to operating expenses for depreciation have not been excessive. That burden is not sustained by proof that its general accounting

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<sup>143</sup> 66 Pa. C.S. § 315(a); *Lindheimer v. Illinois Bell Telephone Co.*, 292 U.S. 151, 169 (1934) (*Lindheimer*); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 606 (1944) (*Hope*).

system has been correct. The calculations are mathematical, but the predictions underlying them are essentially matters of opinion.<sup>144</sup>

Additionally, the *Hope* court stated: “this Court recognized in [*Lindheimer*], the propriety of basing annual depreciation on cost. By such a procedure the utility is made whole and the integrity of its investment maintained. No more is required.”<sup>145</sup>

Importantly, the Commission is not bound by any particular methodology or procedure in determining annual depreciation expense. The Commonwealth Court stated as follows:

The [Commission] is not bound to accept any particular method in estimating accrued depreciation which is essentially a judgment figure. If the Commission based its finding on substantial evidence, it is binding upon appellate review.<sup>146</sup>

Similarly, the Superior Court stated:

It is recognized that accrued depreciation is essentially a judgment figure, based on all the evidence, and the weight to be given any particular estimate is for the commission. The commission is not bound to accept any particular method of estimating accrued depreciation.<sup>147</sup>

The only limitation on procedure is that the Commission must provide for the computation of a utility’s accumulated depreciation and annual depreciation expense on a reasonably consistent basis. Indeed, the Commonwealth Court in *Pa. Power* held that “[i]n a rate case, both annual depreciation expense allowance and accrued depreciation should

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<sup>144</sup> *Lindheimer* at 169.

<sup>145</sup> *Hope*, 320 U.S. at 606.

<sup>146</sup> *Pa. Power & Light Co. v. Pa. PUC*, 311 A.2d 151, 158 (Pa. Cmwlth. 1973) (*Pa. Power*).

<sup>147</sup> *Pittsburgh v. Pa. PUC*, 222 A. 2d 395 (Pa. Super. 1966) (upholding a Commission decision to give less weight to a utility’s depreciation study as the Commission had considered all relevant factors in connection with accrued depreciation).

be calculated on a reasonably consistent basis.”<sup>148</sup> Moreover, “[a]lthough the PUC **may be guided** by its finding of accrued and annual depreciation in a prior case or cases, in determining such items in a rate case currently before it, **such prior findings are not res judicata.**”<sup>149</sup>

In *Pa. Power*, the Commonwealth Court affirmed a Commission decision which disallowed PPL’s proposed rate increases based upon a determination of “annual depreciation” of PPL’s assets. The Commonwealth Court reasoned that the Commission consistently applied the same reserve requirement study methods and statistics for both accrued and annual depreciation.<sup>150</sup>

Importantly, the “reasonably consistent basis” language used by the Commonwealth Court specifically relates to the calculation of accrued depreciation and annual depreciation in determining just and reasonable rates.<sup>151</sup> However, it is not *de facto* authority of a utility’s depreciation procedure for its plant in rate base or a mandate that a utility’s procedure be accepted indefinitely. Merely because a utility used a depreciation procedure in the past is neither a justification nor a limitation for determining what constitutes just and reasonable rates in this proceeding.<sup>152</sup> Instead, both accrued and annual depreciation must be reasonably consistent with each other, which is accomplished by ALG.<sup>153</sup>

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<sup>148</sup> *Pa. Power* at 158.

<sup>149</sup> *Id.* (emphasis added).

<sup>150</sup> *Id.*

<sup>151</sup> *See Id.*

<sup>152</sup> *See Id.*

<sup>153</sup> *Id.*

**D. Nothing prohibits the adoption of the ALG procedure.**

The Public Utility Code does not require that a utility's currently utilized depreciation procedure for certain plant must be accepted indefinitely. Importantly, the Public Utility Code provides the following regarding depreciation:

**a) Accounts.**--Every public utility shall carry on its books or records of account, proper and reasonable sums representing the annual depreciation on its property used or useful in the public service, which sums shall be based upon the average estimated life of each of the several units or classes of depreciable property. The commission, by appropriate order, after hearing, shall, **except where found to be inappropriate**, establish for each class of public utilities, the units of depreciable property, the loss upon the retirement of which shall be charged to the depreciation reserve.

**(b) Statements.**--Every public utility shall file with the commission, at such times and in such form as the commission may prescribe, statements setting forth the details supporting its computation of annual depreciation, as recorded on the books or records of accounts of the public utility. **If the commission, upon review of such statements, is of the opinion that the amount of annual depreciation so recorded by any public utility is not reasonable and proper, it may, after hearing, require that provision be made for annual depreciation in such sums as may be found by it to be reasonable and proper.** In making its findings, the commission shall give consideration to the experience of the public utility, and the predecessors of the public utility in accumulating depreciation reserves, the retirements actually made, and such other factors as may be deemed relevant.

**(c) Use of estimates.**--**The commission shall not be bound in rate proceedings to accept, as just and reasonable for rate-making purposes, estimates of annual depreciation** established under the provisions of this section, but in such rate proceedings it shall give consideration to statements submitted under this section, in addition to such other factors as may be relevant.<sup>154</sup>

The Public Utility Code does not require that a utility's currently utilized depreciation procedure for certain plant must be accepted indefinitely.

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<sup>154</sup> 66 Pa. C.S. § 1703 (emphasis added).

The Commission's regulations provide:

(c) In subsequent ratemaking proceedings, the most recent annual depreciation report or service life study approved or deemed approved for accounting purposes **only** under this chapter, **constitutes a rebuttable presumption** as to the reasonableness of the accrued depreciation claimed for ratemaking purposes, and the burden of proving the unreasonableness of the accrued depreciation shall be on the challenging party.<sup>155</sup>

The purpose of the Commission's regulations regarding annual depreciation reports, service life studies, and capital investments plans is "to establish uniform and industry wide reporting requirements designed to improve the Commission's ability to monitor on a regular basis the depreciation practices and capital planning of electric, telephone, gas and water public utilities subject to Commission jurisdiction."<sup>156</sup>

The Commission's regulations must be read in the context of Section 1301(a)'s mandate that all rates be "just and reasonable"<sup>157</sup> and Section 315(a)'s placing of the burden of proof on the utility to establish the justness and reasonableness of every element of a propose rate increase.<sup>158</sup> Additionally, the U.S. Supreme Court stated that the public utility bears the burden of proof regarding operating expenses for depreciation:

The point is as to the necessity for the annual charges for depreciation, as made or claimed by the Company, in order to avoid confiscation through the rates in suit. On that point the Company has the burden of proof. We find that this burden has not been sustained. Nor is the result changed by figuring the allowances at the somewhat reduced amounts fixed by the court below.

We find this point to be a critical one. The questionable amounts annually charged to operating expenses for depreciation are large enough to destroy

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<sup>155</sup> 52 Pa. Code § 73.9(c) (emphasis added).

<sup>156</sup> 52 Pa. Code § 73.1

<sup>157</sup> 66 Pa. C.S. § 1301(a).

<sup>158</sup> 66 Pa. C.S. 315(a).

any basis for holding that it has been convincingly shown that the reduction in income through the rates in suit would produce confiscation.<sup>159</sup>

PAWC has the burden of proof to show that its rates are just and reasonable. As PAWC's rates have become increasingly unaffordable, PAWC's continued use of ELG due to PAWC's current use ELG is unjust and unreasonable.

**E. The ELG procedure is inconsistent with the “matching principle.”**

The well-established “matching principle” of ratemaking requires that expenses, revenue, and rate base match over the same time period.<sup>160</sup> For example, if post-test year additions to expenses and revenues are allowed, “the balance established by the test year is lost and the matching principle is violated.”<sup>161</sup> Two basic principles of public utility ratemaking are that: 1) a public utility only earns money from its rate base and 2) a public utility does not earn money on its expenses.<sup>162</sup> “A utility is not permitted to pad its estimates of annual depreciation so as to meet unknown contingencies, or to compensate for possible future errors in judgment.”<sup>163</sup>

OCA witness Garrett testified that ELG results in higher depreciation rates for current customers.<sup>164</sup> Mr. Garrett further testified that, “[t]he larger the amount of the investments, the larger the discrepancy will be between the two procedures.”<sup>165</sup>

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<sup>159</sup> *Lindheimer* at 175.

<sup>160</sup> *Pa. PUC v. NFGD*, 1994 Pa. PUC LEXIS 135, \*13 (Order Oct. 7, 1994) (*NFGD*).

<sup>161</sup> *Id.*; see also *Re. Niagra Mohawk Power Co.*, 1986 N.Y. PUC LEXIS 3, \*97 (Dec. 19, 1986) (a plant running for 50 years but packing all of its depreciation accruals into the first 40 years would violate generational equity and the matching principle).

<sup>162</sup> *Pa. Power* at 159.

<sup>163</sup> *Pa. Power* at 157.

<sup>164</sup> OCA St. 2SR at 15

<sup>165</sup> OCA St. 2 at 50.

Under ELG, annual depreciation expense is accelerated relative to accrued depreciation. The Kentucky Public Service Commission found that under ELG the depreciation reserve grows disproportionately fast in earlier years, producing mismatches between revenues and expenses.<sup>166</sup> ALG results in reasonably consistent annual expense relative to accrued depreciation, while ELG creates a mismatch between revenues, expenses, and rate base in violation of the matching principle.

**F. The ELG procedure results in intergenerational inequity.**

PAWC's use of the ELG procedure results in intergenerational inequity. As stated in *Re Minnegasco, Inc.* "[a]s a general rule, it is inequitable and economical [sic] unsound to ask one 'generation' of captive ratepayers to bear the cost of providing service to another."<sup>167</sup> PAWC's ratepayers should not be required to pay accelerated depreciation costs for the potential that years from now those rates may be lower to future customers, who may or may not be the same customers paying accelerated rates now. Moreover, Section 1304 of the Public Utility Code, which prohibits discrimination in rates, provides:

No public utility shall, as to rates, make or grant any unreasonable preference or advantage to any person, corporation, or municipal corporation, or subject any person, corporation, or municipal corporation to any unreasonable prejudice or disadvantage. No public utility shall establish or maintain any unreasonable difference as to rates, either as between localities or as between classes of service.<sup>168</sup>

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<sup>166</sup> OCA St. 1 at 50.

<sup>167</sup> *Re Minnegasco, Inc.*, 143 PUR4th 419, 426 (May 3, 1993) (Re Minnegasco is not available on LEXIS and is attached as Appendix D); see also *Re Limerick Nuclear Generating Station*, 1982 Pa. PUC LEXIS 102, \*65 Order (May 7, 1982).

<sup>168</sup> 66 Pa. C.S. § 1304.

Under Section 1304, PAWC's current customers are being unreasonably disadvantaged because they are subject to PAWC's preferred depreciation procedure. Consumers, on their own, cannot readily negotiate with a utility and must "rely upon" the Commission to provide "a complete, permanent, and effective bond of protection from excessive rates and charges" of the public utility.<sup>169</sup> The Commission's "responsibilities include the protection of future, as well as present, consumer interests."<sup>170</sup>

ELG is an accelerated form of depreciation, which causes current customers to pay greater depreciation expense than future customers for the same level of utility service, resulting in intergenerational inequity.<sup>171</sup> OCA witness Garrett testified that:

Furthermore, I do not believe the financial well being of future customers is the primary motivation for the Company's proposal to use the ELG method. Mr. Spanos does not represent either present or future customers in this case, and he exclusively represents utility companies as I understand. Also, in Mr. Spanos's rebuttal testimony, I did not see him rebut the fact that compared with the ALG procedure, the ELG procedure will result in higher depreciation rates for current customers. Likewise, the ELG procedure will result in higher cash flows for the Company relative to the ALG procedure.<sup>172</sup>

OCA witness Garret Further testified:

**Q. Did Mr. Spanos rebut the fact that current customers would pay more for the Company's assets relative to future customers under the ELG procedure?**

A. No. This point is undisputable and is proven mathematically in both Mr. Spanos's testimony and my testimony. Under the ELG procedure proposed

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<sup>169</sup> *Permian Basin Area Rate Cases*, 390 U.S. 747, 794-95 (1968) (*Permian Basin*) (citing *Atlantic Ref. Co. v. Pub. Serv. Comm'n*, 360 U.S. 378, 388 (1981)).

<sup>170</sup> *Permian Basin*, 390 U.S. at 797.

<sup>171</sup> See *Re Limerick Nuclear Generating Station*, 1982 Pa. PUC LEXIS 102, \*65 Order (May 7, 1982) ("Intergenerational inequities -- Current consumers should not pay for a plant from which they may not be around to benefit.")

<sup>172</sup> OCA St. 2SR at 15.

by Mr. Spanos (in this jurisdiction), current customers would effectively be subsidizing future customers by paying a larger proportionate share of what is essentially the same asset base.<sup>173</sup>

OCA witness Garrett testified that “[u]nder the ELG procedure, there are higher rates and accrual amounts during the earlier years.<sup>174</sup> OCA witness further Garrett testified that “[i]n reality, Columbia has numerous units of property that are depreciated on a group basis in each account.”<sup>175</sup> OCA witness Garrett further testified that:

Under the ELG procedure, customers rates (not just depreciation rates), would need to be adjusted every year in order for the ELG procedure to produce accurate depreciation rates. Since that is not practical, the vast majority of jurisdictions have adopted the ALG procedure.<sup>176</sup>

The ALG procedure simplifies the Commission’s ability to monitor depreciation practices and capital planning for regulated utilities, it furthers the Commission’s regulations regarding depreciation “to establish uniform and industry-wide reporting requirements designed to improve the Commission’s ability to monitor on a regular basis the depreciation practices and capital planning of electric, telephone, gas and water public utilities subject to Commission jurisdiction.”<sup>177</sup>

**G. ALG recovers depreciation expense while removing excess amounts.**

Use of the ALG procedure will permit PAWC’s recovery of reasonable amounts charged to operating expenses for annual depreciation, as required by *Lindheimer* and *Hope*, but will remove excess amounts from being charged in rates. Specifically, OCA

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<sup>173</sup> OCA St. 2SR at 17.

<sup>174</sup> OCA St. 2SR at 17.

<sup>175</sup> *Id.*

<sup>176</sup> OCA St. 2SR at 17.

<sup>177</sup> 52 Pa. Code § 73.1.

witness Garrett testified that PAWC's depreciation expense balance should be set in the FPFTY at \$213,130,885 in contrast with PAWC's claimed depreciation expense balance of \$263,028,483.<sup>178</sup> Mr. Garrett's adjustment of \$49,897,598 essentially removes the excess amounts charged to operating expense for annual depreciation based on use of the ELG procedure.<sup>179</sup>

Further, Mr. Garrett testified that PAWC's use of ELG unnecessarily increases the depreciation accrual charged to customer by approximately \$1.4 million stating:

The ALG method results in a fairer application of depreciation rates compared to the ELG method given the realities of ratemaking proceedings ... In other words, even if no other adjustments are made to the depreciation study except the adoption of the majority-view ALG method, it would result in a decrease of \$1.4 million to PAWC's proposed annual depreciation accrual.<sup>180</sup>

The sheer magnitude of the unreasonably high amount of depreciation expense PAWC unnecessarily proposes to charge ratepayers through the continued use of the ELG procedure is immediately apparent and mathematically uncontested.

By contrast the use of the ALG procedure will permit PAWC's accumulated depreciation and annual depreciation to be calculated on a reasonably consistent basis in accordance with *Pa. Power*. OCA witness Garrett testified, "the ALG procedure is used by analysts and adopted by regulators in the vast majority of jurisdiction and in the vast majority of cases".<sup>181</sup> Mr. Garrett further testified that:

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<sup>178</sup> OCA St. 2 at 5 (Figure 3).

<sup>179</sup> *Id.*

<sup>180</sup> OCA St. 2 at 47.

<sup>181</sup> OCA St. 2 at 48.

In reality, the Company's proposal to use the ELG method results in higher cash flow for the Company in the present, which is likely the primary motivation for the Company's proposal to use the ELG method. From my point of view, it is the ELG method, not the ALG method, that results in intergenerational inequity for customers. To say otherwise would mean that the vast majority of regulatory jurisdictions (using the ALG method) are authorizing inequitable depreciation rates, and have been doing so for decades, which cannot be accurate.<sup>182</sup>

PAWC's continued use of ELG will charge customers with nearly \$60 million of additional depreciation expense per year.<sup>183</sup> Conversely, ALG will simplify the Commission's ability to monitor depreciation practices and capital planning for regulated utilities, it furthers the Commission's regulations regarding depreciation "to establish uniform and industry-wide reporting requirements designed to improve the Commission's ability to monitor on a regular basis the depreciation practices and capital planning of electric, telephone, gas and water public utilities subject to Commission jurisdiction."<sup>184</sup>

**H. The vast majority of state commissions approve the ALG procedure.**

Given ELG's effect of accelerated depreciation recovery from ratepayers, OCA witness Garrett testified that "In my experience, the ALG procedure is used by analysts and adopted by regulators in the vast majority of jurisdiction and in the vast majority of cases."<sup>185</sup> OCA witness Garrett further testified that PAWC witness Spanos recommends using the ALG procedure in the vast majority of cases he appears in, including PPL's recent base rate case, stating:

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<sup>182</sup> OCA St. 2SR at 17-18.

<sup>183</sup> *Id.* at 18.

<sup>184</sup> 52 Pa. C.S. § 73.1.

<sup>185</sup> OCA St. 2 at 48.

Likewise, in the pending PPL case, only ALG depreciation rates were presented to the Commission for approval, including the rates proposed by Mr. Spanos in that case...Based on my experience, Mr. Spanos utilizes the ALG method in the vast majority of depreciation studies I have reviewed that have been sponsored by him and Gannett Fleming. This fact alone should negate any of Mr. Spanos's statements or inferences in his rebuttal testimony suggesting the ALG procedure might not be fair, accurate, or reasonable. In other words, his claim in this case that the ELG procedure is "more equitable" would necessarily mean that he is using a *less* equitable procedure in his depreciation studies in other jurisdictions.<sup>186</sup>

There are multiple examples of regulatory commissions moving away from the ELG procedure in favor of ALG. The Indiana Utility Regulatory Commission found that the ELG procedure resulted in unreasonable rates as follows:

First, with respect to the question of whether the ELG or ALG method should be used, we find the evidence presented by OUCC witness Mr. Garrett and Industrial Group witness Mr. Andrews persuasive, as both witnesses showed that the ELG method results in unreasonably high depreciation rates. ALG depreciation rates result in systematic and rational cost recovery with near term customer rate relief and full cost recovery of utility investments. While we have determined in the past that the ELG methodology was appropriate and acknowledge the weight given to precedent in many prior decisions, we always evaluate each case as it comes before us and do not need to approve the same methodology based on prior decisions, especially in light of a changed landscape. The use of ELG in a higher than average investment cycle has the effect of unnecessarily increasing the near term depreciation expense as compared to the use of ALG.<sup>187</sup>

Similarly, the Kentucky Public Service Commission (Kentucky PSC) found that the ELG procedure front-loads depreciation expense in earlier years and decreases it in later years, resulting in a mismatch between revenues and expenses. The Kentucky PSC stated:

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<sup>186</sup> OCA St. 2SR at 15.

<sup>187</sup> OCA St. 2 at 49-50 *citing Petition of Duke Energy Indiana, LLC.*, Cause No. 45253, Order at 90 (June 29, 2020) (*Duke Indiana*).

Duke Kentucky proposes, as part of developing its depreciation rates, continued use of the ELG procedure. The Attorney General recommends the Commission adopt the ALG procedure in developing Duke Kentucky's depreciation rates. The Attorney General contends that the ALG methodology is the predominant method that is used in the electric industry for developing depreciation rates. The Attorney General contends that, under the ELG methodology, the capital recovery periods are accelerated and shortened and, thus, the depreciation rates are greater than if the ALG procedure was used. The Attorney General argues that the ALG procedure is as accurate as the ELG procedure and the ALG procedure smooths the data so that the depreciation rates for the group of assets tend to remain constant. Use of the ALG procedure will result in a decrease in Duke Kentucky's depreciation expense of \$6.920 million.

Duke Kentucky requested an increase in depreciation expense of \$6.920 million, based on its request to utilize the ELG procedure for computing depreciation rates. As was discussed in the rate base section of this Order, this Commission has found that the ELG procedure does not accurately match revenues and expenses, is front-loaded, and Duke Kentucky is the only Kentucky based utility that utilizes the ELG procedure for computing depreciation rates.

Regulatory accounting requires the proper matching of revenues and expense in order to produce fair, just and reasonable rates. The Commission finds Duke Kentucky's proposed ELG procedure does not meet that criteria and that Duke Kentucky's depreciation expense should be reduced by \$6.920 million.<sup>188</sup>

Similar to *Duke Kentucky*, PAWC's proposed ELG methodology does not properly match revenues to expenses in order to produce just and reasonable rates. Importantly, the Kentucky PSC found that Duke Kentucky's continued use of the ELG procedure resulted in unjust and unreasonable rates due to a \$6.920 million difference to Duke Kentucky's depreciation expense balance between using ALG instead of ELG.<sup>189</sup> Here, the difference

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<sup>188</sup> OCA St. 2 at 49-50 *citing Application of Duke Energy Kentucky, Inc.*, Case No. 2017-00321, Order at 26-27 (Apr. 13, 2018) (*Duke Kentucky*).

<sup>189</sup> *Id.*

between the ELG and ALG procedure results in charging customers nearly a \$60 million difference per year.<sup>190</sup>

### **I. Conclusion**

PAWC's continued use of the ELG procedure imposes an unjustified and unreasonable \$58.7 million revenue requirement burden on ratepayers who already are facing difficulties.<sup>191</sup> The Commission has the authority to protect ratepayers from unjustified rate increase proposals, including PAWC's proposal to use the ELG procedure.<sup>192</sup> Further, continued use of the ELG procedure is not required by law or regulation.<sup>193</sup>

Substantial record evidence demonstrates that the ALG procedure produces just and reasonable rates while the ELG procedure is a form of accelerated depreciation.<sup>194</sup> OCA witness Garrett's depreciation rates were calculated using the same service life parameters proposed in PAWC's depreciation study.<sup>195</sup> No service life adjustments were recommended by OCA witness Garrett.<sup>196</sup> The only difference is that OCA witness Garrett uses the ALG procedure while PAWC witness Spanos uses the ELG procedure.<sup>197</sup>

Rejecting PAWC's proposal to continue using ELG is not only legally sound, it is essential in preventing the systematic overcharging of customers due to PAWC's choice of

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<sup>190</sup> OCA St. 2SR at 18.

<sup>191</sup> OCA St. 1 SR at 3.

<sup>192</sup> See Section VII.C.1.

<sup>193</sup> See Section VII.C.2.

<sup>194</sup> See Section VII D.

<sup>195</sup> OCA St. 2 at 56.

<sup>196</sup> *Id.* at 55.

<sup>197</sup> *Id.* at 56.

depreciation procedure to provide PAWC with a higher immediate cash flow at the expense of its ratepayers. By requiring PAWC to switch to the ALG procedure, the Commission will ensure reasonable consistency between annual depreciation and accrued depreciation. The Commission will also join the supermajority of states that require the ALG procedure.

## **IX. RATE OF RETURN**

### **A. Summary**

PAWC proposed an excessive 10.95% return on equity (ROE).<sup>198</sup> The Commission should adopt an overall weighted Rate of Return of 6.96% for water operations and 6.59% for wastewater operations with no adjustments to PAWC's proposed capital structure, and an 8.7% ROE based on OCA witness Garrett's discounted cash flow (DCF) and capital asset pricing model (CAPM), which produce a range of 6.8% to 9.3%.<sup>199</sup>

OCA witness Morgan testified that the primary driver of PAWC's rate increase is PAWC's requested 10.95% ROE.<sup>200</sup> The difference between the OCA's 8.7% ROE and PAWC's 10.95% ROE has a \$113.9 million impact on PAWC's rate increase request.<sup>201</sup> OCA witness Garrett testified that every 10 basis point change in the ROE in this case results in approximately \$5.3 million of impact to the revenue requirement at PAWC's as-filed case.<sup>202</sup> Mr. Garrett further testified that the market based evidence shows that PAWC's authorized ROE should be lower than their current authorized ROE of 9.45% and

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<sup>198</sup> OCA St. 2 at 2.

<sup>199</sup> OCA St. 2 at 2-3; Exhibit DJG-12.

<sup>200</sup> OCA St. 1SR at 3.

<sup>201</sup> *Id.*

<sup>202</sup> OCA St. 2SR at 2.

not more than 100 basis points higher as proposed by PAWC witness Bulkley.<sup>203</sup> Mr. Garrett testified that if PAWC is awarded a 9.45% ROE, it would reduce PAWC's revenue requirement to \$17.3 million.<sup>204</sup> Adopting Mr. Garrett's recommended adjustment to ROE would result in a \$113.9 million reduction to PAWC's requested revenue requirement.<sup>205</sup>

In recognition of the facts and analysis presented below, the OCA requests the Commission accept the OCA's 8.7% ROE because it results in just and reasonable rates.

**B. Proxy Group**

OCA witness Garrett's proxy group aligns with Commission precedent by containing exclusively water utilities.<sup>206</sup> In PAWC's last BRC, just two years ago, the Commission rejected a similar proxy group proposed by PAWC in this proceeding stating:

On review, we find that I&E's proxy group, comprised solely of water utilities, is the proxy group proffered in this proceeding that most closely resembles PAWC. Therefore, we shall deny PAWC's Exceptions on this issue, consistent with the following discussion.<sup>207</sup>

Here, OCA witness Garrett testified that, unlike PAWC witness Bulkley, he chose not to include gas companies because they are less comparable to PAWC than water utilities.<sup>208</sup> Mr. Garrett used American States Water Co., American Water works Company,

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<sup>203</sup> *Id.*

<sup>204</sup> OCA St. 2 at 41. A revenue requirement of \$17.3 million assumes all other OCA adjustments to the revenue requirement are adopted by the Commission.

<sup>205</sup> OCA St. 1SR at 3.

<sup>206</sup> OCA witness Garrett included Essential Utilities Inc. in his proxy group which has Aqua Pennsylvania as well as Peoples Natural Gas. Essential Utilities is in the process of being acquired by American Water Works Company.

<sup>207</sup> *Pa. PUC v. Pa.-American Water Co.*, Docket Nos. R-2023-3043189 *et al.*, Order at 28 (July 22, 2024) (*PAWC 2023*) (internal citations omitted).

<sup>208</sup> OCA St. 2 at 11

Inc., California Water Service Gp, Essential Utilities, Inc., Middlesex Water Co. and H2O America for his proxy group.<sup>209</sup> PAWC witness Bulkley critiqued OCA witness Garrett for including American Water and Essential Utilities in his proxy group due to the pending merger before the Commission.<sup>210</sup> Mr. Garrett testified that the merger could significantly reduce PAWC's risk as follows:

Ms. Bulkley discusses the proposed merger as justification for excluding WTRG from the proxy group, even though it would have no material impact on the cost of equity modeling results (as discussed above). However, Ms. Bulkley also does not address any potential risk-reducing impacts of the proposed merger. A merger between AWK and WTRG could significantly reduce risk for the combined entity by improving financial stability, and geographic diversity. Intuitively, it would not make sense for entities to consider a merger that management would anticipate could increase the combined entity's risk profile.<sup>211</sup>

OCA witness Garrett's proxy group contains utilities that are comparable to PAWC.

As such, the OCA's proposed proxy group is reasonable.

**C. Capital Structure**

The OCA did not address this issue in its testimony.

**D. Cost of Long-Term Debt**

The OCA did not address this issue in its testimony.

**E. Return on Equity**

The OCA recommends an 8.7% ROE based on OCA witness Garrett's discounted cash flow (DCF) and capital asset pricing model (CAPM). Mr. Garrett's DCF produced a range of possible reasonable ROE's from 6.8% to 9.3%.<sup>212</sup> Mr. Garrett's CAPM analysis

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<sup>209</sup> OCA Exh. DJG-8.

<sup>210</sup> OCA St. 2SR at 5.

<sup>211</sup> OCA St. 2SR at 6.

<sup>212</sup> OCA Exh. DJG-12.

produced an ROE of 8.7%, confirming the range provided in his DCF model is reasonable.<sup>213</sup>

In 2023, PAWC requested the same excessive 10.95% ROE.<sup>214</sup> In its previous base rate proceeding, PAWC requested a 25 basis point adder to its ROE based on superior management.<sup>215</sup> The Commission rejected PAWC's management performance adder.<sup>216</sup> The Commission also rejected PAWC's 10.95% ROE and found that a 9.45% ROE was appropriate by averaging I&E's DCF and CAPM which ranged from 8.45% to 10.44%.<sup>217</sup>

In this proceeding PAWC again requests a 10.95% ROE.<sup>218</sup> OCA witness Morgan noted that the primary driver of this BRC is related to PAWC's ROE stating:

For the combined water and wastewater operations, these two components account for approximately \$173 million of the OCA's recommended reduction in the proposed rate increase. The revenue requirement effect of the OCA's change in the Company's requested return on equity ("ROE") accounts for \$113.9 million ...and the OCA's change in depreciation rates accounts for \$58.7 million.<sup>219</sup>

## 1. DCF Model

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<sup>213</sup> *Id.*

<sup>214</sup> *Id.* at 189.

<sup>215</sup> *Id.* at 174.

<sup>216</sup> *Id.* at 185.

<sup>217</sup> *Id.* at 194

<sup>218</sup> OCA St. 2 at 2.

<sup>219</sup> OCA St. 1SR at 3.

OCA witness Garrett applied a DCF analysis based on analyst growth projections and another based on sustainable growth projections.<sup>220</sup> The Analyst Growth DCF Model resulted in a 9.3% ROE and the Sustainable Growth DCF Model resulted in a 6.8% ROE.<sup>221</sup>

There are three primary inputs in the DCF Model: 1) stock price; 2) dividend; and 3) the long term growth rate.<sup>222</sup> Mr. Garrett used a 30-day average of stock prices for each company in the proxy group to calculate stock price.<sup>223</sup>

OCA witness Garrett used forward-looking annualized dividends published by Yahoo! Finance.<sup>224</sup> Mr. Garrett testified that the stock price and dividend inputs for each proxy group are not a significant issue in this case.<sup>225</sup>

None of PAWC witness Bulkley's DCF results indicate a 10.95% ROE, with the highest being 10.45%.<sup>226</sup> Bulkley's DCF produced an average result of 10.42%.<sup>227</sup>

Mr. Garrett testified that the primary difference between his DCF and Ms. Bulkley's is Ms. Bulkley's use of unsustainably high growth rates in her proxy group.<sup>228</sup> Ms. Bulkley considered average growth rates as high as 13% for individual companies in her proxy group.<sup>229</sup> These growth rates are significantly higher than projected annual U.S. GDP

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<sup>220</sup> OCA St. 2 at 18-27.

<sup>221</sup> *Id.* at 41.

<sup>222</sup> OCA St. 2 at 19.

<sup>223</sup> *Id.*

<sup>224</sup> OCA St. 2 at 20.

<sup>225</sup> *Id.*

<sup>226</sup> *Id.*

<sup>227</sup> OCA St. 2 at 26.

<sup>228</sup> OCA St. 2 at 26.

<sup>229</sup> *Id.* at 27.

growth over the long run.<sup>230</sup> Mr. Garrett explained that “growth rates that exceed GDP effectively suggest that the individual earnings of a single company will eventually surpass U.S. GDP, which is impossible.”<sup>231</sup> Mr. Garrett further testified that it is reasonable to assume that a regulated utility would grow at a rate less than the U.S. economic growth rate because, unlike competitive firms which can increase their growth through a new product line, franchising, or expanding into developing markets, utility operating companies with defined service territories grow similarly.<sup>232</sup>

## 2. CAPM

The CAPM is used as a check on the reasonableness of the DCF.<sup>233</sup> In calculating the CAPM, OCA witness Garrett determined the appropriate values of ranges of the three model inputs: 1) risk-free rate; (2) beta, and; (3) equity risk premium.<sup>234</sup> OCA witness Garrett’s CAPM resulted in an 8.7% cost of equity.<sup>235</sup>

### a. Risk Free Rate based on U.S. Treasuries

The risk-free rate is the level of return investors can achieve without assuming any risk.<sup>236</sup> Mr. Garrett testified that, even though no investment is technically devoid of risk, investors often use U.S. Treasury securities to represent the risk-free rate because they

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<sup>230</sup> *Id.*

<sup>231</sup> OCA St. 2 at 27.

<sup>232</sup> *Id.*

<sup>233</sup> *Pa. PUC v Aqua Pennsylvania, Inc.*, 2022 Pa. PUC LEXIS 161, \*83, (Order May 16, 2022) (*Aqua 2022*).

<sup>234</sup> OCA St. 2 at 28.

<sup>235</sup> *Id.* at 36.

<sup>236</sup> *Id.* at 28.

accept that those securities essentially contain no default risk.<sup>237</sup> Mr. Garrett noted “long-term Treasury bonds are usually used to represent the risk-free rate in the CAPM.”<sup>238</sup> OCA witness Garrett considered a 30-day average of daily U.S. Treasury yield curve rates on 30-year Treasury bonds for the risk-free rate, which result in a risk-free rate of 4.66%.<sup>239</sup>

**b. OCA witness Garrett uses the most recent Value Line beta.**

Beta represents the sensitivity of a given security to movements in the overall market.<sup>240</sup> An index, such as the S&P 500, is used as a proxy for the market portfolio.<sup>241</sup> A security with a beta greater than 1.0 is more sensitive to market risk than the average stock while a security with a beta less than 1.0 is less sensitive to market risk.<sup>242</sup>

OCA witness Garrett used betas recently published by Value Line Investment Survey.<sup>243</sup> The beta for each proxy company as less than 1.0 with the average beta for the total proxy group being 0.78.<sup>244</sup> Mr. Garrett testified that this survey objectively proves that utility stocks are less risky than the average stock in the market.<sup>245</sup>

**c. Reliance on expert surveys is reasonable.**

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<sup>237</sup> *Id.*

<sup>238</sup> *Id.*

<sup>239</sup> *Id.*

<sup>240</sup> *Id.*

<sup>241</sup> *Id.*

<sup>242</sup> *Id.* at 29-30.

<sup>243</sup> *Id.* at 30.

<sup>244</sup> *Id.*

<sup>245</sup> *Id.*

Equity Risk Premium (ERP) is the most important factor in estimating the cost of capital through the CAPM.<sup>246</sup> OCA witness Garrett used two methods to estimate the ERP: (1) expert surveys and (2) calculating the implied ERP.<sup>247</sup>

The expert survey approach to estimating ERP relies on surveys of professors, analysts, chief financial officers, and other executives, asking what experts think the ERP is.<sup>248</sup> The IESE Business School conducts an expert survey every year and its 2025 survey reported an average ERP of 5.5%.<sup>249</sup>

OCA witness Garrett considered the results of expert surveys, the estimated ERP reported by Kroll, the estimated ERP calculated by Dr. Damodaran, and the implied ERP based on Mr. Garrett's calculations.<sup>250</sup> The results were as follows:

IESE Business School Survey	5.5%
Kroll (Duff & Phelps) Report	5.0%
Damodaran (average)	4.4%
Garrett	5.0%
<b>Average</b>	<b>5.0%</b>

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<sup>246</sup> *Id.*

<sup>247</sup> *Id.* at 32

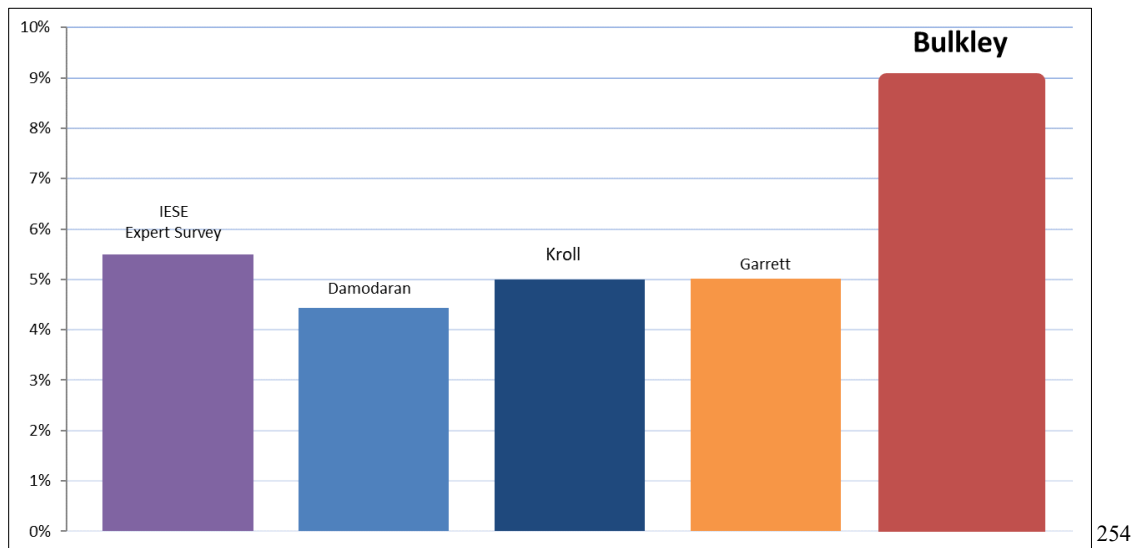
<sup>248</sup> *Id.* at 33.

<sup>249</sup> *Id.*

<sup>250</sup> *Id.* at 36.

<sup>251</sup> OCA St. 2 at 36.

OCA witness Garrett used the average from these sources to arrive at the 5.0% ERP for his CAPM.<sup>252</sup> Mr. Garrett’s ERP estimate is reasonable and falls within an appropriate range of possibilities. By contrast, PAWC witness Bulkley’s used an ERP estimate as high as 8.94% in her CAPM analysis.<sup>253</sup> To following table illustrates the significant variance between PAWC witness Bulkley, OCA witness Garrett, and leading scholars/institutions:



Mr. Garrett testified as follows:

When compared with other independent sources for the ERP (as well as my estimate), which do not have a wide variance, Ms. Bulkley’s ERP estimate is clearly not within the range of reasonableness. Ms. Bulkley offers various criticisms of these sources, and basically argues the Commission should accept her estimate over the opinions of hundreds of CEOs, CFOs, scholars, and an international corporate finance advising company. I would argue that investors are more likely to rely on these types of sources for the ERP than Ms. Bulkley’s personal ERP estimate. Effectively, Ms. Bulkley is suggesting the Commission should adopt her ERP estimate over the opinions of

<sup>252</sup> *Id.*

<sup>253</sup> OCA St. 2 at 38.

<sup>254</sup> OCA St. 2 SR at 12.

thousands of unbiased experts, Kroll (a global financial advisory firm), and one of the world's leading experts on the ERP.<sup>255</sup>

Thus, the Commission should find that PAWC's CAPM analysis utilized an inappropriately high ERP.

### **3. Reasonableness of the OCA's proposed ROE**

In response to critique regarding his recommended ROE, OCA witness Garrett:

In this case, if I simply averaged the analyst-growth variation of my DCF Model (9.3%) and the results of my CAPM (8.7%), the result would be 9.0%. An authorized ROE of 9.0% would certainly be much fairer than the ROE proposed by the Company...However, my recommended ROE of 8.7% is notably higher than my modeling average. In that regard, an authorized ROE of 8.7% is still likely higher than PAWC's market-based cost of equity. Thus, my proposed ROE is not simply a low result that would reduce rates for customers, but rather it would be a fair outcome for both the Company and customers that would reduce the excess transfer of wealth from customers to shareholders that would otherwise occur under the Company's proposed ROE.<sup>256</sup>

I&E recommended an ROE of 9.8% based on the results of I&E witness Patel's DCF and CAPM which were 10.09% and 9.51% respectively.<sup>257</sup> Mr. Garrett testified that I&E's proposed ROE was much higher due to I&E witness Patel's use of unsustainably high growth rates.<sup>258</sup> Mr. Patel used a composite growth rate for the proxy group of 7.13%, which assumes that PAWC can achieve dividend and/or earnings growth at a rate nearly double the projected annual GDP growth every year in perpetuity.<sup>259</sup> Mr. Garrett testified

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<sup>255</sup> *Id.*

<sup>256</sup> OCA St. 2SR at 2-3 (emphasis added).

<sup>257</sup> OCA St. 2R at 1.

<sup>258</sup> OCA St. 2R at 3.

<sup>259</sup> *Id.*

“from a strict mathematical standpoint this suggests that the annual earnings of the proxy group would eventually surpass total U.S. GDP, which is impossible.”<sup>260</sup>

On cross examination, PAWC witness Bulkley testified that increased inflationary concerns negatively impact PAWC ratepayers.<sup>261</sup> Ms. Bulkley further testified that as increases in fuel prices due to inflation and the conflict in Iran, PAWC ratepayers need to pay more for fuel like gasoline, diesel, and heating oils.<sup>262</sup> The Commission should account for the rising affordability concerns of PAWC ratepayers in determining a just and reasonable ROE. PAWC failed their burden of proof that a 10.95% ROE is reasonable.

#### **F. Management Performance**

PAWC requests that the Commission adopt a rate of return on equity of 10.95%, the upper end of PAWC witness Bulkley’s recommended range, in recognition of PAWC’s superior management performance.<sup>263</sup> However, Ms. Bulkley does not provide a specific amount of ROE as a management adder.<sup>264</sup> PAWC’s alleged superior management performance is partially encompassed by what PAWC witness Ladner testified to as “efforts in many areas across the business that benefit customers.”<sup>265</sup> The voluminous amount of formal and informal complaints, public input hearing testimony, and the testimonies of OCA witness Alexander regarding customers service and OCA witness Colton regarding PAWC’s service to its low-income customers tells a different story.

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<sup>260</sup> *Id.*

<sup>261</sup> Tr. at 1831.

<sup>262</sup> Tr. at 1829-1830.

<sup>263</sup> OCA St. 2 at 41-42.

<sup>264</sup> *Id.*

<sup>265</sup> PAWC St. 1 at 9.

The Commission is not obligated to increase PAWC’s ROE. Under the constitutional standards, the return needs to be “equal to that being made at the same time on investments in other business undertakings which are attended by corresponding risks and uncertainties”<sup>266</sup> 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.”<sup>267</sup>

OCA witness Garrett testified that “[t]he performance of company management should not be a factor when determining a fair authorized ROE for the Company.”<sup>268</sup> Mr. Garrett explained that the authorized ROE should be based on the cost of equity and that the cost of equity is not impacted by management performance.<sup>269</sup> Mr. Garrett testified that above-average managerial performance would actually have a decreasing effect on the cost of equity due to its risk reducing effect.<sup>270</sup>

Throughout the public input hearings PAWC customers testified to the poor customer service they received from interactions with PAWC as well as to the poor quality of water and service disruptions.<sup>271</sup> Additionally, as discussed in Section XIII.B, OCA witness Alexander testified that PAWC’s call center performance is inadequate and has been inadequate for some time.<sup>272</sup>

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<sup>266</sup> *Bluefield* at 692.

<sup>267</sup> *Hope* at 603.

<sup>268</sup> OCA St. 2 at 42.

<sup>269</sup> *Id.*

<sup>270</sup> *Id.*

<sup>271</sup> *See generally* OCA St. 5 at App. A.

<sup>272</sup> OCA St. 5 at 5, 10-11, 16-17, 32-33.

OCA witness Colton testified that several provisions of PAWC's service as reasons why that management performance does not warrant using a higher return on equity in this proceeding. First, Mr. Colton notes that PAWC has not been successful in identifying its low-income customer population.<sup>273</sup> As noted previously, PAWC has developed no mechanism to identify roughly 90% of the low-income population in its service territory and, by inattention to identifying its low-income population, Mr. Colton testified:

PAWC locks itself into what the Commission has previously found to be the "wasteful cycle of consecutive, unrealistic payment agreements that cannot be kept, despite the best of intentions, followed by service termination, then restoration and then more unrealistic agreements."<sup>274</sup>

Second, PAWC continues to offer Deferred Payment Arrangements (DPAs) to low-income customers which are largely ineffective at providing an opportunity for those customers to retire their arrears. Mr. Colton testified that "[f]rom a management perspective, however, it is the failure to respond to this high level of defaults to determine why those defaults occur and thus to examine what the Company might do differently to improve its performance."<sup>275</sup> PAWC is entering into tens of thousands of payment arrangements which default and yet PAWC has made no effort to determine why, or to examine what might be done differently to improve its performance.<sup>276</sup>

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<sup>273</sup> OCA St. 4 at 112.

<sup>274</sup> OCA St. 4 at 113 *citing Pa. PUC v. Columbia Gas of Pennsylvania, Inc.*, Docket Number R-891468, Order at 159 (Sept. 19, 1990).

<sup>275</sup> OCA St. 4 at 113.

<sup>276</sup> OCA St. 4 at 114.

Third, Mr. Colton opposes a management adder and high ROE because of PAWC's reliance on the disconnection of service to control its unpaid bills. Mr. Colton's examination revealed that "for every one nonpayment disconnection PAWC pursues, ... it issues 15 disconnect notices" and that "a significant number of the Company's identified low-income customers maintain arrearage balances of 91 days or more, despite receiving disconnection notices."<sup>277</sup> Mr. Colton concludes that "not only are PAWC disconnection notices ineffective in preventing the disconnection of service for nonpayment, the notices are also ineffective at promoting payments that reduce long-term arrears."<sup>278</sup> The management implication regarding disconnection notices is not only a recognition of PAWC's continued reliance on a collection process that is demonstrably ineffective, but is also the failure to consider or address the reason why the practice is ineffective that demonstrates less than superior management performance.<sup>279</sup>

Lastly, PAWC's disregard of the winter shutoff moratorium also warrants not including a performance adder for ROE or a high ROE. According to Mr. Colton's analysis, despite the fact that nonpayment disconnections of customers with incomes of 250% of the federal poverty level or less are barred by law, PAWC continues to issue disconnect notices warning of an impending disconnection in the absence of a customer payment.<sup>280</sup> PAWC's

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<sup>277</sup> OCA St. 4 at 114-115.

<sup>278</sup> OCA St. 4 at 117.

<sup>279</sup> OCA St. 4 at 117 *citing* OCA-04-031 (the Company does not have documents that assess why nonpaying residential customers do not make contact with the utility when, in response to bill nonpayment, those nonpaying customers receive a request or notice to contact a utility to avoid the disconnection of service.)

<sup>280</sup> OCA St. 4 at 118-120; OCA Exh. RDC-5.

disconnection notice does not make any mention of the availability of protections offered by the shutoff moratorium. Mr. Colton characterized this as a “serious management failure” that contradicts Commission regulations.<sup>281</sup>

PAWC’s response to the impact of management performance on return on equity is limited to focusing solely on PAWC’s acquisition of troubled systems.<sup>282</sup> However, under Section 1329, a system does not have to be troubled to be acquired.<sup>283</sup> Acquisitions under Section 1329 already grant PAWC a ratemaking rate base under fair market value and thus should have no impact on PAWC’s ROE.<sup>284</sup> Troubled systems are generally acquired under Section 529.<sup>285</sup> In this proceeding there is only one acquisition being proposed by PAWC that was acquired under Section 529, namely Rock Springs, where all other systems were acquired under Sections 1102 or 1329.<sup>286</sup>

**X. RATE STRUCTURE**  
**A. Cost of Service Studies**  
**1. Water Operations**

OCA witness Mierzwa testified that, PAWC’s water class cost of service study needs to be revised to include more recent system wide maximum day and maximum hour demand factors, otherwise PAWC’s rates fail to meet the just and reasonable standard.<sup>287</sup>

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<sup>281</sup> OCA St. 4 at 121, citing, 52 Pa. Code § 56.99 (“A public utility may not threaten to terminate service when it has no present intent to terminate service or when actual termination is prohibited under this chapter”).

<sup>282</sup> PAWC St. 2-R at 21-22 and 24-26.

<sup>283</sup> 66 Pa. C.S. § 1329.

<sup>284</sup> OCA St. 1 at 10; *McCloskey v. Pa. PUC*, 195 A.3d 1055, 1066 (Pa. Cmwlth. 2018).

<sup>285</sup> 66 Pa. C.S. § 529.

<sup>286</sup> See PAWC St. 1 at 10-15, PAWC St. 7 at 3-11.

<sup>287</sup> OCA St. 3 at 14; 66 Pa. C.S. §§ 1301, 1304.

Without this adjustment, Residential customers will be overpaying \$7.2 million dollars based on PAWC's as-filed revenue amount.<sup>288</sup>

PAWC's water COSS uses the base-extra capacity method.<sup>289</sup> No party disputes the use of the base-extra capacity (BEC) method and commission precedent recognizes it as a reasonable method to determine cost of service and method for allocation.<sup>290</sup>

A key functional cost category in the BEC method is the "Extra Capacity Costs," which OCA witness Mierzwa explains as follows:

Extra Capacity Costs are costs associated with meeting usage requirements in excess of average usage. This includes operating and capital costs for additional plant and system capacity beyond that required for average usage. Extra capacity costs in the Company's study have been subdivided into costs necessary to meet maximum day extra demand and maximum hour extra demand. These extra capacity costs were allocated to customer classes on the basis of each class's maximum day and maximum hour usage in excess of average usage.<sup>291</sup>

To calculate Extra Capacity Costs, PAWC developed numerical factors which it incorporates into its COSS.<sup>292</sup> In this case, PAWC used a system-wide maximum day extra-capacity demand factor of 1.4 and a system-wide maximum hour extra capacity factor of

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<sup>288</sup> OCA St.3 at 18.

<sup>289</sup> PAWC St. 12 at 6.

<sup>290</sup> *Pa. PUC v. York Water Company*, R-2025-3053442, Order at 70 (Feb. 19, 2026) citing *Pa. PUC v. Aqua Pa. Inc.*, R-2021-3027385, Order (May 16, 2022).

<sup>291</sup> OCA St. 3 at 12-13.

<sup>292</sup> PAWC St. 12-R at 3-6.

2.1 in its water COSS.<sup>293</sup> The extra-capacity factors used by PAWC in this proceeding are the same factors utilized in PAWC's 2023 base rate proceeding.<sup>294</sup>

The system-wide extra-capacity demand factors PAWC applied to its COSS in this case are outdated and do not reflect current customer usage.<sup>295</sup> The system-wide maximum day extra capacity demand factor used in PAWC's COSS was last experienced in 2003, or almost 25 years ago.<sup>296</sup> Since 2003, PAWC's water demand has changed due to aggressive water conservation, legislation, development, and changing land uses.<sup>297</sup> PAWC's 1.4 maximum day extra-capacity demand factor is reflective of actual maximum day to average day demands observed for the years 1988, 1995, 1996, 1999 and 2003.<sup>298</sup> Mr. Mierzwa testified that the maximum hour extra capacity demand factor of 2.1 is based on an analysis of peak hour consumption experienced by PAWC in its three largest operating districts.<sup>299</sup> This peak hour analysis was conducted in 1988, nearly 40 years ago.<sup>300</sup>

Mr. Mierzwa recommends utilizing system-wide extra day and extra hour demand factors of 1.2 and 1.5 respectively. The extra day factor is based on the actual systems' usage going back to 2011.<sup>301</sup> Mr. Mierzwa likewise based the extra hour factor on the recent

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<sup>293</sup> OCA St. 3 at 14.

<sup>294</sup> *Id.* at 15 (*Pa. PUC v. Pennsylvania American Water Company*, R-2023-3043189 (July 11, 2024)).

<sup>295</sup> *Id.*

<sup>296</sup> *Id.*

<sup>297</sup> *Id.*

<sup>298</sup> *Id.* at 14.

<sup>299</sup> *Id.*

<sup>300</sup> *Id.*

<sup>301</sup> *Id.* at 17.

actual demands experienced by PAWC as reflected on Table 1 and Table 2 presented by Mr. Herbert in his Direct Testimony.<sup>302</sup>

Mr. Mierzwa included the following table to illustrate the difference between using his extra capacity factors, which are based on more recent system usage, or PAWC’s extra capacity factors, which is based off of obsolete data:

<b>Table 1. Water Direct Cost of Service Study Comparison<sup>303</sup></b>			
<b>Classification</b>	<b>Initial Company</b>	<b>OCA</b>	<b>Difference</b>
Residential	\$682,920,439	\$675,657,224	(\$7,263,215)
Commercial	245,729,206	241,688,665	(4,040,541)
Industrial	45,903,121	51,079,540	5,176,419
Industrial – Contract Sales	5,383,847	5,636,175	252,328
Public (Municipal)	25,209,837	27,383,917	2,174,080
Other Water Utilities – Group A	1,188,981	1,266,060	77,079
Other Water Utilities – Group B	29,187	23,821	(5,366)
Other Water Utilities – Contract Sales	7,456,244	7,914,764	458,520
Private Fire Protection	7,794,783	9,199,248	1,404,465
Public Fire Protection	14,138,879	15,905,110	1,766,231
<b>Total:</b>	<b>\$1,035,754,523</b>	<b>\$1,035,754,523</b>	<b>\$0</b>

Mr. Mierzwa’s revisions bring PAWC’s water COSS to just and reasonable standard and the Commission should agree for the following three reasons:

<sup>302</sup> *Id.* at 17 (citing PAWC St. 1 at 12).

<sup>303</sup> *Id.* at 18. (Mr. Mierzwa’s comparison below is based on PAWC’s as-filed requested revenue requirement claim but excludes any Act 11 shift of the wastewater revenue requirement to water service customers).

First, PAWC used the same maximum day and maximum hour system-wide maximum capacity factors in its 2023 rate case. Mr. Mierzwa was the OCA’s witness in that proceeding and raised the same concerns about PAWC using outdated information in its COSS.<sup>304</sup> In its Order, the Commission found PAWC’s COSS to be “adequate” and did not require any changes, but agreed the extra capacity factors to be outdated.<sup>305</sup> The Commission stated:

Although, for the purposes of this proceeding, we have found that the Company’s water COSS should be accepted as adequate given the data available in this case, we acknowledge that PAWC has not updated its analysis of system-wide maximum hour extra capacity demands since 1988. As indicated by the Company, the system-wide maximum day extra capacity demand factor used in its water COSS was last experienced in 2003, which was over twenty (20) years ago. Since 2003, water demand on the PAWC system has changed due to water conservation, legislation, development, and changing land uses. Therefore, since PAWC does not have recent actual maximum peak hour demand data for its water system, we agree with the ALJs’ recommendation that PAWC should be required to update this analysis prior to its next base rate proceeding and include the results of that analysis in the COSS filed in the next base rate proceeding.<sup>306</sup>

PAWC nominally complied with the Commission’s order and included new maximum hour demand data in in Table 1 and Table 2 on page 12 of Mr. Herbert’s testimony (PAWC Statement No. 12) and developed updated maximum hour extra capacity factors based on that data.<sup>307</sup> However, PAWC did not utilize those updated capacity

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<sup>304</sup> OCA St. 3 at 16.

<sup>305</sup> *Id.*

<sup>306</sup> *Pa. PUC v. Pennsylvania American Water Company*, R-2023-3043189, Order at 209 (July 11, 2024).

<sup>307</sup> OCA St. 3 at 16-17.

factors in its COSS. The Commission should not permit PAWC to continue reusing stale extra capacity demand factors in its COSS and use the results of Mr. Mierzwa's COSS.

Second, in accordance with the American Water Works Association's Manual, M1, Principles of Water Rates, Fees, and Charges (AWWA M1 Manual), development of demand factors should be based off a "representative number of recent years."<sup>308</sup> Mr. Mierzwa developed his up-to-date demand factors according to the manual: "I believe that 14 years meets the standard identified in the AWWA M1 Manual, and the more than 25 years relied upon by PAWC does not. Demands experienced over 25 years ago are not representative of current demands."<sup>309</sup> PAWC witness Herbert countered by testifying that a water system must be designed to meet the highest peak demand that potentially could be experienced – not just the highest peak demand that was experienced within a recent historical period.<sup>310</sup> He draws on historical data that show the demand factors in PAWC's COSS were once applicable to the PAWC system, therefore they continue to be applicable to PAWC's system.<sup>311</sup>

Mr. Herbert's observations are not based using the recent information, therefore his primary argument about *potential* peaks should be afforded little consideration. To emphasize this point, Mr. Mierzwa observed that "PAWC witness Max McClellan presents evidence on pages 50-56 of his direct testimony that indicates that there has been a

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<sup>308</sup> OCA St. 3 SR at 2.

<sup>309</sup> *Id.*

<sup>310</sup> PAWC St. 12 R at 3-4.

<sup>311</sup> *Id.*

pervasive decline in customer usage over the last 10 years, and Mr. McClellan believes that this trend will continue.”<sup>312</sup> This statement supports Mr. Mierzwa’s methodology for developing maximum day and maximum hour extra capacity factors because they are consistent how PAWC’s system currently operates.

In a recent proceeding, the Commission agreed with the OCA that the York Water Company needed to update its maximum day and maximum hour extra capacity factors because the data they are based off are outdated.<sup>313</sup> Like this case, York Water Company was utilizing data decades old and like this case, Mr. Mierzwa proposed using extra capacity factors based off of system usage from more recent years.<sup>314</sup> The Commission wrote in its order:

We also agree with the ALJs that York Water has not satisfied its burden of proof to demonstrate that its proposed COSS is reasonable. That is, we find that York Water did not justify that data from a customer class demand study conducted in the 1970s is useful and reliable, given how the Company’s customers utilize York Water’s current system. We are not persuaded by York Water’s decision not to conduct a demand study to inform its COSS in the instant proceeding. As observed by the ALJs, York Water’s demand data does not meet the “over a representative number of recent years” standard from the AWWA Manual. Indeed, as the ALJs observed, York Water’s decision not to conduct a demand study contributed to the Company’s failure to meet its burden of proving the justness and reasonableness of its COSS. See R.D. at 114-16 (emphasis in original). We concur.<sup>315</sup>

The Commission should likewise reject PAWC’s COSS and utilize OCA witness Mierzwa’s, which includes more recent maximum capacity demand factors.

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<sup>312</sup> OCA St. 3SR at 2-3.

<sup>313</sup> *Pa. PUC v. York Water Company*, R-2025-3053442, Order (Feb. 19, 2026).

<sup>314</sup> *Id.*

<sup>315</sup> *Id.* at 75.

## 2. Wastewater Operations

The OCA recommends no direct adjustments to PAWC's Wastewater COSS.<sup>316</sup>

## 3. Class Cost of Service Studies For Future Rate Increases

The Commission should direct PAWC to continue preparing separate COSSs in the first base rate case that includes those systems, unless the utility shows in the underlying Section 1329 proceeding that a separate COSS should not be required. This is accordance with the Commission's Order in PAWC's 2023 base rate case:

We agree with the ALJs' recommendation that, not only should PAWC continue to prepare separate COSSs for new Section 1329 acquisitions in the first base rate proceeding where those systems are included in PAWC's revenue requirement, but for Section 1329 acquisitions that are included in the present base rate case, PAWC should continue to prepare separate COSSs either individually for each acquisition or as a group. This requirement is reasonable given the amount of revenue requirement at issue and the principle that rates should be reasonably cost-based . . . We find that this requirement allows for greater transparency of the system in order to determine whether an Act 11 reallocation to subsidize a revenue shortfall is actually in the public interest.<sup>317</sup>

OCA witness Mierzwa testified that this an important practice to continue: "This requirement is reasonable given the amount of revenue requirement at issue and the principle that rates should be reasonably cost-based."<sup>318</sup> PAWC witness Chard testified requesting that the Commission "reconsider" this practice and claiming among other reasons, it is inconsistent with the goals of single tariff pricing and that it adds cost that are

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<sup>316</sup> OCA St. 3 at 19.

<sup>317</sup> *Pa. PUC v. Pennsylvania American Water Company*, R-2023-3043189, Order at 217-218 (July 11, 2024).

<sup>318</sup> OCA St. 3 at 20.

passed on to customers.<sup>319</sup> PAWC’s reasons do not address the problem of determining whether rates are cost-based.<sup>320</sup>

PAWC should continue to provide separate COSS for the Section 1329 systems either individually or (for non-CSS Wastewater only) as a group and where Section 1311(c) is used to require water customers to subsidize revenue shortfall for systems acquired under Section 1329, the amount of that subsidy should be known and transparent, so a determination can be made whether the proposed Act 11 reallocation is in the “public interest.”<sup>321</sup>

**B. Revenue Allocation/Act 11 Shift**

Pursuant to Section 1311(c), the Commission allows a public utility like PAWC to allocate a portion of its Wastewater revenue requirement to its combined Water and Wastewater customer base, if it is in the public interest.<sup>322</sup> In its filing, PAWC proposed to charge \$53 million in its calculated wastewater revenue requirement to water customers.<sup>323</sup> OCA witness Mierzwa provided the following table, which illustrates how the funds collected from water customers would be allocated among PAWC’s wastewater systems:<sup>324</sup>

**Table 2. PAWC Direct Wastewater Cost of Service and Allocation to Water Service**

<b>Direct Cost of Service</b>	<b>Water Allocation</b>	<b>Total Revenue Requirement</b>
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<sup>319</sup> PAWC St. 2 at 9.

<sup>320</sup> *Id.*

<sup>321</sup> 66 Pa. C.S. § 1311(c).

<sup>322</sup> *Id.*

<sup>323</sup> OCA St. 3 at 3-4.

<sup>324</sup> OCA St. 3 at 22 (Table 2).

Sanitary Systems	\$128,602,237	(12,710,621)	\$115,891,616
Combined Systems	96,162,959	(7,062,475)	89,100,484
BASA	48,125,644	(30,280,040)	17,845,604
EBMA	5,254,181	(2,957,046)	2,297,135
<b>Total</b>	<b>\$278,145,021</b>	<b>\$(53,010,182)</b>	<b>\$225,134,839</b>
<b>Percent</b>	<b>100.0%</b>	<b>19.1%</b>	<b>80.9%</b>

The OCA finds the proposed water allocation shift for Butler Area Sewer Authority (BASA) and Elizabeth Borough Municipal Authority (EBMA) meets the public interest standard. Conversely the proposed shift for PAWC’s Sanitary Sewer Systems (SSS) and Combined Sewer Systems (CSS) failed to meet the same standard. The determination of what is in the public interest in Section 1311(c) is within the Commission’s discretion.<sup>325</sup> PAWC’s impacted water and wastewater customers are key constituencies when considering what is in the public interest.<sup>326</sup> Mr. Mierzwa said, “the public interest should remain a flexible concept, but could include a consideration of policies that promote the cost-effective provision of safe and reliable water and wastewater service throughout the Commonwealth as well as questions about rate shock and affordability.”<sup>327</sup>

Mr. Mierzwa provided two extreme examples for how the Commission might consider approving a 1311(c) shift of water customer revenue to wastewater revenue requirement:

At one extreme, the Commission could do nothing. As I understand it, Section 1311(c) is discretionary, not mandatory. So, the Commission could choose to allocate none of the wastewater revenue requirement to water customers. Such a

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<sup>325</sup> OCA St. 3 at 23.

<sup>326</sup> *Id.* at 22.

<sup>327</sup> *Id.* at 22-23.

decision would be lawful but would not accomplish an important purpose of Act 11, which is to provide some relief to wastewater customers in relatively small or overburdened service areas.

At the other extreme, the Commission could allocate almost the entire wastewater revenue requirement increase to water customers as is proposed by PAWC. This subsidy would benefit wastewater customers, but it would come at the expense of PAWC's water customers who would be required to pay not only for their own wastewater service but that of others because of the Act 11 shift. This is because nearly 90% of PAWC water customers are not PAWC wastewater customers.<sup>328</sup>

Mr. Mierzwa examined how PAWC is proposing to divide the funds taken from water customers by class and apply them toward the wastewater customers, also by class.<sup>329</sup> He found that, "PAWC has generally directly assigned the wastewater Act 11 shift costs tied to a specific wastewater customer class to the same water class."<sup>330</sup> For example, Mr. Mierzwa testified that an Act 11 shift from the Residential wastewater class has been assigned to the Residential water customer Class.<sup>331</sup> To illustrate what PAWC is proposing with its Act 11 shift, Mr. Mierzwa included the following Table to compare the revenue increases that would be experienced by SSS, CSS, BASA, and EBMA wastewater operations with and without the Act 11 shift:

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<sup>328</sup> OCA St. at 23

<sup>329</sup> *Id.* at 24.

<sup>330</sup> *Id.*

<sup>331</sup> *Id.*

**Table 3. Impact of Act 11 Shift on Wastewater Rate Increases<sup>332</sup>**

	Direct Cost of Service			Total Revenue Requirement	
	Present			Increase	Percent
	Rates	Increase	Percent		
Sanitary Systems	\$108,561,975	\$20,040,262	18.5%	\$7,329,641	6.8%
Combined					
Systems	85,758,589	10,404,370	12.1%	3,341,895	3.9%
BASA	12,748,475	35,377,169	277.5%	5,097,129	40.0%
EBMA	1,767,267	3,486,914	197.3%	529,868	30.0%
<b>Total</b>	<b>\$208,836,306</b>	<b>\$69,308,715</b>	<b>33.2%</b>	<b>\$16,298,533</b>	<b>7.8%</b>

As shown above, without shifting the revenue requirement amount, the direct cost of service for BASA and EBMA would increase 277.5% and 197.3% respectively. Without the shift, SSS and CSS wastewater operations would experience rate increases of 18.5% and 12.1%, respectively. With the Act 11 shift, SSS and CSS wastewater operations would experience rate increases of 6.8% and 3.9%, with the Act 11 shift, BASA and EBMA wastewater operations would experience rate increases of 40.0% and 30.0%, respectively.

Without PAWC's proposed Act 11 shift, the amount of revenue requirement assigned the SSS and CSS wastewater systems in this proceeding is at parity with PAWC's water operations at 18.5% and 12.1%, respectively.<sup>333</sup> Mr. Mierzwa testified that:

The actual revenue requirement increases approved by the Commission for SSS and CSS wastewater operations will likely be less than PAWC's requested revenue requirement increases, and would reduce the increases experienced by SSS and CSS wastewater operations to less than the 18.5% and 12.1% that would occur, respectively, under the Company's requested revenue requirement and thus not require mitigation compared to PAWC's entire customer base.<sup>334</sup>

<sup>332</sup> *Id.* at 24-25.

<sup>333</sup> OCA St. 3 at 25.

<sup>334</sup> OCA St. 3 at 26.

Comparatively, Mr. Mierzwa testified that “the 277.5% and 197.3% rate increases that would be experienced by BASA and EBMA wastewater operations, respectively, without an Act 11 shift, would be extreme, inconsistent with the principal of gradualism, and requires mitigation.<sup>335</sup>” OCA therefore accepts the Act 11 shift. To the extent the Commission authorizes revenue requirements for BASA and EBMA wastewater operations that are less than PAWC’s requested revenue requirements, the Act 11 shift to water customers should proportionately be reduced to reflect the reduced revenue requirements.

Additionally, PAWC’s proposed allocation to the various water customer classes is not reasonable. Mr. Mierzwa testified:

Approximately 90% of PAWC’s water customers are not wastewater customers. Under PAWC’s proposal, Residential water customers would be responsible for a portion of the costs associated with serving Residential wastewater customers. Residential water customers are largely not directly responsible for these wastewater costs. I recommend that the Act 11 shift be assigned to the customer classes PAWC has initially assigned these costs to based on each customer class’s cost of service as determined by the OCA’s revised COSS.<sup>336</sup>

The Commission evaluated this approach during PAWC’s 2023 rate proceeding and said in its Order, “we agree with the OCA that an Act 11 reallocation that results in comparable percentage increases for water and wastewater customers would be in the

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<sup>335</sup> *Id.*

<sup>336</sup> *Id.* at 27.

public interest.<sup>337</sup> Mr. Mierzwa provided an exhibit, which presents a comparison of the Act 11 assignments to each customer class based on PAWC's proposal in this proceeding, and the Act 11 assignments that would result based on the Company's COSS and the OCA's revised COSS<sup>338</sup>. If the Commission determines that an Act 11 shift is appropriate in this proceeding, it should utilize the OCA's COSS.

**C. Tariff Structure**  
**1. Customer Charges**

OCA witness Mierzwa testified that PAWC's Residential customers charges for its water customers should be based on the customer charges initially proposed by PAWC for the Residential class, proportionately reduced to reflect the total direct water cost of service increase authorized by the Commission in this proceeding.<sup>339</sup>

PAWC's wastewater rate design proposals need to be recalibrated to include customer charges that reflect accurate cost-based principles.<sup>340</sup> PAWC currently provides SSS wastewater service in eight different rate zones and CSS wastewater service in two different rate zones.<sup>341</sup> PAWC is including an additional CSS rate zone for the EBMA system, which PAWC completed acquiring December 16, 2025.<sup>342</sup> PAWC has included

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<sup>337</sup> *Pa. PUC v. Pennsylvania American Water Company*, R-2023-3043189, Order at 297 (July 11, 2024).

<sup>338</sup> See OCA Exh. JDM-3.

<sup>339</sup> OCA St. 3 at 35.

<sup>340</sup> See OCA St. 3 at 43-45.

<sup>341</sup> OCA St. 3 at 6-7.

<sup>342</sup> OCA St. 3 at 7.

EBMA in this case as Rate Zone 2b.<sup>343</sup> Those rate zones and PAWC's proposed customer charges are as follows:

PAWC's SSS Rate Zones:

- Rate Zone 1 – General Statewide Rate | Rate Zone 1a – Royersford | Rate Zone 1b – York
  - The current Residential monthly service charge in SSS Rate Zones 1, 1a and 1b is \$15.00, and PAWC is proposing to set that charge at \$20.00.
- Rate Zone 1c – Foster | Rate Zone 1e – Sadsbury
  - In SSS Rate Zones 1c and 1e customers are currently assessed a flat charge, and PAWC does not assess separate customer service and usage charges.
  - In SSS Rate Zone 1c, PAWC is proposing to increase the Residential flat rate charge from \$110.00 to \$120.00, and PAWC is proposing to maintain the current Residential flat rate charge for Rate zone 1e at \$128.33.
- Rate Zone 1d – Butler Area Sewer Authority
  - In SSS Rate Zone 1d, the current Residential monthly customer charge is \$45.50, and PAWC is proposing to reduce that charge to \$20.00.
- Rate Zone 1f – Farmington
  - In SSS Rate Zone 1f, PAWC is proposing to reduce the Residential customer charge from \$53.50 to \$20.00.
- Rate Zone 1g – Manwalamink
  - In SSS Rate zone 1g, PAWC is proposing to increase the current Residential monthly customer charge of \$16.92 to \$18.60.<sup>344</sup>

PAWC's CSS Zones:

- Rate Zone 2 – Kane and McKeesport
  - In CSS Rate Zone 2, the Company is proposing to increase the current monthly customer charge of \$20.00 to \$25.00
- Rate Zone 2a – Scranton
  - in CSS Rate Zone 2a the Company is proposing to maintain the current Residential monthly customer charge of \$20.19
- Rate Zone 2b Elizabeth Borough Municipal Authority
  - In CSS EMBA Rate Zone 2b, the Company is proposing to

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<sup>343</sup> *Id.*

<sup>344</sup> OCA St. 3 at 43.

maintain the current Residential monthly customer charge of \$35.00.<sup>345</sup>

OCA witness Mierzwa testified that the proposed customer charge proposal for Rate Zones 1, 1a, 1b, 1d, and 1f are not rooted in an accurate cost-based analysis.<sup>346</sup> PAWC's direct customer charge calculation includes the costs associated with collecting and treating Infiltration and Inflow (I&I).<sup>347</sup> Factoring in I&I costs means including a component that is largely a function of precipitation and does not vary directly with the addition or subtraction of a customer.<sup>348</sup> Mr. Mierzwa testified that only costs that vary directly with the addition or subtraction of a customer should be included in the calculation of customer charges.<sup>349</sup>

Mr. Mierzwa recommended that SSS wastewater Rate Zones 1, 1a, and 1b retain its Residential customer charge of \$15.00 and the SSS Residential customer charge in Rate Zones 1d, 1f, and 1g be reduced to \$15.00.<sup>350</sup>

Mr. Mierzwa testified that his observations are based upon an industry recognized authority as follows:

According to the WEF Manual of Practice No. 27, Infiltration is the flow entering the sanitary sewer system resulting from high groundwater or precipitation that occurred days or weeks before the observed flow in the sanitary system, and inflow results from the rainfall that enters the sanitary collection system through a number of direct connections such as catch

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<sup>345</sup> *Id.*

<sup>346</sup> OCA St. 3 at 44.

<sup>347</sup> *Id.*

<sup>348</sup> *Id.*

<sup>349</sup> *Id.*

<sup>350</sup> OCA St. 3 at 44-45.

basins, roof drains, foundation drains, and manhole covers.<sup>351</sup>

PAWC does not directly refute Mr. Mierzwa's position.<sup>352</sup> PAWC witness Herbert agreed in Rebuttal that I&I is primarily driven by precipitation, and because of this, claimed there is no meaningful relationship between I&I and a customer's wastewater flows.<sup>353</sup> For this reason, he opines that it is inappropriate to recover I&I-related costs through volumetric rates.<sup>354</sup> Mr. Mierzwa testified that precipitation is not affected by the number of customers served by PAWC.<sup>355</sup> Therefore, I&I related costs should not be included in a customer charge calculation.<sup>356</sup>

Furthermore, some Residential SSS ratepayers are already over contributing to the wastewater system. Mr. Mierzwa testified that the current monthly Residential customer charge for SSS wastewater Rate Zones 1, 1a, and 1b is \$15.00.<sup>357</sup> However, excluding I&I, the direct cost is \$13.55.<sup>358</sup> Yet, PAWC is proposing to increase its customer charge to \$20.00.<sup>359</sup> The Commission should reject PAWC's SSS Residential Customer Charge proposals and adopt the OCA's revision.<sup>360</sup>

PAWC's proposed customer charge for CSS Residential customer charges in Rate

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<sup>351</sup> OCA St. 3 at 44.

<sup>352</sup> PAWC St. 12-R at 11.

<sup>353</sup> *Id.*

<sup>354</sup> *Id.*

<sup>355</sup> OCA St. 3-SR at 7.

<sup>356</sup> *Id.*

<sup>357</sup> OCA St. 3 at 44.

<sup>358</sup> *Id.*

<sup>359</sup> *Id.*

<sup>360</sup> *Id.*

Zones 2, 2a, and 2b likewise not rooted in an accurate cost-based analysis<sup>361</sup> Mr. Mierzwa testified:

In response to data request OCA 08-018, the Company presented a customer cost analysis for CSS service similar to the analysis it presented in PAWC Exhibit No. 12-13, Attachment RS1j, page 2, for SSS service. The response to OCA-08-018 is attached to my testimony as Schedule JDM-2. The Company CSS cost analysis indicates that a cost based monthly customer charge for a 5/8-inch meter would be \$57.50. However, as with the Company's SSS customer cost analysis, the Company's CSS customer cost analysis improperly included I/I. Excluding I/I costs from the Company's CSS customer analysis indicates a customer cost of \$4.59.<sup>362</sup>

Mr. Mierzwa therefore recommended that the existing CSS monthly customer charges in Rate Zones 2, 2a, and 2b be maintained.<sup>363</sup>

## **2. Water Rate Design**

As stated by OCA witness Mierzwa, a sound revenue allocation should:

- Utilize class cost-of-service study results as a guide;
- Provide stability and predictability of the rates themselves, with a minimum of unexpected changes that are seriously adverse to ratepayers or the utility (gradualism);
- Yield the total revenue requirement;
- Provide for simplicity, certainty, convenience of payment, understandability, public acceptability, and feasibility of application; and
- Reflect fairness in the apportionment of the total cost of service among the various customer classes.<sup>364</sup>

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<sup>361</sup> OCA St. 3 at 45.

<sup>362</sup> OCA St. 3 at 45.

<sup>363</sup> *Id.*

<sup>364</sup> OCA St. 3 at 28.

With these principles in mind, Mr. Mierzwa recommended that the direct cost of service for each customer class, with the exception of the Industrial Contract Sales, Other Water Utilities Contract Sales, and Other Water Utilities Group B customer classes, should be proportionately scaled back to reflect the direct water cost of service, or revenue requirement, approved by the Commission in this proceeding without the Act 11 wastewater adjustment.<sup>365</sup> The direct cost of service for each customer class should then be adjusted to account for the Act 11 wastewater cost of service assigned to water service as determined by the Commission based on the direct cost of service for each class with the exception of the two Contract Sales customer classes, the Other Water Utilities Group A and B customer classes, and Public Fire Protection service.<sup>366</sup>

Under PAWC's as-filed COSS, the direct Residential cost of service under PAWC's COSS is \$682,920,439, or 65.93% of the total direct cost of service.<sup>367</sup> Under Mr. Mierzwa's COSS, the direct Residential cost of service under the OCA's cost of service study is \$675,757,224, or 65.23% of the total direct cost of service study. To determine the direct cost of service to assign the Residential class based on the Commission's authorized revenue requirement increase, the total direct cost of service authorized should be multiplied by 65.23%.<sup>368</sup>

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<sup>365</sup> OCA St. 3 at 32.

<sup>366</sup> *Id.*

<sup>367</sup> OCA St. 3 at 35.

<sup>368</sup> *Id.*

The total direct cost of service of the customer classes receiving an Act 11 assignment of the wastewater revenue requirement is \$1,005,008,593 and under an assignment of the Act 11 shift to water service customer classes based on a cost of service, Residential customers would receive an assignment of 67.23% of the Act 11 assignment authorized by the Commission.<sup>369</sup> The Act 11 shift assigned to Residential class under this approach should be added to the Residential direct cost of service calculated as previously described to determine the total revenues to be collected from the Residential class and design rates.<sup>370</sup> These total revenues should be recovered through the monthly customers and usage charges assessed to Residential customers.<sup>371</sup> Following the OCA's method, the Commission would be remove the adverse impact of PAWC's COSS and therefore it should be adopted.

### **3. Wastewater Rate Design**

#### **a. Sanitary Sewer System Allocation**

Mr. Mierzwa recommended that the SSS revenue increase authorized by the Commission in this proceeding be assigned to each SSS rate zone based on the percentage share of the SSS increase initially assigned to each rate zone by PAWC.<sup>372</sup> Mr. Mierzwa also recommended that the SSS revenue requirement increase amount authorized by the Commission be assigned to each class based on the same percentage PAWC assigned.<sup>373</sup>

#### **b. Combined Sewer System Allocation**

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<sup>369</sup> *Id.*

<sup>370</sup> *Id.*

<sup>371</sup> *Id.*

<sup>372</sup> OCA St. 3 at 35.

<sup>373</sup> OCA St. 3 at 37.

For CSS Rate Zones 2 and 2a (Scranton), Mr. Mierzwa recommended that each rate zone be assigned a percentage increase equal to the overall CSS percentage rate increase authorized by the Commission.<sup>374</sup> In the Scranton application proceeding, the Commission approved an Amended Asset Purchase Agreement.<sup>375</sup> PAWC is proposing no increase for Scranton to comply with the Amended Asset Purchase Agreement.<sup>376</sup> However Mr. Mierzwa proposed an increase for Scranton equal to the overall system average CSS increase authorized by the Commission in this proceeding.<sup>377</sup> Mr. Mierzwa noted that, in the 2023 rate proceeding, PAWC also proposed no rate increase for Scranton for the same reasons it is proposing no increase in this proceeding.<sup>378</sup> The Commission found that an increase for Scranton was reasonable.<sup>379</sup> The Commission has the power to assign rates that differ from those identified in PAWC's Amended Asset Purchase Agreement with Scranton.<sup>380</sup> The OCA's proposed increase for Scranton is that it should be equal to the overall system average CSS increase authorized by the Commission in this proceeding.<sup>381</sup>

For the CSS rate zones, OCA recommended that the revenue allocation proposed by PAWC for the Bulk customer class be maintained. For the remaining CSS customer classes, OCA recommended that the revenue requirement increase be assigned to each

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<sup>374</sup> OCA St. 3 at 36.

<sup>375</sup> *Id.*

<sup>376</sup> *Id.*

<sup>377</sup> OCA St. 3 at 38.

<sup>378</sup> *Id.*

<sup>379</sup> *Id.*

<sup>380</sup> 66 Pa. C.S. § 508.

<sup>381</sup> OCA St. 3 at 38.

customer class in proportion to the increase initially assigned to each customer class by PAWC, including assigning a portion of the increase to the customer classes in Rate Zone 2A (Scranton).<sup>382</sup>

**c. Butler Area Sewer Authority and Elizabeth Borough Municipal Authority Allocations**

For Butler Area Sewer Authority (BASA) and Elizabeth Borough Municipal Authority (EBMA), PAWC has assigned the same percentage increase to each customer class based on the overall increases requested for BASA and EBMA, and Mr. Mierzwa recommended that the increase for each customer class be based on the overall increases authorized by the Commission for the BASA and EBMA rate zones.<sup>383</sup>

**4. Wastewater Deduct Adjustment**

PAWC proposed a “deduct adjustment,” also referred to as “winter averaging,” where a customer’s bill is based on average winter usage to estimate indoor consumption.<sup>384</sup> Under the proposal, PAWC will bill a customer for whichever is less: the actual metered water usage for that month or the average water consumption for that customer in the winter months.

PAWC overstates the benefits projected for its deduct adjustment proposal and therefore should not be approved.<sup>385</sup> The difference between the winter average period usage and usage during the remaining months of PAWC’s Residential customers is di

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<sup>382</sup> OCA St. 3 at 37.

<sup>383</sup> OCA St. 3 at 37.

<sup>384</sup> PAWC St. 10 at 25.

<sup>385</sup> See OCA St. 3 at 38-42.

minimis, ranging from 119 to 165 gallons per month during the past two years.<sup>386</sup> Mr. Mierzwa testified that there are reasons why the difference is immaterial:

I would expect that during the summer months customers are likely to take more showers and wash clothes more often. The average shower uses 17.2 gallons of water. A standard washing machine uses 20 gallons of water per load. A few extra showers and clothes washing loads per month would totally account for the historic difference between Residential winter and summer water usage. Therefore, it does not necessarily follow that PAWC's Residential customer outdoor water usage during the summer is sufficiently significant to justify adopting a deduct adjustment and the resulting increase in volumetric rates and should be rejected.<sup>387</sup>

Mr. Mierzwa stated that PAWC's current proposal is similar to PAWC's proposal in its 2023 rate proceeding. In that case, Mr. Mierzwa presented a similar analysis and the Commission agreed with the OCA's position.<sup>388</sup> Notably, the data Mr. Mierzwa used in that proceeding demonstrated a broader range of 100 gallons to 173 gallons per month, compared to this proceeding that demonstrated a range of 119 gallons to 165 gallons per month.<sup>389</sup> In other words, there is less of a difference between the winter averaging months compared to the remaining months of the year in this proceeding than the last time PAWC proposed this measure. The Commission additionally found that PAWC's winter averaging proposal in its 2023 rate case may have a disproportionate adverse impact on low income

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<sup>386</sup> OCA St. 3 at 41.

<sup>387</sup> OCA St. 3 at 41 (internal citations omitted).

<sup>388</sup> *Pa. PUC v. Pennsylvania American Water Company*, R-2023-3043189, Order at 284 (July 11, 2024).

<sup>389</sup> OCA St. 3 at 42.

customers.<sup>390</sup> The OCA found similar issues in this rate proceeding as discussed at length in OCA witness Colton's testimony.<sup>391</sup>

## **5. Demand-Based Contract Rates**

The OCA did not address this issue in its testimony.

### **D. Summary and Alternatives (Including Scale Back of Rates)**

A pivotal factor to determine whether PAWC's proposed water and wastewater rate increases are just and reasonable is accomplished by evaluating how revenues are allocated among rate classes.<sup>392</sup> The cost of service studies (COSS), rate structures, and rate designs proposed by PAWC need to be modified to meet the just and reasonable standard. Specifically, as discussed below: 1) The system-wide maximum day and maximum hour demand factors used in PAWC's water COSS study are outdated; the OCA provided an updated and accurate COSS study; 2) the Commission should continue to Order PAWC to provide separate cost of service studies for its 1329 acquisitions for transparency; 3) The Commission should reject in-part and adopt in-part PAWC's Act 11 wastewater revenue requirement shift; 4) Customer charges for water and wastewater operations need to be changed to reflect accurate cost-based principles; 5) The Commission should allocate its approved revenue requirement according to the OCA's COSS; 6) Any reductions to PAWC's requested revenue increase should be adjusted proportionately across water and

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<sup>390</sup> *Pa. PUC v. Pennsylvania American Water Company*, R-2023-3043189, Order at 285 (July 11, 2024).

<sup>391</sup> OCA St. 4 at 105-111; OCA St. 4SR at 12-15.

<sup>392</sup> *Lloyd v. Pa. PUC*, 904 A.2d 1010, 1020 (Pa. Cmwlth. 2006).

wastewater operations and proportionately across customer classes not subject to contract sales; and 7) PAWC's proposed deduct adjustment should be rejected.

## **XI. ALTERNATIVE RATEMAKING REQUESTS**

### **A. Customer Assistance Program ("CAP") Rider**

PAWC proposed a CAP rider for actual costs of PAWC's customer assistance programs that would act as a true-up mechanism and include PAWC's Bill Discount Program (BDP) discounts, Arrearage Management Program (AMP) credits, Rental Assistance Pilot Program (RAPP) stipends and RAPP administrative costs.<sup>393</sup> OCA witness Colton testified that PAWC's proposed CAP rider should be denied, and that the costs should be recovered in base rates, because accepting PAWC's proposal isolates one element out of a multitude of elements that affects PAWC customer rates.<sup>394</sup> Mr. Colton testified:

Without taking into consideration all other rate impacts of the changing level of BDP/AFP costs, it is not possible to determine the extent to which, if at all, PAWC's *total* cost of service had increased as a result of the increased BDP/AFP costs. It is thus not possible to determine what dollar amount of cost recovery would need to be reflected in any increase in rates through the proposed CAP Rider.<sup>395</sup>

Mr. Colton added that any increase in BDP/Arrearage Forgiveness Program (AMP) costs due to increased participation, for example, will be offset, in whole or in part, by decreases in expenses such as the working capital associated with carrying arrears; by decreases in expenses associated with decreased credit and collection expenses; by decreased expense

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<sup>393</sup> PAWC St. 2 at 30.

<sup>394</sup> OCA St. 4 at 92-93.

<sup>395</sup> OCA St. 4 at 93.

associated with bad debt; or by the increased revenues associated with decreased disconnections or more frequent reconnections.<sup>396</sup>

Mr. Colton recommended that PAWC's proposal be rejected and that PAWC monitor and review the appropriate billing data for purposes of determining, in its next base rate proceeding, to what extent changes, if any, to the offset he recommended are reasonable to avoid double recovery.<sup>397</sup>

Mr. Colton cautioned against the double recovery of universal service costs. Mr. Colton demonstrated that it is the utilities' burden of proof to demonstrate that allowing for recovery of a claim for arrearage forgiveness will not give the utility double-recovery of these costs – a burden that PAWC has not satisfied in this case.<sup>398</sup> The Commission has recognized the potential of double recovery of costs without a universal service offset as support for why an offset is necessary.<sup>399</sup> Mr. Colton concluded that PAWC's proposal to establish a universal service offset of \$0 is unreasonable and should be rejected.<sup>400</sup>

PAWC failed to rebut Mr. Colton's analysis that, without taking into consideration all other rate impacts of the changing level of BDP/AFP costs, it is impossible to determine the extent to which, if at all, PAWC's total cost of service had increased as a result of the

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<sup>396</sup> OCA St. 4 at 93-94.

<sup>397</sup> OCA St. 4 at 94, adding that universal service costs for energy utilities are recoverable through a rider as per statute.

<sup>398</sup> OCA St. 4 at 96-97, *citing*, *Customer Assistance Programs: Funding Levels and Cost Recovery Mechanism*, Final Investigatory Order, at 38 (Oct. 19, 2006).

<sup>399</sup> *Id.* at 97-99.

<sup>400</sup> *Id.*

increased BDP/AFP costs.<sup>401</sup> Mr. Colton testified: “changes in participation will affect both revenues and expenses. It would be inappropriate to provide a reconciliation for revenues without adjusting also for the overall impacts on total cost of service.”<sup>402</sup>

## **XII. LOW-INCOME CUSTOMER ASSISTANCE**

### **A. Summary**

This case is about affordability. There are few considerations as important as affordability, as affordability “is in both the shareholder and ratepayers’ best interests. Affordable bills will maximize revenues for the Company and will enable ratepayers to continue to receive an essential service.”<sup>403</sup> PAWC’s proposed rate increase should be rejected because it will make its rates unaffordable. In addition, it is a fundamental precept of utility law that every rate made, demanded or received by any public utility be just and reasonable.<sup>404</sup>

Through the testimony of Roger D. Colton, the OCA reviewed the impact of PAWC’s rates on its customers.<sup>405</sup> Specifically, Mr. Colton examined the overall affordability of PAWC’s bills for current service and the importance of considering the affordability of PAWC bills to low- and moderate-income customers. Mr. Colton testified regarding ways to enhance PAWC’s identification of its low-income customers and expanding enrollment in its Customer Assistance Programs (CAP), including the Arrearage Forgiveness Program (AFP). Mr. Colton also addressed the Company’s proposed Renter

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<sup>401</sup> OCA St. 4SR at 34.

<sup>402</sup> OCA St. 4SR at 35.

<sup>403</sup> *Pa. PUC v. Roaring Creek Water Co.*, 73 Pa. PUC 373, 400 (1990).

<sup>404</sup> 66 Pa. C.S. § 1301.

<sup>405</sup> *See*, OCA St 4, *passim*.

Assistance Pilot Program, proposed “deduct adjustment,” the proposed recovery of universal service costs through a rider and the impact of PAWC’s management performance as it pertains to universal service issues on equity return.

Mr. Colton recommended:

- PAWC should adopt an internal process to identify its low-income customer base that is based on the policy that the Commission has adopted for Pennsylvania’s energy utilities.
- PAWC should initiate a screening process at the time a household first applies to receive service from the Company to determine whether the applicant: (a) should be classified as an Identified Low-Income customer; and (b) should be referred to the bill discount program (BDP) application process.
- PAWC should actively seek, in its customer contacts, to ascertain from a customer whether that customer is participating in a program providing state benefits based on household income eligibility requirements that are consistent with those of the Company’s bill discount program.
- Before PAWC enters into a deferred payment agreement (DPA) with a customer which the Company either: (1) knows to be an Identified Low-Income customer; or (2) has generated information through the DPA process documenting that the customer is in the income range at or below 150% Federal Poverty Level (FPL), it should be required to provide the customer a stand-alone Plain Language notice to that customer of the customer’s right to apply for BDP and an explanation of the advantages of BDP’s arrearage forgiveness benefits.
- Prior to the disconnection of an Identified Low-Income customer, PAWC should adopt a procedure, developed in collaboration with its Low-Income Advisory Group under which it will offer the Identified Low-Income customer the opportunity to apply for the Company’s BDP and AFP.
- PAWC should allow customers to earn a monthly arrearage forgiveness credit for each complete payment the customer makes.

- PAWC should expand the monthly credit that PAWC provides for a timely payment or for a cured missed or late payment for the AFP.
- PAWC should tie enrollment of low-income customers into its AFP more closely to enrollment in its BDP.
- Further attention be devoted to developing operational details for the proposed Residential Assistance Pilot Program (RAPP) prior to the program being re-presented to the Commission in PAWC's next base rate proceeding.
- The PAWC proposal to align its discounts for fixed and volumetric charges should be found to be reasonable and should be approved.
- PAWC discounts: (1) should continue to be offered on a tiered basis. What this entails is offering different discount levels based on different income ranges; and (2) should continue to be offered as a four-tiered discount.
- The specific bill discount levels proposed by PAWC in this proceeding should be found to be reasonable and should be approved.
- PAWC's proposed CAP Rider should be denied.
- PAWC's request for cost recovery of its AFP credits in this proceeding be denied.
- The "deduct adjustment" proposal of PAWC be disapproved in this proceeding. An alternative mechanism through which to address the legitimate concerns of customers about not paying for wastewater service on water consumption that does not flow through the wastewater system should be considered.

**B. Affordability of Water and Wastewater Service**

**1. Unaffordability for Low- and Moderate-Income Customers.**

The importance for the Commission to ensure that the rates that result from this proceeding are affordable is paramount.<sup>406</sup> As OCA witness Roger Colton testified:

Water service in today’s world is an essential human need. Water is not only for drinking, but also for cooking and sewer needs. A 2022 White Paper by the U.S. Water Alliance states that ‘for every community in our country, the availability of safe drinking water and wastewater services is a precondition for public health and prosperity.’ Water is vital to maintaining hygiene and health. The lack of water has a particularly negative impact on children, the elderly, women and persons suffering from an illness or chronic health concern.<sup>407</sup>

The fundamental need for affordable water is recognized not only by laws relating to the protection of children, but also by laws relating to the habitability of homes.<sup>408</sup>

Mr. Colton also testified regarding the costs incurred in the form of housing costs, community costs and city costs due to PAWC’s failure to adequately address the need for bill discounts to low-income customers. Such costs include liens and foreclosures, vacant homes, homelessness, increased hospitalizations, strain on the legal community, public safety and macroeconomic impacts.<sup>409</sup> Mr. Colton concluded that water cannot be viewed as just another commodity with access denied when customers find the cost to be unaffordable but that PAWC “must remain mindful that public health is their core business and there is as much impact at stake in the manner in which they obtain revenue from low-income households as there is in treating the water to high standards.”<sup>410</sup>

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<sup>406</sup> 66 Pa. C.S. § 1301.

<sup>407</sup> OCA St. 4 at 8-9 (internal citations omitted).

<sup>408</sup> OCA St. 4 at 9-10 (internal citations omitted).

<sup>409</sup> OCA St. 4 at 10-11 (internal citations omitted).

<sup>410</sup> OCA St. 4 at 11.

In doing so, Mr. Colton criticized PAWC's broad definition of "basic water service" as failing to identify what water is needed for drinking, cooking, sanitation and general health service. Mr. Colton testified:

By not identifying any particular end uses, PAWC does not attempt to base its determination of what represents what level of service is 'necessary and reasonable to meet' particularly end household need. PAWC does not use a process to identify end uses and the water consumption associated with those end uses.<sup>411</sup>

PAWC's definition of "basic water service of 40 gallons per household member per day ignores differences based on factors such as age or number of children in the household, or the age or number of adults in the household. It considers no individual circumstances of the household."<sup>412</sup> In contrast, Mr. Colton referenced reports from the 2016 Water Research Foundation (WRF) and the U.S. Environmental Protection Agency (EPA) showing that PAWC's assumed consumption of 40 gallons per household member per day is too low.<sup>413</sup> Mr. Colton concluded that:

[T]he Commission should be aware of the inherent fallacies in [PAWC's] affordability analysis. In considering issues such as the return on equity, rate design, or other similar issues, the Commission should not make a decision based on PAWC's assertion that total bills being charged to customers might be high because they exceed the Company's unsupported and undefined assertion of what is 'necessary and reasonable to meet basic household needs for drinking, cooking, sanitation, general health service.'<sup>414</sup>

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<sup>411</sup> OCA St. 4 at 13.

<sup>412</sup> OCA St. 4 at 13.

<sup>413</sup> OCA St. 4 at 13-15 (noting the WRF estimate of 50.7 gallons per household member per day and the EPA's estimate of 82 gallons per household member per day).

<sup>414</sup> OCA St. 4 at 15.

In response to Mr. Colton, Ms. Ather continued to argue that her use of the concept of Basic Water Service is an appropriate foundation upon which to base an affordability analysis. Notably, Ms. Ather argued that her concept of BWS “is meant to differentiate the type of service PAWC is including in this analysis from seasonal water use, which is discretionary and which should not be subject to an analysis of affordability.”<sup>415</sup> As Mr. Colton testified, however, Ms. Ather refused to accept the fact that the level of household water consumption is highly dependent on individual household characteristics, whereas Ms. Ather assumes an average household size and characteristics.<sup>416</sup> Mr. Colton analyzed data from the American Community Survey to get a more accurate picture of the households in PAWC’s service territory. For example, Mr. Colton noted that “rather than accounting for those differences, Ms. Ather simply averages them all together and deems them all to have affordable bills ‘on average.’”<sup>417</sup>

Similarly, Ms. Ather did not consider the seasonal nature of consumption when she argued that the “40 gallon threshold is specifically calibrated to non-seasonal consumption patterns for PAWC’s customers and is consistent with the average non-seasonal use per customers for PAWC’s residential population.”<sup>418</sup> However, Mr. Colton testified that “while there is monthly variation for both low-income and residential customers generally,

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<sup>415</sup> PPL St. 9-R at 4.

<sup>416</sup> OCA St. 4SR at 4.

<sup>417</sup> OCA St. 4SR at 5, *citing*, American Community Survey (2023 5-year data), at Table B25010. Ms. Ather does not consider differences based on household size or that water consumption differs by age. OCA St. 4SR at 6.

<sup>418</sup> PAWC St. 9-R at 4.

that variation does not evidence the seasonal variation which PAWC identifies.”<sup>419</sup> Mr. Colton concluded that “Ms. Ather’s justification for her BWS consumption is arbitrary and not support by the data.”<sup>420</sup>

Increases in PAWC rates have been substantial since 2020, where rates have increased nearly 35% from 2020 through 2024.<sup>421</sup> Mr. Colton testified that:

This rate increase request by PAWC is the fourth general rate case which PAWC has filed since 2020. Any increase approved as part of this proceeding will increase prices even further. The constant flow of rate increases being sought by PAWC is difficult not only for ratepayers generally but for the delivery of affordability assistance to low-income ratepayers in particular.<sup>422</sup>

Mr. Colton noted that while PAWC rates increased from 2020 through 2023 by 26% over that timeframe, incomes in the PAWC service territory were not keeping up.<sup>423</sup>

PAWC has an affordability problem regarding its low-income customers. Mr. Colton assessed the decline in affordability in dollar terms for the lowest income customers by, first, determining what income would be required for that bill to represent an affordable burden of 2%.<sup>424</sup> The income deficit (i.e., the shortfall between the actual income and income needed for the bill to be affordable at 2%) substantially increased from 2019 through 2025 in the PAWC counties studied.<sup>425</sup> PAWC’s bills at both the existing and

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<sup>419</sup> OCA St. 4SR at 7-8.

<sup>420</sup> OCA St. 4SR at 8.

<sup>421</sup> OCA St. 4 at 15-16.

<sup>422</sup> OCA St. 4 at 16-17 (citations omitted).

<sup>423</sup> OCA St. 4 at 17. PAWC witness Ather did not dispute, nor seek to rebut, this finding in her rebuttal testimony. *See* OCA St. 4SR at 2-3.

<sup>424</sup> OCA St. 4 at 18-20.

<sup>425</sup> OCA St. 4 at 18-20.

proposed rates are unaffordable for customers with income between \$50,000 and \$60,000.<sup>426</sup> The issue becomes even more significant when examining the depth of that unaffordability at the lower incomes.<sup>427</sup> Mr. Colton concluded:

I find that PAWC has significant bill affordability problems facing its low-income customers. Not only should this unaffordability be considered in assessing issues such as an appropriate return on equity and rate design, the specific remedies which I recommend below should be adopted to address the issue from both the perspective of delivering reasonably adequate service to the low-income customers and from the perspective of delivering the least-cost service to all customers of the utility.<sup>428</sup>

PAWC's prices have been increasing at rates faster than the incomes of low-income customers in the PAWC service territory.

PAWC also has an affordability problem with its moderate-income customers. Mr. Colton's analysis also included an examination of the ability to pay of more moderate income households, sometimes referred to as "ALICE," with incomes above the poverty level but below the cost of basics included in the ALICE Household Survival Budget.<sup>429</sup> In doing so, Mr. Colton reviewed the ALICE Survival Budget, the ALICE Essentials Index and the ALICE Wage. The ALICE Wage, in particular, is the dollars needed for a household to meet the ALICE Survival Budget which Mr. Colton reviewed for a selection

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<sup>426</sup> OCA St. 4 at 20-22.

<sup>427</sup> OCA St. 4 at 22-23 (noting that "PAWC bills, for example, impose twice the affordable burden (3.9% at proposed rates) even at an annual income of \$30,000 to \$35,000, while bills range from more than 3.5 times (7.3% at income of \$15,000 to \$20,000 at proposed rates) to nearly thirteen times (25.5%) the affordable burden when income falls to less than \$10,000.").

<sup>428</sup> OCA St. 4 at 24. PAWC witness Ather did not dispute Mr. Colton's findings regarding the depth of unaffordability in the PAWC service territory. *See*, OCA St. 4SR at 3.

<sup>429</sup> OCA St. 4 at 25. "ALICE" refers to "Asset-Limited, Income-Constrained, Employed."

of PAWC counties representing a diversity in geographic locations and urban/rural status.<sup>430</sup> Mr. Colton testified: “the cost-of-living for moderate income households, and thus the ability of these PAWC customers to absorb the rate increase sought in this proceeding, varies widely across the PAWC service territory.”<sup>431</sup> He noted that common occupations throughout Pennsylvania provide insufficient wages to allow a household to cover the ALICE Survival Budget, such as retail salespersons, cashiers, janitors, customer service representatives, waiters and waitresses, etc., whose median hourly wage does not come close to covering the hourly wage needed to meet the ALICE Survival Budget.<sup>432</sup>

The cost-of-living leaves many seniors, for example, in the PAWC service territory with inadequate income to meet their basic living expenses. Mr. Colton testified:

While the number of persons in Pennsylvania with income falling below the FPL has remained relatively steady from 2010 through 2024, the number of persons with income falling below the ALICE Threshold has seen a steady increase. As Figure 5 documents, the number of Pennsylvania residents within income below the ALICE Threshold has grown more than three times faster than the number of households with income below Poverty.<sup>433</sup>

Mr. Colton concluded that his analysis shows that there is a significant population living with incomes greater than the FPL but less than what is needed to meet basic living

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<sup>430</sup> OCA St. 4 at 27.

<sup>431</sup> OCA St. 4 at 27.

<sup>432</sup> OCA St. 4 at 28-29 (internal citations omitted).

<sup>433</sup> OCA St. 4 at 32 (internal citations omitted).

expenses and the affordability of PAWC bills could well depend in substantial part on the cost-of-living in different parts of the PAWC service territory.<sup>434</sup>

## **2. PAWC has an affordability issue.**

A detailed examination of affordability of PAWC's service to low- and moderate-income households in its service territory is necessary as affordability is a critical task to undertake within the structure of a utility rate case in relation to just and reasonable rates. As Mr. Colton testified: "As bills become increasingly unaffordable, the payment difficulties of those customers who face unaffordability become increasingly substantial as well."<sup>435</sup> Much of utility ratemaking involves a balancing of investor interests and customer interests, as Mr. Colton testified, for example:

Establishing a Return on Equity (ROE) is fundamentally predicated on balancing customer and investor interests. It is necessary for the Commission to understand the customer interests in order to appropriately balance them against competing investor interests. In deciding on an appropriate ROE and the reasonable mix of debt and equity securities, the obligation of the Commission is to balance consumer and investor interests.<sup>436</sup>

Mr. Colton added that "if a sizable portion of customers cannot afford to pay the rates charged by PAWC, the Commission can hardly be said to have approved just and reasonable rates," noting that the most fundamental response to unaffordability in the

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<sup>434</sup> OCA St. 4 at 33. Ms. Ather did not refute in her rebuttal testimony Mr. Colton's demonstration regarding the unaffordability of PAWC bills to moderate income customers. See OCA St. 4SR at 3.

<sup>435</sup> OCA St 4 at 34.

<sup>436</sup> OCA St. 4 at 34 *citing*, *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 577, 606-608 (1942).

PAWC service territory is to minimize the rate increases, if any, approved in this proceeding.<sup>437</sup>

In considering affordability, it is important to assess the extent to which PAWC has both: 1) identified its low-income population and 2) enrolled its low-income population in the BDP and Arrearage Forgiveness Program (AFP). As Mr. Colton testified:

PAWC has identified a relatively small proportion of the estimated number of low-income customers which it serves and enrolled those low-income customers in its BDP. ... Only one-in-ten estimated low-income customers on the PAWC system have been identified as low-income. Even fewer have been enrolled in the Company's BDP.<sup>438</sup>

Therefore, roughly 134,000 PAWC low-income customers are not receiving PAWC's low-income services.<sup>439</sup>

PAWC's failure to identify its low-income customers and to enroll those customers into CAP results in harm.<sup>440</sup> PAWC disconnected low-income customers, or sent them a disconnection notice, at rates five to more than six times higher than residential customers as a whole.<sup>441</sup> Mr. Colton testified that "PAWC cannot say that it was offering its low-income customers an opportunity to redress payment difficulties and to maintain service through deferred payment arrangements, let alone through successful payment

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<sup>437</sup> OCA St. 4 at 35.

<sup>438</sup> OCA St. 4 at 36-37 (internal citations omitted) (noting that 23% of Columbia's estimated low-income customers were enrolled in Columbia's CAP).

<sup>439</sup> OCA St. 4 at 37.

<sup>440</sup> OCA St. 4 at 38-40.

<sup>441</sup> OCA St. 4 at 38-39; PAWC response to OCA interrogatory IV-06.

arrangements.”<sup>442</sup> It is unreasonable to assert PAWC is effectively using universal service programs, including enrollment in BDP, to help low-income customers maintain service.

PAWC is much less successful in collecting from its low-income customers in the absence of its BDP and AFP. Mr. Colton added that “the data shows that while PAWC received roughly 70 payments for each 100 bills rendered to Identified Low Income customers from 2023 through 2025, it received roughly 90 payments for each 100 bills issued to residential customers as a whole.”<sup>443</sup> This shows that, in the absence of BDP, PAWC struggles to collect low-income customer bills. Mr. Colton noted that PAWC also fails to reconnect a substantial number and percentage of customers after those customers were disconnected for nonpayment. Mr. Colton testified:

This data is significant in that when a customer has service disconnected, *not* followed by a reconnection, the dollars of arrears on the customer account at the time of disconnection will generally not be collected by the Company. To the extent that disconnected customers are not being reconnected, PAWC is losing revenue due to nonpayment.<sup>444</sup>

Not only are proportionately more low-income customers in arrears, but those that are in arrears are deeper in arrears. Mr. Colton added: “PAWC is unnecessarily incurring working capital expenses. Given that working capital is a capital expense, it has an equity return associated with it. In turn, the equity return will have an additional tax impact associated with it.”<sup>445</sup> Furthermore, the reverse is also true. Given the improved low-

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<sup>442</sup> OCA St. 4 at 39.

<sup>443</sup> OCA St. 4 at 41.

<sup>444</sup> OCA St. 4 at 42-43.

<sup>445</sup> OCA St. 4 at 45-47.

income payment patterns generated by enrollment of low-income customers in PAWC's BDP and AFP, identifying low-income customers and enrolling those customers in CAP can reasonably be expected to have a positive financial impact on PAWC.<sup>446</sup>

Identifying PAWC's low-income customers and enrolling those customers into BDP and AFP not only benefits the customers by helping those customers maintain their water service, but it will also benefit PAWC by enhancing revenues and reducing expenses.

### **C. Bill Discount Program (BDP) Design**

#### **1. Identification of Low-Income Customers and Expanded Enrollment into the Customer Assistance Program.**

Mr. Colton next discussed steps PAWC should be directed to take as part of this proceeding to improve its performance of its low-income programs. In doing so, Mr. Colton identified recent Commission decisions in the *Columbia Gas* base rate case and the *PGW* base rate case wherein the Commission stated that a narrow definition of "confirmed low-income" is inappropriate.<sup>447</sup> In both cases, the Commission raised concerns that recognize the needs of low-income customers who are income-eligible but who, for whatever reason, are not participating in PAWC's BDP or AFP programs. Mr. Colton testified that, "given the history of the Commission's concerns, it is important to assess the extent to which PAWC has both: (1) identified its low-income population; and (2) enrolled its low-income customers into the BDP/AFP where possible and appropriate."<sup>448</sup>

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<sup>446</sup> OCA St. 4 at 47.

<sup>447</sup> OCA St. 4 at 48-49 *citing Pa. PUC v. Columbia Gas Co.*, Docket No. R-2025-3053499, Order at 350 (Dec. 4, 2025); *Pa. PUC v. Philadelphia Gas Works*, Docket No. R-2023-3037933, Order at 226 (Nov. 9, 2023).

<sup>448</sup> OCA St. 4 at 49-50.

PAWC should adopt an internal process to identify its low-income customer base that is based on the policy that the Commission adopted for Pennsylvania’s energy utilities because it represents good business practice that benefits both PAWC and its ratepayers. The Commission’s regulations allows customers to self-certify their eligibility, including through the receipt of LIHEAP funds.<sup>449</sup> A customer’s self-attestation of the receipt of public assistance places a customer in the low-income designation and is sufficient for identification as low-income.<sup>450</sup> To address this issue, Mr. Colton testified:

I recommend that PAWC initiate a screening process at the time a household first applies to receive service from the Company to determine whether the applicant: (a) should be classified as an identified low-income customer; and (b) should be referred to the BDP application process. Indeed, this screening process presents an ideal opportunity for PAWC to determine if new applicants for service might qualify for the Company’s low-income programs.<sup>451</sup>

Mr. Colton added that PAWC should actively seek to ascertain from a customer whether that customer is participating in a program providing “state benefits based on household income eligibility requirements that are consistent with those of the [BDP].”<sup>452</sup> The mere fact of receiving such assistance is sufficient to meet the recommended definition.<sup>453</sup>

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<sup>449</sup> OCA St. 4 at 50-51 *quoting* 52 Pa. Code § 62.2.

<sup>450</sup> OCA St. 4 at 51 (noting that such identification is also important because it would qualify a customer for various fee waivers); 66 Pa. C.S. § 1409 and 52 Pa. Code § 56.22.

<sup>451</sup> OCA St. 4 at 53.

<sup>452</sup> OCA St. 4 at 53-54.

<sup>453</sup> OCA St. 4 at 54-55 (noting that 98% of the households that are income-eligible for SNAP are actually enrolled in SNAP in Pennsylvania and that using PAWC’s customer contacts to ask customers whether they are enrolled in SNAP would increase PAWCs identification of its low-income customers).

PAWC should expand its enrollment in CAP within its identified low-income customer population by directing customers to the program before they enter into a DPA or before they are disconnected for nonpayment. Mr. Colton testified that this should be done by PAWC providing a stand-alone written plain language notice informing those customers of their right, in the alternative to enroll in the BDP.<sup>454</sup> This is consistent with the requirement of Section 1303 of the Public Utility Code that utilities with rates applicable to service rendered to a patron being required to compute bills under the rate most advantageous to the patron.<sup>455</sup> Again, this issue has been addressed recently in both the recent *Columbia Gas* base rate case and the *Columbia Gas Universal Service and Energy Conservation Plan* proceeding.<sup>456</sup> As a result, as Mr. Colton testified:

[B]efore PAWC enters into a [DPA]with a customer which the Company either: (1) knows to an identified low-income customer; or (2) has generated information through the DPA process documenting that the customer is in the income range at or below 150% FPL, it should be required to provide the customer a stand-alone plain language notice to that customer of the customers' right to apply for BDP and an explanation of the advantages of BDP's arrearage forgiveness benefits.<sup>457</sup>

Similarly, prior to the disconnection of an identified low-income customer, PAWC should adopt a procedure, developed in collaboration with its low-income advisory group under

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<sup>454</sup> OCA St. 4 at 55.

<sup>455</sup> OCA St. 4 at 56-57 *quoting* 66 Pa. C.S. § 1303 (“Any public utility, having more than one rate applicable to service rendered to a patron, shall, after notice of service conditions, compute bills under the rate most advantageous to the patron.”).

<sup>456</sup> *Pa PUC v. Columbia Gas Co.*, Docket No. R-2025-3053499, Recommended Decision at 549 (Oct. 3, 2025) and *Columbia Gas of Pennsylvania, Inc. Universal Service and Energy Conservation Plan for 2024-2028*, Docket No. M-2023-3039487, Order at 31 (April 25, 2024).

<sup>457</sup> OCA St. 4 at 59.

which it will offer the identified low-income customer the opportunity to apply for PAWC's BDP and AFP.<sup>458</sup> Any such duplication is reasonable because experience in multiple programs documents that more effective program outreach is associated with making multiple "touches" with the potential participant population.<sup>459</sup>

Finally, Mr. Colton's analysis also included a review of PAWC's outreach and other information provided by PAWC regarding promotion of the BDP and AFP. Mr. Colton noted that the outreach does not address the shortcomings he identified and, in particular, "the outreach does not allow customers to make decisions regarding whether to enter into a deferred payment arrangement or to enroll in the arrearage forgiveness program with 'informed consent.'"<sup>460</sup> Nor does the outreach provide information to assist customers to not only know that a program exists, but information on how to access the program.<sup>461</sup> Mr. Colton also noted instances where, regrettably, the information PAWC provides to its customers on this issue is not always complete or accurate.<sup>462</sup> Mr. Colton concluded that none of the customer outreach provided by PAWC in response to discovery would substitute for the specific notices he recommends in this proceeding.<sup>463</sup>

## **2. PAWC's Rate Discount Levels in the Bill Discount Program.**

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<sup>458</sup> OCA St. 4 at 60-61.

<sup>459</sup> OCA St. 4 at 61-62.

<sup>460</sup> OCA St. 4 at 63.

<sup>461</sup> OCA St. 4 at 63.

<sup>462</sup> OCA St. 4 at 64 (noting, for example, that the information provided does not explain that a \$25 credit is for *each* month that a bill is paid in full so long as an unpaid bill exists).

<sup>463</sup> OCA St. 4 at 65.

PAWC proposed to modify its BDP so that discounts are provided on a whole-bill basis rather than having separate discounts provided to fixed monthly charges and monthly volumetric charges. PAWC's proposal to align its discounts is reasonable and should be approved. As Mr. Colton testified: "I agree that aligning the discounts on the fixed and variable portions of the bills will 'improve clarify and operational efficiency.' Moreover, I find no conceptual reason why discounts should not be provided on a whole-bill basis."<sup>464</sup>

According to Mr. Colton's analysis, with few exceptions, the impact of moving the proposed rate structure will have a monthly bill impact of less than one dollar (\$1) per month and, in some instances, bills actually decline under the proposed discount level.<sup>465</sup>

**D. Arrearage Management Program (AMP)**

The purpose of an arrearage forgiveness plan is to forgive arrears. In its filing, however, PAWC witness Chard testified, "as part of the [arrearage management plan], customers receive a \$25 arrearage forgiveness credit in exchange for each full and timely monthly payment."<sup>466</sup> In response, Mr. Colton noted that, pursuant to PAWC's own report to the Commission, PAWC's program is not successful in retiring arrears.<sup>467</sup> Mr. Colton made three recommendations in this proceeding.

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<sup>464</sup> OCA St. 4 at 87.

<sup>465</sup> OCA St. 4 at 89.

<sup>466</sup> PAWC St. 2 at 13.

<sup>467</sup> OCA St. 4 at 66, citing *Petition of Pennsylvania American Water Company for Approval of an Arrearage Management Plan*, Docket No. P-2021-3028195, Order at ordering para. 4 (Dec. 7, 2023) (noting that the average amount of participant arrearages forgiven was only \$24.93, and the average number of months in which participants earned forgiveness was only 0.268).

First, Mr. Colton recommended that PAWC's AFP should be modified to allow customers to earn a monthly arrearage forgiveness credit for each complete payment the customer makes, similar to the policy the Commission has adopted for Pennsylvania's energy utilities.<sup>468</sup> The Commission's arrearage forgiveness policy for energy utilities is that forgiveness credits should be provided for full and timely payments and, in addition, retroactive credits should be provided once the household pays its in-program balance in full.<sup>469</sup> Mr. Colton testified that "the failure to provide arrearage forgiveness credits in this fashion results in unreasonable and unfair results to the customer. Moreover, it impedes achieving the objective that the program is seeking to achieve in the first instance."<sup>470</sup> Mr. Colton testified:

Denying such credits not only impedes accomplishing the objective of the program in the first instance, it also fails to provide an incentive for customers to make their payment once the customer has missed the 'due date.' The Company's restrictive policies on when, or whether, to grant AFP credits has resulted in the program being largely ineffective in delivering arrearage relief to low-income customers.<sup>471</sup>

Mr. Colton added that the restrictive policies of PAWC provide no incentive for customers to make partial payments in order to facilitate retiring their entire bill in a future month.<sup>472</sup>

Furthermore, Mr. Colton noted that PAWC's restrictive policies on granting AFP credits

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<sup>468</sup> OCA St. 4 at 67 *citing 2019 Amendments to Policy Statement on Customer Assistance Programs, 52 Pa Code §§ 69.291-69.267, Docket No. M-2019-3012599, Final Policy Statement and Order at 5-6 (Sept. 19, 2019).*

<sup>469</sup> OCA St. 4 at 67-68.

<sup>470</sup> OCA St. 4 at 68.

<sup>471</sup> OCA St. 4 at 68-69.

<sup>472</sup> OCA St. 4 at 70.

is inequitable, noting that for the 14 months for which data is provided, despite AFP customers paying nearly half of their bills (48.3%), they received less than one quarter (24%) of the AFP credits that were potentially available.<sup>473</sup>

Second, Mr. Colton recommended that PAWC's AFP be modified to expand the monthly credit that is provided for a timely payment or for a cured missed or late payment to either: 1) give complete forgiveness in a pro rata fashion over a 24-month period or 2) provide a \$40 credit instead of a \$25 credit.<sup>474</sup> Mr. Colton testified:

A \$25 monthly credit will not allow low-income customers to retire their pre-program arrears in a reasonable time period given the level of pre-existing arrears they are bringing into the program. As a result, the efficacy of the program as a prompt (or incentive) for customers to continue to make payments over a long time period is impeded. Even when customers make their payments, they do not see the end-point at which they will have earned complete forgiveness of their arrears incurred before they enrolled in the AFP (and the corresponding BDP to improve the affordability of their bills).<sup>475</sup>

It would take in excess of four years to retire those arrears assuming that customers received their arrearage forgiveness credits in every month they participated in the program.<sup>476</sup> Mr. Colton noted that AFP participants had participated in the program for an average of 6.3 months and virtually no participant reduced pre-existing arrears to \$0.<sup>477</sup> PAWC should be directed to adopt Mr. Colton's recommendation that PAWC provide a pro rata forgiveness of pre-existing arrears each month over a 24-month period.

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<sup>473</sup> OCA St. 4 at 71-72.

<sup>474</sup> OCA St. 4 at 73.

<sup>475</sup> OCA St. 4 at 73.

<sup>476</sup> OCA St. 4 at 74.

<sup>477</sup> OCA St. 4 at 75-76.

Third, Mr. Colton testified that PAWC should tie its enrollment of low-income customers into its AFP more closely to enrollment in BDP since a significant number of low-income customers are being enrolled into the BDP with a pre-existing arrears on their account at the time of enrollment who are not also enrolled in the AFP upon their enrollment in BDP.<sup>478</sup> Mr. Colton testified: “For whatever reason, PAWC appears to be enrolling customers into its BDP who have pre-existing arrears without at the same time enrolling those customers in PAWC’s AFP. This failure impedes the effectiveness of the BDP in promoting the affordability of low-income bills.”<sup>479</sup> The barriers to simultaneous enrollment in both programs should be removed.

Here too, PAWC opposed every modification proposed by Mr. Colton to improve the AFP. PAWC does not respond to the factual evidence presented by Mr. Colton. As Mr. Colton testified, “[Ms. Chard] ignores the facts which show that the Company’s program is not only failing to achieve its objective, but is also operating in a punitive fashion to its AFP participants.”<sup>480</sup> Mr. Colton added that “the only impact of the Company’s timeliness requirement is to deny arrearage forgiveness to program customers who have made payments.”<sup>481</sup>

Similarly, with regard to the \$25 arrearage forgiveness credit, Ms. Chard considers that credit amount to be reasonable, even though, according to PAWC’s own data,

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<sup>478</sup> OCA St. 4 at 78.

<sup>479</sup> OCA St. 4 at 79.

<sup>480</sup> OCA St. 4SR at 28-29.

<sup>481</sup> OCA St. 4SR at 29.

customers are not being provided an opportunity to make meaningful progress toward the forgiveness of their pre-existing arrears.<sup>482</sup> Likewise, Ms. Chard’s position on hardship grants should be rejected too because hardship grants are not used to reduce pre-existing arrears, nor will the receipt of a hardship grant qualify the customer for any arrearage forgiveness credits.<sup>483</sup>

**E. H2O Help To Others (H2O) Program Screening, Outreach, and Enrollment procedures.**

The OCA did not address this issue in its testimony.

**F. Water Conservation and Line Repair and Replacement Assistance**

The OCA did not address this issue in its testimony.

**G. Hardship Fund**

The OCA did not address this issue in its testimony.

**H. Renter Assistance Pilot Program**

PAWC proposed a renter assistance pilot program (RAPP) for income-eligible renters receiving water and wastewater service in master-metered buildings. As PAWC witness Chard explains: “The RAPP assists low-income residents with paying their utility bills when they are not responsible for paying for their utility service directly to their utilities because they are located in an apartment building that is master metered.”<sup>484</sup>

However, the RAPP represents a substantial change in regulatory policy in Pennsylvania and care should be taken in structuring any such program and providing for approval even on a pilot basis. As Mr. Colton testified, “the proposed RAPP represents a

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<sup>482</sup> OCA St. 4SR at 30-31. *See also*, PAWC St. 2-R at 7.

<sup>483</sup> OCA St. 4SR at 31 (arrears forgiveness is provided only for a “timely” payment; hardship grants are provided only for past-due bills). *See also* PAWC St. 2-R at 8.

<sup>484</sup> PAWC St. 2 at 15.

substantial change in regulatory policy in that it proposes to use ratepayer money to provide assistance to non-ratepayers.”<sup>485</sup> Mr. Colton noted that this is contrary to the original rationale advanced by the Commission when it first considered the energy utilities’ CAPs which arose out of the Commission’s investigation to control uncollectible accounts.<sup>486</sup> By providing assistance to non-customers, the issue of whether the program assists in improving payment patterns is removed. As such, Mr. Colton recommended that PAWC be directed to present its conceptual proposal for RAPP to its Low-Income Advisory Committee for further development of program details prior to re-submitting the proposal, either in a separate proceeding or as part of its next rate case.<sup>487</sup>

PAWC did not acknowledge the shortcomings with this proposed program. PAWC witness Chard argued in rebuttal that “the purpose of the RAPP is to assist low-income residents of master-metered rental buildings with paying their utility bills.”<sup>488</sup> Yet, in her Direct Testimony, Ms. Chard explicitly acknowledged that the RAPP is designed to provide assistance to help “low-income residents with paying their utility bills when they are *not responsible for paying for their utility service directly to their utilities*.”<sup>489</sup> Ms. Chard does not reconcile her two statements; yet both should be rejected.

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<sup>485</sup> OCA St. 4 at 82.

<sup>486</sup> OCA St. 4 at 82, citing, *In the Matter of the Investigation into the Control of Uncollectible Accounts*, Docket No. I-9000002 (initiated Oct. 11, 1990).

<sup>487</sup> OCA St. 4 at 84-85. Such details include: how the program will determine whether a household is, in fact, being allocated some portion of a multi-family dwelling water bill; what objectives the RAPP is seeking to accomplish and how those objectives would be accomplished; and, how multi-family dwellings are defined for purposes of RAPP.

<sup>488</sup> PAWC St. 2-R at 11.

<sup>489</sup> PAWC St. 2 at 15.

## **I. Universal Service Plan**

The OCA did not address this issue in its testimony.

## **XIII. SERVICE QUALITY AND CUSTOMER SERVICE ISSUES**

### **A. Summary**

OCA witness Alexander reviewed the service quality and customer service issues in this matter. Ms. Alexander recommended that PAWC adopt the following measures:

First, PAWC, as a condition of any rate increase in this proceeding, must require that its call centers and its call center performance overall conform, at a minimum, to its corporate call center performance objective of answering 80% or more of the calls within 60 seconds with an abandonment rate of 8% or less. These performance objectives should be imposed on call centers operated by its Parent Company and its third-party contractors.

Second, PAWC should be required to undertake an annual audit and investigation of customer call center compliance with Pennsylvania's regulations by not only investigating customer complaints but affirmatively reviewing a valid sample of customer calls and subsequent transactions to find and respond to potential violations or improperly handled calls. Such audits with their findings and responses in the form of internal action undertaken should be available to stakeholders and submitted as evidence in PAWC's next base rate case. It is unreasonable to rely solely on PAWC's use of "coaching" to respond to findings of improper call handling.

Third, PAWC should be required to conduct a proper root cause analysis of customer disputes and informal and formal complaints to identify complaint trends, underlying causes, and reforms or other steps undertaken to respond to these findings. PAWC should share its plan to conduct and methodology for a root cause analysis with stakeholders prior to undertaking such analysis. A root cause analysis should be undertaken within six months of the final order in this proceeding and the results shared with stakeholders and included in PAWC's next base rate case filing.

Fourth, I recommend that, at a minimum, PAWC's performance as I have documented here support the recommendations of other OCA witnesses to oppose PAWC's request for any increase in its rate of return for management performance.

Finally, I recommend that PAWC's actual costs included in its revenue requirement for third party call centers be penalized in the form of a 10%

reduction in response to the oversight failures and poor performance I have documented.<sup>490</sup>

Regarding the billing arrangement between PAWC and AWR:

First, the Commission should order that the marketing of these services be reformed to require that the marketing and billing of these services be identified as optional services provided by Oncourse Home Services. The use of the PAWC logo and the fictitious name of American Water Resources (and entity that operates as a “brand” for Oncourse Home Solutions and is adopted specifically to market its products to American Water utility customers) should be prohibited as a basic consumer protection matter. The Commission has the authority to impose such conditions on allowing the use of PAWC’s customer lists and access to the PAWC bill by this third-party entity.

Second, PAWC’s customer bill should not include any non-basic charges in the same section and calculation of the regulated service charges. Non-basic charges should be separately identified and disclosed with a separate total with a statement that the customer has the option to include this charge on the monthly PAWC bill or receive a separate bill for these optional services from Oncourse Home Services.

Third, PAWC’s customer service training materials should require PAWC representatives to state that PAWC is paid to promote and bill for these optional Oncourse Home Services and that home protection services are available from a number of providers.

PAWC should be required to document that it has offered the use of its customer bills for non-basic services to any third-party provider that markets home protection services or, as an option, terminate this program. Among other purposes, such a competitive process may result in less expensive products to PAWC’s customers compared to the sole source use of Oncourse Home Solutions.

Finally, the revenues PAWC receives for these non-basic services, and their accompanying costs should be shifted to shareholders and not PAWC’s ratepayers.<sup>491</sup>

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<sup>490</sup> OCA St. 5 at 16-17.

<sup>491</sup> OCA St. 5SR at 22-23.

## **B. Customer Service Performance**

OCA witness Alexander testified that PAWC's poor customer service performance should be viewed in context with the magnitude and frequency of PAWC's rate cases as follows:

These issues are important themselves, but particularly so in this case given the magnitude of PAWC's proposed rate increases and the fact that PAWC's customers have seen rate increases in 2021, 2022, 2023, resulting from a two-stage significant rate increase from its 2020 rate case and the increase that just took effect in January 2023 from the 2022 rate case and a rate increase authorized in August 2024 as a result of the most recent base rate case filed in 2023. Since its 2020 rate case, the average residential customer in Rate Zone 1 has seen a nearly 35% increase in water rates.<sup>492</sup>

### **1. Call Center Performance**

Sections 523, 1501, and 1505 of the Public Utility Code provide pertinent legal standards to assess when evaluating PAWC individual call center performance. Pursuant to Section 523:

The commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title. On the basis of the commission's consideration of such evidence, it shall give effect to this section by making such adjustments to specific components of the utility's claimed cost of service as it may determine to be proper and appropriate. Any adjustment made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.<sup>493</sup>

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<sup>492</sup> OCA St. 5 at 3.

<sup>493</sup> 66 Pa. C.S. § 523.

OCA witness Alexander testified that “PAWC requests that the Commission’s adopt the higher end of its requested return on equity based on its management performance.”<sup>494</sup>

In addition to Section 523, Section 1501 of the Public Utility Code provides in pertinent part, “Every public utility shall furnish and maintain adequate, efficient, safe, and reasonable service and facilities, and shall make all such repairs, changes, alterations, substitutions, extensions, and improvements in or to such service and facilities as shall be necessary or proper for the accommodation, convenience, and safety of its patrons, employees, and the public.”<sup>495</sup> Furthermore, if the Commission finds that services or facilities of a public utility are “unreasonable, unsafe, inadequate, insufficient, or unreasonably discriminatory” Section 1505 of the Public Utility Code gives the Commission the authority to “determine and prescribe by regulations or order, the reasonable, safe, adequate, sufficient, services or facilities to be observed, furnished, enforced, or employed, including all such repairs, changes, alterations, extensions, substitutions, or improvements in facilities as shall be reasonably necessary and proper for the safety, accommodation, and convenience of the public.”<sup>496</sup>

OCA witness Alexander testified that PAWC’s call center performance is inadequate and has been inadequate for some time, based on (1) high call-answer times, (2) high call abandonment rates, and (3) and customer complaints.<sup>497</sup> According to OCA

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<sup>494</sup> OCA St. 5 at 6.

<sup>495</sup> 66 Pa. C.S. § 1501

<sup>496</sup> 66 Pa. C.S. § 1505.

<sup>497</sup> OCA St. 5 at 5, 10-11, 16-17, 32-33; OCA Exh. BA-2; OCA St. 5, App. A

witness Alexander, “[t]he call centers perform at a dramatically lower level of performance than should be tolerated...”<sup>498</sup> PAWC’s inadequate call center performance supports the OCA’s recommendations to disallow certain call center expenses and should be considered in relation to the ROE, as discussed in Section IX.F. This is also supported by Section 1501 and Section 1505 of the Public Utility Code. In addition, the OCA’s recommendations to improve call center and complaint handling should be implemented by PAWC as a part of any authorized rate increase to ensure that consumers are receiving adequate service.<sup>499</sup>

PAWC outsources its call center and customer service functions to its affiliate, the Service Company, and it does not provide appropriate managerial oversight thereof.<sup>500</sup> OCA witness Alexander testified that “[t]he 2024 and 2025 annual averages percentage of calls answered within 60 seconds is 47% and 44%, respectively, for one contractor, and 31% and 22%, respectively, for the other contractor.”<sup>501</sup> Further, “[t]he annual average abandonment rate reflects similarly poor and unacceptable performance: 19% for one contractor for both 2024 and 2025, and 20% in 2024 and 23% in 2025, for the other contractor.”<sup>502</sup> At the public input hearings, one consumer testified that they called PAWC regarding poor water quality, and was placed on hold for over 20 minutes waiting to speak

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<sup>498</sup> OCA St. 5 at 10-11

<sup>499</sup> 66 Pa. C.S. §§ 523, 1501, 1505; *Pa. PUC v. Pa. Gas & Water Co.*, 74 PUR4th 238 (*Pa. PUC 1986*); *Pa. PUC v. Philadelphia Gas Works*, 2000 Pa. PUC LEXIS 876 (*Order Nov. 22, 2000*).

<sup>500</sup> OCA St. 5 at 8-10.

<sup>501</sup> *Id.* at 11

<sup>502</sup> *Id.*

to a supervisor, and that no supervisor picked up the phone.<sup>503</sup> PAWC provided no response to this testimony.

The Commission requires electric and natural gas distribution companies to report call center performance for the percentage of calls answered within 30 seconds and the call abandonment rate.<sup>504</sup> The Commission's 2023 Management Audit found that PAWC had a decline in call handling, which lead PAWC to state it would strive to achieve 80% of calls answered within 60 seconds by December 2024.<sup>505</sup> OCA witness Alexander testified that "the typical performance reported by these public utilities is to answer 80% of the calls within 30 seconds (not 60 seconds), much higher than PAWC."<sup>506</sup> Ms. Alexander further testified "PAWC's stated objective for 2026 is to answer 80% of the calls within 60 seconds and experience an abandonment rate of 8% or less. Clearly, PAWC's contractors, the costs for which are included in its revenue requirement in this proceeding, fail to come close to these performance objectives."<sup>507</sup>

Even though call center performance has been subpar, PAWC has failed to conduct a proper root-cause analysis or any analysis to determine trends and failed to take corrective

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<sup>503</sup> Tr. at 1418-1419; OCA St. 5 App. A at 13.

<sup>504</sup> PA. PUC Bureau of Consumer Services, *2024 Customer Service Performance Report, Pennsylvania Electric & Natural Gas Distribution Companies*, 6-7 (Dec. 2025) (<https://www.puc.pa.gov/media/3762/2024-customer-service-performance-report-final.pdf>).

<sup>505</sup> Pa. PUC Bureau of Audits, *Pennsylvania American Water Co. Management and Operations Audit*, 80-84 (Oct. 2023) (<https://www.puc.pa.gov/pcdocs/1810662.pdf>).

<sup>506</sup> OCA St. 5 at 11; See generally Pa. PUC Bureau of Audits, *Pennsylvania American Water Co. Management and Operations Audit*, 80-84 (Oct. 2023) (<https://www.puc.pa.gov/pcdocs/1810662.pdf>).

<sup>507</sup> OCA St. 5 at 11.

actions related to proven inadequate call center performance. OCA witness Alexander testified that “A root cause analysis is a fact-based exercise in which the underlying cause or causes of an undesirable outcome are identified then specific remedial steps are identified and determined to result in correcting or improving the previously identified undesirable result.”<sup>508</sup> OCA witness Alexander further testified that conducting a root cause analysis would allow PAWC to “to audit the performance of the contractor from time-to-time, thus ensuring compliance with PAWC’s statutory and regulatory obligations. This would allow PAWC to impose contractual remedies, including termination of the contract, should the contractor’s performance not be satisfactory.”<sup>509</sup>

## **2. Customer Complaints**

Over the course of these proceedings, the parties participated in ten in-person public input hearings in Washington, Scranton, Harrisburg, Reading, and Chester, as well as two telephonic public input hearings.<sup>510</sup> Areas of public concern include *inter alia* affordability of service, frequency of rate increases, impact from data centers, customer service, water quality, and service disruptions. In addition to the testimony received at the public input hearings, at the time of Ms. Alexander’s testimony, 147 formal complaints and 364 informal complaints were filed with the Commission.<sup>511</sup> As of March 25, 2026, a total of 159 formal and 572 informal complaints have been lodged against PAWC.

### **a. Affordability**

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<sup>508</sup> OCA St. 5 at 13.

<sup>509</sup> *Id.* at 12.

<sup>510</sup> OCA St. 5 at App. A.

<sup>511</sup> OCA St. 5 at 5.

In all, 75 individuals and 15 public officials provided testimony at the public input hearings regarding the affordability of water and/or wastewater service provided by PAWC.<sup>512</sup> OCA witness Alexander testified that, “under the Company’s proposal, the total bill for a residential water customer purchasing 3,263 gallons of water per month would see increases ranging by Rate zone, between 9.8% to 41.1%.”<sup>513</sup> Ms. Alexander further testified that “the average residential customer in Rate Zone 1 has seen a nearly 35% increase in water rates.”<sup>514</sup> Increases are not exclusive to water service. Ms. Alexander testified that “[t]he total bill for a residential wastewater customer purchasing 3,164 gallons of water per month would see increases, ranging by Rate Zone, between 8% to 54%.”<sup>515</sup>

The continued increase in prices that PAWC customers must pay for the vital water and wastewater service has become unaffordable. A customer stated during the public input hearings that moving to an area where PAWC provides water service might have been a mistake.<sup>516</sup> Many customers over the course of the 12 different hearings stated that they were using various methods to reduce water usage, including, short showers, purchasing bottled water, not using in home washing machines and dishwashers, refraining from watering lawns and washing cars, some even testified to reducing the amount to times they flush toilets.<sup>517</sup> Consumers should not be forced to choose between paying their water bill

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<sup>512</sup> OCA St. 5 App. A at 1-9; OCA St. 5 App. A Supp. at 1-4.

<sup>513</sup> OCA St. 5 at 4

<sup>514</sup> OCA St. 5 at 3

<sup>515</sup> *Id.*

<sup>516</sup> OCA St. 5-Supp. App. A at 2; Tr. 1514-1516

<sup>517</sup> *See generally*, OCA St. 5 App. A; OCA St. 5-Supp. App. A.

and the amount of times they shower or flush the toilet. PAWC's multitude of rate increases over the past six years have reached a level of unaffordability for many consumers.

**b. Customer Service, Water Quality, and Service Disruptions**

Throughout the public input hearings, PAWC consumers testified to the poor customer service they received from interactions with PAWC as well as to the poor quality of water and service disruptions. Again, at the public input hearings, 24 consumers and 3 public officials provided testimony regarding these issues.<sup>518</sup> Several consumers testified to purchasing bottled water or reverse osmosis filters, water that has black specks, white specks, or is brown, and chemical, chlorine, and rotten egg smells.<sup>519</sup>

**C. Billing Arrangement with American Water Resources**

OCA witness Alexander testified that PAWC is engaging in deceptive and discriminatory billing and marketing practices for nonutility services provided by PAWC's ex-affiliate, American Water Resources (AWR), to the detriment of consumer interests.<sup>520</sup> This is inadequate and unreasonable utility service under Section 1501.<sup>521</sup>

OCA witness Alexander testified to the reasons that the billing arrangement between AWR and PAWC is unreasonable and inadequate for its consumers. Ms. Alexander raised three concerns with the relationship between American Water Resources and PAWC. First, Ms. Alexander states that "the use of the shared name and logo by American Water Resources would mislead the average PAWC customer to believe that American Water

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<sup>518</sup> *Id.*

<sup>519</sup> Tr. 402-405; 548-549; 917; 930-931; 978-979; 1033; 1033; 1116; 1145 1362;1418-1422; *See also* OCA St. 5 App. A; and OCA St. No. 5 Supp. App. A.

<sup>520</sup>OCA St. 5 at 21-22; 24-25.

<sup>521</sup> 66 Pa. C.S. § 1501

Resources is legally affiliated with PAWC under common ownership or management...<sup>522</sup>

This can lead to unfair advantages and benefits for both PAWC and American Water Resources. Specifically, AWR receives more customers and PAWC benefits “from this false impression as PAWC’s collects additional service fees from American Water Resources under the Utility Billing Agreement as the number of customers being billed for Warranty Services increases.”<sup>523</sup> It is unreasonable and inadequate service to mislead consumers into believing that two companies are affiliated, when they are not, especially when both companies stand to gain financially from this billing arrangement.

Second, Ms. Alexander stated that “American Water Resources’ exclusive marketing and billing arrangement with PAWC is discriminatory to any other provider of these services in PAWC’s service territory.”<sup>524</sup> Discriminating against other companies that provide these same services is inadequate and unreasonable service. The potential effect of these discriminatory practices is consumers paying more for the same services. With regard to the first two concerns, Ms. Alexander recommends the following:

First, the Commission should order that the marketing of these services be reformed. I recommend requiring that marketing and billing for these services be identified as optional services provided by Oncourse Home Services. The use of the PAWC logo and the fictitious name of American Water Resources (an entity that operates as a “brand” for Oncourse Home Solutions and is adopted specifically to market its products to American Water utility customers) should be prohibited as a basic consumer protection matter. The Commission has the authority to impose such conditions on

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<sup>522</sup> OCA St. 5 at 24.

<sup>523</sup> OCA St. 5 at 24-25.

<sup>524</sup> OCA St. 5 at 25.

allowing the use of PAWC's customer lists and access to the PAWC bill by this third-party entity.<sup>525</sup>

Applying Ms. Alexander's recommendation potentially allows more consumer choice.

Ms. Alexander's final concern is "the charges are presented on customer's bills in a manner that does not clearly differentiate these unregulated and non-basic services from PAWC's regulated charges."<sup>526</sup> Ms. Alexander asserts that these non-basic charges should be differentiated from regulated charges.<sup>527</sup> Not only is this Ms. Alexander's assertion, but also, pursuant to 52 Pa. Code Section 56.263, "[c]harges for other than basic service...must appear *after* charges for basic services and *appear distinctly separate*. This includes charges for optional recurring services which are distinctly separate and clearly not required for the physical delivery of service. Examples include *line repair programs* and appliance warranty programs."<sup>528</sup> Ms. Alexander recommended:

PAWC's customer bill should not include any non-basic charges in the same section and calculation of the regulated service charges. Non-basic charges should be separately identified and disclosed with a separate total with a statement that the customer has the option to include this charge on the monthly PAWC bill or receive a separate bill for these optional services from Oncourse Home Services.<sup>529</sup>

In addition to the above recommendations, Ms. Alexander also recommends the following with regard to the non-basic charges seen on consumers bills, specifically with respect to the relationship between American Water Resources and PAWC.

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<sup>525</sup> OCA St. 5 at 27.

<sup>526</sup> OCA St. 5 at 25.

<sup>527</sup> *Id.*

<sup>528</sup> 52 Pa. Code § 56.263. (Emphasis added).

<sup>529</sup> OCA St. 5 at 26.

PAWC should be required to document that it has offered the use of its customer bills for non-basic services to any third-party provider that markets home protection services or, as an option, terminate this program. Among other purposes, such a competitive process may result in less expensive products to PAWC's customers compared to the sole source use of Oncourse Home Solutions.

Finally, the revenues PAWC receives for these non-basic services should continue to be used to offset revenue requirement recovered from PAWC's ratepayers.... My recommendations regarding American Water Resources are intended to benefit consumers, not harm them, by ending the misleading practice of giving utility consumers the false impression that American Water Resources is affiliated with PAWC and ensuring consumer access to competitive pricing and terms of warranty services by ending PAWC's discriminatory billing practices.<sup>530</sup>

PAWC's current billing arrangement with AWR is unreasonable and does not provide adequate service to its customers. The Commission should adopt the OCA's recommendations to bring PAWC into compliance with 52 Pa Code Section 56.263.

#### **XIV. CONCLUSION**

PAWC has not affirmatively demonstrated the reasonableness of every element of its claims for rate base, revenues and expenses, rate of return, revenue allocation, cost of service allocation, rate design, deferred accounting treatment, and alternative ratemaking. Accordingly, it is within the discretion of the ALJs and the Commission to deny, and the ALJs and the Commission should deny, PAWC's ratemaking claims and requests in this proceeding that are challenged by the OCA.

Respectfully submitted,

Counsel for:  
Darryl A. Lawrence  
Consumer Advocate

/s/ Harrison W. Breitman  
Harrison W. Breitman  
Senior Assistant Consumer Advocate

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<sup>530</sup> OCA St. 5 at 26-27.

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Dated: April 6, 2026

**Pennsylvania-American Water Company**  
**Water Operations**  
**Table I**

Line No.	Description	Pro Forma at Present Rates	Recommended Adjustments	Adjusted at Present Rates	Revenue Adjustment	Total Allowable Revenues
1	Operating Revenues	<u>\$ 953,098,389</u>	<u>\$ -</u>	<u>\$ 953,098,389</u>	<u>\$ (39,080,536)</u>	<u>\$ 914,017,853</u>
2						
3	Deductions:					
4	Operation and Maintenance	281,915,131	(3,450,744)	278,464,387	(428,713)	278,035,674
5	Depreciation	227,388,538	(36,952,810)	190,435,728		190,435,728
6	Amortizations	1,282,111	(118,513)	1,163,598	-	1,163,598
7	Taxes					
8	State Income Tax	19,888,012	2,848,139	22,736,151	(2,681,858)	20,054,293
9	Federal Income Tax	46,994,519	7,958,531	54,953,050	(7,493,894)	47,459,156
10	Taxes Other Than Income	17,174,070	(199,646)	16,974,424	(284,754)	16,689,670
11	Deferred Income Taxes	<u>(233,592)</u>	<u>-</u>	<u>(233,592)</u>	<u>-</u>	<u>(233,592)</u>
12	Net Income	<u>\$ 358,689,600</u>	<u>\$ 29,915,044</u>	<u>\$ 388,604,644</u>	<u>\$ (28,191,317)</u>	<u>\$ 360,413,327</u>
13						
14	Rate Base	<u>\$5,179,526,769</u>		<u>\$5,178,352,411</u>		<u>\$5,178,352,411</u>
15						
16	Recommended Rate of Return	<u>6.93%</u>		<u>7.50%</u>		<u>6.96%</u>

Pennsylvania-American Water Company  
Water Operations  
Table II

Line No.	Recommended Adjustment	Exhibit Reference	Rate Base Effect	Revenue Effect	Expense Effect	Depreciation Expense Effect	Amortization Expense Effect	Effect Upon Taxes-Other	State Tax Effect	Federal Tax Effect
1	Adjustment to Annual Performance Pay	Exhibit LKM-3W-SR	\$ -	\$ -	\$ (2,604,650)	\$ -	\$ -	\$ (199,646)	\$ 196,020	\$ 547,738
2	Adjustment to Group Insurance	Exhibit LKM-3W-SR	-	-	(435,915)	-	-	-	30,470	85,143
3	Adjustment to Transportation Expense	Exhibit LKM-3W-SR	-	-	(177,557)	-	-	-	12,411	34,681
4	Adjustment to Manwalamink Acquisition Adjustment	Exhibit LKM-8W-SR	(1,051,330)	-	-	-	(106,097)	-	7,416	20,723
5	Adjustment to Farmington Township Acquisition Adjustment	Exhibit LKM-8W-SR	(123,028)	-	-	-	(12,416)	-	868	2,425
6	Remove Towamencin Township Transaction Costs	Exhibit LKM-8W-SR	-	-	- <sup>1/</sup>	-	-	-	-	-
7	Change in Depreciation Rates	Exhibit LKM-3W-SR	-	-	-	(36,952,810)	-	-	2,583,001	7,217,660
8	Interest Synchronization Adjustment	Exhibit LKM-10W-SR	-	-	-	-	-	-	1,691	4,725
9	Remove 10% of Third Party Call Centers Expense	Exhibit LKM-12W-SR	-	-	(232,622)	-	-	-	16,260	45,436
10	Total Adjustments		<u>\$ (1,174,358)</u>	<u>\$ -</u>	<u>\$ (3,450,744)</u>	<u>\$ (36,952,810)</u>	<u>\$ (118,513)</u>	<u>\$ (199,646)</u>	<u>\$ 2,848,139</u>	<u>\$ 7,958,531</u>

Note

<sup>1/</sup> During preparation of this table, it was determined that the Towamencin transaction costs were inadvertently included as an adjustment to Water Operations in Exhibit LKM-3W-SR. The error has been corrected in this table.

**Pennsylvania-American Water Company**  
**Wastewater SSS Operations**  
**Table I**

Line No.	Description	Pro Forma at Present Rates	Recommended Adjustments	Adjusted at Present Rates	Revenue Adjustment	Total Allowable Revenues
1	Operating Revenues	\$ 108,665,761	\$ -	\$ 108,665,761	\$ 2,834,013	\$ 111,499,774
2						
3	Deductions:					
4	Operation and Maintenance	\$ 29,370,450	\$ (286,547)	\$ 29,083,903	\$ 31,089	\$ 29,114,992
5	Depreciation	28,338,641	(5,801,678)	22,536,963	-	22,536,963
6	Amortizations	256,872	(157,527)	99,345	-	99,345
7	Taxes					
8	State Income Tax	3,141,738	439,092	3,580,830	194,481	3,775,311
9	Federal Income Tax	8,196,101	1,226,951	9,423,052	543,437	9,966,489
10	Taxes Other Than Income	2,491,390	(15,678)	2,475,712	20,650	2,496,362
11	Deferred Income Taxes	-	-	-	-	-
12	Net Income	<u>\$ 36,870,569</u>	<u>\$ 4,595,388</u>	<u>\$ 41,465,957</u>	<u>\$ 2,044,356</u>	<u>\$ 43,510,313</u>
13						
14	Rate Base	<u>\$ 661,208,859</u>		<u>\$ 660,247,539</u>		<u>\$ 660,247,539</u>
15						
16	Recommended Rate of Return	<u>5.58%</u>		<u>6.28%</u>		<u>6.59%</u>

Pennsylvania-American Water Company  
Wastewater SSS Operations  
Table II

Line No.	Recommended Adjustment	Exhibit Reference	Rate Base Effect	Revenue Effect	Expense Effect	Depreciation Expense Effect	Amortization Expense Effect	Effect Upon Taxes-Other	State Tax Effect	Federal Tax Effect
1	Adjustment to Annual Performance Pay	Exhibit LKM-3WSS-SR	\$ -	\$ -	\$ (204,545)	\$ -	\$ -	\$ (15,678)	\$ 15,394	\$ 43,014
2	Adjustment to Group Insurance	Exhibit LKM-3WSS-SR	-	-	(46,661)	-	-	-	3,262	9,114
3	Adjustment to Transportation Expense	Exhibit LKM-3WSS-SR	-	-	(8,820)	-	-	-	617	1,723
4	Adjustment to Manwalamink Acquisition Adjustment	Exhibit LKM-8WSS-SR	(961,320)	-	-	-	(97,014)	-	6,781	18,949
5	Remove Towamencin Township Transaction Costs	Exhibit LKM-8WSS-SR	-	-	-	-	(60,513)	-	4,230	11,819
6	Change in Depreciation Rates	Exhibit LKM-3WSS-SR	-	-	-	(5,801,678)	-	-	405,537	1,133,190
7	Interest Synchronization Adjustment	Exhibit LKM-9WSS-SR	-	-	-	-	-	-	1,418	3,962
8	Remove 10% of Third Party Call Centers Expense	Exhibit LKM-3WSS-SR	-	-	(26,521)	-	-	-	1,854	5,180
9	Total Adjustments		<u>\$ (961,320)</u>	<u>\$ -</u>	<u>\$ (286,547)</u>	<u>\$ (5,801,678)</u>	<u>\$ (157,527)</u>	<u>\$ (15,678)</u>	<u>\$ 439,092</u>	<u>\$ 1,226,951</u>

**Pennsylvania-American Water Company**  
**BASA Wastewater Operations**  
**Table I**

Line No.	Description	Company Amounts at Present Rates <sup>1/</sup>	OCA Adjustments	Amounts After OCA Adjustments	Pro Forma Change in Revenues	Amounts After Change in Revenues
1	Operating Revenues	\$ 12,761,096	\$ -	\$ 12,761,096	\$ 27,354,153	\$ 40,115,249
2						
3	Deductions:					
4	Operation and Maintenance	\$ 7,504,913	\$ (84,296)	\$ 7,420,617	\$ 300,075	\$ 7,720,692
5	Depreciation	11,360,328	(3,867,209)	7,493,119	-	7,493,119
6	Amortizations	130,326	-	130,326	-	130,326
7	Taxes					
8	State Income Tax	(112,877)	276,533	163,656	1,877,148	2,040,804
9	Federal Income Tax	(348,368)	772,713	424,345	5,245,300	5,669,645
10	Taxes Other Than Income	685,092	(4,612)	680,480	199,311	879,791
11	Deferred Income Taxes	-	-	-	-	-
12	Net Income	\$ (6,458,318)	\$ 2,906,872	\$ (3,551,446)	\$ 19,732,319	\$ 16,180,873
13						
14	Rate Base	\$ 245,536,760		\$ 245,536,760		\$ 245,536,760
15						
16	Recommended Rate of Return	-2.63%		-1.45%		6.59%

**Pennsylvania-American Water Company**  
**BASA Wastewater Operations**  
**Table II**

Line No.	Recommended Adjustment	Exhibit Reference	Rate Base Effect	Revenue Effect	Expense Effect	Depreciation Expense Effect	Amortization Expense Effect	Effect Upon Taxes-Other	State Tax Effect	Federal Tax Effect
1	Adjustment to Annual Performance Pay	Exhibit LKM-3BASA-SR	\$ -	\$ -	\$ (60,170)	\$ -	\$ -	\$ (4,612)	\$ 4,528	\$ 12,653
2	Adjustment to Group Insurance	Exhibit LKM-3BASA-SR	-	-	(17,770)	-	-	-	1,242	3,471
3	Adjustment to Transportation Expense	Exhibit LKM-3BASA-SR	-	-	(3,236)	-	-	-	226	632
4	Change in Depreciation Rates	Exhibit LKM-3BASA-SR	-	-	-	(3,867,209)	-	-	270,318	755,347
5	Interest Synchronization Adjustment	Exhibit LKM-8BASA-SR	-	-	-	-	-	-	-	-
6	Remove 10% of Third Party Call Centers Expense	Exhibit LKM-3BASA-SR	-	-	(3,120)	-	-	-	216	609
7	Total Adjustments		<u>\$ -</u>	<u>\$ -</u>	<u>\$ (84,296)</u>	<u>\$ (3,867,209)</u>	<u>\$ -</u>	<u>\$ (4,612)</u>	<u>\$ 276,534</u>	<u>\$ 772,713</u>

**Pennsylvania-American Water Company  
Wastewater CSS Operations  
Table I**

Line No.	Description	Company Amounts at Present Rates <sup>1/</sup>	OCA Adjustments	Amounts After OCA Adjustments	Pro Forma Change in Revenues	Amounts After Change in Revenues
1	Operating Revenues	\$ 85,843,356	\$ -	\$ 85,843,356	\$ (806,610)	\$ 85,036,746
2						
3	Deductions:					
4	Operation and Maintenance	\$ 19,880,761	\$ (103,749)	\$ 19,777,012	\$ (8,849)	\$ 19,768,163
5	Depreciation	21,615,574	(2,983,191)	18,632,383	-	18,632,383
6	Amortizations	130,661	-	130,661	-	130,661
7	Taxes					
8	State Income Tax	2,530,164	215,795	2,745,959	(55,353)	2,690,606
9	Federal Income Tax	6,535,020	602,993	7,138,013	(154,672)	6,983,341
10	Taxes Other Than Income	2,253,554	(250)	2,253,304	(5,877)	2,247,427
11	Deferred Income Taxes	-	-	-	-	-
12	Net Income	<u>\$ 32,897,622</u>	<u>\$ 2,268,402</u>	<u>\$ 35,166,024</u>	<u>\$ (581,859)</u>	<u>\$ 34,584,165</u>
13						
14	Rate Base	<u>\$ 524,797,637</u>		<u>\$ 524,797,637</u>		<u>\$ 524,797,637</u>
15						
16	Recommended Rate of Return	<u>6.27%</u>		<u>6.70%</u>		<u>6.59%</u>

Pennsylvania-American Water Company  
Wastewater CSS Operations  
Table II

Line No.	Recommended Adjustment	Exhibit Reference	Rate Base Effect	Revenue Effect	Expense Effect	Depreciation Expense Effect	Amortization Expense Effect	Effect Upon Taxes-Other	State Tax Effect	Federal Tax Effect
1	Adjustment to Annual Performance Pay	Exhibit LKM-3CSS-SR	\$ -	\$ -	\$ (3,267)	\$ -	\$ -	\$ (250)	\$ 246	\$ 687
2	Adjustment to Group Insurance	Exhibit LKM-3CSS-SR	-	-	(55,883)	-	-	-	3,906	10,915
3	Adjustment to Transportation Expense	Exhibit LKM-3CSS-SR	-	-	(23,637)	-	-	-	1,652	4,617
4	Change in Depreciation Rates	Exhibit LKM-3CSS-SR	-	-	-	(2,983,191)	-	-	208,525	582,680
5	Interest Synchronization Adjustment	Exhibit LKM-8CSS-SR	-	-	-	-	-	-	-	-
6	Remove 10% of Third Party Call Centers Expense	Exhibit LKM-3CSS-SR	-	-	(20,962)	-	-	-	1,465	4,094
7	Total Adjustments		<u>\$ -</u>	<u>\$ -</u>	<u>\$ (103,749)</u>	<u>\$ (2,983,191)</u>	<u>\$ -</u>	<u>\$ (250)</u>	<u>\$ 215,795</u>	<u>\$ 602,993</u>

**Pennsylvania-American Water Company**  
**Elizabeth Borough WW Operations**  
**Table I**

Line No.	Description	Company Amounts at Present Rates <sup>1/</sup>	OCA Adjustments	Amounts After OCA Adjustments	Pro Forma Change in Revenues	Amounts After Change in Revenues
1	Operating Revenues	\$ 1,767,267	\$ -	\$ 1,767,267	\$ 2,753,177	\$ 4,520,444
2						
3	Deductions:					
4	Operation and Maintenance	\$ 868,308	\$ (425)	\$ 867,883	\$ 30,202	\$ 898,085
5	Depreciation	1,035,785	(292,710)	743,075	-	743,075
6	Amortizations	63,680	-	63,680	-	63,680
7	Taxes					
8	State Income Tax	24,927	20,460	45,387	188,934	234,321
9	Federal Income Tax	72,489	57,172	129,661	527,936	657,597
10	Taxes Other Than Income	29,882	-	29,882	20,061	49,943
11	Deferred Income Taxes	-	-	-	-	-
12	Net Income	\$ (327,804)	\$ 215,502	\$ (112,302)	\$ 1,986,044	\$ 1,873,742
13						
14	Rate Base	\$ 28,433,120		\$ 28,433,120		\$ 28,433,120
15						
16	Recommended Rate of Return	-1.15%		-0.39%		6.59%

**Pennsylvania-American Water Company**  
**Elizabeth Borough WW Operations**  
**Table II**

Line No.	Recommended Adjustment	Exhibit Reference	Rate Base Effect	Revenue Effect	Expense Effect	Depreciation Expense Effect	Amortization Expense Effect	Effect Upon Taxes-Other	State Tax Effect	Federal Tax Effect
1	Change in Depreciation Rates	Exhibit LKM-1E-SR	\$ -	\$ -	\$ -	\$ (292,710)	\$ -	\$ -	\$ 20,460	\$ 57,172
2	Interest Synchronization Adjustment	Exhibit LKM-4E-SR	-	-	-	-	-	-	-	-
3	Remove 10% of Third Party Call Centers Expense	Exhibit LKM-3E-SR	-	-	(425)	-	-	-	30	83
4	Total Adjustments		<u>\$ -</u>	<u>\$ -</u>	<u>\$ (425)</u>	<u>\$ (292,710)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 20,490</u>	<u>\$ 57,255</u>

## OCA PROPOSED FINDINGS OF FACT

### III. OVERALL POSITION ON RATE INCREASE

1. PAWC is requesting an overall revenue increase of \$159,597,595 (\$90.4 million for water and \$69.2 million for wastewater). PAWC Ex. 3-A Revised at 2.

2. The OCA recommends a revenue requirement decrease of no less than \$18,650,096, or \$178,247,691 lower than the Company's requested revenue requirement increase. App. A, OCA Tables.

3. This rate increase was filed on November 14, 2025, less than two years after the Commission granted PAWC a combined \$99,329,013 (\$88,121,069 for water and \$11,207,944 for wastewater) increase on July 11, 2024, in a case where PAWC requested a \$203.9 million increase based on a FPFTY ending June 30, 2025. *Pa. PUC v. PAWC*, R-2023-3043189, Order at 5, 26, 391 (July 11, 2024).

4. PAWC has a claimed capital spend of \$1.2 billion for new or replacement plant and equipment during the future test year (FTY) ending June 30, 2026, and its FPFTY ending June 30, 2027. PAWC St. of Reasons at 1; PAWC St. 1 at 7.

5. PAWC seeks deferred accounting treatment for pension and other post-employment benefit (OPEB) expenses for tracking and recovery in future rate cases. OCA St. 1 at 25-26; OCA St. 1SR at 3-7.

### IV. RATE BASE

6. PAWC proposes to include the following systems in rate base for the first time: Farmington Township Water and Wastewater, Audubon Water Company, Butler

Area Sewer Authority, East Dunkard Water Authority, Elizabeth Borough Municipal Authority, Manwalamink Sewer Company, Manwalamink Water Company, Appalachian Utilities, Sadsbury Township Municipal Authority, and Corner Water Supply and Service Corporation. These systems were acquired pursuant to 66 Pa. C.S. Sections 1329 or 1102. OCA St. 1 at 6; PAWC St. 7 at 3-13.

7. The only acquired system being added to rate base in this case that was a troubled system was the East Dunkard Water Authority (EDWA). PAWC St. 1 at 11-13.

8. PAWC and EDWA had already made plans for PAWC to acquire the EDWA system and executed the acquisition agreement before PAWC was appointed as a receiver for the EDWA system due to an operational failure. PAWC St. 1 at 11-13.

8. PAWC is seeking to recover acquisition costs for the following systems: Audubon Water Company (AWC), Farmington Township water system (Farmington), and Manwalamink Water Company (MWC) and Manwalamink Sewer Company (MSC) (together, Manwalamink). OCA St. 1 at 9.

9. As part of the AWC acquisition proceeding, the parties, including the OCA, waived their rights to challenge PAWC's request to recover the acquisition premium. OCA St. 1SR at 13-14.

10. The application for PAWC's acquisition of Manwalamink was filed under Section 1102(a) of the Pennsylvania Public Utility Code. OCA St. 1 at 8.

11. The purchase price allocated \$1,809,000 for the water system and \$2,191,000 for the wastewater system. OCA St. 1 at 8.

12. In the Manwalamink acquisition proceeding, testimony showed that day-to-day operations were handled by a third-party operator, and that the sale was motivated by the owners' age rather than any service failure. OCA St. 1 at 8.

13. While the Manwalamink systems had a number of violations of the Safe Drinking Water Act (SDWA), these violations were largely monitoring and reporting issues, Manwalamink showed improvement overtime, with 5 violations in 2023 down from 17 in 2021, and they were not tied to customer harm or service degradation. OCA St. 1SR at 15, 17-19.

14. By the time of PAWC's Application to acquire Manwalawink's assets, Manwalawink's compliance improved. OCA St. 1SR at 15, 17-19.

15. The purchase price of the Manwalamink systems was derived from a pre-existing agreement negotiated by a previous potential buyer. OCA St. 1 at 19.

16. PAWC paid an 111% premium over book value for the Manwalamink systems. OCA St. 1SR at 14-15.

17. PAWC's projections showed revenue deficiencies post-acquisition. OCA St. 1SR at 14-15.

18. The application for PAWC's acquisition of Farmington was filed under Section 1102(a). OCA St. 1 at 7.

19. The purchase price allocated \$2,621,312 for the water system and \$2,923,688 for the wastewater system. OCA St. 1 at 7.

20. PAWC is seeking inclusion of an acquisition adjustment for Farmington's water system in this case. OCA St. 1SR at 18.

## **VI. EXPENSES**

21. PAWC originally calculated its payroll expense assuming a full complement of employees without consideration of vacant positions. OCA St. 1 at 20.

22. PAWC has accepted the adjustment proposed by I&E witness Okum to reflect a vacancy rate of 1.25% using the average vacancy of the three years ended June 30, 2025. PAWC St. 6R at 2.

23. PAWC has implemented a compensation policy under which a portion of employee pay is tied to performance metrics. OCA St. 1 at 20.

24. One aspect of the compensation policy emphasizes the achievement of earnings goals, and it is primarily aimed at enhancing shareholder value and conferring benefits to shareholders. OCA St. 1 at 20.

25. Performance pay related to achievement of earnings goals is not tied to ratepayer benefits such as meeting quality of service, operational efficiency, or conservation goals. OCA St. 1 at 20-21.

26. Shareholder value has a correlation to earnings, so when improved earnings are reported, shareholder value improves but rates do not go down. OCA St. 1 at 20-21.

27. When share prices increase, the value of the shareholders' investment in the Company increases. OCA St. 1SR at 9-10.

28. Rates paid by customers are fixed until changed by the Commission. OCA St. 1SR at 9-10.

29. If the performance-based compensation plan results in higher earnings, i.e., ROR, customers do not receive a rebate or a rate reduction. OCA St. 1SR at 9-10.

30. PAWC's adjustment of its group insurance cost is "based on the January 2026 premiums annualized for the future test year number of employees, less the annualized employee contribution, and adjusted for the portion not charged to operations. The fully projected future test year was developed by adjusting the annualized 2026 amount by a 3 year average of 3.74%." PAWC Workpaper 4d Group Insurance Adjustment Revised.

31. The 3.74% average was applied as a growth rate instead of a normalization adjustment. OCA St. 1SR at 19.

32. PAWC derived its FPFTY transportation expense from the number of units in PAWC's fleet, the average monthly leasing fees, and the inclusion of other transportation expenses. OCA St. 1 at 23.

33. PAWC also applied a 6.94% inflation factor to certain expenses based on a three-year average (2023-2025) of the Consumer Price Index (CPI) for transportation services. OCA St. 1 at 23.

34. According to data presented by the Company between December 2023 and December 2024, the transportation CPI increased by an annual rate of 7.47%. Between

December 2024 and December 2025, the transportation CPI increased by an annual rate of 1.72%. OCA St. 1 at 23-24.

35. The Company's fuel expenses decreased from the historical period to 2025. OCA St. 1 at 23-24.

36. Titling and registration fees are generally fixed until changed by jurisdictional authority. OCA St. 1 at 23-24.

37. In PAWC witness O'Malley's rebuttal testimony, she acknowledged the change in inflation factor pointed out by Mr. Morgan and recommended applying the June 2025 inflation rate of 3.11% instead of the three-year average of 6.94%. PAWC St. 6R at 21.

38. On May 15, 2023, PAWC filed an application with the Commission under Sections 1102(a) and 1329 of the Code, for approval of the right to acquire substantially all of the wastewater system assets of Towamencin. OCA St. 1 at 21.

39. The Commission approved the use of a revised RRR in a Final Supplemental Implementation Order issued on July 2, 2024, which was after PAWC filed its Application, but before the transaction was finalized. PAWC St. 7R at 15.

40. On September 12, 2024, PAWC and Towamencin filed a letter with the Commission indicating that the Applicants had mutually agreed to terminate the underlying transaction of the Joint Application and requested leave to withdraw the Joint Application. OCA St. 1 at 21.

41. Interest synchronization is used in ratemaking to determine the amount of interest expense to be used in the calculation of income tax. OCA St. 1 at 24-25.

### **VIII. DEPRECIATION**

42. Annual depreciation expense is the return of a utility's investment in plant which collected through the life of the plant. OCA St. 2 at 42; OCA St. 2SR at 25.

43. While single units may be analyzed for depreciation, a group plan of depreciation is particularly adaptable to utility property. OCA St. 2, App. C at 3.

44. Employing a grouping procedure allows for a composite application of depreciation rates to groups of similar property, rather than excessively conducting calculations for each unit. OCA St. 2, App. C at 3.

45. PAWC uses the ELG procedure. OCA St. 2 at 46.

46. Under the ALG procedure, a constant accrual rate is calculated based on the average life of all property in the group. OCA St. 2 at 46.

47. Use of the ALJ procedure results in the same depreciation rate applied to each age interval. OCA St. 2 at 47.

48. Under the ELG procedure property is divided into subgroups (also referred to as 'vintages') that each have a common life. OCA St. 2 at 46.

49. PAWC's use of the ELG depreciation procedure instead of the ALG procedure results in consumers paying \$60 million per year more than they otherwise would. OCA St. 2SR at 14.

50. The ALG method results in a fairer application of depreciation rates compared to the ELG method given the realities of ratemaking proceedings. OCA St. 2 at 47.

51. PAWC claimed depreciation expenses balance was \$263,028,483. OCA St. 2 at 5 (Figure 3).

52. OCA witness Garrett's recommended a downward adjustment to PAWC's claimed depreciation of \$49,897,598. OCA St. 2 at 5 (Figure 3).

53. The basic components of a depreciation system are: 1) method of allocation; 2) a procedure for applying the method; 3) a technique of applying the depreciation rate; and 4) a model for analyzing the characteristics of vintage property groups. OCA St. 2 at 45-46.

54. Depreciation rates calculated under the ELG procedure would need to be adjusted every year in order for the ELG procedure to produce accurate depreciation rates. OCA St. 2SR at 17.

55. Depreciation rates calculated under the ELG procedure result in higher depreciation rates in early years relative to later years. OCA St. 2 at 46.

56. Under the ELG procedure, the depreciation reserve grows disproportionately fast in earlier years, producing mismatches between revenues and expenses. OCA St. 2 at 50.

57. OCA witness Garrett used the straight-line method, the average life group procedure, the remaining life technique, and the broad group model. OCA St. 2 at 46.

58. OCA witness Garrett calculated that, if PAWC's depreciation expense were calculated using the ALG procedure instead of the ELG procedure, then the annual depreciation accrual charged to customers would be reduced by \$50.1 million in 2025 by \$50.2 million in 2026, and by \$49.9 million in the 2027. OCA St. 2 at 4.

59. The Indiana Utility Regulatory Commission and Kentucky Public Service Commission have recently required regulated public utilities within their jurisdictions to switch from the ELG to the ALG procedure. OCA St. 2 at 49-50.

## **IX. RATE OF RETRUN**

60. PAWC recommended the Commission grant a 10.95% return on equity. OCA St. 2 at 2.

61. The OCA recommended a return on equity of 8.7%. Exhibit DJG-12.

62. The OCA recommended an overall weighted Rate of Return of 6.96% for water operations and 6.59% for wastewater operations. OCA St. 2 at 2-3.

63. The OCA's Discount Cash Flow (DCF) cost of equity analysis results are 9.3% for the Analysts Growth Model and 6.8% for the Sustainable Growth Model. OCA St. 2 at 41.

64. The OCA's Capital Asset Pricing Model (CAPM) cost of equity analysis results was 8.7%. OCA Exh. DJG-12.

65. PAWC witness Bulkley's earnings risk premium (ERP) was significantly higher than the ERPs estimated by expert surveys, Kroll (formerly Duff & Phelps), Dr. Damodaran, and that calculated by OCA witness Garrett. OCA St. 2 SR at 12.

66. PAWC offers Deferred Payment Arrangements (DPAs) to low-income customers which are largely ineffective at providing an opportunity for those customers to retire their arrears. OCA St. 4 at 113.

67. For every one nonpayment disconnection PAWC pursues, it issues 15 disconnect notices. OCA St. 4 at 114-115.

68. A significant number of the Company's identified low-income customers maintain arrearage balances of 91 days or more, despite receiving disconnection notices. OCA St. 4 at 114-115.

69. PAWC's disconnection notice does not make any mention of the availability of protections offered by the shutoff moratorium. OCA St. 4 at 121.

## **X. RATE STRUCTURE**

70. OCA's COSS shows Residential customers will be paying a difference of \$7.2 million dollars based on PAWC's as-filed revenue amount. OCA St. 3 at 18.

71. PAWC's water COSS using the base-extra capacity method. PAWC St. 12 at 6.

72. No party disputes the use of the base-extra capacity (BEC) method and commission precedent recognizes it as a reasonable method to determine cost of service and method for allocation. OCA St. 3 at 12-13; PAWC St. 12-R at 2.

73. A functional cost category in the BEC method is the "Extra Capacity Costs" category. OCA St. 3 at 12-13

74. Extra Capacity Costs are costs associated with meeting usage requirements in excess of average usage, which includes operating and capital costs for additional plant and system capacity beyond that required for average usage. OCA St. 3 at 12-13.

75. Extra capacity costs in the Company's study have been subdivided into costs necessary to meet maximum day extra demand and maximum hour extra demand. OCA St. 3 at 12-13.

76. These extra capacity costs were allocated to customer classes on the basis of each class's maximum day and maximum hour usage in excess of average usage. OCA St. 3 at 12-13.

77. PAWC used a system-wide maximum day extra-capacity demand factor of 1.4 and a system-wide maximum hour extra capacity factor of 2.1 in its water COSS. OCA St. 3 at 14.

78. The extra-capacity factors used by PAWC in this proceeding are the same factors utilized in PAWC's 2023 base rate proceeding. OCA St. 3 at 15.

79. The system-wide maximum day extra capacity demand factor used in PAWC's COSS was last experienced in 2003, or almost 25 years ago. OCA St. 3 at 15.

80. Since 2003, PAWC's water demand has changed due to aggressive water conservation, legislation, development, and changing land uses. OCA St. 3 at 15.

81. PAWC's 1.4 maximum day extra-capacity demand factor is reflective of actual maximum day to average day demands observed for the years 1988, 1995, 1996, 1999 and 2003. OCA St. 3 at 14; PAWC Exhibit No. 12-A, Schedule G.

82. The maximum hour extra capacity demand factor of 2.1 is based on an analysis of peak hour consumption experienced by PAWC in its three largest operating districts. OCA St. 3 at 14.

83. This peak hour analysis was conducted in 1988, nearly 40 years ago. OCA St. 3 at 14.

84. OCA recommended utilizing system-wide extra day and extra hour demand factors of 1.2 and 1.5 respectively. OCA St. 3 at 15.

85. The extra day factor is based on the systems' usage going back to 2011. OCA St. 3 at 17.

86. PAWC included new maximum hour demand data and developed updated maximum hour extra capacity factors based on that data. OCA St. 3 at 16-17. PAWC Statement No. 12 at 12, Table 1, Table 2.

87. PAWC did not utilize those updated capacity factors in its COSS. OCA St. 3 at 17.

88. In accordance with the American Water Works Association's Manual, M1, Principles of Water Rates, Fees, and Charges (AWWA M1 Manual), development of demand factors should be based off a representative number of recent years. OCA St. 3SR at 2.

89. There has been a pervasive decline in PAWC customer usage over the last 10 years. PAWC St. 10 at 50-56.

90. The OCA recommends no direct adjustments to PAWC's Wastewater COSS. OCA St. 3 at 19.

91. PAWC proposed to charge \$53 million in its calculated wastewater revenue requirement to water customers. OCA St. 3 at 20-21.

92. Without shifting the revenue requirement amount, the direct cost of service for BASA and EBMA would increase 277.5% and 197.3% respectively. OCA St. 3 at 25.

93. Without the shift, SSS and CSS wastewater operations would experience rate increases of 18.5% and 12.1%, respectively. OCA St. 3 at 25.

94. With the Act 11 shift, SSS and CSS wastewater operations would experience rate increases of 6.8% and 3.9%. OCA St. 3 at 25.

95. With the Act 11 shift, BASA and EBMA wastewater operations would experience rate increases of 40.0% and 30.0%, respectively. OCA St. 3 at 25.

96. Without PAWC's proposed Act 11 shift, the amount of revenue requirement assigned the SSS and CSS wastewater systems in this proceeding is at parity with PAWC's water operations at 18.5% and 12.1%, respectively. OCA St. 3 at 25.

97. Approximately 90% of PAWC's water customers are not wastewater customers. OCA St. 3 at 27.

98. Under PAWC's proposal, Residential water customers would be responsible for a portion of the costs associated with serving Residential wastewater customers. OCA St. 3 at 27.

99. Residential water customers are largely not directly responsible for these wastewater costs. OCA St. 3 at 27.

100. PAWC currently provides SSS wastewater service in eight different rate zones and CSS wastewater service in two different rate zones. OCA St. 3 at 6-7.

101. PAWC is including an additional CSS rate zone for the EBMA system, which PAWC completed acquiring December 16, 2025. The Company has included EBMA in this case as Rate Zone 2b. OCA St. 3 at 7.

102. Factoring in I&I costs means including a component that is largely a function of precipitation and does not vary directly with the addition or subtraction of a customer. OCA St. 3 at 44.

103. Under PAWC's as-filed COSS, the direct Residential cost of service under the Company's COSS is \$682,920,439, or 65.93% of the total direct cost of service. OCA St. 3 at 35.

104. Under Mr. Mierzwa's COSS, the direct Residential cost of service under the OCA's cost of service study is \$675,757,224, or 65.23% of the total direct cost of service study. OCA St. 3 at 35.

105. The total direct cost of service of the customer classes receiving an Act 11 assignment of the wastewater revenue requirement is \$1,005,008,593. OCA St. 3 at 35.

106. Under an assignment of the Act 11 shift to water service customer classes based on a cost of service, Residential customers would receive an assignment of 67.23% of the Act 11 assignment authorized by the Commission. OCA St. 3 at 35.

107. Under the proposal, PAWC would bill a customer for whichever is less: the actual metered water usage for month or the average water consumption for that customer in the winter months. PAWC St. 10 at 25.

108. In the 2023 rate proceeding the OCA demonstrated a difference of 100 gallons to 173 gallons per month between the Company's winter months versus the remaining 9 months of the year. OCA St. 3 at 42.

109. In this rate proceeding, the OCA demonstrated a difference of 119 gallons to 165 gallons per month. OCA St. 3 at 42.

110. Low-income customers are less likely to be residents of homes with substantial outdoor summer consumption. OCA St. 4 at 109.

111. The highest usage for PAWC customers was not necessarily in the non-winter months and the lowest usage was not necessarily in the winter months. OCA St. 4 at 106-108.

## **XI. ALTERNATIVE RATEMAKING REQUESTS**

112. It is not possible to determine the extent to which, if at all, PAWC's total cost of service had increased as a result of the increased BDP/AFP costs. OCA St. 4SR at 34.

113. Changes in participation in the BDP/AFP will affect both revenues and expenses. OCA St. 4SR at 35.

## **XII. LOW-INCOME CUSTOMER ASSISTANCE**

114. Water is vital to maintaining hygiene and health. OCA St. 4 at 8-9.

115. The lack of water has a particularly negative impact on children, the elderly, women and persons suffering from an illness or chronic health concern. OCA St. 4 at 8-9.

116. The fundamental need for affordable water is recognized not only by laws relating to the protection of children, but also by laws relating to the habitability of homes. OCA St. 4 at 9-10.

117. PAWC does not use a process to identify end uses and the water consumption associated with those end uses. OCA St. 4 at 13.

118. PAWC's definition of "basic water service" of 40 gallons per household member per day ignores differences based on factors such as age or number of children in the household, or the age or number of adults in the household and considers no individual circumstances of the household. OCA St. 4 at 13.

119. While there is monthly variation for both low-income and residential customers generally in water usage, that variation does not evidence the seasonal variation which PAWC identifies. OCA St. 4SR at 7-8.

120. Increases in PAWC rates have been substantial since 2020, where rates have increased nearly 35% from 2020 through 2024. OCA St. 4 at 15-16.

121. The constant flow of rate increases being sought by PAWC is difficult not only for ratepayers generally but for the delivery of affordability assistance to low-income ratepayers in particular. OCA St. 4 at 16-17 (citations omitted).

122. PAWC has significant bill affordability problems facing its low-income customers. OCA St. 4 at 24.

123. PAWC has an affordability problem with its moderate-income customers. OCA St. 4 at 25.

124. The cost-of-living for moderate income households, and thus the ability of these PAWC customers to absorb the rate increase sought in this proceeding, varies widely across the PAWC service territory. OCA St. 4 at 27.

125. The number of Pennsylvania residents within income below the ALICE threshold has grown more than three times faster than the number of households with income below poverty. OCA St. 4 at 32.

126. There is a significant population in PAWC's service territory living with incomes greater than the federal poverty level but less than what is needed to meet basic living expenses and the affordability of PAWC bills could well depend in substantial part on the cost-of-living in different parts of the PAWC service territory. OCA St. 4 at 33.

127. As bills become increasingly unaffordable, the payment difficulties of those customers who face unaffordability become increasingly substantial as well. OCA St 4 at 34.

128. Only one-in-ten estimated low-income customers on the PAWC system have been identified as low-income. OCA St. 4 at 36-37.

129. Roughly 134,000 PAWC low-income customers are not receiving PAWC's low-income services. OCA St. 4 at 37.

130. PAWC has disconnected low-income customers, or sent them a disconnection notice, at rates five to more than six times higher than residential customers as a whole. OCA St. 4 at 38-39.

131. While PAWC received roughly 70 payments for each 100 bills rendered to Identified Low Income customers from 2023 through 2025, it received roughly 90 payments for each 100 bills issued to residential customers as a whole. OCA St. 4 at 41.

132. To the extent that disconnected customers are not being reconnected, PAWC is losing revenue due to nonpayment. OCA St. 4 at 42-43.

133. Given the improved low-income payment patterns generated by enrollment of low-income customers in the Company's BDP and AFP, identifying low-income customers and enrolling those customers in CAP can reasonably be expected to have a positive financial impact on PAWC. OCA St. 4 at 47.

134. It is important to assess the extent to which PAWC has both: (1) identified its low-income population; and (2) enrolled its low-income customers into the BDP/AFP where possible and appropriate. OCA St. 4 at 49-50.

135. A customer's self-attestation of the receipt of public assistance places a customer in the low-income designation and is sufficient for identification as low-income. OCA St. 4 at 51.

136. PAWC's outreach and other information provided by the company regarding promotion of the BDP and AFP does not address shortcomings and, in particular, does not allow customers to make decisions regarding whether to enter into a deferred payment

arrangement or to enroll in the arrearage forgiveness program with informed consent. OCA St. 4 at 63.

137. PAWC's outreach and other information provided by the company regarding promotion of the BDP and AFP assists customers to not only know that a program exists, but information on how to access the program. OCA St. 4 at 63.

138. The enrollment of low-income customers is important for purposes other than the actual enrollment in BDP and AFP but also such information would be helpful in referring customers to hardship funds and assist in other data gathering purposes. OCA St. 4SR at 17.

139. PAWC's arrearage management program is not successful in retiring arrears. OCA St. 4 at 66.

140. PAWC's arrearage forgiveness program should be modified to allow customers to earn a monthly arrearage forgiveness credit for each complete payment the customer makes, similar to the policy the Commission has adopted for Pennsylvania's energy utilities. OCA St. 4 at 67.

141. The Commission's arrearage forgiveness policy for energy utilities is that forgiveness credits should be provided for full and timely payments and, in addition, retroactive credits should be provided once the household pays its in-program balance in full. OCA St. 4 at 67-68.

142. PAWC's restrictive policies on when, or whether, to grant AFP credits has resulted in the program being largely ineffective in delivering arrearage relief to low-income customers. OCA St. 4 at 68-69.

143. The restrictive policies of PAWC provide no incentive for customers to make partial payments in order to facilitate retiring their entire bill in a future month. OCA St. 4 at 70.

144. A \$25 monthly credit will not allow low-income customers to retire their pre-program arrears in a reasonable time period given the level of pre-existing arrears they are bringing into the program. OCA St. 4 at 73.

145. It would take in excess of four years to retire arrears assuming that customers received their arrearage forgiveness credits in every month they participated in the program. OCA St. 4 at 74.

146. AFP participants had participated in the program for an average of 6.3 months and virtually no participant reduced pre-existing arrears to \$0. OCA St. 4 at 75-76.

147. PAWC enrolls customers into its BDP who have pre-existing arrears without at the same time enrolling those customers in the Company's AFP. OCA St. 4 at 79.

148. PAWC's proposed RAPP represents a substantial change in regulatory policy in that it proposes to use ratepayer money to provide assistance to non-ratepayers. OCA St. 4 at 82.

### **XIII. SERVICE QUALITY AND CUSTOMER SERVICE ISSUES**

149. PAWC customers have seen rate increases in 2021, 2022, 2023, resulting from a two-stage significant rate increase from its 2020 rate case and the increase that just took effect in January 2023 from the 2022 rate case and a rate increase authorized in August 2024 as a result of the most recent base rate case filed in 2023. OCA St. 5 at 3.

150. Since its 2020 rate case, the average residential customer in Rate Zone 1 has seen a nearly 35% increase in water rates. OCA St. 5 at 3.

151. PAWC call centers perform at a dramatically lower level of performance than should be tolerated. OCA St. 5 at 10-11.

152. PAWC outsources its call center and customer service functions to its affiliate and it does not provide appropriate managerial oversight thereof. OCA St. 5 at 8-10. The 2024 and 2025 annual averages percentage of calls answered within 60 seconds was 47% and 44%, respectively, for one contractor, and 31% and 22%, respectively, for the other contractor. OCA St. 5 at 11.

153. The annual average abandonment rate reflects similarly poor and unacceptable performance: 19% for one contractor for both 2024 and 2025, and 20% in 2024 and 23% in 2025, for the other contractor. OCA St. 5 at 11.

154. At the public input hearings, one consumer testified that they called PAWC regarding poor water quality, and was placed on hold for over 20 minutes waiting to speak to a supervisor, and that no supervisor picked up the phone. Tr. at 1418-1419; OCA St. 5 App. A at 13.

155. The Commission's 2023 Management Audit found that PAWC had a decline in call handling, which lead PAWC to state it would strive to achieve 80% of calls answered within 60 seconds by December 2024. Pa. PUC Bureau of Audits, *Pennsylvania American Water Co. Management and Operations Audit*, 80-84 (Oct. 2023) (<https://www.puc.pa.gov/pcdocs/1810662.pdf>).

156. Areas of public concern include inter alia affordability of service, frequency of rate increases, impact from data centers, customer service, water quality, and service disruptions. OCA St. 5 Appendix A.

157. In all, 75 individuals and 15 public officials provided testimony at the public input hearings regarding the affordability of water and/or wastewater service provided by PAWC. OCA St. 5 App. A at 1-9; OCA St. 5 App. A Supp. at 1-4.

158. Under the Company's proposal, the total bill for a residential water customer purchasing 3,263 gallons of water per month would see increases ranging by Rate zone, between 9.8% to 41.1%. OCA St. 5 at 4.

159. The total bill for a residential wastewater customer purchasing 3,164 gallons of water per month would see increases, ranging by Rate Zone, between 8% to 54%. OCA St. 5 at 3.

160. Customers stated that they were using various methods to reduce water usage, including, short showers, purchasing bottled water, not using in home washing machines and dishwashers, refraining from watering lawns and washing cars, some even

testified to reducing the amount to times they flush toilets. See generally, OCA St. 5 App. A; OCA St. 5-Supp. App. A.

161. Several consumers testified to purchasing bottled water or special reverse osmosis filters for drinking, water that has black specks, white specks, or is brown, and consumers complained about chemical, chlorine, and rotten egg smells. Tr. 402-405; 548-549; 917; 930-931; 978-979; 1033; 1033; 1116; 1145 1362;1418-1422; See also OCA St. 5 App. A; and OCA St. No. 5 Supp. App. A.

162. The use of the shared name and logo by American Water Resources and PAWC would mislead the average PAWC customer to believe that American Water Resources is legally affiliated with PAWC under common ownership or management, leading to unfair advantages and benefits for both PAWC and AWR. OCA St. 5 at 24.

163. AWR receives more customers and PAWC benefits from this false impression as PAWC's collects additional service fees from American Water Resources under the Utility Billing Agreement as the number of customers being billed for Warranty Services increases. OCA St. 5 at 24-25.

164. American Water Resources' exclusive marketing and billing arrangement with PAWC is discriminatory to any other provider of these services in PAWC's service territory. OCA St. 5 at 25.

165. The AWR charges are presented on customer's bills in a manner that does not clearly differentiate these unregulated and non-basic services from PAWC's regulated charges. OCA St. 5 at 25.

## OCA PROPOSED CONCLUSIONS OF LAW

### I. INTRODUCTION

1. PAWC bears the burden of proof to establish the justness and reasonableness of every element of its requested rate increase. 66 Pa. C.S. § 315(a).

2. In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceedings upon the complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility. 66 Pa. C.S. § 315(a).

3. The evidence necessary to meet that burden must be substantial, legally credible, and cannot be mere “suspicion” or “scintilla” of evidence. *Lower Frederick Twp. Water Co. v. Pa. PUC*, 409 A.2d 505, 507 (Pa. Cmwlth. 1980); *Lansberry v. Pa. PUC*, 578 A.2d 600, 602 (Pa. Cmwlth. 1990) (*Lansberry*).

4. The party with the burden of proof has a formidable task to show that the Commission may lawfully adopt its position. *Burleson v. Pa. PUC*, 461 A.2d 1234, 1236 (Pa. 1983).

5. Even where a party has established a *prima facie* case, the party with the burden must establish that “the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary. *Burleson v. Pa. PUC*, 461 A.2d 1234, 1236 (Pa. 1983).

6. It is well-established that in general rate increase proceedings, the burden of proof does not shift to parties challenging a requested rate increase. *Pa. PUC v. Pa. American Water Co.*, 2004 Pa. PUC LEXIS 29 at \*16-18 (Order Jan. 29, 2004) (*PAWC 2004*) citing *Berner v. Pa. PUC*, 116 A.2d 738 (Pa. 1955).

### **III. OVERALL POSITION ON RATE INCREASE**

7. The Company must meet the burden of proof in demonstrating that its proposed increase in rates will produce rates that are just and reasonable, equitable among consumer groups, or in the public interest. 66 Pa. C.S. § 315(e); *Pa. PUC v. Pa. American Water Co.*, 2004 Pa. PUC LEXIS 29, \*16-18 (Order Jan. 29, 2004); *Burleson v. Pa. PUC*, 461 A.2d 1234, 1236 (Pa. 1983); *Lansberry v. Pa. PUC*, 578 A.2d 600, 602 (Pa. Cmwlth. 1990).

8. The Company must affirmatively demonstrate with substantial evidence the reasonableness of its claims for its ROE. 66 Pa. C.S. § 1301; *Bluefield Water Works and Improvement Co. v. Public Serv. Comm'n of W.Va.*, 262 U.S. 679 (1923); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) (*Hope*); *Permian Basin Area Rate Cases*, 390 U.S. 747, 794-95 (1968).

### **IV. RATE BASE**

9. The Public Utility Code provides a recovery method for the amounts that a utility spends to acquire a water or sewer system that exceeds the acquired system's original cost, minus accrued depreciation. 66 Pa. C.S. § 1327.

10. Under Section 1327, a utility must satisfy nine requirements in order to include a positive acquisition adjustment in a rate base. 66 Pa. C.S. § 1327(a)(1-9).

11. The company must demonstrate that the acquired system was providing inadequate, inefficient, unsafe or unreasonable service at the time of the acquisition to include a positive acquisition adjustment in a rate base. 66 Pa. C.S. § 1327(a)(3).

12. To include a positive acquisition adjustment in rate base, the Company must establish that the purchase price of the system was reasonable and the product of an arm's length negotiation. 66 Pa. §§1327(a)(5) and (6).

## **VI. EXPENSES**

13. The Company must affirmatively demonstrate by a preponderance of evidence that its expenses are reasonably necessary to provide services or prudently incurred. *City of Lancaster Sewer Fund v. Pa. PUC*, 793 A.2d 978, 982 (Pa. Cmwlth. 2002); *Popowsky v. Pa. PUC*, 674 A.2d 1149, 1154 (Pa. Cmwlth. 1996).

14. In Columbia's 2025 rate case, the ALJs recommended disallowing the portion of incentive compensation tied to shareholder earnings goals, finding that such metrics lacked a sufficient nexus to ratepayer benefits and instead primarily advanced shareholder interests. *Pa. PUC v. Columbia Gas of PA, Inc.*, R-2025-3053499 Order at 204-05 (Oct. 3, 2025).

15. Only where an incentive compensation plan is reasonable, prudently incurred, not excessive, and there is a benefit to ratepayers, a Company may recover the

expense of that program. *Pa. PUC v. PPL Elec. Util. Corp.*, R-2012-2290597, Order (Dec. 28, 2012).

16. The Commission allowed incentive compensation expense because it was consistent with the Commission's "prior decisions approving incentive compensation programs that are focused on improving operational effectiveness." *Pa. PUC v. PPL Elec. Util. Corp.*, R-2012-2290597, Order at 26 (Dec. 28, 2012) *citing Pa. PUC v. Aqua Pa., Inc.*, 2008 Pa. PUC LEXIS 50, \*24; *Pa. PUC v. Duquesne Light Co.*, 1987 Pa. PUC LEXIS 342 at \*99-100.

17. The Commission has approved incentive compensation plans where employees eligible for the compensation "have direct responsibilities for customer service and regulatory compliance or are otherwise responsible for ensuring safe and reliable service to customers." *Pa. PUC v. PAWC*, 2021 PA. PUC LEXIS 55 at \*59 (Feb. 25, 2021).

18. Having a financial metric component to the incentive compensation plan does not disqualify it from inclusion in the utility's revenue requirement, if the incentive plan establishes that eligibility for the incentive "is based on performance duties and metrics directly related to the provision of service." *Pa. PUC v. PAWC*, 2021 PA. PUC LEXIS 55 at \*60 (Feb. 25, 2021).

19. What constitutes "used and useful property" is committed to the wide discretion of the Commission, and if the Commission reasonably finds that the property will not be used and useful in serving the public, it may make adjustments to exclude the value of the property from rate base and disallow the utility's return on that property. *Pa.*

*Power & Light Co. v. Pa. PUC*, 516 A.2d 426, 430 (Pa. Cmwlth. 1985) (internal citations omitted); *see also UGI Corp. v. Pa. PUC*, 410 A.2d 923, 929 (Pa. Cmwlth. 1980) (*UGI 1980*).

20. The adjustments must be supported with a reasonable degree of specificity in findings and reasoning. *Phila. Suburban Water Co. v. Pa. PUC*, 394 A.2d 1063, 1066-67 (Pa. Cmwlth. 1978).

21. To determine whether property will be “used and useful” in the FPFTY, a utility must sufficiently demonstrate by the close of the record that the utility property is reasonably certain to be used and useful in the FPFTY. *Pa. PUC v UGI Utilities, Inc-Electric Division*, R-2017-2640058, Order at 27-31 (Oct. 25, 2018).

22. The Commission properly excluded the proposed operations center and reduced the utility’s rate base by over \$17.3 million “on the basis that there was insufficient evidence to support that it would be in service during the FPFTY.” *McCloskey v. Pa. PUC*, 225 A. 3d 192, at 207, n. 9. (Pa. Cmwlth. 2020).

23. In PAWC’s last base rate case, the Commission adopted the ALJs’ Recommended Decision with regards to utility plant-in-service, agreeing with the OCA’s and I&E’s arguments that proposed system acquisitions that were not finalized should not be included in rate base because “there must be reasonable certainty by the close of the record in the rate case that the property claimed in rate base will be used and useful by the end of the FPFTY.” *Pa. PUC v. PAWC*, R-2023-3043189, Order at 37 (July 11, 2024).

24. Requested treatments of isolated expenses for deferred recovery in future base rate cases are squarely impermissible single-issue ratemaking. *See Nat'l Fuel Gas Dist. Corp. v. Pa. PUC*, 464 A.2d 546, 567 (Pa. Cmwlth. 1983) (in the context of tariff supplements, the consideration of expense and revenue items in isolation could result in confiscatory rates); *see also Phila. Elec. Co. v. Pa. PUC*, 502 A.2d 722, 727-28 (Pa. Cmwlth. 1985) (holding that there should be no line-by-line examination of items in a rate case and an isolated item of revenue or expense may not be, without more, the subject of a refund or recovery).

25. Single-issue ratemaking is similar to retroactive ratemaking and, in general, is prohibited if it impacts on a matter that is normally considered in a base rate case. *Pa. Indus. Energy Coalition v. Pa. PUC*, 653 A.2d 1336, 1350 (Pa. Cmwlth. 1995), *aff'd*, 543 Pa. 307, 670 A.2d 1152 (1996) (*PIEC*).

26. In the Commission's 2024 Final Supplemental Implementation Order, the Commission adopted the use of a Reasonableness Review Ratio (RRR) for reviewing acquisitions pursuant to Section 1329, which is used to determine the reasonableness of the transaction price. *Valuation of Acquired Municipal Water and Wastewater Systems Act 126 of 2016*, M-2016-2543193 Order at 114 (July 2, 2024).

27. The Commission explained in the 2024 FSIO that the provisions of the Order would not be applied retroactively by stating, “[t]o be clear, the provisions of this Order are not retroactive. The public hearing, rate impact notice, and default appraisal weight provisions of the 2024 FSIO will go into effect 30 days after the entry of this Order with

respect to all acquisitions where an APA has not been executed. For acquisitions where an APA has been executed, including those for which a Section 1329 application has been filed, but not finally accepted, we will consider the unique facts and circumstances of each acquisition and take into account the dates on which the APAs were executed and applications were filed.” *Valuation of Acquired Municipal Water and Wastewater Systems Act 126 of 2016*, M-2016-2543193 Order at 114 (July 2, 2024).

28. The Commission rejected requests for pension/OPEB trackers that were made by PAWC. *Pa. PUC v. PAWC*, R-2023-3043189, Order at 128 (July 11, 2024).

#### **VIII. DEPRECIATION**

29. “Depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence.” *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151, 167 (1934).

30. “Annual depreciation is an operating expense representing the consumption of assets in rendering service.” *Penn Sheraton Hotel v. Pennsylvania Public Utility Com.*, 198 Pa. Super. 618, 627.

31. “A utility is entitled under the law to recover from the rate payers the original cost of construction of its depreciable plant.” *Penn Sheraton Hotel v. Pennsylvania Public Utility Com.*, 198 Pa. Super. 618, 627.

32. “[I]t is clear in our law that ‘[i]n no event will a utility be permitted to recover by annual allowances for depreciation a total amount in excess of the original cost, since

annual depreciation is computed on original cost and not upon fair value or reproduction cost.” *Penn Sheraton Hotel v. Pennsylvania Public Utility Com.*, 198 Pa. Super. 618, 627.

33. “Accrued depreciation for rate purposes means ‘the actual depreciation of the utility's property as it has accrued to the date that fair value is in issue.’” *Penn Sheraton Hotel v. Pennsylvania Public Utility Com.*, 198 Pa. Super. 618, 624.

34. The Superior Court further noted that “accrued depreciation properly determined ‘should disclose the consumption of property to date.’” *Penn Sheraton Hotel v. Pennsylvania Public Utility Com.*, 198 Pa. Super. 618, 624.

35. While the Company is entitled to recover depreciation expense to ensure the utility is whole and the integrity of its investment maintained, the utility bears the burden of demonstrating that its claimed amounts to recover in expenses are not excessive. 66 Pa. C.S. § 315(a); see *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151, 169 (1934); *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 606 (1944).

36. “[T]he company has the burden of making a convincing showing that the amounts it has charged to operating expenses for depreciation have not been excessive. That burden is not sustained by proof that its general accounting system has been correct. The calculations are mathematical, but the predictions underlying them are essentially matters of opinion.” *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151, 169 (1934).

37. “[T]his Court recognized in [Lindheimer], the propriety of basing annual depreciation on cost. By such a procedure the utility is made whole and the integrity of its investment maintained. No more is required.” *Hope*, 320 U.S. at 606.

38. The Commission is not bound by any particular methodology or procedure in determining annual depreciation expense. *Pa. Power & Light Co. v. Pa. Pub. Util. Com.*, 311 A.2d 151, 158 (Pa. Cmwlth. 1973); *Pittsburgh v. Pa. Pub. Util. Comm'n*, 222 A. 2d 395 (Pa. Super. 1966); and *Philadelphia v. Pa. Pub. Util. Comm'n*, 102 A. 2d 428 (Pa. Super. 1954).

39. “[I]t is recognized that accrued depreciation is essentially a judgment figure, based on all the evidence, and the weight to be given any particular estimate is for the commission. The commission is not bound to accept any particular method of estimating accrued depreciation.” *Pittsburgh v. Pa. Pub. Util. Comm'n*, 222 A. 2d 395, 401-402 (Pa. Super. 1966).

40. “In a rate case, both annual depreciation expense allowance and accrued depreciation should be calculated on a reasonably consistent basis.” *Pa. Power & Light Co. v. Pa. Pub. Util. Com.*, 311 A.2d 151, 158 (Pa. Cmwlth. 1973).

41. “Although the PUC may be guided by its finding of accrued and annual depreciation in a prior case or cases, in determining such items in a rate case currently before it, such prior findings are not res judicata.” *Pa. Power & Light Co. v. Pa. Pub. Util. Com.*, 311 A.2d 151, 158 (Pa. Cmwlth. 1973).

42. The “reasonably consistent basis” language used by the Commonwealth Court specifically relates to the calculation of accrued depreciation and annual depreciation in determining just and reasonable rates. *Pa. Power & Light Co. v. Pa. Pub. Util. Com.*, 311 A.2d 151, 158 (Pa. Cmwlth. 1973).

43. Merely because a utility used a depreciation procedure in the past is neither a justification nor a limitation for determining what constitutes just and reasonable rates in this proceeding. *Pa. Power & Light Co. v. Pa. Pub. Util. Com.*, 311 A.2d 151, 158 (Pa. Cmwlth. 1973).

44. Instead, both accrued and annual depreciation must be reasonably consistent with each other. *Pa. Power & Light Co. v. Pa. Pub. Util. Com.*, 311 A.2d 151, 158 (Pa. Cmwlth. 1973).

45. The Public Utility Code and Commissions' regulations do not require that a utility's currently utilized depreciation procedure for certain plant must be accepted indefinitely. 66 Pa. C.S. § 1703; 52 Pa. C.S. § 73.9(c).

46. The public utility bears the burden of proof regarding operating expenses for depreciation. *Lindheimer v. Illinois Bell Tel. Co.*, 292 U.S. 151, 175 (1934).

47. The use of the ELG procedure is not consistent with the well-established "matching principle" of ratemaking requires that expenses, revenue, and rate base match over the same time period. *Pa. PUC v. NFGD*, 1994 Pa. PUC LEXIS 135, \*13.

48. If post-test year additions to expenses and revenues are allowed, "the balance established by the test year is lost and the matching principle is violated." *Pa. PUC v. NFGD*, 1994 Pa. PUC LEXIS 135, \*13 ; *Re. Niagra Mohawk Power Co.*, 1986 N.Y. PUC LEXIS 3, \*97 (a plant running for 50 years but packing all of its depreciation accruals into the first 40 years would violate generational equity and the matching principle).

49. Two basic principles of public utility ratemaking are that: 1) a public utility only earns money from its rate base and 2) a public utility does not earn money on its expenses. *Pa. Power & Light Co. v. Pa. Pub. Util. Com.*, 311 A.2d 151, 158 (Pa. Cmwlth. 1973).

50. “A utility is not permitted to pad its estimates of annual depreciation so as to meet unknown contingencies, or to compensate for possible future errors in judgment.” *Pa. Power & Light Co. v. Pa. Pub. Util. Com.*, 311 A.2d 151, 158 (Pa. Cmwlth. 1973).

23. “As a general rule, it is inequitable and economical [sic] unsound to ask one ‘generation’ of captive ratepayers to bear the cost of providing service to another.” *Re Minnegasco, Inc.*, 143 PUR4th 419, 426 (May 3, 1993); *Re Limerick Nuclear Generating Station*, 1982 Pa. PUC LEXIS 102, \*65.

51. Section 1304 of the Public Utility Code prohibits discrimination in rates. 66 Pa. C.S. § 1304.

52. The ELG procedure is an accelerated form of depreciation, which causes current customers to pay greater depreciation expense than future customers for the same level of utility service, resulting in intergenerational inequity. *Re Limerick Nuclear Generating Station*, 1982 Pa. PUC LEXIS 102, \*65.

53. In Duke Energy Indiana’s (*Duke Indiana*) 2020 base rate case, Duke proposed using the ELG procedure, which had been adopted by the Indiana commission in previous cases, and the Indiana Utility Regulatory Commission found that the ELG

procedure resulted in unreasonable rates. OCA St. 3 at 62 *citing Petition of Duke Energy Indiana, LLC.*, Cause No. 45253, Order at 90 (June 29, 2020).

54. The Kentucky Public Service Commission found that the ELG procedure frontloads depreciation expense in earlier years and decreases it in later years, resulting in a mismatch between revenues and expenses. *Application of Duke Energy Kentucky, Inc.*, Case No. 2017-00321, Order at 26-27 (Apr. 13, 2018) (*Duke Kentucky*).

55. The ALG procedure will allow PAWC's accumulated depreciation and annual depreciation to be calculated on a reasonably consistent basis.

## **IX. RATE OF RETURN**

56. “We conclude that methodologies other than the DCF can be used as a check upon the reasonableness of the DCF derived ROE calculation. Historically, we have relied primarily upon the DCF methodology in arriving at ROE determinations and have utilized the results of the CAPM as a check upon the reasonableness of the DCF derived equity return.” *Riverton Consol. Water Co. v. Pa. PUC*, 140 A.2d 114 at 121 (Pa. Super. 1958).

57. Under the constitutional standards, the return on equity needs to be “equal to that being made at the same time on investments in other business undertakings which are attended by corresponding risks and uncertainties” 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. *Bluefield Water Works and Improvement Co. v. Public Serv. Comm'n of*

*W.Va.*, 262 U.S. 679, 692 (1923); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944).

58. A public utility may not threaten to terminate service when it has no present intent to terminate service or when actual termination is prohibited under this chapter. 52 Pa. Code § 56.99.

## **X. RATE STRUCTURE**

59. Determining the appropriate cost of service by class is a forward-looking exercise which allocates to future beneficiaries their share of the costs incurred to provide them with service. *Phila. Indus. and Comm. Gas Users Group v. Pa. PUC*, 2025 Pa. Commw. LEXIS 133, \*38 (Pa. Cmwlth. Aug. 1, 2025).

60. The Commission considers the results of Cost-of-Service Studies (COSS) to address ratemaking concerns such as unreasonable inter- and intra-class subsidization through revenue allocation. *Lloyd v. Pa. PUC*, 904 A. 2d 1010, 1020 (Pa. Cmwlth. 2006).

61. PAWC failed to meet its burden of proof regarding its cost of service study because PAWC's cost of service study relied on decades-old, stale data to inform a forward-looking exercise. *See Pa. PUC v. York Water Company*, R-2025-3053442, Order (Feb. 19, 2026).

62. The OCA's cost of service study relies on recent data that reflects the forward-looking nature of allocation to future beneficiaries, and thus it is the appropriate COSS for the Commission to use in cost allocation. *See Pa. PUC v. York Water Company*, R-2025-3053442, Order (Feb. 19, 2026).

63. Revenue allocation should seek to eliminate class cross-subsidization and move customer classes towards their cost of service. *Lloyd v. Pa. PUC*, 904 A. 2d 1010, 1020 (Pa. Cmwlth. 2006).

64. The OCA's cost of service study, which more accurately reflects the demands that PAWC's Water's current customer base places on its water system, demonstrates that the Company's proposed revenue allocation failed to meet its burden of proof because it moves classes away from the indicated cost of service for each class. *Lloyd v. Pa. PUC*, 904 A. 2d 1010, 1020 (Pa. Cmwlth. 2006).

65. Rates must not be unduly discriminatory among customer groups. 66 Pa. C.S. § 1304.

66. The Commission may allocate wastewater revenue requirement to be recovered from water customers where it is in the public interest. 66 Pa.C.S. § 1311(c).

67. An allocation under Section 1311(c) is discretionary, not mandatory, and should be equitable to water customers and just and reasonable. 66 Pa. C.S. §§ 1311(c), 1301(a), 1304; *Pa. PUC v. Aqua Pa., Inc.*, 2022 Pa. PUC LEXIS 161, \*112, 114-15 (Order May 16, 2022) (Aqua 2022).

68. An allocation under Section 1311(c) cannot result in water customers supporting a disproportionate share of the wastewater revenue requirement or being moved away from their indicated class cost of service. 66 Pa. C.S. § 1311(c); *Pa. PUC v. Aqua Pa., Inc.*, 2022 Pa. PUC LEXIS 161, \*112, 114-15 (Order May 16, 2022).

## **XII. LOW-INCOME CUSTOMER ASSISTANCE**

69. It is the utilities' burden of proof to demonstrate that allowing for recovery of a claim for arrearage forgiveness will not give the utility double-recovery of these costs – a burden that PAWC has not satisfied in this case. *Customer Assistance Programs: Funding Levels and Cost Recovery Mechanism*, Final Investigatory Order, at 38 (Oct. 19, 2006).

70. The Commission has recognized the potential of double recovery of costs without a universal service offset as support for why an offset is necessary. *Customer Assistance Programs: Funding Levels and Cost Recovery Mechanism*, Final Investigatory Order, at 25 (Oct. 19, 2006).

71. Affordable bills will maximize revenues for the Company and will enable ratepayers to continue to receive an essential service. *Pa. PUC v. Roaring Creek Water Co.*, 73 Pa. PUC 373, 400 (1990).

72. It is a fundamental precept of utility law that every rate made, demanded or received by any public utility be just and reasonable. 66 Pa.C.S. § 1301.

73. In deciding on an appropriate return on equity and the reasonable mix of debt and equity securities, the obligation of the Commission is to balance consumer and investor interests. *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 577, 606-608.

74. A narrow definition of “confirmed low-income” is inappropriate. *Pa PUC v. Columbia Gas Co.*, Docket No. R-2025-3053499, Order at 350 (Dec. 4, 2025) at 350; *Pa. PUC v. Philadelphia Gas Works*, Docket No. R-2023-3037933, Order at 226 (Nov. 9, 2023).

75. Customers may self-certify their eligibility for customer assistance programs, including through the receipt of LIHEAP funds. 52 Pa. Code § 62.2; *see also* 66 Pa. C.S. § 1409.

### **XIII. SERVICE QUALITY AND CUSTOMER SERVICE ISSUES**

76. “The commission shall consider, in addition to all other relevant evidence of record, the efficiency, effectiveness and adequacy of service of each utility when determining just and reasonable rates under this title. On the basis of the commission's consideration of such evidence, it shall give effect to this section by making such adjustments to specific components of the utility’s claimed cost of service as it may determine to be proper and appropriate. Any adjustment made under this section shall be made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly, together with their underlying rationale, in the final order of the commission.” 66 Pa. C.S. § 523.

77. “Every public utility shall furnish and maintain adequate, efficient, safe, and reasonable service and facilities, and shall make all such repairs, changes, alterations, substitutions, extensions, and improvements in or to such service and facilities as shall be necessary or proper for the accommodation, convenience, and safety of its patrons, employees, and the public.” 66 Pa. C.S. § 1501.

78. “The Commission has the authority to determine and prescribe by regulations or order, the reasonable, safe, adequate, sufficient, services or facilities to be observed, furnished, enforced, or employed, including all such repairs, changes, alterations,

extensions, substitutions, or improvements in facilities as shall be reasonably necessary and proper for the safety, accommodation, and convenience of the public.” 66 Pa. C.S. § 1505.

79. “Charges for other than basic service...must appear after charges for basic services and appear distinctly separate. This includes charges for optional recurring services which are distinctly separate and clearly not required for the physical delivery of service. Examples include line repair programs and appliance warranty programs.” 52 Pa. Code § 56.263.

### **OCA Proposed Ordering Paragraphs**

It is hereby ORDERED THAT:

1. Pennsylvania-American Water Company shall not place into effect the rates, rules, and regulations contained in Supplement No. 58 to Tarriff Water – PA P.U.C. No. 5, which have been found to be unjust, unreasonable and, therefore, unlawful.
2. Pennsylvania-American Water Company shall not place into effect the rates, rules, and regulations contained in Supplement No. 61 to Tariff Wastewater – PA P.U.C. No. 16, which have been found to be unjust, unreasonable and, therefore, unlawful.
3. Pennsylvania-American Water Company is authorized to file tariffs, tariff supplement, or tariff revisions containing rates designed to produce no less than an annual base rate decrease of \$12,303,325.
4. Pennsylvania-American Water Company shall file detailed calculations with its tariff filing, which shall demonstrate to this Commission’s satisfaction that the filed rates comply with the proof of revenue, in the form and manner customarily filed in support of compliance tariffs.
5. The request of Pennsylvania-American Water Company to receive an authorized Return on Equity of 10.95% is denied.
6. Pennsylvania-American Water Company shall be authorized to earn a Return on Equity no greater than 8.7%.
7. The request of Pennsylvania-American Water Company to use the Equal Life Group (ELG) procedure to calculate depreciation rates is denied.
8. Pennsylvania-American Water Company shall adopt the Average Life Group (ALG) procedure for calculating depreciation rates.
9. Pennsylvania-American Water Company’s system-wide maximum day and maximum hour demand factors used in its water COSS are outdated and therefore rejected.
10. Pennsylvania-American Water Company’s cost of service, revenue allocation, and rate design proposals for its water division must be modified to incorporate the Office of Consumer Advocate’s COSS.
11. In the interest of transparency, Pennsylvania-American Water Company shall continue providing separate COSSs for its Section 1329 acquisitions.

12. Pennsylvania-American Water Company's as-filed Act 11 wastewater revenue shift results in unjust and unreasonable rates and is therefore rejected.
13. Pennsylvania-American Water's fixed charges for Residential customers are properly maintained at current levels to recover PAWC's costs. Pennsylvania-American Water's fixed charges for the SSS Residential customer charge in Rate Zones 1d, 1f, and 1g shall be reduced to \$15.00.
14. Pennsylvania American Water Company's "deduct adjustment" is denied.
15. Pennsylvania-American Water Company's call center performance is inadequate based on (1) high call-answer times, (2) high call abandonment rates, and (3) and customer complaints and therefore the Company's call centers perform at a dramatically lower level of performance than should be tolerated. The OCA's recommendations regarding Pennsylvania American Water Company's call center performance are adopted.
16. Pennsylvania-American Water Company's shall improve its low-income customer identification and notice procedures consistent with the OCA's recommendations.
17. Pennsylvania-American Water Company shall permit customers to earn a monthly arrearage forgiveness credit for each complete payment, expand the monthly credit that the Company provides for a payments towards arrearage forgiveness, and tie enrollment of low-income customers into its arrearage forgiveness program to enrollment in the Company's bill discount program.
18. Pennsylvania-American Water Company's request for a CAP Rider is denied.
19. Pennsylvania American Water Company's customer bills shall not include any non-basic charges in the same section and calculation of the regulated service charges. Non-basic charges shall be separately identified and disclosed with a separate total with a statement that the customer has the option to include the charge on the Company's monthly bill or receive a separate bill for optional services from Oncourse Home Services. Marketing and billing for non-basic services shall be identified as optional services provided by Oncourse Home Services. Other non-basic service matters are reformed in accordance with the OCA's recommendations.
20. Pennsylvania-American Water Company shall comply with all directives, conclusions and recommendations contained in this Commission's Opinion and Order that are not the subject of individual ordering paragraphs as fully as if they were the subject of specific ordering paragraphs.

21. The Complaints filed by the various parties to this proceeding at Docket Numbers R-2025-3057983 and R-2025-3058051 are granted in part and denied in part, to the extent consistent with this Commission's Opinion and Order.

DATE: \_\_\_\_\_

\_\_\_\_\_  
Emily I. DeVoe  
Jeffrey A. Watson  
Administrative Law Judges

Reconsideration Granted by [In Matter of Application of Minnegasco, a Div. of Arkla, Inc.](#), Minn.P.U.C., May 28, 1993**1993 WL 312274 (Minn.P.U.C.), 143 P.U.R.4th 416**

## Re Minnegasco, Inc.

Docket No. G-008/GR-92-400

Minnesota Public Utilities Commission

May 3, 1993

Before Storm (dissenting), chairman, and Burton (dissenting), Kitlinski, Knaak, and McKanna, commissioners.

BY THE COMMISSION:

***PROCEDURAL HISTORY******I. INITIAL PROCEEDINGS***

\*1 On July 2, 1992, Minnegasco, a Division of Arkla, Inc. (Minnegasco or the Company), filed a petition seeking a rate increase of \$24,822,800 or approximately 5.5 percent over existing rates. The Company filed its direct testimony in support of this increase as part of its rate case filing.

On August 17, 1992, the Commission issued Orders accepting the Company's filing, suspended the proposed rates, and set the matter for contested case hearing. The Office of Administrative Hearings assigned Administrative Law Judge Richard Luis to the case.

On August 27, 1992, the Administrative Law Judge (ALJ) convened a prehearing conference.

On August 31, 1992, the Commission issued its ORDER SETTING INTERIM RATES, authorizing an interim rate increase of \$11.8 million or 2.6 percent, effective September 1, 1992.

On September 14, 1992, Minnegasco made a supplemental filing of additional direct testimony and exhibits concerning the Weather Normalization Adjustment (WNA) and Financial Accounting Standard (FAS) 106.

On September 17, 1992, the ALJ issued a Prehearing Order granting the Petitions to Intervene of the Minnesota Department of Public Service (the Department), the Residential Utilities Division of the Office of the Attorney General (RUD-OAG), Honeymead Products Company (Honeymead), Minnesota Energy Consumers (MEC), Northern Natural Gas Company (Northern), and the Suburban Rate Authority (SRA). The ALJ's Order also established the hearing schedule and procedural guidelines governing the conduct of the case.

On October 26, 1992, the Department, RUD-OAG, MEC and SRA filed their direct testimony.

On November 10, 1992, the Commission issued an Order granting Minnegasco's motion to enlarge the time to object to Gas, Inc.'s petition to intervene and denying Gas, Inc.'s petition.

On or about November 20, 1992, the parties filed Rebuttal Testimony and on December 2, 1992 they filed Surrebuttal Testimony.

***II. PARTIES AND REPRESENTATIVES***

### *A. Intervenors*

The intervenors and their representatives in this matter are as follows:

Minnesota Department of Public Service (the Department) represented by Scott Wilensky and Mark Chalfant, Special Assistant Attorneys General, 1100 Bremer Tower, Seventh Place and Minnesota Street, St. Paul, Minnesota 55101;

Residential Utilities Division of the Office of the Attorney General (RUD-OAG) represented by Gary R. Cunningham, Special Assistant Attorney General, 340 Bremer Tower, Seventh Place and Minnesota Street, St. Paul, Minnesota 55101;

Honeymead Products Company (Honeymead) represented by Rebecca J. Heltzer, McGrann, Shea, Franzen, Carnival, Straughn & Lamb, 1700 Lincoln Center, 333 South 7th Street, Minneapolis, Minnesota 55402-2436;

Minnesota Energy Consumers (MEC) represented by James J. Bertrand, Leonard, Street & Deinard, 50 South 5th Street, Suite 2300, Minneapolis, Minnesota 55402-2436;

Northern Natural Gas Company (Northern) represented by Patrick J. Joyce, P.O. Box 3330, Omaha, Nebraska 68102-0330; and

\*2 Suburban Rate Authority (SRA) represented by James M. Strommen, Holmes & Graven, 470 Pillsbury Center, Minneapolis, Minnesota 55402.

### *B. The Company*

Minnegasco was represented by Brenda Bjorklund, Miggie E. Cramblit, and John C. Sprangers, 201 South Seventh Street, Minneapolis, Minnesota 55402, Sally A. Johnson, Faegre & Benson, 2200 Norwest Center, 90 South Seventh Street, Minneapolis, Minnesota 55402-3901, and Paul T. Ruxin, Jones, Day, Reavis & Pogue, 901 Lakeside Avenue, Cleveland, Ohio 44114.

## **III. PUBLIC HEARINGS AND PUBLIC TESTIMONY**

The ALJ held public hearings to receive comments and questions from non-intervening ratepayers. The dates and locations of these hearings are listed below:

November 10, 1992 Minneapolis

November 10, 1992 Bloomington

November 18, 1992 Mankato

November 19, 1992 Willmar

In Minneapolis, 30 persons attended and four spoke. The four speakers addressed, in turn, their concerns regarding Minnegasco's rate structure, interruptible service, service contracts, and the delivery rate on gas purchased by the customer from a third party.

In Bloomington, of the 19 persons attending, three spoke. The first speaker questioned Minnegasco's rate increase in light of reductions in the cost of gas since 1983, criticized Minnegasco's billing practices, and objected to BTU billing. The second speaker questioned Minnegasco's willingness to invest in storage gas if it wasn't allowed a return on that investment. The

third speaker requested clarification regarding Minnegasco's distribution and fixed costs and opposed the increase in rates and monthly customer fee in light of declining real incomes.

In Mankato and Willmar, 15 and 10 persons attended, respectively, but none spoke. In addition, the Commission received several dozen written comments from affected ratepayers. Generally, the commentators opposed any rate increase, especially on low income or fixed income persons. The comments stressed the pressure of increasing the cost of a basic necessity of life.

#### ***IV. EVIDENTIARY HEARINGS***

The ALJ held evidentiary hearings on December 8-11, 14-16, 18, and 21, 1992 in St. Paul, Minnesota.

#### ***V. PROCEEDINGS BEFORE THE COMMISSION***

On December 4, 1992, four of the parties (Minnegasco, the Department, RUD-OAG, and the SRA) filed with the ALJ an Offer of Partial Settlement.

On December 31, 1992, the ALJ issued an Order submitting the proposed Settlement to the Commission to determine whether the Settlement was in the public interest and supported by substantial evidence in the record. The ALJ stated that he found the Offer of Partial Settlement to be reasonable and supported by substantial evidence. The ALJ recommended that the Commission accept the Offer of Partial Settlement as resolving the financial and rate design issues encompassed therein.

On December 30, 1992, the same parties filed with the ALJ an Amended Offer of Partial Settlement. The Amended Settlement included agreements reached by the parties on additional issues since the start of the evidentiary hearing on December 8, 1992 and made certain clerical and computational changes.

\*3 On January 29, 1993, the ALJ issued an Order submitting the proposed Amended Offer of Partial Settlement (Settlement) to the Commission to determine whether the Settlement was in the public interest and supported by substantial evidence in the record. The ALJ stated that he found the Settlement to be reasonable and supported by substantial evidence. The ALJ recommended that the Commission accept the Settlement as resolving the financial and rate design issues encompassed therein.

On February 19, 1993, the Commission met to deliberate upon the matter and decided to accept the Amended Offer of Partial Settlement in its entirety.

On March 8, 1993, the ALJ filed his final report and recommendations regarding the remaining contested issues.

On March 19, 1993, the Commission met on its own motion to reopen deliberations regarding its February 19, 1993 decision to accept the Offer of Partial Settlement. After further deliberations, the Commission left its acceptance of the Settlement unchanged.

On March 31, 1993, the Commission heard oral arguments from the parties and on April 1 and 2, 1993 the Commission met to deliberate this matter.

Upon review of the entire record of this proceeding, the Commission makes the following Findings of Fact, Conclusions of Law, and Order.

#### ***FINDINGS AND CONCLUSIONS***

## VI. JURISDICTION

The Commission has general jurisdiction over the Company under [Minn. Stat. §§ 216B.01 and 216B.02 \(1992\)](#). The Commission has specific jurisdiction over rate changes under [Minn. Stat. § 216B.16 \(1992\)](#).

The case was properly referred to the Office of Administrative Hearings under [Minn. Stat. §§ 14.48-14.62 \(1992\)](#) and [Minn. Rules, Part 1400.0200 et seq.](#)

## VII. FURTHER ADMINISTRATIVE REVIEW

Under [Minn. Rules, Part 7830.4100](#), any petition for rehearing, reconsideration, or other post-decision relief must be filed within 20 days of the date of the Order. Such petitions must be filed with the Executive Secretary of the Commission, must specifically set forth the grounds relied upon and errors claimed, and must be served on all parties. The filing should include an original, 13 copies, and proof of service on all parties.

Adverse parties have ten days from the date of service of the petition to file answers. Answers must be filed with the Executive Secretary of the Commission and must include an original, 13 copies, and proof of service on all parties. Replies are not permitted.

The Commission, in its discretion, may grant oral argument on the petition or decide the petition without oral argument.

Under [Minn. Stat. § 216B.27, subd. 3 \(1992\)](#), no Order of the Commission shall become effective while a petition for rehearing is pending or until either of the following: ten days after the petition for rehearing is denied or ten days after the Commission has announced its final determination on rehearing, unless the Commission otherwise orders.

\*4 Any petition for rehearing not granted within 20 days of filing is deemed denied. [Minn. Stat. § 216B.27, subd. 4 \(1992\)](#).

## VIII. MINNEGASCO

Minnegasco is an operating division of Arkla, Inc. and maintains its principal office in Minneapolis, Minnesota. At the beginning of this matter, Minnegasco distributed natural gas at retail to customers in three states: Nebraska, South Dakota, and Minnesota. During the hearing, Minnegasco announced its plans to sell its Nebraska properties and trade its South Dakota properties for additional Minnesota properties.<sup>1</sup> At the end of 1991, the Company had approximately 499,539 customers in Minnesota, and an annual throughput of approximately 123 billion cubic feet. The largest metropolitan areas served are Minneapolis and the West Metro suburbs. Additionally, the Company has a significant large volume load.

## IX. BURDEN OF PROOF

[Minn. Stat. § 216B.16, subd. 4 \(1992\)](#) states: “The burden of proof to show that the rate change is just and reasonable shall be upon the public utility seeking the change.”

The Minnesota Supreme Court has articulated standards for the burden of proof in rate cases. *In the Matter of the Petition of Northern States Power Company for Authority to Change Its Schedule of Rates for Electric Service in Minnesota*, 416 N.W. 2d 719 (Minn. 1987). In the *States Power* case, the Court divided the ratemaking function of the Commission into quasi-judicial and legislative aspects. The Commission acts in a quasi-judicial mode when it determines the validity of facts presented. Just as in a civil case, the burden of proof is on the utility to prove the facts by a fair preponderance of the evidence. Such items as claimed costs or other financial data are facts which the utility must prove by a fair preponderance of the evidence.

The Commission acts in a legislative mode when it weighs the facts presented and determines if proposed rates are just and reasonable. Acting legislatively, the Commission draws inferences and conclusions from proven facts to determine if the conclusion sought by the utility is justified. The Commission weighs the facts in light of its statutory responsibility to enforce the state's public policy that retail consumers of utility services shall be furnished such services at reasonable rates. In its legislative capacity, the Commission forms determinations such as the usefulness of a claimed item, the prudence of company decisions, and the overall reasonableness of proposed rates.

\*5 The utility therefore faces a two part burden of proof in a rate case. When presenting its case in the rate change proceeding, the utility has the burden to prove its facts by a fair preponderance of the evidence. The utility also has the burden to prove, by means of a process in which the Commission uses its judgment to draw inferences and conclusions from proven facts, that the proposed rates are just and reasonable.

#### *X. TEST YEAR*

Minnegasco used the period July 1, 1992 through June 30, 1993 for its test year. Accordingly, the financial data submitted by the Company was largely projected. No party objected to the Company's test year period. Minnegasco's test year was used but not specifically addressed in the Offer of Partial Settlement or in the ALJ's report.

The Commission finds that the Company's use of a twelve-month test year ending June 30, 1993 was appropriate in this proceeding.

#### *XI. OFFER OF PARTIAL SETTLEMENT ACCEPTED AND ADOPTED*

The Commission finds that the Amended Offer of Partial Settlement (the Settlement) is supported by substantial evidence, promotes the public interest, and (in conjunction with the resolution of the remaining contested issues in this Order) will result in just and reasonable rates. The Commission will accept and adopt the Settlement.<sup>2</sup> A copy of the Settlement is incorporated into this Order by reference. The non-proprietary version of the Settlement is attached to this Order.

A Stipulation of Facts accompanied the Settlement. The parties set forth the evidentiary basis for their resolutions of individual issues and explained their basis in reason and policy. In addition, the parties made their witnesses available for questioning by Commission staff to clarify the evidentiary basis for Settlement positions if necessary. Since the Commission must base its rate case decisions on the record, this increased the Settlement's value and credibility. [Minn. Stat. § 14.60, subd. 2 \(1992\)](#). While the Commission could have approved the Settlement based solely on its independent review of the record, it is reassuring that the parties demonstrated that the record was central to their negotiations on every issue.

In non-ratemaking settlement negotiations it is common for parties to concede some issues to obtain a more favorable resolution of others they value more highly. This is reasonable and appropriate in private disputes, where the goal of the settlement process is to reach a result satisfactory to all parties. In Commission proceedings, however, the Commission's responsibility is to serve the public interest. This fundamental responsibility does not change when considering the proposed settlement of a rate case. The Commission certainly considers the monetary and administrative efficiency benefits of not subjecting settled issues to a fully contested case treatment. However, the Commission also scrutinizes a proposed settlement to see whether it protects the interests of the Company, the public, and all customer classes. To assure that this objective is achieved, the Commission examines to see that every issue is resolved within the bounds of acceptable regulatory practice. This is particularly important in rate case settlements because resolution of individual issues not only affects rate levels and structures adopted in this proceeding but has implications on future rate levels and rate structures.

\*6 The Commission is convinced that the Settlement proposed in this matter meets that standard. Each issue addressed in the Settlement has been resolved within the established parameters of acceptable regulatory practice. Accordingly, the Commission will accept the Settlement.

This is not to say that if the Commission had considered the issues resolved in the Settlement on the merits in a contested context the Commission would have decided these issues the same way that they were settled. The Commission has serious concerns regarding a number of the settled issues, including Minnegasco's capital structure, incentive plan costs, manufactured gas plant costs, and appliance service regulated/non-regulated cost allocations. The Commission notes that its acceptance of the Settlement in no way provides precedent on how it would resolve the issues contained therein in future rate cases, other than that the Settlement treatment of the issue was within the range of acceptable regulatory practice. In sum, acceptance of the Settlement does not diminish the Commission's discretion in future rate cases to choose other options that fall within the range of reasonable regulatory practice.

### *Additional Filing Requirements*

To underscore the Commission's particular concern regarding the resolution of certain issues, the Commission will require further attention to the following issues:

1. Definition of MGP Costs — Minnegasco's proposed and stipulated recovery amounts for Manufactured Gas Plant cleanup costs were categorized by amounts for remediation, legal services, investigation, and amortization. Minnegasco projected amounts in these categories that totaled over \$5 million. In its compliance filing within 60 days of this Order, the Company will be required to provide further definition of these costs, including the breakdown of costs that would be internal, external, legal, consulting, contracting, and other. Utility regulatory costs, if any, shall also be shown.
2. MGP Cost Recovery Efforts — In its compliance filing within 60 days of this Order, the Company also will be required to provide an update of its insurance recovery activities and plans, including what claims it has filed and what efforts have been made and will be made to identify and recover from other potential parties involved.
3. Annual Report of MGP Costs — Minnegasco will be required to file annually a report of its MGP cleanup costs and MGP cost recoveries.
4. Other issues — The Commission expects that the parties will address the merits of all the settled issues in future rate cases and will require the Company, in its next rate case filing, to describe 1) the treatment of incentive compensation, vacation accrual, and winter leak surveys in the test year costs, and 2) the impact on the revenue requirement of using an industry average capital structure.

## *XII. REMAINING CONTESTED FINANCIAL ISSUES*

### *A. Financial Accounting Standard 106*

#### *1. Factual Background*

\*7 In December of 1990 the Financial Accounting Standards Board, the professional association that sets accounting standards for American finance and business, issued a new standard on the appropriate accounting treatment of certain post-employment benefits. These benefits are known as PBOPs, for "Post-retirement Benefits Other than Pensions." The main benefit in this category is health insurance, but life insurance, dental insurance, and miscellaneous benefits are also included. The new accounting standard requires companies to account for PBOPs on an accrual basis. In the past nearly all Minnesota utilities, including Minnegasco, have recorded these expenses on a cash basis.

Under cash basis (pay-as-you-go) accounting, PBOP expenses are not recognized on a company's books until payment is made. Under accrual accounting, these expenses are recognized on a pro-rata basis during an employee's period of service, as the obligation to pay arises. In a recent all-utility proceeding, the Commission adopted Financial Accounting Standard 106 for recordkeeping and ratemaking purposes, subject to review of all expenses for prudence and reasonableness.<sup>3</sup> The Order in that proceeding authorized Minnesota utilities to shift to accrual accounting to record future PBOP obligations as they are incurred. It also authorized utilities to use deferred accounting to record PBOP costs in excess of those that would have been recorded under cash basis accounting.

To avoid prolonged uncertainty about the rate effects of the new accounting standard, the Commission limited deferred accounting to three years. Companies were required either to secure a ratemaking determination during that time or to forfeit any ability to recover deferred amounts in rates. This general rate case is the first proceeding in which the Commission has been asked to rule on the recoverability of the costs measured using the new FASB standard.

No party challenges the accuracy of the Company's calculations of current PBOP service costs being incurred for active employees or the recovery of these costs in rates. The Commission, too, finds the current service costs of the current plan reasonable, prudent, and recoverable in rates.

The remaining issue is the recoverability of Minnegasco's "transition obligation," the unrecognized amount of accumulated PBOPs as of the Company's adoption of the new accounting standard on January 1, 1993. Amortization of the transition obligation is a significant component of the revenue deficiency claimed in this rate case. The amortization, plus associated interest, accounts for roughly \$3.4 million of the annual rate increase sought by the Company.

\*8 Minnegasco has calculated its transition obligation using the formula prescribed by the Financial Accounting Standards Board (FASB). The total obligation is calculated on the basis of the cost of the Company's current PBOP plan, as required by FASB. The Company proposes to amortize the obligation over 14 years, which is acceptable under FASB guidelines. No party challenges the accuracy of the Company's calculations, which the Commission, too, accepts as accurate. The other parties do, however, challenge the reasonableness of allowing full recovery of the transition obligation and associated interest and the reasonableness of the proposed 14-year amortization period.

The Department and the RUD-OAG recommend disallowing 50 percent of the transition obligation, and associated interest, on grounds that an expense so extraordinary and unrepresentative of test year expense should be shared by ratepayers and shareholders. The SRA recommends total disallowance on grounds that the Company was imprudent in failing to adopt accrual accounting sooner. The Administrative Law Judge recommended granting recovery of the entire transition obligation and associated interest.

## ***2. Accounting Principles Do Not Control Ratemaking***

The Commission notes that costs can be treated differently for accounting and ratemaking purposes. As the Minnesota Supreme Court has explained,

Nothing in the federal regulations or the Minnesota Rules suggests that the system of accounts is determinative of the treatment of any item for purposes of setting rates or that the system deprives MPUC of its power or absolves it of the duty to decide the issues before it and to set just and reasonable rates.

*Petition of Continental Telephone Company*, 389 N.W.2d 910, 915 (Minn. 1986).

## ***3. Commission Action***

The Commission will allow recovery of 50 percent of the transition obligation and associated interest, establish a 20-year amortization period, and authorize internal funding, for the reasons set forth below.

***a. The Transition Obligation is an Out-of-Test-Year Expense***

In every general rate case, the Commission bases rates on a representative slice of the utility's normal operations called the "test year." The main purpose of the test year is to ensure that rates are based on facts and experience instead of conjecture. It is also intended to replace the fiscal discipline of the marketplace, which is absent for monopolies, with the fiscal discipline of prior determination of reasonable costs. Finally, and most significantly in this case, it is intended to ensure as much precision as possible in matching the time a cost is incurred with the time it is recovered from ratepayers.

This final goal, matching the time a cost is incurred with the time it is recovered, is one of the most important functions of regulation. Since utility service is a public necessity provided in a monopoly environment, rates must be set to recover the full cost of providing service while they are in effect. Placing any portion of the cost of service on preceding or succeeding ratepayers raises grave issues of fairness, as well as resource allocation. As a general rule, it is inequitable and economically unsound to ask one "generation" of captive ratepayers to bear the cost of providing service to another.

\*9 Second, matching the time that costs are incurred to the time that they are recovered protects the integrity of the ratemaking process by ensuring that only representative, not aberrant, costs are included in rates. Regulatory commissions assume that actual costs will vary slightly from test year costs. Under normal circumstances, however, utilities are expected to place their costs in test year categories or bear them themselves. The Commission does not normally adjust test year costs to reflect non-test year expenses. As the Commission explained in an earlier Order:

. . . the test year method by which rates are set rests on the assumption that changes in the Company's financial status during the test year will be roughly symmetrical — some favoring the Company, others not. Not adjusting for either type of change maintains this symmetry and maintains the integrity of the test year process. Anomalies are likely to exist in and beyond any test year.

*In the Matter of the Petition of Minnesota Power & Light Company, d/b/a Minnesota Power, for Authority to Change Its Schedule of Rates for Retail Electric Service in the State of Minnesota, Docket No. E-015/GR-87-223 ORDER AFTER RECONSIDERATION AND REHEARING (May 16, 1988).*

Finally, utilities do not face the same pressure as unregulated enterprises to monitor costs precisely and continuously. The test year, and the time matching it forces, are valuable tools for ensuring that costs are promptly and properly identified, recognized, and recovered. In short, the test year is an important regulatory safeguard against under-recovery, over-recovery, and imprecision in ratemaking.

Since the transition obligation is an accounting adjustment for obligations incurred but not recognized in the past, it is an out-of-test-year expense that would normally be disallowed. The Commission believes there are sound reasons for allowing part of it in this case, however.

***b. Partial Recovery of the Transition Obligation is Equitable***

First of all, the costs represented in the transition obligation are costs whose recovery has been allowed in past ratemakings under cash basis accounting. Furthermore, in recording these expenses on a cash basis in the past, Minnegasco was following established accounting and regulatory practice. To disallow them entirely now because of a change in generally accepted accounting principles would be unduly harsh.

At the same time, however, placing the entire transition obligation in rates would be less than equitable. Although the ratepayers are now paying retirees' PBOPs under cash basis accounting, converting both retirees' and current employees' PBOPs to accrual accounting results in just the sort of overlap of past and current costs the test year concept is designed to avoid. It results in one group of ratepayers bearing expenses that would have been charged to another group, given perfect information earlier. Furthermore, the financial burden of the accounting change is substantial, increasing annual PBOP expense by some 350 percent. Placing the entire burden on ratepayers, then, cannot be done lightly.

\*10 Finally, although the new accounting standard benefits all stakeholders by enhancing the accuracy of corporate financial statements, it benefits investors so significantly that apportioning part of the transition cost to them is reasonable. It is the investment community, after all, who has the greatest interest in the financial condition and prospects of individual companies, and the greatest need to make valid comparisons between them. It is these needs FAS 106 was designed to meet. Of course, ratepayers also benefit from meaningful financial disclosure and the confidence it produces in investors. Under these circumstances, the Commission concludes allowing recovery of 50 percent of the transition adjustment in rates is reasonable.

It is also consistent with Commission action in other cases involving extraordinary expenses that do not fit within established rate case categories. In such cases the Commission has not considered itself bound to allow or disallow the expenses in their entirety, but has instead sought creative and judicious regulatory treatment. See, for example, the decision in Minnesota Power's 1987 rate case partially disallowing the costs of maintaining excess capacity<sup>4</sup> and the decision in NSP's 1986 rate case apportioning manufactured gas plant clean up costs between ratepayers and shareholders.<sup>5</sup>

Other regulatory bodies have taken similar approaches. The Illinois Commerce Commission, for example, has determined that coal tar clean up costs should be apportioned equally between ratepayers and shareholders.<sup>6</sup> The Vermont Public Service Board has found that the costs of a management incentive plan should be allocated equally between ratepayers and shareholders. *In Re Green Mountain Power Corporation*, 119 PUR4th 62 (Vermont Public Service Board 1991).

### *c. Full Recovery of the Transition Obligation Not Required for Investor Confidence*

The Commission rejects the Company's claim that failure to include the entire transition obligation in rates is likely to adversely affect investors' perception of the Minnesota regulatory environment and drive up the Company's cost of capital. The Commission believes that this Order speaks for itself and will be properly interpreted by the investment community. The Commission has consistently included, and will continue to include, all allowable costs in rates. The Commission will continue to seek innovative and equitable approaches to costs, such as the transition obligation, that do not qualify for automatic inclusion in rates.

### *d. Total Disallowance Not Required for Failure to Adopt Accrual Accounting Sooner*

\*11 The Suburban Rate Authority (SRA) argued that the entire transition obligation should be disallowed because the Financial Accounting Standards Board had indicated as early as 1979 that it was rethinking its position allowing cash basis accounting for PBOPs. The SRA contended the prudent course would have been to seek Commission approval to implement accrual accounting earlier.

The Commission agrees with and adopts Findings 46 and 53 of the Administrative Law Judge rejecting this claim. It was prevailing business practice, and the preferred practice under generally accepted accounting principles, to record PBOPs using cash accounting. The Commission believes the Company acted prudently in waiting for the new accounting standard to be issued before converting to accrual accounting.

*e. External Funding of PBOPs Unnecessary*

The Company proposed that it be allowed to fund its PBOP obligation internally, arguing that its strong equity position made external funding unnecessary and that its inability to use tax-deductible funding vehicles made it counterproductive. No party opposed internal funding, and the Administrative Law Judge recommended it.

The Commission agrees that internal funding offers adequate security and clear cost advantages at present. The Commission will require the Company to file an annual report with the Department of Public Service, however, detailing amounts accrued in the internal fund, amounts expended, projected future accruals and expenditures, the feasibility of alternative funding options (including tax-deductible funding options), and Company equity levels. This report will allow continuous monitoring of the internal fund and prompt identification of any conditions warranting re-examination of external funding.

*f. 50 Percent of the Interest on the Transition Obligation Allowed*

The Company seeks recovery of both the transition obligation and associated interest. The transition obligation consists of unrecognized PBOP obligations, reduced to present value. Interest on those obligations for the time between accrual and payment is necessary if the goal is to make the Company whole. The Administrative Law Judge found that interest on the transition obligation should be allowed to the same extent as the transition obligation itself. Finding No. 47. The Commission accepts and adopts that recommendation, believing it would be anomalous to allow recovery of interest on principal that has been disallowed.

*g. Twenty Year Amortization Period Established*

Under FAS 106 Minnegasco can recognize the total transition obligation immediately, amortize it over the average remaining service period of active participants in its PBOP plan, or amortize it over 20 years. The Company proposed a 14-year amortization period, based on the remaining service period of active plan participants, for ratemaking purposes. (The Company stated it had not yet determined whether to amortize the transition obligation or recognize it immediately for financial reporting purposes.) The Department proposed a 16-year period, based on the weighted average remaining lives of active and inactive plan participants. The RUD-OAG recommended a 20 year amortization; the SRA recommended a 40-year period.

\*12 The Commission agrees with the Administrative Law Judge that a 20-year amortization period represents the best balance between shareholder and ratepayer interests. It eliminates the mismatch between the times costs are incurred and recognized within a reasonable time period and with moderate rate impact. The Financial Accounting Standards Board's acceptance of 20 year amortization periods is another indication of its basic reasonableness. The Commission accepts and adopts the Administrative Law Judge's finding (No. 43) and recommendation, and will establish a 20-year amortization period.

*B. Annual Adjustment for Gas Storage Carrying Costs*

Minnegasco proposed an annual true-up of carrying costs associated with gas storage inventory. The true-up would compare the carrying costs on the level of stored gas inventory included in base rates with the carrying costs on its actual month-end levels of inventory for the year purchased from Natural Gas Pipeline of America (NGPL). The difference would be included in its annual gas cost reconciliation (PGA true-up). The carrying charge would be the overall authorized rate of return.

The Company argued that gas inventory carrying costs are a direct gas cost which should be true-up through the PGA. Minnegasco stated that in the absence of a true-up, the Company will be at risk for under-recovery and ratepayers for over-recovery of these costs. Minnegasco argued that its position is consistent with Commission precedent on carrying costs on gas storage inventory.

The Department opposed the carrying-cost true-up proposed by Minnegasco. The Department contended that stored gas should be treated no differently than any other type of inventory used to provide utility service. Inventory is included in rate base and earns a return, thus allowing Minnegasco the opportunity to recover the associated carrying cost. The Department contended that there was no reason to guarantee the Company dollar for dollar recovery of this particular cost.

The ALJ recommended adopting Minnegasco's proposal to true-up carrying costs on gas storage inventory, finding it to be reasonable and to be consistent with past Commission orders.

The Commission rejects the Company's proposal to allow an annual true-up of carrying costs on stored gas inventory. The Commission finds no compelling reason to guarantee Minnegasco dollar for dollar recovery of this particular cost. Rather, stored gas inventory should be treated like all other types of inventory that are included in rate base and earn a return.

As noted by the parties, the Commission has granted variances to its PGA rules which allowed Minnegasco, and other gas companies, to recover carrying costs associated with recent gas storage contracts through the PGA. The Commission recognized that firm contract storage was a new service that was not built into the utility's base rates and was a benefit to ratepayers. Allowing recovery through the PGA would remove disincentives for the use of storage service by removing the risk of under-recovery. However, the Commission required that the issue of gas storage carrying charges be reviewed in the companies' next rate cases and specifically recognized that it may come to view recovery of carrying costs on a test year basis rather than through PGA filings.<sup>7</sup>

\*13 The Commission agrees with the Department that varying its PGA rules to allow Minnegasco, and other gas utilities, to include carrying charges on gas storage inventory until its next rate case was an equitable stop-gap approach for dealing with a new market environment. At that time, Minnegasco did not have storage costs related to the NGPL contract built into its base rates and thus would not have recovered carrying costs if the variance had not been granted. However, the situation has changed. In the Settlement, the parties agreed to include \$18.2 million in rate base for Gas Stored Underground - Current. This reflects gas stored in Minnegasco's Waterville, Minnesota reservoir and gas storage purchased from NGPL. The Company will be allowed an opportunity to earn its overall rate of return on this amount, the same as with any other item included in rate base for the test year.

### *C. Annual Adjustment for Taxes, Fees, and Permits*

1991 amendments to [Minn. Stat. § 216B.241](#) gave the Commission authority to allow utilities to adjust their rates for changes in taxes, fees, and permits under certain conditions. [Minn. Stat. § 216B.241, subd. 2b](#). Recovery of expenses; taxes, provides in relevant part:

... a utility may file annually, or the public utilities commission may require the utility to file, and the commission may approve, rate schedules containing provisions for the automatic adjustment of charges for utility service in direct relation to changes in the expenses of the utility for real and personal property taxes, fees, and permits, the amounts of which the utility cannot control. A public utility is eligible to file for adjustment . . . under this subdivision only if, in the year previous to the year in which it files for adjustment, it has spent or invested at least 1.75 percent of its gross revenues from provision of electric service and .6 percent of its gross revenues from provision of gas service for that year for energy conservation improvements under this section.

Under [Minn. Stat. § 216B.241, subd. 1a](#), gas utilities are required to spend 0.5 percent of gross Minnesota operating revenues on energy conservation improvements. In order to be eligible for the adjustment for taxes, fees, and permits under subd. 2a, the gas utility must spend at least 0.6 percent.

Minnegasco proposed a Property Tax Adjustment Rider which would establish an annual adjustment for property taxes, fees, and permits, under this statute. Minnegasco proposed to file for the adjustment by March 31 of each year, to go into effect on

June 1. The filing would compare the actual annual expenditures for real and personal property taxes, permits, and fees imposed by state and local governments to the amount collected in rates, based on allowed costs in the most recent rate case. The filing would also include documentation to show that the Company had met the required conservation spending levels.

\*14 Minnegasco argued that it is important to establish the adjustment rider now, before the Company has met the additional conservation spending levels. The rider will act as an incentive to encourage Minnegasco to spend more than the statutory minimum on conservation and avoid regulatory lag.

The Department opposed the Property Tax Adjustment Rider and argued that Minnegasco's request is premature. The Department noted that Minnegasco has not yet met the 0.6 percent conservation spending requirement. The Department argued that a more thorough review of the intent of the statute, the basis for authorizing such an adjustment, and the specifics of various terms need closer scrutiny to ensure consistent application. Therefore, if the statute is implemented it should be done through a rulemaking or some other generic proceeding.

The Department mentioned several policy questions that it believed should be addressed in a more generic manner. These included whether actual property tax expenses should be flowed through or just changes in tax rates; whether dollar for dollar recovery is appropriate; the effect of changes in jurisdictional allocations on tax expense; and how to define fees and permits. The Department also noted that if Minnegasco's merger with Midwest Gas is approved, its gross revenues and CIP expenses will change.

The ALJ recommended adopting the Company's proposed Property Tax Adjustment Rider. He stated that the concerns raised by the Department can be addressed in Minnegasco's compliance filing to be made when the Company achieves the required spending levels. The ALJ said that a rulemaking is not specifically required before the statute may be implemented and that a generic proceeding may not conclude before the Company reaches the required spending levels.

The Commission agrees with the Department that Minnegasco's proposal is premature and should be denied. The Company's CIP spending levels have not yet met the 0.6 percent threshold required to qualify for the automatic adjustment. If the proposed merger with Midwest Gas takes place, it may take some time to determine new annual revenue levels and to design and implement CIP programs at the required spending levels. There is therefore no clear need to act on the proposal now. Furthermore, establishing an automatic adjustment for the first time raises issues of law, policy, and implementation that were not thoroughly addressed in this proceeding. The Commission will therefore reject the Company's proposed Property Tax Adjustment Rider.

#### *D. Lost and Unaccounted for Gas*

Lost and unaccounted for (LUF) gas is the difference between gas purchased and gas sold. Minnegasco proposed that LUF gas be included in the calculation of monthly PGA's. The Department recommended that the LUF gas be recovered by adjusting the volumes in the annual PGA trueup filing. Minnegasco agreed with the Department's approach. The Commission finds that this issue is uncontested and adjusting the volumes in the annual PGA trueup is a reasonable method to recover the cost for LUF gas. The Commission approves this method of recovery for LUF gas.

### *XIII. DEMAND-SIDE MANAGEMENT (DSM) INCENTIVES AND CONSERVATION ISSUES*

#### *A. Energy Conservation Improvement Plan*

\*15 Minn. Stat. § 216B.16, subd. 1 (1992) requires utilities filing for a general rate change to include an energy conservation plan pursuant to Minn. Stat. § 216B.241 (1992). Minnegasco submitted its plan as part of its general rate case filing on July 2, 1992. Minnegasco's plan included information on the Company's strategy to expand its conservation activities into a comprehensive demand-side management plan.

The Department stated that Minnegasco's energy conservation plan complied with applicable statutes and contained the information requested by the Commission in the past. The Department recommended that the Commission accept the energy conservation plan filed by the Company.

The Commission believes the appropriate focus of a rate case conservation plan is on a utility's long-term conservation goals. Short-term projects and plans are currently reviewed by the Department in the Conservation Improvement Program (CIP) process under [Minn. Stat. § 216B.241 \(1992\)](#). The Commission finds that Minnegasco's energy conservation plan meets the requirements of the applicable statutes and addresses the long-term conservation goals of the Company. The Commission accepts the plan as filed.

### *B. Carrying Charge on CIP Tracker Balances*

In a previous docket, the Commission authorized the establishment of a CIP tracker account for Minnegasco<sup>8</sup>. CIP expenditures and revenues are tracked in this account, until the balance is submitted for potential recovery or refund in the Company's next general rate case.

Minnegasco requested that it be allowed to implement a carrying charge on its CIP tracker balance in this rate case. The Company proposed that the carrying charge be applied at the Company's authorized rate of return on equity. The Company argued that setting the carrying charge at the return on equity rather than the overall return was consistent with the legislative mandate to encourage conservation.

The Department and the RUD-OAG agreed that Minnegasco should be allowed to implement a carrying charge on its CIP tracker balance. However, these parties recommended the carrying charge be set at the Company's overall rate of return, rather than the return on equity. The Department and RUD-OAG contended that a carrying charge at the overall rate of return adequately compensates the Company for the time value of money and that the carrying charge should not be used as a conservation incentive mechanism since it is tied only to spending, not to performance.

The ALJ agreed with the Department and RUD-OAG positions. He noted that in past cases, the Commission has set the carrying charge at the overall rate of return, finding that it adequately compensates utilities for the time value of money.

**\*16** The Commission agrees with all the parties and the ALJ that Minnegasco should be allowed a carrying charge on its CIP tracker account. In other dockets, the Commission has consistently found that application of a carrying charge to the CIP tracker account, at the utility's authorized overall rate of return, is an equitable means of adjusting the actual level of CIP expenditures to the level projected in the utility's last rate case.<sup>9</sup> Allowing a carrying charge gives recognition to the time value of money to the utility and its ratepayers. If a utility spends more than is collected through the rates set in the most recent rate case, the utility is made whole. By the same token, ratepayers are made whole if they have "lent" money to the company through over-collection between rate cases. The Commission will apply the same reasoning to this docket and will allow Minnegasco to apply carrying charges to its CIP tracker account at the Company's authorized overall rate of return.

The Commission agrees with the Department, RUD-OAG, and ALJ that Minnegasco's proposal to set the carrying charge at the rate of return on equity should be rejected. As stated above, setting the carrying charge at the overall rate of return adequately recognizes the time value of money and meets the objective of making the Company and ratepayers whole for any under- or over- collection of actual CIP costs. Any further encouragement for utility investment in conservation is better left to a well-designed demand-side management (DSM) financial incentive mechanism. DSM financial incentive proposals are discussed in a subsequent section of this Order.

### ***C. Conservation Cost Recovery Charge***

A conservation cost recovery charge (CCRC) is used by most utilities to track recovery of CIP-related costs. The CCRC is calculated by dividing allowed test-year CIP expenses by allowed test-year sales units; the result represents the revenue per Mcf that will be collected in rates related to test year CIP costs. These revenues are booked to the CIP tracker. The difference between the revenues booked and the actual expenses incurred will determine the CIP tracker balance.

In response to staff questions at evidentiary hearings, Department witness Kosowski stated that the proper CCRC to use in calculating the CIP-related revenues in this case was \$0.02894/Mcf. Minnegasco agreed with this calculation. The ALJ found it to be reasonable.

The Commission notes that the CCRC can be derived from numbers agreed to in the Settlement. Test year CIP expenses of \$3,544,833 are divided by test year gas sales volumes of 122,475,162 Mcf, resulting in the CCRC of \$0.02894/Mcf noted by the parties. Therefore, the Commission finds that a CCRC of \$0.02894 is reasonable and should be used by the Company.

### ***D. Demand-Side Management Financial Incentive***

#### ***1. The Company's Request***

\*17 On October 18, 1991, the Commission issued its ORDER REQUIRING GAS UTILITIES TO FILE FINANCIAL INCENTIVE PROPOSALS in Docket No. G-999/CI-91-188, *In the Matter of a Summary Investigation into Financial Incentives for Encouraging Demand-Side Resource Options for Minnesota Gas Utilities*. In that Order, the Commission required all natural gas utilities (except Midwest Gas, which was already implementing a financial incentive pilot program) to file DSM financial incentive proposals. Minnegasco filed its proposal as part of this rate case.

For its DSM financial incentive, Minnegasco proposed to recover 100 percent of lost margins due to conservation from direct impact programs. The Company planned to measure lost margins by comparing pre- and post-participation usage for a participant and comparison group. Minnegasco proposed to book lost margins to its tracker account on a monthly basis.

The Company stated that the removal of disincentives was the Company's highest priority at this time. Minnegasco argued that the Commission has previously found that 100 percent recovery of lost margins is adequately tied to performance and complies with statutory criteria. In rebuttal testimony, Minnegasco stated that if the Commission were to find a bonus incentive desirable, the Company could accept adding a 10 percent bonus on lost margins if the Company exceeded its energy savings goals.

Minnegasco opposed the performance-linked recovery of lost margins proposed by the Department and RUD-OAG. The Company stated that both proposals were unreasonable because the small "carrot" (amount of potential bonus recovery) would be quickly offset by the magnitude of the "stick" (less than full recovery of lost margins if 100 percent of goals were not met). Minnegasco argued that a number of factors beyond the Company's control could affect its ability to meet its CIP goals, and thus its ability to recover lost margins.

#### ***2. Position of the Parties; Recommendation of the ALJ***

The Department and the RUD-OAG both opposed Minnegasco's DSM financial incentive mechanism and instead proposed plans that would tie lost margin recovery to the achievement of energy savings goals. These parties argued that Minnegasco would be financially indifferent as to whether it achieves more or less than its projected energy savings, because it will receive 100 percent of the margin for each unit of gas sold or each unit of gas saved.

The Department proposed to tie lost margin recovery to savings goals for direct impact programs on a project by project basis. The Department incentive mechanism would allow recovery of 110 percent of lost margins if energy savings goals are exceeded; 100 percent recovery if the goals are met; 75 percent recovery if 75 to 100 percent of goals are achieved; 50 percent recovery if 35 to 75 percent of goals are met; and no recovery if less than 35 percent of goals are achieved.

\*18 The RUD-OAG incentive proposal would require at least 50 percent of program savings goals to be achieved before any lost margin recovery was allowed. If 50 percent or more of goals are achieved, the proposal would allow lost margin recovery as a percentage of actual savings compared to projected savings. For example, if Minnegasco achieved 60 percent of its projected goal, the Company would receive 60 percent of its lost margins. Recovery would be capped at 1.2 times savings, allowing a maximum bonus of 20 percent of lost margins.

The Department and the RUD-OAG recommended approval of Minnegasco's method for measuring lost margins, with the modification that CIP participants be excluded from the comparison group to provide a greater accuracy of measurement.

The Department and RUD-OAG argued that lost margins should be booked to the tracker annually, after the Commission has approved the energy savings achieved. These parties recommended that Minnegasco file its calculation of lost margins and incentives to be included in the tracker on November 1 of the succeeding CIP year, beginning in 1994. The RUD-OAG also recommended an initial compliance filing within 60 days of this Order which would list all projects the Company believes qualify for the incentive and the associated energy savings goals.

The Department recommended that the program be limited to a two year pilot project, as the Commission has done for all other DSM incentive programs.

The ALJ recommended approving Minnegasco's DSM incentive proposal to recover 100 percent of its lost margins from direct impact programs. He agreed with the RUD-OAG that CIP participants should be excluded from the comparison group for measuring lost margins. The ALJ agreed with the Department and OAG that lost margins should be booked annually, rather than monthly. He found that annual compliance filings were appropriate.

### 3. Commission Analysis

[Minn. Stat. § 216B.16, subd. 6c \(1992\)](#) sets out the following factors the Commission is to consider when evaluating financial incentives:

- (1) whether the plan is likely to increase utility investment in cost-effective energy conservation;
- (2) whether the plan is compatible with the interest of utility ratepayers and other interested parties;
- (3) whether the plan links the incentive to the utility's performance in achieving cost-effective conservation; and
- (4) whether the plan is in conflict with other provisions of the statute.

The Commission put forth the following principles for developing proposed incentive plans in its October 18, 1991 Order requiring gas utilities to file DSM incentive proposals:

Utilities should tailor their incentive plans to meet their own individual needs . . .

. . . The Commission . . . expects financial incentives to be tied to cost effectiveness.

. . . financial incentives should be tied to achieving objective demand side goals. Awarding financial incentives for spending money without results would serve no useful purpose and would undermine the legislative goal of achieving significant reductions in Minnesota energy use.

**\*19** The Commission has approved several different types of DSM incentive mechanisms for Minnesota utilities, including 100 percent lost margin recovery, 100 percent lost margin recovery with a bonus, and incentives which vary the amount of lost margin recovery based on performance. There are a variety of potential DSM incentive mechanisms which can achieve the goals set out in statute and the principles outlined by the Commission.

The Commission notes that Minnegasco has a large CIP program with a relatively wide variety of projects. The Company has considerable experience in successfully running these programs, starting with its participation as one of the utilities in the pilot utility conservation improvement program (PUCIP) which started in 1980. The Commission finds that it would be valuable to look at the effect of a positive financial incentive mechanism, rather than simply removing the obstacle of lost margins, for a utility such as Minnegasco. The Commission finds that either the Department or the RUD-OAG proposal would provide a positive financial incentive to Minnegasco, since the Company has the opportunity to recover more than 100 percent of its lost margins.

The Commission will adopt the RUD-OAG proposal. This financial incentive mechanism employs a continuous sliding scale recovery, thereby providing an increased incentive for achieving energy savings at every step. The Commission finds that the RUD-OAG proposal provides an appropriate level of bonuses and penalties; the Company must achieve at least 50 percent of its energy savings goals before it is eligible for a bonus, and has the potential to receive up to a 20 percent bonus for exceeding its goals. The threshold for achieving recovery and the potential bonus are both higher than under the Department proposal.

The Commission rejects Minnegasco's argument that it is unreasonable to require that a performance threshold be met before lost margin recovery is allowed. In prior orders for other companies, the Commission has found that it is just as reasonable to penalize substandard conservation performance as it is to reward satisfactory or outstanding performance.<sup>10</sup>

Minnegasco proposed to measure lost margins by comparing the consumption levels of CIP participants with the consumption levels of a comparison group of similarly situated ratepayers. The Commission agrees with the RUD-OAG that this is generally a workable approach, but that it should be refined to exclude CIP participants from the comparison group, for greater accuracy.

The Commission will require the Company to file a calculation of lost margins for a given CIP year by November 1 of the succeeding year, beginning with November 1994, as recommended by the parties. The Commission will also adopt the RUD-OAG recommendation to require an initial compliance filing that lists all projects the Company believes qualify for the incentive and the associated energy savings goals. This will help ensure that all parties understand and agree on the specific parameters of the program before proceeding.

**\*20** The Commission has structured all current DSM financial incentive programs as two-year pilot projects. The Commission will do so for Minnegasco also. This structure allows the Commission to review the program in a timely manner and determine if incentive plans are working as intended, need modification, or whether the entire issue should be revisited.

#### ***XIV. OVERALL FINANCIAL SUMMARIES***

##### ***A. Rate Base Summary***

Based on the above findings, the Commission concludes that the appropriate rate base for the test year is \$275,055,140 as shown below:

UTILITY PLANT IN SERVICE	\$524,943,057
Accumulated Depreciation and Amortization	(236,253,545)
	<hr/>
	288,689,512
Gas stored underground:	
Current	18,214,000
Non-current	997,000
Accumulated Deferred Income Taxes	(28,733,000)
Materials and Supplies	3,049,000
Cash Working Capital	(6,493,737)
Deferred Debits and Credits	(4,235,635)
Other Working Capital	3,568,000
TOTAL RATE BASE	\$275,055,140

***B. Operating Income Statement Summary***

Based on the above findings, the Commission concludes that the appropriate Minnesota jurisdictional operating income for the test year under present rates is \$21,206,518 as shown below:

OPERATING REVENUES:	
Gas Sales	\$448,887,256
Other Revenues	2,219,000
Total Operating Revenues	<hr/> 451,106,256
OPERATING EXPENSES:	
Cost of Gas	305,567,255
Production and Maintenance	13,412,723
Distribution and Utilization	14,257,783
Depreciation and Amortization	23,341,397
Customer Service and Information	5,160,029
Sales and Customer Accounts	16,025,114
Administrative and General	21,782,555
Other Expense	895,000

Taxes Other Than Income	22,234,000
Federal and State Income Taxes	6,650,588
Total Operating Expenses	429,326,444
TOTAL OPERATING INCOME	\$21,779,812

### *C. Gross Revenue Deficiency*

\*21 Based on the Commission findings and conclusions, the Minnesota jurisdictional revenue deficiency for the test year is as shown below:

Rate Base	\$275,055,140
Rate of Return	10.41%
Required Operating Income	\$28,633,240
Operating Income	21,779,812
Income Deficiency	\$6,853,428
Revenue Conversion Factor	1.67977
Revenue Deficiency	\$11,512,000

## *XV. REMAINING CONTESTED RATE DESIGN ISSUES*

### *A. Revenue Apportionment to the Customer Classes*

MEC, a party to these proceedings but a non-signatory of the Settlement, challenged the revenue allocation among the customer classes proposed in the Settlement. In its consideration of the Settlement, the Commission considered MEC's claim that the revenue allocation was unreasonable. The Commission rejected MEC's claim and found that the Settlement's revenue allocation was reasonable, pursuant to the following analysis.

In the Amended Offer of Partial Settlement, the parties proposed the following rate increases and decreases:

Residential	+7.30 percent
Commercial & Industrial Sales	+2.63 percent
Large-Volume Commercial and Industrial	+0.00 percent
Small-Volume Dual Fuel	+7.90 percent
Large-Volume Dual Fuel	+0.00 percent

MEC was not content that rates for Large-Volume customers remain unchanged while rates for all the other classes increased. MEC proposed that the rates for Large-Volume customers actually decrease. Under MEC's proposal, rates for the Residential

and small Commercial and Industrial customers would increase and rates for all of the other customer classes would decrease. MEC proposed rate increases and decreases which it modified in surrebuttal testimony to the following:

Residential	+8.9 percent
Small Commercial & Industrial Sales	+8.9 percent
Commercial & Industrial Sales	-5.4 percent
Large-Volume Commercial and Industrial	-3.52 percent
Small-Volume Dual Fuel	-3.28 percent
Large-Volume Dual Fuel	-6.76 percent

\*22 MEC argued that the Settlement's revenue allocation would perpetuate what it characterized as the subsidization of residential and small C&I customers by the Large Volume C&I and Dual Fuel customers. MEC also argued that an 8.9 percent rate increase for Residential customers would not be large enough to cause "rate shock" and would move the Company more rapidly toward cost-based rates.

MEC failed to persuade the Commission that the Settlement's revenue allocations were outside the range of acceptable regulatory practice so that the resulting rates are unfair and unreasonable. Judgements as to what constitutes rate shock and how far and how rapidly the Commission should move toward cost-based rates are uniquely legislative decisions left to the Commission's sound discretion. In addition to cost, there are other critical rate design considerations. As the Minnesota Supreme Court has stated:

Once revenue requirements have been determined, it remains to decide how, and from whom, the additional revenue is to be obtained. It is at this point that many countervailing considerations come into play. The Commission must balance factors such as cost of service, ability to pay, tax consequences, and ability to pass on increases in order to achieve a fair and reasonable allocation of the increase among the customer classes. *St. Paul Area Chamber of Commerce vs. Minnesota Public Service Commission*, 251 N.W. 2d 350 (1977).

The Commission has recognized that moving prices toward cost is a reasonable policy. The Commission generally supports the movement toward cost-based pricing, but recognizes that there are other non-cost factors that are equally important. For example, the Commission has stated:

Avoiding rate shock is a primary ratemaking goal, because sudden, drastic increases in energy costs can be burdensome for residential and non-residential ratepayers alike. Avoiding rate shock is particularly important for residential ratepayers, however, because increases in the cost of basic needs can cause hardship for customers on low or fixed incomes. *In the Matter of the Application of Midwest Gas, a Division of Iowa Public Service Company, for Authority to Change Its Schedule of Gas Rates for Retail Customers within the State of Minnesota*, Docket No. G-010/GR-90-678, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (July 12, 1991), p. 35.

Furthermore, the Commission recognizes that cost studies and their underlying economic theories necessarily involve some imprecision. This imprecision adds to the Commission's unwillingness to place the entire rate increase on residential customers and small businesses, as MEC proposed. Given these considerations, the Commission finds that the revenue allocations proposed in the Settlement are reasonable.

### ***B. Residential Customer Charge***

### *1. Historical and Factual Background*

\*23 The residential customer charge is the fixed monthly rate residential customers pay for being hooked up to Minnegasco's system. Minnegasco proposed raising the customer charge for residential customers to \$5.00 from \$3.00 per month. The Department proposed an increase to \$5.50 and the RUD-OAG proposed leaving the customer charge at \$3.00. The parties reached no agreement on this issue and it was litigated in the contested case proceeding. (Customer charges for the other customer classes were agreed to by the parties to the Settlement.)

In setting the level of a customer charge, parties generally analyze the fixed cost of providing service to the customer class. Normally the monthly cost is determined through a Class Cost of Service Study (CCOSS) and is apportioned between the fixed monthly customer charge and the variable commodity charge. The proportional levels of these two factors have important effects on such issues as energy consumption, rate and revenue stability, and equity in and among customer classes.

In this rate case, the parties to the Settlement adopted the Department's Class Cost of Service Study (CCOSS) for the purpose of setting rates. This study demonstrated fixed residential customer costs of \$14.62 per month. Minnegasco did not believe there was a significant enough difference between the numbers in its CCOSS and the Department's to contest the Department's study. Both parties agreed that rate shock would occur if rates for the residential class were exactly aligned with the cost of service.

### *2. Positions of the Parties; Recommendation of the ALJ*

*Minnegasco* — The Company proposed to increase the residential customer charge from \$3.00 to \$5.00. The Company argued that a \$2.00 increase was a reasonable move towards the \$14.62 stipulated class cost of service in this case. The Company argued that a \$5.00 customer charge would only recover approximately 35 percent of its embedded customer costs.

Minnegasco argued that a higher customer charge would give it greater financial stability because the fixed monthly charge would provide it with additional revenue independent of weather conditions and customer gas usage.

Minnegasco also argued that moderating the increase to \$5.00 instead of going right to full cost, i.e. \$14.62, would make the increase more acceptable to customers and maintain a reasonable degree of continuity with the Company's historical rates.

*The Department* — The Department proposed to increase the customer charge to \$5.50. The Department proposed a higher increase than the Company because it believes the Company's proposal does not move far enough in the direction of cost based rates. The Department also argued that a higher customer charge would promote economically efficient use of gas because rates would better represent cost and would allow ratepayer to make better informed decisions about the cost of the energy they consume.

\*24 The Department agreed that revenue stability would be improved and Minnegasco would have a better chance of recovering its revenue requirement.

The Department argued that setting the customer charge closer to cost would reduce the potential for intra-class cross-subsidization of fixed costs between high use and low use customers.

*RUD-OAG* — RUD-OAG proposed leaving the customer charge at \$3.00 and allowing the Company to collect the entire class revenue deficiency through an increase to the energy charge. RUD-OAG argued that putting the entire increase into the energy charge would encourage energy conservation because energy consumption is sensitive to price.

The RUD-OAG relied heavily upon [Minn. Stat. § 216B.03 \(1992\)](#) to support its argument. Among other things, that statute states: "To the maximum reasonable extent, the Commission shall set rates to encourage energy conservation . . ." The RUD-

OAG argued that increasing the proportion of fixed costs in the customer charge (and thereby decreasing the proportion in variable charges, which are tied to energy consumption) would diminish consumer incentives to conserve energy.

According to the RUD-OAG, analysis of a rate design proposal demands a balancing between the need for revenue stability and conservation goals. The RUD-OAG also argued that if a reliance on variable charges caused under-recovery in years with above-normal temperatures, this would eventually be balanced by over-recovery in years of below-normal temperatures.

RUD-OAG argued that maintaining the existing customer charge would give the Company a reasonable opportunity to meet its revenue requirement with the only difference between it and the Company's proposal being that more of the revenue requirement would be collected through the energy charge.

RUD-OAG believes its proposal would allow for a greater amount of historical continuity with prior rates and would promote a greater degree of customer acceptance of those rates because it would allow customers more control over their bills due to more of the cost being recovered through a variable charge.

*The ALJ's Recommendation* — The ALJ recommended adopting the Company's proposal for a \$5.00 customer charge. The ALJ found it appropriate to move in the direction of cost based rates and believes that a \$2.00 increase would be an appropriate step in that direction.

The ALJ concluded that a \$5.00 customer charge would improve the Company's revenue stability because it would allow the Company to recover more of its fixed costs on a steady basis and would reduce the Company's risk of under-recovering its revenue requirement in warmer than normal weather.

The ALJ recommended the Company's proposal over the Department's because he believes a \$5.00 rather than a \$5.50 customer charge would be more likely to gain customer acceptance and is more in line with historical rates.

### 3. Commission Analysis

\*25 A rate design decision requires exercise of the Commission's legislative function. The Commission must weigh the facts in evidence to determine if the rate design proposed by the utility is justified and will result in just and reasonable rates.

The Commission agrees with the ALJ that Minnegasco's proposed increase to the residential customer charge should be approved. This position is reasonable and equitable, is not inconsistent with the facts in evidence, and is in line with prior Commission decisions.

In the 1992 Interstate rate case<sup>11</sup> the Commission adopted the Company's proposal for an increase to the residential customer charge, against opposition from the RUD-OAG. In that Order the Commission stated:

The Commission notes that customer charges are substantially below cost for all classes of customers. . . . As a result, the Commission believes an active step should be taken in this case to move these charges closer to cost. Moving prices toward cost is a reasonable policy which sends the proper price signals, spreads costs in an equitable fashion, and tends to eliminate intraclass cost subsidization.

Order at p. 44.

The Commission notes that in this case the present monthly residential customer charge is \$3.00 and fixed cost is approximately \$14.62. A move toward cost is warranted in this case and will promote the goals cited in the Interstate Order.

The Commission is aware of its statutory mandate to set rates to encourage energy conservation “[t]o the maximum reasonable extent.” *Minn. Stat. § 216B.03 (1992)*. Even at \$5.00, the customer charge will not adversely affect the Commission's conservation goals because a substantial part of the Company's fixed costs will remain in the variable charge. This will provide customers with an incentive to conserve energy. Moreover, acting in its legislative mode, the Commission views any rate design proposal in its full context to determine what is reasonable in the context of the case. The Commission must balance such factors as fairness to ratepayer, conservation goals, revenue and rate stability when making a rate design decision. The Commission is also aware that the statute instructs the Commission to resolve all questions regarding reasonableness in favor of the consumer. *Minn. Stat. § 216B.03 (1992)*. Having weighed the factors in this case, the Commission finds that Minnegasco's proposed increase in the residential customer charge will result in just and reasonable rates. The Commission will approve Minnegasco's increase.

### *C. Energy Charge for the Firm Customer Classes*

\*26 At issue was how the “energy charge” for Residential and C&I firm customer classes would be designed.

#### *1. Historical and Factual Background*

In this rate case, the term energy charge is used to describe the combination of the unit margin (also called the commodity-margin or the non-gas unit margin) and the per unit demand costs that are included in the base cost of gas and the monthly purchased gas adjustments (PGAs). This explanation is necessary because it is more common to use the term energy charge to refer to the entire variable cost of energy including the commodity cost of gas.

In its current rates, Minnegasco recovers its unit margin and its demand costs at a constant rate per unit of gas over the entire 12 months of the year. The only seasonal variability in Minnegasco's rates are due to seasonal difference in the commodity cost of gas and the amount of gas its customers buy during one part of the year versus another.

#### *2. Proposals of the Parties; Recommendation of the ALJ*

*Minnegasco*— Minnegasco proposed what it termed a “balanced energy charge.” The Company proposed to recover its pipeline demand costs on a seasonal basis at the same time those costs are incurred, i.e. higher PGA demand charges in winter, during the five month heating season from November through March, when it uses more firm pipeline capacity, and lower PGA demand charges in the summer, during the seven month non-heating season, when it uses less pipeline capacity.

To balance the seasonal fluctuations that would be caused by recovering its pipeline demand costs on a seasonal basis, however, Minnegasco also proposed to vary the non-gas unit (commodity) margin on a seasonal basis *in the opposite direction* from PGA demand costs. During the five month winter heating season when demand costs are higher the unit margin would be reduced and in the summer when demand costs are lower the unit margin would be increased. This arrangement would offset the difference between heating season and non-heating season demand costs with a seasonal unit margin and keep the total per unit energy charge, excluding the commodity cost of gas, constant.

Minnegasco argued for a balanced energy charge because it would provide Minnegasco with a more stable revenue stream and a better opportunity to recover its fixed costs under abnormal weather conditions because it would reduce the Company's dependence on a high level of winter throughput. Minnegasco also argued that under its proposal the demand component of the balanced rate would be more closely based on cost.

*The Department*— The Department proposed rates fully responsive to the seasonal fluctuation of pipeline demand costs. The Department stated that the Company's rates should reflect pipeline capacity costs at the time those costs are incurred. The Department argued that fully seasonal rates would send more appropriate price signals to Minnegasco's customers when the

Company's system is at its peak. The Department argued that seasonal rates have the potential for improving Minnegasco's system load factor, lowering system-wide peak demand costs and would better promote energy conservation.

*\*27 RUD-OAG* — The RUD-OAG proposed making no design changes to the unit margin and in the way PGA demand costs are recovered. The RUD-OAG recommended maintaining level demand charges and margins throughout the entire year without any seasonal variation. The RUD-OAG argued that the Company had offered no cost justification for its balanced energy charge proposal except to maintain level year-round rates which already exist.

The RUD-OAG also objected to the Department's proposal on the grounds that it would put too much of a burden on customers during the winter and cause rate shock. The RUD-OAG argued that the benefits that would result from increased conservation due to higher winter bills must be carefully evaluated against the additional financial burden higher winter rates would place on customers during the heating season.

*ALJ* — The ALJ recommended adopting the Department's proposal for seasonal, time-of-use rates. The ALJ believes the Department's proposal would encourage customers to use and conserve natural gas efficiently, while attempting to keep overall cost recovery from the class constant.

The ALJ found that the Department's seasonal rate proposal sends the best price signals to firm customers by increasing the demand rate they pay during the winter season and lowering it in the summer when gas is cheaper. The ALJ also found that the Department's seasonal rates reflect actual cost by keeping the unit margin constant throughout the year. Any rate shock on customer bills during the winter is balanced by cheaper bills during the summer, and leads to the same amount of annual revenue.

The ALJ also found that the availability of the Company's budget plan mitigates any hardship that could result from higher winter bills. The ALJ believes that recording on budget plan customers' bills the actual rate charged such customers during the winter sends appropriate price signals.

The ALJ also found that the Company failed to demonstrate a benefit to ratepayers from its balanced recovery proposal beyond maintaining level rates throughout the year, a result which is achieved already under the current rate structure and the Company's budget plan.

### *3. Commission Analysis*

The Commission finds Minnegasco's proposal for a balanced energy charge is unacceptable. It does not send accurate price signals, does not offer any benefit to ratepayers above and beyond what exists under current rates, and does not appear practical from a regulatory standpoint.

The Commission is intrigued by the Department's seasonal rate proposal. The Commission is interested in exploring the potential benefits to be achieved through the implementation of seasonal rates that send accurate price signals to consumers. These benefits may be in the form of increased energy conservation and/or lower rates because of improvements in the efficient utilization of Minnegasco's distribution system during periods of peak demand.

However, the Commission finds that the Department's proposal in this case leaves too many questions unanswered about how seasonal rates would transmit price signals to customers and whether those signals would have enough impact on customers to be worth the change in rate design. The Commission is also concerned about the regulatory feasibility of changing rates outside of a rate case or a miscellaneous tariff filing and believes this issue needs to be explored more carefully in any future request for implementation of a seasonal rate.

*\*28* After careful consideration of the three rate design proposals the Commission finds that it is appropriate to leave the design unchanged as recommended by the RUD-OAG. The Commission will not require Minnegasco to develop and propose

a seasonal rate at this time because the Company's existing rate design already sends a price signal during the heating season based on seasonal commodity prices and customer gas usage. However, the Commission would entertain a more fully developed proposal in the future.

#### *D. Three-Part Rate for Large-Volume Commercial and Industrial (C&I) Customers*

The Department recommended that the Company design and propose a three-part rate for its Large-Volume C&I customer class. The Department argued that a three-part rate instead of the current two-part rate would be a more efficient pricing scheme because it would separate fixed costs, demand costs, and commodity costs on the customer's bill and would send a clear price signal to customers about the cost of using natural gas.

The Department recommended allowing the Company one year from the date of the final order in this rate case to design and propose a three-part rate for these customers in a miscellaneous tariff filing. The Department believed a year was needed because implementation would require each of these customers to install expensive tele-metering equipment at their place of business.

Minnegasco did not rebut the Department's position on the need for a three-part rate for this customer class and the ALJ did not make a recommendation on this issue. (All rate design issues for the Large-Volume C&I customer class were settled except for this one and the design of the energy charge.)

The Commission finds the Department's recommendation may warrant further consideration but will not require Minnegasco to make a proposal in a separate miscellaneous tariff filing. Rather, the Commission finds it would be a more efficient use of parties' and the Commission's time for Minnegasco to develop a three-part rate for its Large-Volume C&I customers as an alternative for parties to consider in its next rate case.

#### *E. Additional Rate Classes for Small-Volume Dual Fuel Customers*

The Department recommended that the Company examine whether there is a need for additional customer classes and tariffs for smaller, more homogenous groups of Small-Volume Dual Fuel (interruptible) customers. All rate design issues for the Small-Volume Dual Fuel customer class except this one were settled. The Department made its recommendation in response to the Company's proposal to offer this customer class a two-tier declining block rate.

Minnegasco did not rebut the Department's recommendation. The ALJ recommended that the Company prepare a study of Dual-Fuel customers for submission prior to its next rate case, analyzing appropriate subclasses or customer groupings.

The Commission finds that a separate study of this issue is not necessary at this time and rejects the Department's recommendation without prejudice. The Commission notes that the Department recommended this study in response to the Company's original proposal to offer a declining block rate. Subsequently, the parties agreed to a single, flat-rate unit margin in the Settlement. The Commission finds that any party may make a specific proposal for additional interruptible customer classes when the Company files its next rate case.

#### *F. Process Interruptible Sales Service Rider*

\*29 Under Minnegasco's original proposal, process gas users with no alternative fuel capability would be eligible for the Small-Volume Dual Fuel rate if they were willing to accept curtailment upon notice from the Company. Minnegasco identified three other conditions that would have to be met for a customer to qualify for this rate: a signed contract accepting the curtailment provisions of the service, designation of three individuals that can be notified in the event of a curtailment and installation of tele-metering equipment at the customer's expense.

The Department agreed that an interruptible rate would be appropriate for these customers under these conditions. However, the Department did not agree that eligibility for the rate should be limited only to process gas users. The Department recommended making the rate available to all customers with these load characteristics. Minnegasco amended its proposal to incorporate the Department's recommendation.

The ALJ recommended approving Minnegasco's amended proposal. The ALJ found that the Process Interruptible Sales Service Rider would improve the Company's overall load factor to the benefit of all customers.

The Commission agrees with the Department and believes rates should be based on load characteristics and conditions of service rather than on what the gas is going to be used for. Therefore, the Commission accepts and adopts the ALJ's recommendation and approves the Company's amended Process Interruptible Sales Service Rider.

### *G. Main and Service Line Extensions*

Minnegasco proposed an increase to the footage allowances for main and service line extensions provided to new customers without charge and decreases in the per foot charges for extensions in excess of the footage allowances. The Department agreed that the proposed changes were appropriate and would reflect Minnegasco's average cost for new extensions.

The Department also recommended that the Company add an economic feasibility formula to its tariff to clarify what criteria it uses to evaluate whether it needs to collect an extension charge, a contribution-in-aid-of-construction or a customer-advance-for-construction. The Department also suggested modifications that would require the Company to collect an advance-for-construction and make refunds under certain conditions instead of allowing the Company complete discretion over these decisions.

Minnegasco agreed to the Department's recommendations and proposed to incorporate them into its tariff when it makes its compliance filing. The ALJ found this tariff proposal to have merit.

The Commission accepts and adopts the ALJ's recommendation and approves the new extension footage allowances and excess footage charges. The Commission will require the Company to submit an economic feasibility formula and revised tariff language in its Compliance Filing as recommended by the Department.

### *H. Late Payment Policy for Commercial and Industrial (C&I) Customers*

**\*30** Minnegasco proposed to extend the due date for C&I customers to pay their gas bills by 10 days, an increase from 15 to 25 days. This increase would give C&I customers the same amount of time as Residential customers to pay their bill before a late charge is assessed. The Department agreed that this would be a fair policy for all customers.

The ALJ did not make a specific recommendation on the late payment policy for C&I customers.

The Commission finds that the Company's proposal is reasonable and approves the extension of the late payment time period for C&I customers.

### *I. Therm Billing*

Minnegasco proposed to bill all of its customers in therms because it would ensure that all of its customers receive an equivalent amount of energy for every unit billed. (A therm is a standardized unit of energy commonly used in the gas industry and is equivalent to 100,000 Btus.) Minnegasco proposed to replace its current Btu pressure adjustment with a therm factor adjustment.

The Department agreed this would be an appropriate change because it would ensure that all customers are billed using equivalent units of energy and that it would not have any impact on revenue. The ALJ recommended allowing Minnegasco to adopt therm billing.

The Commission accepts and adopts the ALJ's recommendation and approves the Company's proposal to bill all of its customers in therms instead of Btu-adjusted Ccfs.

#### *J. Miscellaneous Tariff Book Organizational Changes*

Minnegasco proposed several language and organizational changes to its tariff book that make the tariffs easier to use. None of the parties objected to these changes and the ALJ found they were reasonable and appropriate. The ALJ recommended that they be approved.

The Commission accepts and adopts the ALJ's recommendation and approves the Company's miscellaneous tariff book changes.

#### *K. Continuity of Service*

Minnegasco proposed to replace its tariff entitled Maintenance and Responsibility with a substitute tariff entitled Continuity of Service. Minnegasco's proposal would limit its risk for service interruptions and shifts some of that risk onto its customers. Minnegasco argued that NSP has been permitted to use language in its tariff that is practically identical to what Minnegasco has proposed.<sup>12</sup>

The Department argued against changing any of the existing tariff language because it believes the proposed language would unreasonably limit the Company's liability. The Department argued that the existing tariff language adequately addresses the Company's responsibility for providing an adequate and continuous supply of gas to its customers.

**\*31** The ALJ found that the Company's proposed language provides sufficient protection for customers and puts a reasonable limit on the Company's liability. The ALJ recommended adopting the Company's proposal.

The Commission is not completely persuaded by any of the arguments in favor or against maintaining the current standard of negligence and liability found in the Company's tariff and believes that further development and examination of the issues involved will be required. However, the Commission finds merit in the Company's proposal to limit its liability against claims resulting from loss of profits and other consequential damages due to service related problems because these kinds of losses are typically covered by a C&I or Dual-Fuel customer's own insurance.

Therefore, the Commission will maintain the current tariff language but permit the Company to add the following sentence:

Minnegasco will not be liable for any loss of profits or other consequential damages resulting from the use of service or any interruption or disturbance of service.

#### *L. Right to Remove a Gas Meter*

Minnegasco proposed to be allowed to remove the gas meter from a customer's premise if the customer has not used any gas for at least 12 months. Minnegasco argued that the customer charge alone does not cover the cost of keeping an idle meter in place.

The Department suggested modifying the Company's proposal to require Minnegasco to give its customers advance notice of its intention to remove a meter at a customer's premise and a requirement that the meters selected for removal are chosen on a non-discriminatory basis.

The ALJ recommended acceptance of the Company's proposal with the modifications suggested by the Department. The ALJ found that with the Department's modifications the proposal was reasonable.

The Commission agrees with the ALJ and will approve the Company's amended tariff entitled Minnegasco's Right to Remove a Gas Meter.

#### *M. Customer Deposits*

The Department proposed making it mandatory for Minnegasco to collect a deposit from all new and existing customers. The Department was concerned that allowing Minnegasco discretion over whether it collects a deposit from customers would make it too easy for Minnegasco to administer its customer deposit program in an unfair or discriminatory manner.

The Company objected because it currently does not collect a deposit from any of its customers. The Company argued that a deposit program would cost more to administer than it would save by reducing unpaid bills. The Company also argued that a mandatory deposit program would be inconsistent with the Commission's Rules which allow a utility to collect a deposit only if the customer has an unsatisfactory credit or service record as determined using the criteria set forth in [Minn. Rules parts 7820.4100-.4700](#).

The ALJ recommended accepting the Company's tariff language as originally proposed because it is consistent with the Commission's rules on customer deposits and adequately describes the Company's customer deposit policy.

**\*32** The Commission agrees with the ALJ's recommendation and approves the Company's tariff as originally proposed. In light of Minnegasco's current practice of charging no deposit to any customer, the expense to Minnegasco and detriment to all customers of requiring the Company to collect a deposit from all customers clearly outweighs the value of guarding against potential discriminatory application of some future deposit requirement.

#### *N. No Charge Service*

The Department recommended changing the name of the Company's No Charge Service tariff to No Surcharge Service. This tariff describes some of the services Minnegasco provides to customers without any additional charge including emergency leak inspections, maintenance of meters, pressure regulator and service lines and meter turn-ons for new customers. The Company did not object to the Department's proposal and the ALJ recommended adopting it.

The Commission finds the Department's recommendation is reasonable and approves the new title for this tariff.

#### *O. New Area Surcharge*

Minnegasco proposed a New Area Surcharge Rider that would allow it to extend service to areas where service cannot be economically justified under Minnegasco's present rates. The New Area Surcharge Rider would allow Minnegasco to add a fixed monthly surcharge to customer bills for no longer than 10 years or whenever Minnegasco recovers its incremental cost of providing service to the new area, whichever comes first.

The Department agreed that a New Area Surcharge would be appropriate but objected to Minnegasco's proposal because it did not contain enough details for the Department to make an evaluation and did not conform to the New Town Rate that was approved for Northern Minnesota Utilities in Docket No. G-007/M-92-212.<sup>13</sup> The Department recommended rejecting the New Area Surcharge Rider and requiring the Company to make a separate miscellaneous tariff filing. The Department argued that this would ensure the Rider received an adequate level of review.

The Company agreed to redesign its tariff in conformance with Northern Minnesota Utilities' New Town Rate but proposed to do this as part of its compliance filing in this rate case.

The ALJ recommended approving a New Area Surcharge Rider for Minnegasco as consistent with the Commission's decision regarding Northern Minnesota Utilities' New Town Rate. The ALJ recommended allowing Minnegasco to make its revised filing a part-of its rate case compliance filing and suggested allowing parties additional time to comment on this particular issue. In response to questions during Oral Arguments the Department stated that it would not object to reviewing the Rider as part of the rate case compliance filing.

**\*33** The Commission believes that a New Area Surcharge Rider is appropriate but that it will need to review the Company's modified language of that rate before granting final approval. The Commission finds that review of the modified rate language in a compliance filing will afford adequate opportunity to address the issue. Therefore, the Commission will approve Minnegasco's modified New Area Surcharge Rider provisionally, i.e. subject to review in the Company's compliance filing.

#### *P. Reconnection Charges*

Minnegasco proposed an increase for all customer reconnection charges to \$35 from the current level of \$10 for customers who have had their meter locked for non-payment of their bill and \$20 for customers who have had their meter removed for non-payment of their bill. Minnegasco argued that it costs the same to reconnect a customer regardless of the reason service is terminated and that charging a below cost reconnection charge to some of its customers sends an inaccurate price signal about the cost of not paying the gas bill.

The Department objected to Minnegasco's proposal and suggested that the reconnection charge for non-payment of a bill should be \$15 and the reconnection charge for all other reasons such as meter tampering should be \$35. The Department argued that it is more important to maintain access to service for low income ratepayer who have trouble paying their bills than it is to send the correct price signal about reconnection charges. The Department argued that it was important to try and maintain these people on the system and that a too high reconnection charge would prevent them from getting back onto the system after a disconnection. The Department did not object to the \$35 reconnection charge for meter tampering, breach of contract and fraudulent use of services.

The ALJ recommended adopting the Department's proposal for a \$15 and a \$35 reconnection charge depending on the Company's reason for disconnecting the customer's service. The ALJ believes that customers should not be penalized for reasons due to economic hardship to the same extent as customers who wrongfully avail themselves of the Company's property and services.

The Commission agrees with the Department's and the ALJ's recommendation for a \$15 reconnection charge for non-payment of a bill. The Commission finds that a higher charge may contribute to another cycle of non-payment of bills.

The Commission also finds that a \$50 reconnection charge for reasons other than non-payment of a bill would be more appropriate than a \$35 charge. The Commission believes that a higher reconnection charge for customer malfeasance will help offset some of the cost of allowing a lower reconnection charge for customers who are disconnected for non-payment of their bill. The Commission finds this two-fee rate structure is consistent with its decision in the 1991 NSP-Electric rate case.<sup>14</sup> In that case, the Commission viewed the relock issue with the utmost seriousness and found that customer tampering with Company equipment is a violation of the law as well as a safety hazard and an infringement on the Company's right to disconnect service for non-payment.

*Q. Seasonal Sales Cooling Service Rider*

\*34 The Company proposed a Seasonal Sales Cooling Service Rider for separately metered, gas powered, energy efficient, air conditioning equipment that would make interruptible rates available to these customers off-peak between April 15 and October 15. The Company argued that this would encourage investment in gas powered air conditioning equipment, help the Company improve its off-peak system load factor and reduce the amount of electricity needed for summertime air conditioning.

The Department objected to the Company's proposal to offer a reduced rate to customers based on the customers' end-use for the gas. The Department argued that rates should be based instead on cost of service and load characteristics and that only if the customer meets the established criteria for a reduced rate should the customer be entitled to the reduced rate. The Department also argued that if the Company wanted to request permission to recover funds invested in natural gas air conditioning equipment because of potential conservation benefits, then the appropriate place to make that request would be in a CIP plan budget proposal.

The ALJ agreed with the Company and found that the use of gas for summertime air conditioning is likely to improve the Company's overall load curve to the advantage of all of its customers. The ALJ also found that it would be in the public interest to allow this rider because it would help reduce demand for electricity when electric utilities are at their summertime peaks. The ALJ did not agree with the Department's argument that the appropriate place to make this kind of proposal was in the Company's CIP plan.

The Commission agrees with the Department and will not allow the Company to charge natural gas air conditioning customers a reduced rate because of their end use for the gas. The Commission finds that rates should be based on a customer's load characteristics and that to qualify for an interruptible rate a customer will have to meet the criteria established in the Company's tariffs for those rates.

*R. Water Pumping Sales Service Rider*

Minnegasco proposed to reduce the Commercial and Industrial energy charge for municipal water pumping customers. The Company argued that a lower rate for these customers would promote the use of natural gas powered water pumping equipment and improve the Company's overall load curve.

The Department objected to the Company's proposal because it would make a reduced rate available to a customer on the basis of the customer's end-use for the gas. The Department argued that rates should be based on load characteristics and cost of service. The Department argued that municipal water pumping customers should receive whatever rate they are entitled to on the basis of how much gas they use and whether they are willing to be interrupted rather than on the basis of a seasonal difference in gas usage.

The ALJ recommended approving the rider because of its potential for improving the Company's overall load curve and for decreasing the demand for electricity in the summer. The ALJ believes these potential benefits outweigh any harmful impact rate discrimination might have on the Company's other Commercial and Industrial customers.

\*35 The Commission agrees with the Department and will not approve a reduced Commercial and Industrial rate for municipal water pumping customers because of their end use for the gas. The Commission finds that rates should be based on a customer's load characteristics and that to qualify for a reduced rate a customer will have to meet the criteria established in the Company's tariffs for the reduced rate.

*S. Natural Gas Vehicle Service Rider*

Minnegasco proposed a Natural Gas Vehicle Service Rider that would allow it to give a \$2.00 per Mcf credit to Commercial and Industrial Sales Service customers who use natural gas as fuel for dedicated natural gas vehicles (NGVs). Under Minnegasco's proposal for a customer to qualify for this rate all NGVs would have to run exclusively on compressed natural gas, the customer would have to own and run its own gas compressor and the gas would have to be separately metered. In addition, the rate would only be available for a term of four years and would be used to help defray the cost of investing in dedicated NGVs.

Minnegasco argued that the use of alternate fuels in NGVs would reduce the level of air pollution and reduce the United States dependence on foreign oil. Minnegasco argued that these are compelling public policy reasons for approving this rider.

The Department objected to the Company's proposal because it would be a discriminatory rate based on end use rather than load characteristics or cost of service. The Department argued that Minnegasco's ratepayer should not be expected to subsidize private investment in NGVs. The Department also argued that if there are compelling public policy reasons that warrant subsidizing investment in NGVs then the Company's shareholders or taxpayers should pay for those subsidies.

The Department also argued that gas for use in dedicated NGVs is a year-round load and would add capacity costs during the winter as well as the summer. The Department argued that if these customers are buying gas under the same conditions as other firm customers they should pay the same rates as other firm customers. But if they are willing to risk being interrupted then they should be entitled to an interruptible rate.

The ALJ recommended approving the rider because an increase in the use of alternate fuels in NGVs would help promote the public policy objective of cleaner air and reduced dependence on foreign oil.

The Commission agrees with the Department and will not approve a \$2.00 per Mcf credit to the applicable Commercial and Industrial Sales Service rate for gas purchased for use in NGVs. The Commission finds that the Company's proposal would create a discriminatory rate based on end use instead of a rate based on load characteristics and cost of service. The Commission finds that to the extent that the Company's proposal would help society attain cleaner air and reduce the United States dependence on foreign oil it would be more appropriate for Minnegasco (or the NGV owners) to seek recovery of the \$2.00 per Mcf investment from all of the beneficiaries of the those policies rather than just Minnegasco ratepayers.

### ***ORDER***

**\*36** 1. Minnegasco is entitled to increase gross annual Minnesota jurisdictional revenues by \$11,512,000 in order to produce total gross annual jurisdictional operating revenues of \$462,618,256.

2. Within 30 days of the date of this Order, the Company shall file with the Commission for its review and approval, and serve on all parties in this proceeding, revised schedules of rates and charges reflecting the revenue requirement and the rate design decisions contained herein, along with the proposed effective date.

3. The compliance filing filed pursuant to Ordering Paragraph 2 shall contain:

a. Schedules showing all billing determinants collecting the total annual gross operating revenues from the sale of gas in the amount of \$460,399,256. These schedules shall include but not be limited to:

1. Total revenue by customer class,

2. Total number of customers, the customer charge and total customer charge revenue by customer class,

3. Total number of commodity related billing units, the per unit commodity and demand cost of gas, the non-gas unit margin and total commodity related sales revenue by customer class.

b. A revised version of the Company's Gas Rate Book incorporating the rate design decisions contained in this Order and including but not limited to the following:

1. The \$5.00 per month Residential Class customer charge and the customer charges contained in the stipulation,
2. The stipulated class revenue apportionments,
3. The Process Interruptible Sales Service Rider as agreed to by the parties,
4. The main and service line footage allowances extension charges as agreed to by the parties,
5. The extension of the late payment period for the C&I customer class by 10 days to correspond to the Residential customer class late payment period,
6. Therm billing,
7. The tariff changes not specifically referred to in this order except in Section XIII, J that are of a housekeeping nature,
8. The addition of the last sentence in Minnegasco's proposed language on continuity of service to the existing tariff on Maintenance and Responsibility,
9. The tariff language on Minnegasco's Right to Remove a Gas Meter as agreed to by the parties,
10. Minnegasco's customer deposit tariff language,
11. The renaming of the No Charge Service tariff to No Surcharge Service,
12. The increased reconnection charges of \$15.00 and \$50.00 depending on the reason for disconnection.

c. Proposed customer notices explaining the final rates.

d. A proposal for a separate customer notice on therm billing to be distributed in customer bills when therm billing goes into effect.

4. Within 30 days of the date of this Order, the Company shall file with the Commission and serve on the parties, a revised base cost of gas and supporting schedules incorporating the changes made herein. The Company shall also file its automatic adjustment establishing the proper adjustment to be in effect at the time final rates become effective. The Department shall review these filings as it does other automatic adjustment filings.

**\*37** 5. Within 30 days of the date of this Order, the Company shall file with the Commission for its review and approval, and serve upon all parties to this proceeding, a proposal to make refunds, including interest calculated at the average prime rate, or other appropriate adjustments, to affected customers. The proposal shall reflect the difference between the revenue collected during the interim rate period and the amount authorized herein.

6. Within 30 days of the service date of this Order, the Company shall file proposed extension tariff language that includes an economic feasibility formula detailing the conditions under which Minnegasco can waive extension charges and requiring the Company to collect advances-for-construction and make refunds under certain conditions.

7. Within 30 days of the date of this Order, the Company shall file with the Commission for its review and approval, and serve on all parties in this proceeding, a modified New Area Surcharge Rider as discussed herein.

8. Parties shall have 15 days to comment on the filings required in Ordering Paragraphs 1 through 7.

9. Within 60 days from the date of this Order, the Company shall file an update of its MGP cleanup cost recovery activities to date, including what claims it has filed, and what efforts it has made to identify and recover costs from other potential parties. Minnegasco shall also file information showing what future actions it plans to take and a schedule of those activities with regard to recovery of its MGP costs from insurance companies and other parties.

10. Within 60 days from the date of this Order, the Company shall file a report that explains and defines the categories of expenses that Minnegasco proposes to classify and recover as MGP cleanup costs.

11. Within 60 days of the date of this Order, the Company shall file with the Commission and serve on the parties a filing detailing which programs are eligible for lost margin recovery and the associated energy savings goals. Parties shall have 30 days to comment on this filing.

12. On an annual basis, beginning no later than November 1, 1994, instead of its current annual filing date, the Company shall file with the Commission and serve on the parties its annual conservation tracker account report. This report shall include conservation costs incurred, the conservation costs recovered, and the balance in the tracker account. This report shall also include the Company's calculations of actual lost margins and energy savings goals achieved due to its conservation efforts. Parties shall have 30 days to comment on these filings.

13. On an annual basis, beginning April 1, 1994 the Company shall file with the Department, an update of FAS 106 funding. This update shall include: 1) the existing funding situation; 2) tax-deductible alternatives available to Minnegasco; 3) a five year forecast of future funding levels; 4) the amount of equity in Arkla's and Minnegasco's capital structures; and 5) the existing post retirement benefit obligation.

\*38 14. Minnegasco shall file on an annual basis the amount of its expenditures for the year and its cumulative expenditures to date for MGP costs. The annual reporting of these costs shall explain and show the types of costs that were incurred and what monies were recovered from insurance companies and other parties. This information shall be filed by April 1st of each year.

15. Minnegasco, in its next rate case, shall file information and provide calculations showing the impact on proposed final and interim rates of using an industry average capital structure. Minnegasco shall also file information describing the effect of manufactured gas plant cleanup costs, incentive compensation, vacation accruals, and winter leak surveys on test year costs and rate base.

16. Minnegasco, in its next rate case, shall develop a proposal for a three-part rate for its Large-Volume Commercial & Industrial Sales Service customer class.

17. This Order shall become effective immediately.

## DISSENTING OPINION

Commissioners Storm and Burton, dissenting.

### *I. Introduction*

In a generally accepted model of utility regulation, utilities as regulated monopolies give up certain marketplace opportunities and choices which are allowed nonregulated entities. Their regulators in turn permit the regulated utilities to present evidence of their revenue requirements in rate cases. A properly presented rate case will allow a utility to recover its prudently incurred expenses, plus a reasonable return on its investment.

As will be shown in the body of this dissent, Minnegasco did not overstep the bounds of the regulatory model in its treatment of prudent post-retirement employee benefits. Neither did Minnegasco fail in its burden of proof when it presented those expenses for recovery in its rate case. In addition, Minnegasco consistently abided by specific Commission requirements in its accounting treatment of the expenses.

Despite these facts, the majority has chosen to disallow a significant portion of Minnegasco's prudently incurred SFAS 106 expenses. We respectfully dissent from that portion of the majority opinion.

## *II. Factual Background*

In the past, Minnegasco recorded PBOP expenses on a cash basis. In doing so, Minnegasco acted in accordance with standard utility practice. The ALJ recognized the prudence of Minnegasco's past accounting practices in Findings No. 46 and 53 of the ALJ's report. The Commission also found that Minnegasco's past treatment of PBOPs on a PAYGO basis was prudent. Order at p. 12.

In 1990 FASB changed its accounting standards for PBOPs from the cash basis to the accrual basis. The Commission issued its official response to the change in its September, 1992 ORDER ADOPTING ACCOUNTING STANDARD AND ALLOWING DEFERRED ACCOUNTING in Docket No. U-999/CI-92-96 (the FASB docket). In that Order the Commission stated:

The Commission adopts SFAS 106 accrual accounting for Minnesota utility recordkeeping and ratemaking purposes, subject to Commission review for prudence and reasonableness of the [PBOP] programs, expenses, and all calculations in future rate cases.

\*39 Order at p. 6.

The Commission also established a process for utility changeovers to the new accounting method. The Commission authorized a three year deferred accounting period for utilities, with the deferred balance of PBOP expenses subject to Commission general rate case review. In its November 2, 1992 ORDER DENYING PETITION FOR RECONSIDERATION, GRANTING IN PART AND DENYING IN PART PETITIONS FOR CLARIFICATION in the FASB docket, the Commission clarified that deferred balances which were not brought forward for rate case review within the allowed three year period would be denied recovery.

On July 2, 1992, Minnegasco filed a general rate case in which it sought, among other things, recovery of its PBOP expenses. Test year PBOP expenses consisted of three component parts:

1. The year's service cost, the present value of the future benefits earned by current employees during the year;
2. The interest cost, equal to the discount rate used to determine the present value multiplied by the accumulated present value, of the total of expected future PBOPs;
3. The amortization of the transition obligation, which is defined as the present value of the accumulated expected future PBOP liability on the day SFAS 106 is adopted.

The Commission found that the current service component of Minnegasco's PBOP expenses was "reasonable, prudent, and recoverable in rates." Order at p. 10. The ALJ also recommended complete recovery of the transition obligation, together with

interest. The majority, however, disallowed one half of the transition obligation component, and one half of the associated interest.

### *III. Analysis*

Analysis of Minnegasco's treatment of PBOPs brings us to the firm conclusion that the majority erred when it disallowed one half of the transition obligation and associated interest. Minnegasco experienced normal and ordinary expenses when it incurred liability for employees' post-retirement benefits. This category of expense is considered a normal cost of service in utility accounting, and is consistently treated as such in rate cases before the Commission. Prior to FASB accounting changes, Minnegasco accounted for the expenses in a manner consistent with prevailing industry practice and approved by the Commission in the Company's rate cases. Minnegasco changed to accrual accounting for PBOPs for ratemaking purposes in response to the Commission's direction in the September 22, 1992 Order addressed to all utilities. After Minnegasco's accounting change took place, the Company proposed an ongoing PBOP accounting plan in this rate case; neither the prudence of the plan nor its calculations was contested. Since the new accounting plan, pursuant to Commission direction, was based on the accrual method, a transition obligation was an inevitable and integral part of the proposed rate case expenses.

After reviewing this history, we are convinced that there was no action by Minnegasco at any time which converted a normal, ordinary, prudently incurred business expense into something for which shareholders should be penalized by disallowance. (Indeed, it is unclear how Minnegasco could have prudently made any other decisions throughout this period.) The benefits paid to employees and the timing of the payments are exactly the same under the PAYGO and the accrual methods. The character and the amount of the obligation remain unchanged; only the manner of booking the expense for accounting purposes changes. Nothing increases ratepayer liability or renders a prudent cost imprudent. An accounting change should not distract the Commission from its basic examination of the prudence and reasonableness of costs of service for rate case recovery. The PBOP costs under the accounting change, including the transition obligation and associated interest, were reasonable and prudent and should be recovered in full.

**\*40** Because Minnegasco adhered to sound regulatory practice in its treatment of PBOP costs and in its presentation of the expenses for rate case recovery, the Company should recover these prudent costs of utility service. We believe that this fundamental principle is ignored or misunderstood in the majority opinion. No reasoning offered by the majority convinces us otherwise.

#### **1. The Test Year Concept**

The majority focuses strongly upon a philosophical discussion of the test year principle. We agree with the majority that the test year is a useful device for balancing revenue and expense to arrive at a revenue requirement. However, nothing in the basic concept of the test year requires disallowance of these PBOP expenses.

The majority states that the transition obligation is an out-of-test year expense and therefore cannot be recovered. (Although, inexplicably, the Company is later allowed to recover one half of the transition obligation). In actuality, the obligation *was* recognized in the test year.

The majority lists a host of regulatory evils against which the test year concept stands as a bulwark. We believe that even if the transition obligation were considered an out-of-test-year expense, none of the cited evils would be present in this case. As will be explained later, there is no inequitable intergenerational matching present. The costs for which recovery is sought are "representative, not aberrant." There is absolutely nothing in the record to indicate that the proposed expenses are based on "conjecture" instead of "facts and experience." On the contrary, the expenses were determined carefully and precisely, using calculations accepted by all the parties. There is no need for the test year to act as a "regulatory safeguard against under-recovery, overrecovery, [or] imprecision in ratemaking" in this case.

In short, the Commission should continue to view the test year as a tool in arriving at the revenue requirement component of just and reasonable rates. The test year concept should not overshadow considered Commission judgment on the prudence and reasonableness of incurred expenses.

## 2. The Matching Concept

The majority holds that one half of the transition obligation should be disallowed because it produces an improper match between the time a cost is incurred and the recovery of that cost. The truth is that neither PAYGO or SFAS 106 accrual accounting, or any other accounting method, produces a perfect match. The SFAS 106 method, however, is a move toward better matching.

Under the PAYGO method, liability is incurred when service is rendered in the present, but that liability or cost is not recognized until benefits are paid in the future. If the incurring of a future liability is recognized as a present cost, as under SFAS 106 accounting, PAYGO may be viewed as the ultimate mismatch.

Under the SFAS 106 accrual method, the present value of future liabilities is booked at the time those liabilities are incurred, when present service is rendered. SFAS 106 accounting achieves a better match of the incurring of the obligation with both recognition of the cost and recovery from ratepayers. Because the transition obligation is an integral part of the changeover from cash basis to accrual basis, it is part of the move to better matching. The transition obligation actually accelerates the matching process, allowing recovery to rest with present ratepayers, who are more likely than future ratepayers (who would pay under PAYGO) to have rendered the service from whence the transition obligation arose.

\*41 The majority seems to believe that the transition obligation produces a mismatch which is akin to retroactive ratemaking. “It results in one group of ratepayers bearing expenses that would have been charged to another group, given perfect information earlier.” Order at p. 4. In its September 22, 1992 Order, the Commission specifically found that the transition obligation does not result in retroactive ratemaking:

While under pay-as-you-go accounting [PBOP] expenses are recognized at the same time as they are paid out to employees, the employee services from which the benefits arose occurred in the past. This imperfect matching of expense recognition with employee services also occurs if a transition obligation is recognized. Recovery of [PBOP] costs under pay-as-you-go accounting has never been considered retroactive ratemaking, and neither should the recovery of a transition obligation which arises as a result of a change to accrual accounting. Neither of these situations is the type of reaching back for past costs which the retroactive ratemaking doctrine prohibits. The utility is not in either case attempting to recover in current rates costs which should properly have been recovered in past rates.

Order at pp. 5-6.

## 3. The Benefits to Shareholders

The majority disallows one half of the transition obligation amount because the transition obligation “. . . benefits investors so significantly that apportioning part of the transition cost to them is reasonable.” Order at p. 4. We find this reasoning flawed.

The SFAS 106 benefits to shareholders mentioned by the parties are more accurate financial reporting and more precise identification of costs. There is nothing in the record to show that these benefits would not result in more prudent managerial decisions, benefiting ratepayers at least as much as shareholders. More accurate financial reporting and identification of costs impose no burden or higher cost on ratepayers; employee benefit payouts remain unchanged after the switch to accrual accounting. There is absolutely no reason to penalize shareholders by a 50% disallowance because an accounting change has brought about greater accuracy and accountability in company recordkeeping and financial reporting.

#### 4. Extraordinary Expenses

The majority states that a disallowance of employee benefit expenses would be “. . . consistent with Commission action in other cases involving extraordinary expenses that do not fit within established rate case categories.” PBOP expenses, however, are not extraordinary expenses, but normal and ordinary costs of providing utility service. The only meaning of the term “extraordinary” which could possibly be applied to these expenses is a definition found in *Webster's Third New International Dictionary*: “not of the usual order or pattern.” The only thing “not of the usual” about these expenses is the one-time change in their recognition from cash basis to accrual. This accounting change does not render an ordinary, normal and necessary cost of providing service into something extraordinary, for which disallowance is justified.

#### 5. Other Regulatory Bodies

\*42 The majority cites actions taken by other regulatory bodies as justification for the disallowance of Minnegasco's expense. The majority notes a partial disallowance of coal tar clean up costs by the Illinois Commerce Commission and a partial disallowance of the costs of a management incentive plan by the Vermont Public Service Board.

These cited regulatory actions do not involve sets of facts similar to those before the Commission. Neither case addresses disallowances of otherwise inarguably ordinary and prudent expenses because of changes in booking the expenses. In cases in which regulators have addressed SFAS 106 accounting questions, the expenses, including the transition obligation, have been allowed. Wisconsin and California public utility commissions, as well as others, have adopted SFAS 106 accounting, including the recognition of the transition obligation for ratemaking purposes. The Federal Energy Regulatory Commission has endorsed the policy of allowing recovery of the transition obligation. While these decisions certainly do not bind our Commission, they are instructive.

#### IV. Conclusion

Within the framework of utility regulation, regulators have a responsibility to both ratepayers and utility shareholders. This is intrinsic to the dynamic “give and take” of the regulatory model.

Public utility commissions have the duty to ensure that ratepayers are provided high quality service at fair and reasonable rates. Ratepayers must be protected from discriminatory and unfair treatment by regulated monopolies. Goals of universal service must be promoted when possible.

Regulators also have a responsibility to utility shareholders. Shareholders have a right to expect that prudent and reasonable managerial decisions will allow them to achieve a reasonable return on their investment, comparable to returns made on investments and other business undertakings of corresponding risks and uncertainties. Shareholders have a right to regulatory decisions which will enable the utility to maintain its financial integrity and attract new capital on reasonable terms. See, *Bluefield Water Works and Improvement Co. v. P.S.C.*, 262 U.S. 679 (1923) and *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

For the reasons stated in this dissenting opinion, Minnegasco has the right to recover its prudent expenses for post-retirement employee benefits, including the transition obligation inherent in the Commission-sanctioned accounting method. Allowing Minnegasco full recovery of these prudent and reasonable costs of service would fulfill the Commission's responsibilities toward both ratepayers and shareholders.

**AMENDED OFFER OF PARTIAL SETTLEMENT**

The undersigned parties to this proceeding have entered into this Amended Offer of Partial Settlement (“Settlement”) which resolves many of the disputed issues between the parties in the above referenced Dockets. In so doing, no party is admitting or supporting any of the positions agreed upon on any specific issues, other than for purposes of this Settlement.

**BACKGROUND**

\*43 On July 2, 1992, Minnegasco, a Division of Arkla, Inc. (“Minnegasco”) filed a petition seeking a general revenue increase of \$24,823,000 or 5.5 percent. On August 17, 1992, the Minnesota Public Utilities Commission (“Commission”) issued an Order Accepting Filing and Suspending Rates, and a Notice and Order for Hearing referring the case to the Office of Administrative Hearings for contested case proceedings. On August 31, 1992, the Commission issued an Order Setting Interim Rates authorizing Minnegasco to collect \$11,800,000 in interim rates.

The Administrative Law Judge (“ALJ”) who will hear this matter is Richard C. Luis. A prehearing conference was held on August 27, 1992. The ALJ issued a Prehearing Order on September 17, 1992. The ALJ granted the Petitions to Intervene of the Minnesota Department of Public Service (“Department” or “DPS”), the Minnesota Office of Attorney General (“OAG”), Minnesota Energy Consumers (“MEC”), Honeymead Products Company, (“Honeymead”) the Suburban Rate Authority (“SRA”), and Northern Natural Gas Company (“Northern”).

Pursuant to the ALJ's Prehearing Order, Minnegasco's additional direct testimony and exhibits, filed September 14, 1992, concerning the Weather Normalization Adjustment (WNA) and FAS 106 constituted a supplemental filing. No parties objected to the inclusion of the supplemental information in the record.

On October 26, 1992, the Department, OAG, MEC and SRA filed intervenor Direct Testimony. On or about November 20, 1992, the parties filed Rebuttal Testimony.

Public Hearings were conducted on November 10, 1992 in Minneapolis and Bloomington, on November 18, 1992 in Mankato, and on November 19, 1992 in Willmar. Evidentiary hearings are scheduled to begin in St. Paul, Minnesota, on December 8, 1992.

**1. TERMS OF SETTLEMENT**

This section describes the terms of the Settlement, shows how the testimony or Stipulation of Facts (which will be filed Tuesday December 1, 1992 as Exhibit A) support the Settlement and describes why the Settlement should be approved. *The terms described herein reflect modifications to Joint Exhibit 1 made since the time of the evidentiary hearings. The terms described herein replace the agreements in Joint Exhibit 1 and represent the final agreement among the parties.*

**1.1 Overall Description of Stipulation.**

Through this Settlement, the parties intend that the agreed- to issues be brought to a close. To that end, the parties have agreed that Minnegasco's proposal to increase its annual Minnesota jurisdictional retail revenues by \$24,823,000 will be reduced. The final revenue requirement and fund rates cannot be determined until the remaining disputed financial and rate design issues have been resolved.

The parties believe this Settlement results in just and reasonable rates for the items settled and is in the public interest. The parties agree that the Commission's decision on disputed issues will not affect the reasonableness of this Settlement. The parties

further agree that the Commission can approve this Settlement without jeopardizing its ability to determine disputed issues, such that the Commission's final decision in this proceeding can result in just and reasonable rates.

### ***1.2 Evidentiary Basis for Settlement.***

\*44 The parties agree that there is ample evidentiary support for this Settlement, both in prefiled testimony and in the Stipulation of Facts (Exhibit A). The parties offer this Settlement to resolve certain matters and to narrow the scope of contested issues to matters actually in dispute, as encouraged by the Commission and the ALJ. The evidentiary support is described below.

#### ***1.2.1 Financial and Capital Issues.***

The parties present complete financial schedules detailing the financial impact of this Settlement in Exhibit A, Revised Schedules 1-8. The remainder of this section of the Settlement discusses the parties' agreements on individual financial issues.

##### ***a. Rate Base Adjustments***

(1) *Pipeline Storage Inventories.* The Department recommended that Minnegasco update its pipeline storage information from its filing by decreasing rate base by \$310,000. This adjustment reflects the updated contract gas costs and volume levels for the test year filed by the Company in Docket No. G-008/M-92-777 which is still pending before the Commission. Layton Direct pp. 117-18. The parties agree to further update the test year for the actual volumes and cost of gas injected into storage and to recognize volumes associated with a new storage contract. Exhibit A, pp. 1-2 and Schedule 9 (*PROPRIETARY*). The parties agree to increase rate base by \$3,546,000 to reflect this adjustment.

(2) *Non-Cash Working Capital.* The Department and the OAG proposed a decrease to the cash working capital component of rate base to remove depreciation and deferred income taxes from the cash working capital calculation. Layton Direct pp. 15-16 and Nelson Direct pp. 13-15. The parties agree to decrease rate base by \$2,990,000 to reflect the adjustment. Exhibit A, p. 2 and Schedule 10.

(3) *Manufactured Gas Plant Deferred Clean-up Costs ("MGP Clean-up Costs").* The Department and the OAG recommended the MGP clean-up costs be shared 50/50 between ratepayers and Minnegasco shareholders. Layton Direct pp. 19-23 and Nelson Direct, pp. 15-21. Minnegasco does not agree to a 50/50 sharing arrangement. The SRA recommended the establishment of an amortization allowance for clean-up costs for all sites incurred since January 1, 1992. The amortization would take place over a rolling ten year period with no rate base treatment. Towers Direct, pp. 4-11. The parties agree to remove all deferred MGP clean-up costs and related accumulated deferred income taxes from rate base. It is agreed to remove \$1,661,000 of average deferred MGP clean-up costs, Daugherty Direct, Schedule 10, p. 1, and the offsetting related \$672,000 of accumulated deferred taxes, Daugherty Direct, Schedule 4, p. 3, from rate base. Exhibit A, p.3 and Schedule 11. See the Income Statement section for the impact on operating expenses.

(4) *Compressed Natural Gas (CNG) Assets.* The Department and the OAG proposed that all gross assets associated with Minnegasco's investment in its CNG facilities be removed. Chavez Direct, pp. 54-60, Kosowski Direct, pp. 15-16, and Nelson Direct, pp. 26-29. The parties agree to remove net CNG assets of \$700,925 and related offsetting accumulated deferred taxes of \$138,622 from rate base. Exhibit A, p.3 and Schedule 12. See Income Statement for the impact of this adjustment on depreciation expense.

\*45 (5) *Prepaid Taxes on Unbilled Revenues.* The Department recommended removing the prepaid taxes on unbilled revenues from rate base. Layton Direct, pp. 13-15. The OAG offered three adjustments for unbilled revenues and recommended one. The OAG recommended amortizing the unbilled revenues to income over a period of time for ratemaking purposes and retaining Minnegasco's proposed adjustment for prepaid taxes on unbilled revenues. Nelson Direct, pp. 4-13.

<<- The parties agree to reduce Minnegasco's revenue requirement by recognizing unbilled revenues for regulatory purposes over twenty (20) years (see Income Statement section) and to recognize the related — accumulated deferred income taxes on unbilled revenues in rate base. ->>The parties agree to resolve all unbilled revenues issues in this proceeding by decreasing rate base by \$13,260,000 for the prepaid taxes on unbilled revenues. <<- and to increase rate base by \$1,070,389, Exhibit A, p.3 and Replacement Schedule 13., for the accumulated deferred income taxes on the unbilled revenues. ->>

(6) *Conservation Improvement Program (CIP) Tracker Balance.* The parties agree that if approved final rates result in an interim rate refund to customers, the refund will be offset by the CIP tracker balance of \$1,413,278. Hagen Direct, Schedule 19, p. 1. If any interim rate refund is not large enough to completely offset the CIP tracker balance, the parties agree to reduce the tracker balance by the amount of the refund and to amortize the remaining tracker balance over five years, with rate base recognition of the unamortized balance. If approved final rates do not result in any interim rate refund, the parties agree to amortize the CIP tracker balance over five (5) years, with rate base treatment of the unamortized balance, increasing rate base by \$212,000. Exhibit A, p.4 and Schedule 14. See the income statement section of this Settlement for the impact of this agreement on operating expenses.

(7) *Rate Case Expense Unamortized Balance.* The Department recommended that rate case expenses be shared 50/50 between ratepayers and Minnegasco shareholders together with an amortization of those remaining costs over five (5) years. Zamansky Direct, pp. 7-9. Minnegasco does not agree to a 50/50 sharing arrangement. The parties agree to amortize the rate case expenses over five years and to remove the average rate case expense balance of \$604,000, Daugherty Direct, Schedule 10, p. 3, from rate base. Exhibit A, p. 4 and Schedule 15. See Income Statement section for impact of the five (5) year amortization.

(8) *Cash Working Capital.* The Department recommended removing the zero day items from cash working capital, recalculating the change in the late payment revenues based on a 2.2 day adjustment instead of Minnegasco's proposed 4.4 days, and recalculating the lead-lag study based upon the revised level of operating expenses. Layton Direct, pp. 16-17. The parties agree to recalculate Minnegasco's cash working capital with the removal of zero-day items, use a zero 2.2 day impact of the change in the late payment policy for commercial/industrial customers rather than a 4.4 day impact proposed by Minnegasco, and to calculate the revised level of operating expenses as finally determined by the Commission. The parties have recalculated cash working capital based on the operating expenses agreed to in the Settlement in order to determine the revenue required under the Settlement. Exhibit A, p.4 and Replacement Schedule 16.

**\*46** (9) *Headquarters Allocations.* The parties agree to decrease rate base by \$271,563 associated with the joint use of furniture and fixtures, personal computers and office equipment in the Minnegasco headquarters building located in downtown Minneapolis. This rate base adjustment is based upon an allocation factor to unregulated activities of \*\*\* Begin Proprietary \*\*\* See Income Statement, Section 19, Proprietary Schedule 28 for an explanation of and calculation of this allocation factor.

The parties acknowledge that the allocation of Minnegasco's costs between its regulated and non-regulated businesses are at issue in the complaint made by the Minnesota Alliance for Fair Competition (MAC), Docket No. G-008/CI-91-942. The parties agree that this settlement or elements thereof shall not have any precedential effect on the MAC complaint proceedings for any purpose. The parties further agree that no party to this settlement is estopped from contesting any factual or legal issue in the MAC complaint and that no party has waived the right to challenge the appropriateness of any allocation process, method, or practice in the MAC complaint docket.

### ***b. Income Statement***

(1) *Correction of errors.* Minnegasco identified errors in its original filing in Ms. Reimer's rebuttal testimony. Reimer Rebuttal, Schedule 2, p. 10. *An additional correction was found since the close of hearings to remove the cost of merchandise from total appliance sales expense for the purpose of computing an allocation factor applied to accounting costs. This reduces the allocation correction presented in Ms. Reimer's rebuttal testimony. The calculation of this reduction and the revised correction*

of <<- these errors ->> are shown in Exhibit A, replacement Proprietary Schedule 17 and reduces revenue requirements by \$110,917. <<- \$138,375. Exhibit A, p. 5 and ->> <<- Schedule 17. ->> This amount includes the correction of an inflation adjustment error identified by the Department during their audit. The parties agree to reduce revenue requirements by \$110,917 <<- \$138,375 ->> to correct these errors.

(2) *Employee and Corporate Dues.* The Department and OAG recommended that certain employee and corporate dues be disallowed. Zamansky Direct, pp. 5-6 and Nelson Direct, pp. 29-31. The parties agree to remove \$25,601 for certain employee dues and \$6,000 for U.S. Chamber of Commerce dues. Zamansky Direct, pp. 5-6.

(3) *Marketing Expenses.* The Department recommended the marketing expenses related to Minnegasco's desiccant cooling, irrigation water pumping and natural gas vehicle (NGV) programs be disallowed. Kosowski Direct, pg. 13-15. The parties agree to remove \$541,442 of marketing expenses for these programs.

(4) *Advertising Expenses.* The Department recommended removal of certain Minnegasco advertising costs. Specifically, the Department recommended removal of twenty-five (25) percent of Minnegasco's customer information pamphlet, *In-Touch*, 100 percent of advertising account #913, and a portion of advertising account #930. Kosowski Direct, pg. 16-19. The parties agree to reduce revenue requirements by \$297,565 for these costs.

\*47 (5) *Flowers/Tickets/Lobbying Meals/ Veterans Club.* The OAG recommended removal of the costs associated with these items. Nelson, Direct, pg 40. The parties agree to reduce revenue requirements by \$10,718 for the cost of flowers, tickets and lobbying meals. Exhibit A, p.5 and Schedule 18.

(6) *Carbon Monoxide (CO) Leak Checks.* As determined by the Commission in Docket No. G-008/C-91-942, the cost of CO checks should not be borne by the ratepayers and should not be allocated to the utility. *Certain errors were identified with this adjustment. However, the impact of these errors was de minimus. Therefore,* The parties continue to agree to reduce revenue requirements by \$224,217 for the direct cost of CO checks. *See Proprietary Schedule 30.*

(7) *Economic Development.* The Department recommended disallowance of all economic development costs. The Department and the OAG recommended only one-half of the economic development costs be allowed if the cost-benefit of these costs are demonstrated. Kosowski Direct, pp. 19-20 and Nelson Direct, pp. 21-24. The parties agree to disallow one-half of these costs, reducing revenue requirements by \$27,500. Exhibit A, Schedule 19.

(8) *Lobbying Expenses.* The OAG proposed to remove Minnegasco's lobbying expenses. Nelson Direct, pp. 24-25. The parties agree to remove these expenses, reducing revenue requirements by \$136,609.

(9) *Incentive Compensation.* The OAG recommended the disallowance of incentive compensation costs. Morrisette Direct, pp. 17-21. Minnegasco's incentive compensation payments are tied to the achievement of both employees' personal goals and Minnegasco's and Arkla's financial goals. Hagen Direct, p. 71. The parties agree to disallow 60% of management incentive compensation costs, reflecting the companies' financial goals, reducing revenue requirements by \$251,314. Exhibit A, pp. 5-6 and Schedule 20.

(10) *In-Kind Contributions.* The OAG recommended that one-half of Minnegasco's in-kind charitable contributions be excluded. Nelson Direct, pp. 25-26. The parties agree to reduce revenue requirements by \$2,375 to reflect this adjustment.

(11) *MGP Clean-Up Costs.* In its rate case filing, Minnegasco requested total test year expenses associated with MGP clean-up of \$5,060,277. This amount consists of \$2,975,000 in test year expenses for remediation of the former Minneapolis Gas Works plant, legal fees associated with the Park Board lawsuit of \$403,000 and investigation costs of other Minnesota MGP sites of \$575,000. The Company also included deferred expenses of \$2,214,554 for the period beginning in 1991 through June 30, 1992, amortized over two years, resulting in \$1,107,277 of test year expenses. Hagen Direct, Schedule 17. The Commission disallowed

the pre-1992 deferred balance of MGP clean-up costs in Docket No. G-008/M-91-1015. The parties agreed to decrease expenses by the \$482,277 in pre-1992 costs which Minnegasco amortized to operating expense in the filing.

\*48 The DPS and the OAG recommended that the remaining amortized balance and test year expense be shared 50/50 with Minnegasco shareholders. Layton Direct, pp. 19-23 and Nelson Direct, pp. 15-21 (see Rate Base section for the SRA position. Minnegasco does not agree to a 50/50 sharing arrangement. The parties agree to recognize ongoing, annual MGP clean-up costs and legal fees of \$3.1 million. No deferred accounting of MGP clean-up costs will occur after December 31, 1992. Further, as a result of Docket No. G-008/M-91-1015, the Company began deferring MGP costs beginning January 1, 1992. However, the Company received no interim rate recovery for MGP costs. Therefore, the parties agree to amortize the estimated 1992 deferred balance of \$2,500,000 to expenses over five years, with no rate base treatment of the unamortized balance. This results in a total test year expenditure (including amortization) of \$3,600,000, requiring a reduction in revenue requirements of \$1,460,000 from the Company's original filing. Exhibit A, p. 6 and Schedule 21.

Minnegasco will place any insurance recoveries in a deferred debit account without carrying charges, until its next rate filing. Net insurance proceeds will be flowed back to ratepayers.

(12) *CNG Expenses*. The Department and OAG recommended the removal of CNG assets from rate base. See Rate Base section. The removal of the related depreciation expense associated with those assets is a reduction in revenue requirements of \$33,603.

The parties recognize that the Energy Policy Act of 1992 encourages the development of alternative fuel vehicles. For purposes of settlement in this case, other than \$18,458 associated with the Company's own fleet of vehicles which operate on CNG, the parties agree that the revenue requirements associated with the marketing, depreciation, O&M expenses and return on certain investments of Minnegasco's CNG vehicle program will not be reflected in the rates ultimately determined in this case. Lack of recognition of these costs in this case shall be without prejudice to Minnegasco's right to request full rate case treatment of these and similar costs in its next rate case and shall not be deemed of any precedential value in this or any other proceeding. The parties agree to a reduction in revenue requirements of \$52,061 for this issue. Exhibit A, pp. 6-7 and Schedule 22. See CNG Assets and Marketing Expenses for other revenue requirement impacts.

<<- (13)->> *Unbilled revenues*. The parties ->> <<- agree to reduce Minnegasco's revenue requirement by recognizing unbilled revenues for regulatory purposes each year over 20 years. This adjustment reduces revenue requirements by \$481,771. Exhibit A, p. 7 and Schedule 23. ->>

(13) *Allocation of Senior Officer's Pay*. The parties agree to remove \$24,193 in senior officer's pay due to updated 1992 percentages and a change in the allocation factor for certain senior officers to a factor based on the ratio of non-utility operating expenses to company operating expenses, removing cost of goods sold. See Proprietary Replacement Schedule 23 for calculation of this adjustment.

\*49 (14) *Industrial Heating Sales Volumes*. The Department proposed an increase to the forecasted volumes for the industrial heating sales class based upon a higher level of customers in that class than Minnegasco proposed. O'Connell Direct, pp. 7. The parties agree to increase revenues by \$1,087,600, increase cost of gas by \$626,500, increase late payment revenues by \$5,656 and increase bad debt expense by \$8,755 for this adjustment. This adjustment decreases Revenue requirements by \$458,001. Exhibit A, p.7 and Schedule 24. Schedule 24 also provides a monthly breakout of the stipulated sales volumes by class.

(15) *Inflation on Adjusted Expenses*. Certain expenses that were removed for settlement were separately inflation impacted within Minnegasco's filing. The parties agree to reduce revenue requirements by \$42,965 to remove the related inflation for those items. Exhibit A, p. 8 and Schedule 25.

(16) *CIP Tracker Balance*. The Department recommended a five (5) year amortization of the underrecovered CIP tracker balance to the extent, if any, the balance is not offset by a rate refund. See Rate Base section. The parties agree to reduce amortized CIP expenses, and therefore revenue requirements, by \$423,983. Exhibit A, pp. 8-9 and Schedule 26.

(17) *Rate Case Expense*. As identified in the Rate Base section, the parties agree to amortize Minnegasco's rate case expense over five (5) years as recommended by the DPS. This reduces revenue requirements by \$241,431.

(18) *Coopers & Lybrand Audit*. The parties agree to remove \$38,540 with respect to the Coopers & Lybrand audit. Bender Direct, pp. 10-11.

(19) *Headquarters Allocations*. The parties agree to remove \*\*\* Begin Proprietary \*\*\* expenses associated with joint and common headquarters costs which are currently charged to the utility operations. The adjustment reflects an allocation between Minnegasco's regulated and unregulated activities for headquarters rent, property taxes and maintenance, including utilities, as well as depreciation on shared furniture and fixtures, personal computers and office equipment. The expense adjustment is based on an average for each floor of the allocated payroll and other expenses for shared divisions. The weighted average factor of \*\*\* Begin Proprietary\*\*\* Proprietary \*\*\* and the Minnesota jurisdictional factor are applied to total company expenses for these items to derive the adjustment. See Exhibit A, Proprietary Schedule 29, for the calculation of the allocated expense adjustments and the allocation factor.

#### *c. Rate of Return*

(1) Capital Structure. Minnegasco proposed the following capital structure:

- a. debt of 48.34%;
- b. common equity of 51.66%;
- c. total of 100.00%.

The Department agreed with Minnegasco's proposed capital structure. Thompson Direct, p. 31. None of the other parties took issue with the filed capital structure. The parties agreed to use the capital structure proposed by Minnegasco.

(2) Cost of Capital. Minnegasco proposed that the cost of its long-term debt is 4.47%. No party disagreed. Minnegasco proposed a return on equity of 13% using both the constant growth and general forms of the DCF model on a group of sixteen comparable companies. The Department recommended a return on equity of 11.5% based on its application of the DCF model. MEC recommended a return on equity of 9.75% based on its DCF analysis. The parties agree to use the Department's recommended return on equity of 11.5% and the cost of debt-proposed by Minnegasco. Along with the agreed upon capital structure, this results in an overall rate of return of 10.41%. Thompson Direct, p. 31.

#### *d. Weather Normalization Adjustment (WNA)*

\*50 The parties agree to remove the issue of a weather normalization adjustment from this proceeding. The parties further agree that Minnegasco may not file to implement a WNA until its next rate case.

#### *e. Rate Design and Other*

(1) Residential Sales Service. Minnegasco proposed several changes in the prices and services offered to residential customers presently receiving Small Volume Firm Gas Service. Bridge Direct pp. 7-8; Chavez Direct, pp. 9, Morrisette Direct pp 3-4. The parties agree only on the following changes:

- (a) To adopt Minnegasco's proposal to create a new Residential Sales Service customer class.
- (b) To increase revenues 7.3% for the new customer class. However, the parties also agree to reduce this increase proportionately based upon reductions in the final revenue deficiency, in order for Minnegasco to realize only the total revenue increase authorized by the Commission.
- (c) To eliminate the three Ccfs of usage allowance included in the monthly customer charge.

Minnegasco's other proposed changes regarding rate design for residential customers remain contested and the parties will litigate those issues.

(2) Commercial and Industrial Sales Service. Minnegasco proposed several changes in the prices of services offered to commercial and industrial customers presently receiving Small Volume Firm Gas Service. The parties have reached agreement on several of these issues, as follows:

(a) Minnegasco proposed to divide the current Small Volume Firm Gas Service customer class into two groups: a Residential class and a Commercial and Industrial class. The Department recommended that Minnegasco further divide its proposed Commercial and Industrial class into two separate classes: (1) Commercial and Industrial Sales Service for commercial and industrial customers with daily usage less than 200 Mcf; (2) Large Volume Commercial and Industrial Sales Service for commercial and industrial customers with daily usage greater than or equal to 200 Mcf. Chavez Direct, p. 17-19. The parties agree to adopt Minnegasco's proposal, together with the Department's recommendation to further divide the Commercial and Industrial Sales Service customer class.

(b) Minnegasco proposed a 4.0% increase in class revenue for the Commercial and Industrial Sales Service class. The Department proposed a 2.63% increase in class revenue for its Commercial and Industrial class and no increase in class revenue for its Large Volume Commercial and Industrial class. Chavez Direct, pp. 19-20. The parties agree to adopt the Department's proposed revenue responsibility for the two commercial and industrial classes. The parties further agree to reduce the 2.63% increase in class revenue for the Commercial and Industrial class proportionately based upon reductions in the final revenue deficiency, in order for Minnegasco to realize only the total revenue increase authorized by the Commission.

(c) The Department proposed increasing the monthly customer charge for the Commercial and Industrial customer segments as follows: (1) Commercial and Industrial customers with annual usage of less than 150 Mcf would have a \$10 monthly customer charge; (2) Commercial and Industrial customers annual usage equal to or greater than 150 Mcf (with daily usage less than 200 Mcf) would have a \$30 monthly customer charge; (3) Commercial and Industrial customers with *daily* usage equal or greater than 200 Mcf would have a \$100 monthly customer charge. Chavez Direct pp. 20-22. The OAG raised concern over the total revenue responsibility allocated to the smallest Commercial & Industrial customers. Morrisette Rebuttal, pp. 3-4. The parties agree to a \$9 customer charge for Commercial & Industrial customers with annual usage of less than 150 Mcf and the Department's recommended customer charges for all other Commercial & Industrial customers.

\*51 (d) The parties agree to eliminate the three Ccfs of usage allowance from the monthly customer charge, as proposed by Minnegasco.

The parties will litigate the remaining Commercial & Industrial Sales Service issues.

(3) Small Volume Dual Fuel Service. Minnegasco proposed several changes in the prices and service offered to dual fuel customers presently receiving Small Volume Interruptible Service. The parties agreed as follows:

(a) The Department recommended a modification to Minnegasco's proposed name changes. The Department agreed with Minnegasco's change from interruptible services to Dual Fuel Services, however recommended that Minnegasco retain the Small Volume designation to avoid customer confusion with Large Volume Dual Fuel Services. The parties agreed to change the name of these services to Small Volume Dual Fuel Service.

(b) The Department agreed that an increase in class revenues is reasonable, but recommended a 7.9% increase. The parties agree with the Department's recommended 7.9% increase in class revenues. The parties also agree that the 7.9% increase in class revenues will be adjusted further to recognize the proportionate decrease in revenue responsibility necessary to allow Minnegasco to recover only the total revenue increase authorized by the Commission.

(c) The parties agree to adopt the Department's recommendations for monthly customer charges of \$75 for Small Volume Dual Fuel Sales Services and \$175 for Small Volume Dual Fuel Transportation services. Chavez Direct pp. 26-27.

(d) The Department recommended a single unit margin for Small Volume Dual Fuel services. The parties agree to adopt the Department's recommendation for a single unit margin for all Small Volume Dual Fuel services, calculated as described on page 15 of Mr. Chavez's Direct Testimony.

(e) The Department recommended that Minnegasco maintain the ability to negotiate the flexible unit margin up, by the same increment as it has authority to flex the unit margin down. The parties agree to establish Minnegasco's maximum flexible unit margin accordingly. For example, if the standard unit margin is \$0.60, the increment Minnegasco is authorized to flex the unit margin down is \$0.55 (\$0.60 - \$0.05 minimum = \$0.55). Therefore, the maximum flexible unit margin would be \$1.15 (\$0.60 + \$0.55 flexible margin increment).

(f) The parties agree to adopt Minnegasco's proposals for modification of transportation tariffs to incorporate a number of balancing provisions. Chavez Direct, p. 32.

(4) Large Volume Dual Fuel Services. Minnegasco proposed several changes in the prices and services offered to large dual fuel customers presently receiving Large Volume Interruptible Gas Service. The parties agree to the following:

(a) The parties agree to adopt Minnegasco's recommendations for name changes from Large Volume Interruptible to Large Volume Dual Fuel services.

(b) The parties agree that the imputed margin that the Company will receive from its Market Rate Transportation customers is \*\*\* Begin Proprietary \*\*\* A, p. 9 and Proprietary Schedule 27. The difference between the Company's proposed imputed margin of \*\*\* Begin Proprietary \*\*\* Proprietary \*\*\* will decrease the standard unit margin for Large Volume Dual Fuel Sales and Transportation customers.

**\*52** (c) The parties agree to adopt Minnegasco's proposed monthly customer charges of \$200 for sales services and \$300 for transportation services.

(d) The Department recommended that Minnegasco maintain a single unit margin rate, decreased from the present unit rate to offset the revenue increase derived from the increases in the monthly customer charges. The parties agree to adopt the Department's recommendation.

(e) The Department agreed that Minnegasco should maintain its ability to flex its unit margin up by the same increment Minnegasco has authority to flex its unit rate down. The parties agree to adjust Minnegasco's maximum unit rate to the same

increment above the standard unit rate as Minnegasco has authority to reduce its standard unit rate. For example, if Minnegasco has authority to reduce its standard rate by \$.45 (\$.50 standard rate - \$.05 minimum), the maximum rate would equal \$0.95 (\$.50 standard rate + \$.45 flexible increment).

(f) The parties agree to adopt Minnegasco's proposed modifications to the transportation service tariffs to incorporate a number of balancing provisions. Bridge Direct, p. 33.

(5) Developmental Services. Minnegasco proposed six new Developmental Services. The parties agreed to the following items with respect to these proposed services:

(a) Standby Peaking Sales Service. The parties agree to adopt Minnegasco's proposals for this new service. Chavez Direct, pp. 41-42.

(b) Firm Transportation Service. The Department recommended that Minnegasco offer two different rates for firm transportation customers, consistent with the agreed-upon rates established for the Commercial and Industrial Sales Service customer classes. In addition, the Department proposed that \$100 be added to the monthly Sales Service customer charges for the Transportation Service customers. Chavez Direct, p. 39. The parties agree to adopt the Department's recommendations for two separate Firm Transportation services and to adopt the Department's proposed customer charges.

(6) Class Cost of Service Study (CCOSS). The Department and Minnegasco provided different CCOSSs. The Department's CCOSS did not provide significantly different results as compared to Minnegasco's CCOSS. The parties agree to the Department's CCOSS. Ahrens Rebuttal.

## ***2. IMPLEMENTATION.***

The parties intend that this Settlement resolve only those issues expressly addressed in this Settlement.

## ***3. PROPOSED PROCEDURAL SCHEDULE.***

This Settlement contemplates that hearings will begin on December 8, 1992, on all issues not settled by this Settlement. The parties will also make their witnesses available to Commission staff to answer any questions concerning the components to this Settlement. The parties will request the ALJ to separately advise the Commission on the reasonableness of this Settlement, so that the Commission has the opportunity to rule on this Settlement at the earliest possible time.

## ***4. SETTLEMENT AS A COMPROMISE.***

\*53 The parties agree that this Settlement has been entered into as an overall compromise and resolution of the issues presented in this Settlement in order to minimize litigation and controversy. The parties further agree and stipulate that this Settlement does not represent the position, in *total* or on any individual issue, that the parties would have taken had the issues in this proceeding been fully litigated, and this Settlement, whether or not adopted by the Commission, shall not be cited or otherwise used to imply the contrary.

## ***5. ACCEPTANCE OF SETTLEMENT.***

The agreement in this Settlement is expressly conditioned on its acceptance by the Commission in its entirety without modification. Pursuant to [Minn. Stat. § 216B.16, subd. 1\(a\)](#), if the Commission modifies this Settlement, the parties shall have ten (10) days in which to reject this modification. If any party rejects the modification, the parties agree that this Settlement

shall be null and void and shall not constitute any part of the record in this proceeding. In such event, the parties agree that any rebuttal testimony and cross-examination which was exchanged but not filed due to the pendency of this Settlement shall be filed and hearings should go forward promptly upon all matters raised in the testimony of the parties to the proceeding and that all parties be permitted to argue their positions with respect to such issues to the Commission in post-hearing briefs and, if requested or permitted by the Commission, oral argument.

#### **SETTLEMENT BENEFITS.**

This Settlement is in the public interest. It reduces Minnegasco's requested revenue requirements by approximately \$11,000,000 based on an overall rate of return of 10.41%. The parties believe that this Settlement, along with the Commission's resolution of the remaining disputed issues, can result in just and reasonable final rates.

The parties agree that there is ample evidentiary basis for this Settlement in the prefiled testimony and in the attached Stipulation of Facts to resolve all possible contested issues, as encouraged by [Minnesota Statutes § 216B.16, \(1\)\(a\)\(1992\)](#) and the Prehearing Order in this case.

#### **CONCLUSION.**

This Settlement is a negotiated agreement, arrived at between the parties for the purpose of resolving the contested revenue requirement and rate design matters in this proceeding in an equitable fashion, consistent with the public interest. As a result, the parties agree that the resolution of the contested issues made in this Settlement established no precedent for resolution of these issues in the future.

While the parties have different positions on the numerous issues raised in this case, they have worked together to arrive at a just and reasonable resolution of this proceeding on terms that treat all parties fairly, and that protect the public interest. The parties respectfully request that the ALJ recommend that the Commission adopt findings and conclusions in its entirety in accord with this Stipulation.

#### Footnotes

- 1 This transaction is being reviewed separately in Docket No. G-008, 010/PA-93-92, *In the Matter of a Joint Petition From Minnegasco and Midwest Gas for Authority to Exchange Assets, Utility Operations and Business*.
- 2 Minnesota Energy Consumers (MEC), a party to this proceeding but a non-signatory of the Settlement, challenged the reasonableness of the Settlement's revenue apportionment. As discussed in greater detail in the Rate Design section of this Order (page 25, *infra*), the Commission rejected MEC's challenge and found that the revenue apportionment proposed in the Settlement was fair and reasonable.
- 3 *In the Matter of the Accounting and Ratemaking Effects of the Statement of Financial Accounting Standards No. 106*, Docket No. U-999/CI-92-96, ORDER ADOPTING ACCOUNTING STANDARD AND ALLOWING DEFERRED ACCOUNTING (September 22, 1992).
- 4 *In the Matter of the Petition of Minnesota Power & Light Company, d/b/a Minnesota Power, for Authority to Change Its Schedule of Rates for Retail Electric Service in the State of Minnesota*, Docket No. E-015/GR-87-223 FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (March 1, 1988).
- 5 *In the Matter of the Petition of Northern States Power Company for Authority to Change its Schedule of Rates for Gas Utility Service Within the State of Minnesota*, Docket No. G-002/GR-86-160, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (January 27, 1987).
- 6 *Re Coal Tar Cleanup Expenditures*, Docket No. 91-0080 *et al*, Order dated September 30, 1992.

- 7 See, for example, *In the Matter of a Petition from Northern States Power Company for a Variance to the Purchase Gas Charges, Automatic Adjustment Rule for Recovery of Carrying Costs Associated with Gas Storage Service*, Docket No. G-002/M-90-630, ORDER GRANTING VARIANCE FOR ONE YEAR, April 4, 1991 and ORDER EXTENDING VARIANCE AND SETTING FILING REQUIREMENTS, December 10, 1991.
- 8 *In the Matter of the Accounting for and Recovery of Conservation Expenses by Minnegasco, Inc.*, Docket No. G-008/CI-88-460, ORDER MODIFYING AND APPROVING COST RECOVERY PROPOSAL AND REQUIRING FILING, September 1, 1989.
- 9 See, for example, *In the Matter of the Proposal of Northern States Power Company's Gas Utility for a Demand-Side Management Incentive Mechanism*, Docket No. G-002/M-92-516, ORDER APPROVING DEMAND-SIDE MANAGEMENT FINANCIAL INCENTIVE PLAN WITH MODIFICATIONS AND REQUIRING FURTHER FILINGS, January 7, 1993.
- 10 See, *In the Matter of the Proposal of Otter Tail Power Company for a Demand-Side Management Financial Incentive*, Docket No. E-017/M-91-457, ORDER ESTABLISHING DEMAND SIDE MANAGEMENT INCENTIVE PILOT PROJECT AND REQUIRING FURTHER FILINGS, March 12, 1992.
- 11 *In the Matter of the Application of Interstate Power Company for Authority to Increase Its Rates for Electric Service in the State of Minnesota*, Docket No. E-011/GR-91-605, FINDINGS OF FACT, CONCLUSIONS OF LAW, AND ORDER (June 12, 1992).
- 12 Staff notes that NSP-Electric's tariff on Continuity of Service was a part of NSP's tariffs prior to electric and gas utilities becoming rate regulated in Minnesota in 1974. The propriety of this kind of language has not come before the Commission for deliberation prior to it becoming an issue in this docket.
- 13 *In the Matter of a Request by Northern Minnesota Utilities for Approval of a New Town Rate*, Docket No. G-007/M-92-212, ORDER APPROVING TARIFF WITH MODIFICATIONS AND REQUIRING FURTHER FILING (May 6, 1992).
- 14 *In the Matter of the Application of Northern States Power Company for Authority to Increase its Rates for Electric Service in the State of Minnesota*, Docket No. E-002/GR-91-1, FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER (November 27, 1991).