

Morgan, Lewis & Bockius LLP
1701 Market Street
Philadelphia, PA 19103-2921
Tel: 215.963.5000
Fax: 215.963.5001
www.morganlewis.com

Morgan Lewis
C O U N S E L O R S A T L A W

Anthony C. DeCusatis
Of Counsel
215.963.5034
adecusatis@morganlewis.com

May 31, 2012

VIA FEDERAL EXPRESS

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
P.O. Box 3265
Harrisburg, PA 17105-3265

RECEIVED

MAY 31 2012

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Re: Implementation of Act 11 of 2012
Docket No. M-2012-2293611

Dear Secretary Chiavetta:

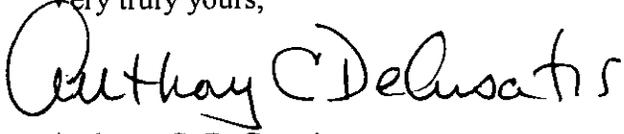
Pursuant to the Pennsylvania Public Utility Commission's ("Commission") Tentative Implementation Order entered May 11, 2012, enclosed are an unbound original and three (3) copies the **Comments of Pennsylvania-American Water Company** ("Comments").

Pursuant to 52 Pa. Code § 1.11(a)(2), the enclosed Comments are deemed filed with the Commission on May 31, 2012, which is the date they were deposited with Federal Express, as shown on the Federal Express delivery receipt attached to envelope containing the documents. We are also enclosing an additional copy of the Comments, which we request that you date-stamp as of May 31, 2012, and return to us in the stamped, pre-addressed envelope we are providing for that purpose.

Rosemary Chiavetta, Secretary
May 31, 2012
Page 2

As instructed in the Tentative Order and indicated below, we are sending electronic (MS Word format) and hard copies of the enclosed Comments to the Commission's Act 11 Resource Account at ra-Act11@pa.gov, the Law Bureau and the Bureau of Technical Services. In addition we are sending courtesy copies to the Commission's Bureau of Investigation and Enforcement, the Pennsylvania Office of Consumer Advocate and the Pennsylvania Office of Small Business Advocate.

Very truly yours,



Anthony C. DeCusatis

ACD/tp

Enclosures

cc: Johnnie E. Simms, Director
Bureau of Investigation and Enforcement (w/encl.)
Irwin A. Popowsky, Consumer Advocate (w/encl.)
Steven Gray, Acting Small Business Advocate (w/encl.)
David Screven, Law Bureau (w/encl.)
Louise Fink Smith, Law Bureau (w/encl.)
Erin Laudenslager, Bureau of Technical Services (w/encl.)

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**IMPLEMENTATION OF
ACT 11 OF 2012**

:
:

**DOCKET NO.
M-2012-2293611**

RECEIVED

MAY 31 2012

**COMMENTS OF PENNSYLVANIA-AMERICAN WATER COMPANY
TO THE COMMISSION'S
MAY 10, 2012 TENTATIVE IMPLEMENTATION ORDER**

**PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU**

I. INTRODUCTION

Pennsylvania-American Water Company ("PAWC" or the "Company") hereby responds to the Pennsylvania Public Utility Commission's ("PUC" or the "Commission") May 10, 2012 Tentative Implementation Order at Docket No. M-2012-2293611 ("Tentative Order"), which solicited comments from interested parties on proposed procedures, guidelines and a model tariff designed to implement certain provisions of Act 11 of 2012 ("Act 11").

Act 11, which was signed into law on February 14, 2012, amended Chapters 3 and 13 of the Public Utility Code (66 Pa.C.S. §§ 101 *et seq.*) in three principal respects: (1) it authorized utilities to use a "fully projected future test year" to determine their revenue requirement for ratemaking purposes (66 Pa.C.S. § 315(e)) and made a concomitant revision to Section 1315 of the Public Utility Code (66 Pa.C.S. § 1315); (2) it authorized utilities that provide water and wastewater service "to combine water and wastewater revenue requirements" and authorized the Commission to "allocate a portion of the wastewater revenue requirement to the combined water and wastewater customer base if in the public interest" (66 Pa.C.S. § 13011(c) and (e)); and (3) it authorized wastewater utilities, electric distribution companies and natural gas distribution companies to implement a distribution system improvement charge ("DSIC").

The May 10, 2012 Tentative Order touches upon the portions of Act 11 that authorize a fully projected future test year (pp. 4-5) and the combination of water and wastewater revenue requirements for ratemaking purposes (pp. 5-6) before addressing at length the implementation of a DSIC by utilities that were not authorized to do so prior to the enactment of Act 11. As a consequence, all but one of PAWC's comments deal with the DSIC implementation provisions of the Tentative Order.¹

In the Company's view, the use of a fully projected future test year is a vitally important provision for all utilities and, especially, for water companies. For that reason and because of the specific legislative directive that the Commission "adopt rules and regulations" for the use of a fully projected future test year (*see* Section 315(e)), PAWC urges the Commission to promptly initiate a separate proceeding for that purpose and solicit the comments of interested parties at that time.

II. COMMENTS

PAWC's comments are arranged in the order in which the subjects that they address appear in the Tentative Order.

A. Chapter 13 – Valuation Of And Return On The Property Of A Public Utility

At pages 5-6, the Tentative Order identifies Act 11's amendments to Section 1311 that *permit water and wastewater revenue requirement to be determined on a combined basis for ratemaking purposes* and discusses the benefits expected to result from those statutory changes. The Tentative Order also provides a summary of the operative amendments, which concludes with the following sentence:

However, as set forth in newly incorporated Section 1311(e), the scope of this exemption applies *only* to those utilities that provide water and

¹ The Tentative Order (p. 5) misstated the operative provisions of Section 1311(c) and (e), which, therefore, requires a *comment* by PAWC.

wastewater service as individually separate companies and are wholly owned by a common parent company.

Id. at 5 (emphasis added).

The foregoing statement is not correct. Section 1311(c) authorizes the determination of a combined water and wastewater revenue requirement for “[a] utility that provides water and wastewater service . . .” In other words, a single company that provides both water and wastewater service is clearly comprehended by Section 1311(c). Section 1311(e), in turn, **expands** the scope of Section 1311(c) by providing as follows:

As used in this section, the term “a utility that provides both water and wastewater service” shall *include* separate companies that individually provide water and wastewater service so long as the companies are wholly owned by a common parent company. (Emphasis added.)

As evidenced by its plain language, Section 1311(e) does not restrict Section 1311(c) to “only” separate subsidiaries of a common parent that each provide either water or wastewater service, as the Tentative Order suggests. Rather, Section 1311(e) permits such separate companies to be treated, for purposes of Section 1311(c), as if they were a single company furnishing water and wastewater service. Accordingly, the Tentative Order should be amended, in relevant part, to state as follows:

As set forth in newly incorporated Section 1311(e), the scope of this exemption also applies to those utilities that provide water and wastewater service as individually separate companies and are wholly owned by a common parent company.

- B. Section 1352 – Long-Term Infrastructure Improvement Plan**
- Section 1356 – Asset Optimization Plan**
- Section 1358(a)(2) – Customer Protections/Limitations**
- Section 1360 – Applicability**

Section 1358(a)(2) of the Public Utility Code provides in relevant part, as follows:

A distribution system improvement charge granted to a water utility under former section 1307(g) (relating to sliding scale of rates; adjustments) or this subchapter may not exceed 7.5% of the amount billed to customers. *All proceedings, orders and other actions of the commission related to a distribution system improvement charge granted to a water utility and all practices and procedures of a water utility operating under a distribution system improvement charge prior to the effective date of this paragraph shall remain in effect unless specifically amended or revoked by the commission.*

66 Pa.C.S. § 1358(a)(2) (emphasis added).

By reason of Section 1358(a)(2), water utilities with approved DSICs may continue to use their existing DSIC without the need either to submit a long-term infrastructure improvement plan under Section 1352 or to petition the Commission, under Section 1353, for any further authorization. Additionally, Section 1360 grants the Commission discretion to decide when it may require a water utility to submit a long-term infrastructure improvement plan. Pursuant to these provisions, the Tentative Order states, at page 20:

At this time, the Commission does not anticipate establishment of a due date for water utilities with previously approved DSICs to file long-term infrastructure improvement plans. The Commission is aware of the substantial progress made in the water industry over the past 15 years in accelerating the rate of main replacements and other infrastructure improvements. The Commission, therefore, will revisit this issue after the initial DSICs are addressed in early 2013.

The Commission should expand on the foregoing discussion in order to make it clear that water utilities with approved DSICs will not be required to file long-term infrastructure improvement plans until directed to do so by the Commission; that such directive will not be issued before 2013; and that water utilities with approved DSICs will be afforded the opportunity to provide comments on the terms and specifications for any long-term infrastructure improvement plan requirement before it is imposed.

Section 1356 requires a utility with an approved DSIC to file an annual asset optimization plan (“AAO plan”) that includes the following:

(1) A description that specifies all eligible property repaired, improved and replaced in the immediately preceding 12-month period *pursuant to the utility's long-term infrastructure improvement plan* and prior year's asset optimization plan.

(2) A detailed description of all the facilities to be improved in the upcoming 12-month period.

66 Pa.C.S. § 1356(a)(1) and (2) (emphasis added).

Section 1356 is discussed at page 14 of the Tentative Order. As part of that discussion, the Commission should make clear that water utilities with approved DSICs that are subject to the terms of Section 1358(a)(2) will not be required to file AAO plans until the Commission issues appropriate guidance for water utility long-term infrastructure improvement plans and such water utilities submit, and the Commission approves, those plans. Moreover, until the Commission issues guidance on long-term infrastructure improvement plans for water utilities in 2013 (*see* Tentative Order, p. 20), water utilities would not be able to comply with the provision of Section 1356(a)(1) requiring an AAO plan to describe DSIC-eligible property “repaired, improved and replaced in the immediately preceding 12-month period pursuant to the utility’s long-term infrastructure improvement plan.” In short, once the Commission has determined – as it has – that water utilities with approved DSICs may continue to employ the DSIC and will not be required to file long-term infrastructure improvement plans until 2013, it necessarily follows that such water utilities should also not be required to file AAO plans until their long-term infrastructure improvement plans have been submitted and approved.

C. Section 1354 – Customer Notice

At page 13 of the Tentative Order, the Commission explains that Section 1354 requires utilities to provide notice of the DSIC’s effective date. The Commission also introduces its proposed “model tariff” and states as follows concerning the implementation of the DSIC:

The model tariff in **Appendix A** reflects that a DSIC tariff must specify an effective date, as approved by the Commission. The DSIC then becomes effective and applicable to rates *for service rendered on and after the effective date*.

Id. (emphasis added).

The Commission's suggestion that the DSIC would "become effective and applicable to rates for service rendered on and after the effective date" is inconsistent with the manner in which the Commission has expressly directed water utilities to implement the DSIC since its inception over fifteen years ago, which is on a "bills rendered" basis. It is also inconsistent with the Model Tariff which, like the Sample Tariff promulgated by the Commission when it approved the first DSIC provisions in 1996, specifies the "bills rendered" application of the DSIC. *See* Model Tariff, Section 2.C. Application of DSIC: "The DSIC will be expressed as a percentage carried to two decimal places and will be *applied to the total amount billed* to each customer for . . . service under the Utility's otherwise applicable rates and charges . . ."

(emphasis added).

The Commission authorized PAWC to implement a DSIC by its Order entered August 26, 1996 at Docket No. P-00961031 (26 *Pa.B.* 4485) ("PAWC's DSIC Order"). As part of PAWC's DSIC Order, the Commission approved "Sample Tariff Language" which set forth the terms of the DSIC. The PUC-approved Sample Tariff Language provided as follows with respect to the effective date(s) of DSIC charges and the manner in which such charges are to be applied:

Effective Date: The DSIC will become *effective for bills rendered* on and after January 1, 1997.

II. *Computation of the DSIC*

Calculation: The initial charge, *effective January 1, 1997*, shall be calculated to recover the fixed costs of eligible plant additions that have not previously been reflected in the Company's rate base and will have

been placed in service between September 1, 1996, and November 30, 1996. Thereafter, the DSIC will be updated on a quarterly basis to reflect eligible plant additions placed in service during the three-month periods ending one month prior to the *effective date* of each DSIC update. Thus, changes in the DSIC rate will occur as follows:

<u>Effective Date of Change</u>	<u>Date to which DSIC-Eligible Plant Additions Reflected</u>
April 1	February 28
July 1	May 31
October 1	August 31
January 1	November 30

Id. (emphasis added).

The Commission-approved Sample Tariff Language also provided as follows concerning the application of the DSIC to customers' bills:

DSIC Surcharge Amount: the charge will be expressed as a percentage carried to two decimal places and will be *applied to the total amount billed to each customer* under the Company's otherwise applicable rates and charges, excluding amounts billed for public fire protection service and the State Tax Adjustment Surcharge (STAS). (Emphasis added.)

Id. (emphasis added).

The Rider that PAWC filed to implement the DSIC, which the Commission approved, contains the language set forth in PAWC's DSIC Order. The Company's tariff, which is on file with the Commission, is a public document and, therefore, is available for review by the Commission and other parties.

On March 5, 1999, the Commission authorized the release of the Report issued by its Bureau of Audits with respect to the audit of PAWC's DSIC for the year ended December 31, 1997. The Report was filed at PUC Docket No. D-97S023 and is a public document under 52 Pa. Code § 5.406. In that Report, the Bureau of Audits stated (p. 9), as follows:

The Commission approved DSIC was on a "bills rendered" basis. Subsequent testing verified that the DSIC was in fact applied as properly approved and that the wording on all of the quarterly filings was incorrect.

RECOMMENDATION:

We recommend that the Company's future quarterly filings have the proper wording reflecting DSIC application on a bills rendered basis.

The Company agrees with this recommendation.

The Company implemented the Bureau of Audit's recommendation by filing Supplement No. 72 to Tariff Water-PA P.U.C. No. 4, Thirteenth Revised Page 12B (Effective July 1, 1999), which stated as follows:

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE

EXCEPT PUBLIC FIRE PROTECTION

In addition to the net charges provided for under this Tariff, a charge of 2.40% will apply *to all bills rendered* for all rate zones.

The above charge will be recomputed quarterly, using the elements prescribed by the Commission in its Order dated August 26, 1996.

Id. (emphasis added).

In its Report dated December 7, 2001, at Docket No. D-99DSC029 on the operation of PAWC's DSIC for the years 1998 and 1999, the Bureau of Audits found and determined that PAWC had properly implemented the recommendation in Finding No. 2 of its March 5, 1999 Audit Report: "The Company agreed with this recommendation and changed the wording to reflect DSIC application on a bills rendered basis, starting with its quarterly filing effective July 1, 1999."

In response to a recommendation in the Bureau of Audits' December 7, 2001 Report (p. 16), PAWC made a further refinement in the language of its quarterly DSIC filings, which was implemented by filing Supplement No. 138 to Tariff Water-PA P.U.C. No. 4, Thirtieth Revised Page 12B (Effective April 1, 2003). The language in the April 1, 2003 filing read as follows:

DISTRIBUTION SYSTEM IMPROVEMENT CHARGE

EXCEPT PUBLIC FIRE PROTECTION

**DISTRIBUTION SYSTEM IMPROVEMENT CHARGE
APPLICABLE TO PAWC EXCLUSIVE OF THE READING
OPERATIONS**

In addition to the net charges provided for in this Tariff, a charge of 1.17% will apply to all bills rendered with an ending read date equal to or greater than the effective date of the tariff supplement for all rate zones.

**DISTRIBUTION SYSTEM IMPROVEMENT CHARGE
APPLICABLE TO THE READING OPERATIONS**

In addition to the net charges provided for in this Tariff, a charge of 3.97% will apply to all bills rendered with an ending read date equal to or greater than the effective date of the tariff supplement for all rate zones.

The above charge will be recomputed quarterly, using the elements prescribed by the Commission in its Order dated August 26, 1996.

In its Report on the operation of PAWC's DSIC, which was issued on September 18, 2003, at Docket No. D-01DSC009, the Bureau of Audits found that PAWC had properly implemented its earlier recommendation and, in so doing, reaffirmed that the DSIC, as approved by the Commission, should be applied on a bills rendered basis:

RECOMMENDATION:

We recommend that PA-American revise its tariff to change the wording "bills rendered" to wording which describes how the company is actually billing its DSIC surcharge.

DISPOSITION:

The Company agreed with this recommendation and revised its tariff to read "bills rendered with an ending meter read date equal to or greater than the effective date of the tariff supplement". This tariff revision was effective April 1, 2003.

The revised language set forth in the tariff supplement filed on April 1, 2003, which is quoted above, has been included in each of the Company's quarterly DSIC filings from and after

April 1, 2003. (The separate provision for the Reading operations was eliminated when that district was incorporated into PAWC's Rate Zone 1.)

PAWC has filed with the PUC, and has served upon the Office of Trial Staff (now, the Bureau of Investigation and Enforcement), the Bureau of Audits, the Office of Consumer Advocate and the Office of Small Business Advocate its annual reconciliations of DSIC-eligible costs and billed revenues for each reconciliation year since the DSIC was initiated. All of PAWC's DSIC reconciliation statements are on file at the Commission and, pursuant to 52 Pa. Code § 5.406, are public documents. All of PAWC's DSIC reconciliation statements through the year ended December 31, 2010 were approved by the Commission following a public hearing. Additionally, PAWC filed a reconciliation statement for the reconciliation period ended December 31, 2011, which was docketed at M-2012-2286042. A Recommended Decision accepting and approving that reconciliation statement was issued on May 3, 2012, but a final order has not yet been entered. In none of those proceedings has PAWC's application of the DSIC on a bills rendered basis been challenged or questioned.

The Commission might decide that a service-rendered application of the DSIC should be adopted for non-water utilities. However, given the Commission's specific direction to PAWC and other water utilities to apply changes in their DSICs on a bills rendered basis, Section 1358(a)(2) appears to require continued use of the bills rendered method by water utilities as one of the "practices and procedures" that, having been approved by the Commission and used since the inception of the DSIC, should continue in effect.

D. Section 1357 (Computation Of Charge)

1. Equity Return Rate

The DSIC is a charge designed to recover "the reasonable and prudent costs incurred to repair, improve or replace eligible property that is part of the utility's distribution system." 66

Pa.C.S. § 1351. Section 1357 recognizes that such costs include a pre-tax return. That section also provides that, if less than two years have elapsed since the entry of a final order in the utility's "most recent fully litigated base rate proceeding," the equity component of the DSIC charge shall be the equity return rate approved in that case.

At page 15, the Tentative Order offers an interpretation of "fully litigated base rate proceeding" as a proceeding in which "all revenue requirement issues were addressed and adjudicated by the Commission in a final rate order." On that basis, the Commission surmised that "a full or partial settlement of a base rate case would not qualify," but invited comments on whether a stipulated cost of equity from a settled rate case could nonetheless be used for DSIC purposes (Tentative Order, p. 15, fn. 5).

The phrase "fully litigated base rate proceeding" need not be construed as narrowly as implied by the Tentative Order. In fact, the same phrase appeared in the "Pre-tax return" section of the Sample Tariff Language that the PUC approved in PAWC's DSIC Order and its Order approving the DSIC for Aqua Pennsylvania, Inc. (then, Philadelphia Suburban Water Company) at Docket No. P-00961036 (August 26, 1996). Subsequently, the Commission approved base rate settlements for both companies that set forth the equity return rate to be used for purposes of calculating the DSIC thereafter. Thus, in *Pa. P.U.C. v. Pennsylvania-American Water Co.*, Docket No. R-00994638, the Commission-approved Joint Petition for Settlement of Rate Investigation provided (§ 9(f)):

For the period that the settlement rates are in effect, a 10.2% rate of return on common equity will be used for DSIC purposes in lieu of the equity return rate(s) calculated by the Commission's Quarterly Earnings Reports.

Similarly, in *Pa. P.U.C. v. Aqua Pennsylvania, Inc.*, Docket No R-00051030 (June 22, 2006) (Ordering Paragraph 9 at page 8), the Commission's final Order stated:

That for the period the Settlement Rates are in effect, a 10.6% rate of return on common equity shall be used by Aqua Pennsylvania, Inc. for Distribution System Improvement Charge (“DSIC”) purposes in lieu of the equity return rate(s) calculated in the Commission’s Quarterly Earnings Reports.

The legislature used the phrase “fully litigated base rate proceeding” with knowledge of the Commission’s prior interpretation of that phrase as including a DSIC equity return rate stipulated in a base rate settlement. Applicable rules of statutory construction provide that “administrative interpretations, not disturbed by the Legislature, are appropriate guides to legislative intent.” *Twp of Derry v. Pa. Dept. of Labor and Industry*, 12 A.3d 489, 495 (Pa. Cmwlth. 2011) (quoting *Hosp. Ass’n of Pa. v. Macleod*, 487 Pa. 516, 523 n. 10, 410 A.2d 731, 734, n. 10 (1980)). Accordingly, it would not be correct nor would it be consistent with legislative intent to interpret the phrase “fully litigated base rate proceeding” used in Section 1357 to preclude parties to a base rate proceeding from stipulating to the use of a specific equity return rate in future DSIC filings. Moreover, the Commission’s practices and procedures allow non-stipulating parties to contest the entire settlement or any part thereof, including the stipulated DSIC equity return rate. In addition, the entire settlement is subject to the Commission’s review and approval. As such, a settlement is subject to full litigation.

Finally, because the Commission has previously approved DSIC equity return rates that were stipulated as part of a base rate settlements for water utilities, such stipulations constitute one of the “practices and procedures” that have effectively been “grandfathered” for water companies under Section 1358(a)(2).

2. Accumulated Deferred Income Taxes

At page 16, the Tentative Order explains that its proposed model tariff retains the factors that have been used by water companies to calculate the DSIC since its adoption for those companies in 1996 and that it will not introduce additional revenue requirement components,

such as accumulated deferred income taxes, which the Commission considers to be “unnecessary complexities.” In this regard, PAWC would point out that, as to water utilities, the factors used to calculate the DSIC are also part of the prior “proceedings, orders and other actions” that remain in effect pursuant to Section 1358(a)(2).

3. Section 1358(d)(1) (Application Of The DSIC “To All Customer Classes”)

At page 18, the Tentative Order mentions informal comments it received to the effect that it would not be appropriate to apply the DSIC to certain natural gas customers that are served on non-standard rates “designed to retain load.” The Commission stated: “In our view, the statutory language does not appear to permit a utility to have variances in its DSIC rates based on customer classes, whether the difference is based on the calculation of the DSIC percentage or on the underlying DSIC-eligible property.” It appears that the Commission has overlooked the “practices and procedures” that it previously approved for water utilities as they pertain to this issue, which support excluding from the DSIC customers with competitive alternatives to service from PAWC that are served on rates designed to retain existing load or acquire new load.

Riders DIS (Demand Industrial Service), DRS (Demand Resale Service) and EGS (Electric Generation Service) were added to the Company’s tariff pursuant to Commission approval granted in *Pa. P.U.C. v. Pennsylvania-American Water Co.*, 85 Pa. P.U.C. 12 (1995) and *Pa. P.U.C. v. Pennsylvania-American Water Co.*, 172 P.U.R. 4th 160 (1996). By their terms, these Riders may be used by the Company to sell water to purchasers that enter into a Service Agreement for a minimum period specified in the Company’s tariff; agree to maintain a favorable load factor; and have a “viable competitive alternative to service from the Company.”

Under the Riders, PAWC is permitted to establish a rate between the “Maximum” and “Minimum” rates specified in the Riders. The Maximum Rate is the rate(s) that would apply if a customer did not qualify for a Rider. The Minimum Rate must be “sufficient to recover: (1) the

Production Cost of Water [as defined in the rider]; (2) the fixed costs (depreciation and pre-tax return) associated with all new facilities added to serve the customer; and (3) some portion of the fixed costs of the Company's other facilities.” Additionally, the Minimum Rate is “subject to an Escalation Clause, during the original and any renewal terms of the Service Agreement, based upon changes in published price indices and/or changes in the Company's cost of service” (PAWC Tariff Water-PA P.U.C. No. 4, Second Revised Pages 9D, 9E and 9F).

In approving Riders DIS, DRS and EGS, the Commission found and determined that: (1) the Minimum Rate, as defined in the Riders, will always be high enough to recover the direct costs of serving a Rider customer **plus** a portion of the fixed costs (*i.e.*, depreciation, a return – or profit – on the Company’s investment, and state and federal income taxes) associated with **all** of PAWC’s facilities used to furnish water service to all of its customers; and (2) the load to be served under the Riders represents sales that the Company would not make absent such Riders. *Id.* Consequently, the Commission concluded that PAWC’s existing customers will always be better off (*i.e.*, pay a smaller share of PAWC’s total fixed costs) as a result of the operation of the Riders. *Id.* Accordingly, the Commission held that the Riders produce rates that are “just and reasonable.”

[S]pecifying the “floor” and “ceiling” rates in the riders establishes a range of ‘just and reasonable’ rates for the negotiated rates under the riders . . . In *Pennsylvania Retailers’ Association v. Pa. P.U.C.*, 64 Pa. Commonwealth Ct. 491, 440 A.2d 1267 (1982) (*Pennsylvania Retailers*), the Commonwealth Court held that the Commission complied fully with the [Public Utility] Code in permitting flexible pricing of utility services subject to competitive forces within specified “floor” and “ceiling” levels:

Flexible pricing is an approved rate-making scheme utilized by Bell whereby Bell submits to the Commission, along with the necessary supporting data, floor and ceiling rates for services deemed to be competitive. Both the floor and ceiling rates must generate sufficient revenue to cover the direct costs of the service and contribute to the costs of

Bell's exchange service. The objective of flexible pricing is to allow Bell maximized profits by charging a rate *in a range of rates approved previously*.

Pennsylvania Retailers at 495, 440 A.2d at 1269 (emphasis added). See also *U.S. Steel Corp. v. Pa. P.U.C.*, 37 Pa. Commonwealth Ct. 173, 187, 390 A.2d 865, 872 (1978) (PUC has a flexible limit of judgment in exercising its administrative discretion to approve a utility's rate structure and rate design) and *The Peoples Natural Gas Co. v. Pa. P.U.C.*, 47 Pa. Commonwealth Ct. 512, 538, 409 A.2d 446, 458 (1979) (PUC may lawfully establish just and reasonable rates within a "range of reasonableness").

Pa. P.U.C. v. Pennsylvania-American Water Co., 172 P.U.R. 4th at 162.

Riders DIS, DRS and EGS were approved in June 1996, i.e., only two months before the Commission approved the DSIC for PAWC. Thereafter, the Commission reviewed and approved a number of contracts entered into by PAWC under Riders DIS and DRS that set forth a specified rate within the parameters established by those Riders and without the application of the DSIC. (However, as previously indicated, under the terms of the Riders, the rates established under those Riders are, in their entirety, subject to annual escalation.) Consequently, the Commission has previously interpreted and applied both the DSIC and the Companies' Riders such that the DSIC does not apply to the "all-in" rate established under the Riders. The Commission's prior interpretation and application of the DSIC constitutes another one of the "practices and procedures" that, for water utilities, is properly "grandfathered" under Section 1358(a)(2).

E. Section 1359 – Projects

At pages 19-20, the Tentative Order addresses Section 1359 and, in particular, provides that "the Commission expects that each quarterly DSIC filing include a verification, (*see* 52 Pa. Code § 1.36), by the utility that qualified employees or contractors were used, and that work performed by independent contractors were (*sic.*) inspected by utility employees." A utility should be permitted to meet the verification requirement for the provision "inspected by utility

employees” where utility employees are actively engaged in the direct supervision of project inspections.

F. Model Tariff

1. Section 1.A.

The second paragraph of Section 1.A. of the Model Tariff inserts an additional eligibility criterion for water and wastewater property, as follows: “Utility projects receiving PENNVEST funding *or* using PENNVEST surcharges are not DSIC-eligible property” (emphasis added). This sentence should be changed to state: “Utility projects receiving PENNVEST funding *and* using PENNVEST surcharges are not DSIC-eligible property” (emphasis added).

Receipt of PENNVEST funding **alone** should not disqualify a project from DSIC-eligibility.² In fact, doing so is inappropriate because it causes a mismatch between the utility’s cost of debt used to establish the pre-tax return rate used in the DSIC calculation and the original cost of the eligible property to which that return rate is applied. Specifically, because the generally low interest rate of PENNVEST debt would be included in the utility’s weighted average cost of debt, the pre-tax return rate applied to all DSIC-eligible property would, therefore, be lower than if PENNVEST funding had not been obtained. Yet, the project that created the opportunity to obtain low-interest rate PENNVEST debt would not be included in the original cost of property to which the correspondingly lower DSIC return rate is applied. That mismatch causes an obvious unfairness, which should be eliminated by substituting “and” for “or” in the relevant sentence, quoted above, in Section 1.A. of the Model Tariff. Of course, where a project is funded by PENNVEST **and** the cost of PENNVEST financing is already being

² Large water utilities, like PAWC, are generally not required by PENNVEST to implement a PENNVEST surcharge in order to obtain PENNVEST financing. In addition, absent a PENNVEST requirement, such water utilities generally do not employ a PENNVEST surcharge.

recovered under a separate PENNVEST surcharge, it is appropriate to exclude the project from DSIC eligibility.

2. Section 2.D.

Section 2.D. of the Model Tariff sets forth the “Formula” for calculating the DSIC. The term “PQR” (projected quarterly revenues) is defined therein as follows:

PQR = Projected quarterly revenues for distribution service (including all applicable clauses and riders) from existing customers plus revenue from any customers which will be acquired by the beginning of the applicable service period.

As the Commission is aware, the major water utilities in Pennsylvania have been encouraged by the Commission and the Department of Environmental Protection to acquire smaller water systems in order to address the service and water quality problems presented by such small and frequently non-viable water suppliers. Generally, when such acquisitions occur, the acquiring company agrees to maintain the rates of the acquired entity until the conclusion of the acquiring company’s next base rate case. Under those circumstances, it would not be appropriate to include revenue from “customers which will be acquired by the beginning of the applicable service period” in the calculation of the PQR. Additionally, the Commission should expressly affirm that, when an acquisition occurs and the terms of the Commission-approved acquisition provide that the acquired entity’s existing rates will be maintained, the acquired customers will not be required to pay the DSIC until the acquiring company has completed a base rate case in which the revenue, expenses and rate base of the acquisition are reflected in base rates and all other conditions imposed by the terms of the Commission-approved acquisition have been satisfied to permit the rates of the acquired customers to be changed.

III. CONCLUSION

PAWC would like to thank the Commission for affording it this opportunity to comment on the important issues identified in the Tentative Order and asks that the Commission carefully consider its comments. PAWC looks forward to continuing to work collaboratively with the Commission and other parties to develop appropriate guidelines for implementing all aspects of Act 11.

Respectfully submitted,



Susan Simms Marsh
Atty. I.D. No. 44687
Seth A. Mendelsohn
Atty. I.D. No. 77063
Pennsylvania-American Water Company
800 Hershey Park Drive
Hershey, PA 17033
Phone: 717.531.3362
Susan.Marsh@amwater.com
Seth.Mendelsohn@amwater.com

Anthony C. DeCusatis, Esquire
Atty. I.D. No. 25700
Thomas P. Gadsden, Esquire
Atty. I.D. No. 28478
Morgan, Lewis & Bockius LLP
1701 Market Street
Philadelphia, PA 19103-2921
Phone: 215.963.5034
Fax: 215.963.5001
ADeCusatis@morganlewis.com
TGadsden@morganlewis.com

Dated: May 31, 2012

Counsel for Pennsylvania-American Water Company

