

COMMONWEALTH OF PENNSYLVANIA



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December 14, 2015

Rosemary Chiavetta, Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
Harrisburg, PA 17120

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

Dear Secretary Chiavetta:

Attached for electronic filing are the Comments of the Office of Consumer Advocate in the above-referenced proceeding.

Copies have been served per the attached Certificate of Service.

Respectfully submitted,

A handwritten signature in cursive script that reads "Erin L. Gannon".

Erin L. Gannon
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Attachment

cc: Office of Administrative Law Judge
Office of Special Assistants
Certificate of Service

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CERTIFICATE OF SERVICE

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

I hereby certify that I have this day served a true copy of the foregoing document, Comments of the Office of Consumer Advocate, upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant), in the manner and upon the persons listed below:

Dated this 14th day of December, 2015.

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Implementation of Act 11 of 2012

Docket No. M-2012-2293611

COMMENTS OF THE
OFFICE OF CONSUMER ADVOCATE

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Dated: December 14, 2015
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I. INTRODUCTION

On November 5, 2015, the Pennsylvania Public Utility Commission (Commission or PUC) issued a Supplemental Tentative Order in the above-captioned proceeding. 45 Pa. B. 6772. The Order invites interested parties to provide the Commission with comments on the following issue areas regarding the implementation, operation and computation of the Distribution System Improvement Charge (DSIC):

- requiring quarterly financial reports for all utilities that use the DSIC mechanism;
- filing and computation issues for when the DSIC is reset to zero;
- treatment of over/under collections, or E-factor, after the DSIC is reset to zero;
- computation issues for determining the DSIC rate cap; and
- requirement to file a Long Term Infrastructure Improvement Plan (LTIIP) by water utilities that use the DSIC.

Order at 4-5. The Office of Consumer Advocate (OCA) appreciates the opportunity to comment. The OCA addresses each of the Commission's proposals and supports many of them as a reasonable and appropriate interpretation of Act 11. In some cases, the OCA recommends modifications or alternatives.

II. COMMENTS

A. Uniform Financial Earnings Reports Requirement

Section 1358(b)(3) of the Public Utility Code provides that the DSIC rate must be reset to zero if, in any quarter, the data reflected in the utility's most recent annual or quarterly financial earnings report shows that the utility will earn a rate of return (ROR) that would exceed the allowable ROR used to calculate its fixed costs under the DSIC mechanism. 66 Pa. C.S. § 1358(b)(3). To ensure that the DSIC rate is reset to zero at the time the utility begins to experience an overearning, the Commission proposes that all jurisdictional utilities that have

implemented a DSIC mechanism should be directed to file quarterly earnings reports with the Commission. Order at 7. This includes utilities that are not otherwise required to file earnings reports. 52 Pa. Code § 71.3 (annual revenues less than \$1 million). The Commission also seeks comment on whether companies with a positive DSIC charge should be required to file quarterly earnings reports during the pendency of a base rate case. Order at 7. Currently, they are exempt. 52 Pa. Code § 71.4(c).

The OCA agrees that all utilities with a positive DSIC should be required to file quarterly earnings reports. First, Act 11 clearly ties DSIC recovery to the utility's financial position for the same period. Section 1357 provides:

(a)(2) the distribution system improvement charge **must** be updated on a quarterly basis to reflect eligible property placed in service during the three-month period ending one month prior to the effective date of each distribution system improvement charge update.

...

(b)(1) The pretax return shall be calculated using the Federal and State income tax rates, the utility's actual capital structure and actual cost rates for long-term debt and preferred stock as of the last day of the three-month period ending one month prior to the effective date of the distribution system improvement charge and subsequent updates.

66 Pa. C.S. § 1357(a)(2), (b)(1). It is consistent with the letter and spirit of the statute to use the most up to date and accurate inputs available to ensure that only the utility's actual costs are recovered and the consumer protection provisions of the statute, such as the earnings cap, function as intended. For this reason, the OCA supports the requirement to file quarterly financial reports, in addition to annual financial reports. For utilities with a positive DSIC, the OCA also recommends the utility be required to file quarterly financial reports during the pendency of a base rate case.

Second, the OCA agrees that utilities that are not currently required to file any annual financial reports should be required to file quarterly financial reports in order to charge a DSIC.¹ If not, the reset provision of the statute cannot function to prevent those utilities from charging a DSIC rate when their quarterly earnings exceed the allowed rate of return. 66 Pa. C.S. §§ 1357(b)(3). As stated by the Commission:

This puts all utilities with a DSIC mechanism on the same footing in determining whether the utility can appropriately recover through their DSIC the fixed costs of all the eligible plant placed in service that has not previously been reflected in the rate base.

Order at 7.

B. Customer Protections — DSIC Rate Reset To Zero

1. Tariff Filing for Reset Due to New Base Rates and Overearning

The Commission requests comment on the rules and procedures it should establish when a utility is required to reset its DSIC rate to zero. 66 Pa. C.S. § 1358(b)(1), (3). Order at 8-9. For a reset related to new base rates, the Commission proposes that the utility incorporate a reference to resetting its DSIC rate to zero within the tariff supplement requesting a general rate increase under Section 1308(d), 66 Pa. C.S. § 1308(d), rather than filing a separate, second tariff supplement under Section 1308(a) (as it recommends for resets due to overearnings). Order at 8. The OCA supports this recommendation because it will streamline the reset process. For the same reason, the OCA also recommends that utilities establishing new base rates under the non-general rate increase provision of Section 1308(a), *i.e.* those filing for a rate increase that is less than 3% of total gross intrastate operating revenues, should likewise incorporate a reference to resetting their DSIC rate to zero within the tariff supplement proposing the non-general rate

¹ It is the OCA's understanding that, currently, all utilities with an approved DSIC file annual financial reports but that may not be true in the future. The impact of this provision on medium and smaller systems may need to be considered.

increase – rather than filing a second, separate Section 1308(a) tariff supplement upon the effective date of the new base rates.

For a reset due to overearnings, the Commission tentatively proposes that a utility should be required to file a tariff supplement pursuant to Section 1308(a) of the Code resetting its DSIC rate to zero if an overearning is indicated in the utility's most recent quarterly financial earnings report. Order at 8, citing 66 Pa. C.S. § 1308(a). The OCA agrees that filing a tariff supplement pursuant to Section 1308(a) for DSIC resets due to overearnings is appropriate because Act 11 does not prescribe another procedure.

The Commission also seeks comment on how to address the requirement of Section 1358(b)(3) that the DSIC rate be reset “if, in any quarter” data filed with the Commission shows that the utility is overearning. Order at 9; 66 Pa. C.S. § 1358(b)(3). The timing of DSIC filings and quarterly and annual financial earnings report filings are not aligned, creating a lag between the utility filing an earnings report and addressing the overearning by resetting the DSIC rate to zero in the next quarterly DSIC update filed thereafter. Order at 9. The Commission tentatively proposes that utilities file their tariff supplement reflecting a zero DSIC rate simultaneously with the filing of their next quarterly DSIC update, effective upon 10-day's notice. *Id.*

The Commission's proposal, as the OCA understands it, could cause significant delay in resetting the DSIC to zero, both from the time of filing and from the time of overearning. For example, the quarterly earnings reports for the 12-months ending March 31, June 30 and September 30 are due within 60 days, or on May 30, August 29 and November 30. A reset would not occur until a DSIC quarterly update is filed on July 1, October 1 and January 1, respectively. This means that a utility experiencing overearnings in any of these 12-month periods could continue charging a positive DSIC for three months until the next DSIC reset.

The lag is even more concerning, however, for the annual financial report due within 90-days. The April 1 quarterly DSIC update is filed on March 22, effective on 10-days' notice. The utility, though, has 90 days to file its annual financial report for the 12-months ending December 31, which is March 31. As a result, the financial report will be filed on March 31 after the quarterly DSIC update. The next quarterly DSIC update does not occur until June 21, effective July 1. This means that a utility experiencing overearnings in the 12-months ending December 31 could continue charging a positive DSIC for six months until the July 1 quarterly DSIC update resets the DSIC to zero. This does not reasonably implement the requirement of Section 1358(b)(3) of the Public Utility Code, which requires a reset at the time the utility experiences an overearning.

The OCA offers two ways to reduce the lag in resetting the DSIC to zero in response to overearnings in the 12-months ending December 31. First, the Commission could reduce the deadline for filing the annual financial report from the current 90 days. Seventy-five (75) days would be a March 14/15 deadline. Sixty-days (60) would be a February 28/29 deadline. In both cases, the deadline would be prior to the March 22 filing deadline for the April 1 quarterly DSIC update and the lag would be 30 days or less, which is in line with the lag for the other quarters.

Second, instead of the foregoing, the Commission could make a Section 1308(a) DSIC reset tariff filing effective in as few as one day's notice for the April 1 quarter. In other words, the utility will file its quarterly DSIC update on March 22. If the utility already knows that it is overearning, the tariff supplement accompanying its DSIC update will reset the DSIC rate to zero effective April 1. If the utility does not know that it is overearning at the time it files its quarterly DSIC update on March 22, then the tariff supplement accompanying its DSIC update

will propose the appropriate non-zero DSIC effective April 1.² In the latter case, if the utility then files an annual financial report on March 31, which shows that it is overearning, the utility will simultaneously file a one page tariff supplement resetting the DSIC rate to zero, effective on one day's notice (April 1).³ In this way, overearnings shown in the annual financial report for the 12 months ending December 31 would result in a zero DSIC rate effective April 1. This is appropriate because the overearnings was experienced in the 12 months ending December 31 and the April 1 DSIC rate would otherwise be recovering the costs of eligible plant placed in service in December, January and February. Thus the time periods are more reasonably aligned than if the reset is not made until July 1.

In summary, the OCA agrees with the Commission that when a utility with an approved DSIC files a proposed tariff to establish new base rates pursuant to Section 1308(d), that tariff supplement should reference resetting its DSIC rate to zero upon the effective date of new base rates. The OCA also recommends that when a utility with an approved DSIC files a non-general base rate filing to establish new base rates pursuant to Section 1308(a), that tariff supplement will reference resetting its DSIC rate to zero upon the effective date of new base rates. The OCA agrees that filing a tariff supplement pursuant to Section 1308(a) for DSIC resets due to overearnings is appropriate; however, the OCA proposes that the tariff supplement become effective in as few as one-days' notice. In the alternative, the OCA recommends that the

² It is important that the effective date for a tariff establishing a non-zero DSIC rate effective April 1 remain ten days. This would ensure that if a utility does not file a tariff supplement proposing a DSIC reset, the Commission and interested parties have time to identify and raise the issue before the next DSIC quarterly update takes effect.

³ The OCA's example addresses the situation where the utility does not realize that it is overearning until the annual financial report is filed on March 31. If the annual financial report is filed prior to the deadline or the utility otherwise determines that a reset due to overearnings is necessary sooner than March 31, the OCA proposes that the utility could file a tariff supplement at that time, i.e. with more than one-day's notice.

Commission change the deadline for filing the annual financial report for the 12 months ending December 31 to 60 or 75 days.

2. DSIC Rate Reset to Zero upon Effective Date of New Base Rates

The Commission proposes that if a utility has surpassed the prospective recovery amount associated with the eligible plant placed in service and which was previously reflected in the utility's base rates as a result of using a future test year or fully-projected future test year (FPFTY) and the utility is not earning more than its allowed return for DSIC purposes, it is then eligible to begin to recover again the fixed costs associated with any new repair, replacement or improvement of eligible property reflected in a quarterly DSIC update. Order at 11. The OCA submits that this is a proper application of Section 1357(a)(1)(i), which limits DSIC recovery to costs that have "not previously been reflected in the utility's rates or rate base." 66 Pa. C.S. § 1357(a)(1)(i).

The Commission seeks comment on what is the criterion to determine whether the prospective recovery amount has been surpassed, which allows the utility "to again continue to recover the fixed costs of eligible property reflected in the quarterly DSIC update." Order at 11-12. The Commission proposes that (1) in its rate filing the utility should specify and (2) the final order establishing new base rates should specify: the total aggregate dollar amount that is associated with the DSIC-eligible property to be placed in service during the test year. Id.

The OCA suggests two clarifications. First, with regard to the Commission's phrasing "again continue to recover," the fixed costs of eligible property that is reflected in base rates will continue to be reflected in base rates. Only the fixed costs of new, additional investment will be eligible for recovery in a positive DSIC rate. Second, the final order establishing new base rates should specify the total aggregate dollar amount that is associated with the DSIC-eligible

property that is used to set rates. This recognizes that the rate base used to determine revenue requirement can be a contested issue in the rate case that is resolved through settlement or litigation. With those clarifications, the OCA supports the Commission's proposals for resuming a positive DSIC rate after a base rate case because, in its view, these proposals will help the parties and Commission to monitor and ensure that costs recovered in base rates are not also recovered in the DSIC rate. These proposals are consistent with the base rate case settlements where the Commission has approved terms specifying that the DSIC "stay-out" would continue until eligible account balances exceed the levels agreed upon for purposes of the settlement. See, e.g., Pa. P.U.C. v. Columbia Gas of Pennsylvania, Inc., Docket No. R-2015-2468056, Opinion and Order at 9 (Dec. 3, 2015); Pa. P.U.C. v. Peoples TWP, Docket No. R-2013-2355886, Opinion and Order at 10 (Dec. 19, 2013)

The Commission also proposes that utilities continue to file quarterly DSIC updates reflecting the eligible property placed into service that was associated with a repair, replacement or improvement during the stay-out period even when they are unable to recover such costs and the DSIC rate remains at zero. Order at 12. The OCA supports this proposed requirement because it shares the Commission's belief that the continuous filing of DSIC updates will help interested parties to monitor and verify that fixed costs are not included in the DSIC if they were reflected in base rates. Id.

3. Resetting DSIC Rate to Zero Due to Overearnings

If a DSIC rate is set to zero⁴ due to overearnings, the Commission seeks to clarify what happens if overearnings persist for two or more successive quarters going forward. Order at 13.

⁴ As discussed in the prior Section, the OCA supports the Commission's proposal that this would be accomplished by simultaneous filing of (1) a tariff supplement pursuant to Section 1308(a) and (2) a quarterly DSIC update.

First, it proposes that during the successive overearnings period, the utility is prohibited from recovering the current fixed costs of the eligible property that it had placed into service prior to the time that the successive overearnings period began to occur. The OCA concurs. The earnings cap is a customer protection because it is intended to prevent a utility from charging a DSIC rate when it is already overearning through non-DSIC rates. 66 Pa. C.S. § 1358(b)(3). As such, the DSIC rate cannot be positive (*i.e.* anything except zero) until the utility stops overearning – however many quarters that may be.

Second, the Commission addresses what happens after the overearnings period ceases. Order at 14. It proposes that the utility be permitted to recover the current fixed costs associated with its cumulative investment in eligible property less depreciation (prior to and during the overearnings period) in the future quarter in which the utility is no longer in an overearning status. The Commission also proposes that utilities would not be permitted to recover through the 1307(e) reconciliation process the otherwise DSIC-eligible costs that were incurred during the overearnings period.

The plain language of Act 11 limits recovery of fixed costs to eligible property that has “been placed in service during the three-month period ending one month prior to the effective date of the distribution improvement system charge.” 66 Pa. C.S. § 1357(a)(1)(ii). The OCA recognizes, however, that the entirety of the fixed costs of the eligible property that was placed into service does not disappear during the time the utility is not permitted to charge a positive DSIC due to overearning. Order at 13. Thus, the OCA does not oppose the Commission’s proposal to allow depreciated recovery of cumulative investment if, consistent with the Commission’s proposal in the Tentative Order, only the net depreciated book value of the prior period plant is recovered in the DSIC rate. Order at 14. The OCA submits that this is a

reasonable means to recognize the time restrictions of Section 1357(a)(1)(ii) by excluding recovery of certain costs for property that was not placed in service during the prior quarter.

In addition, the Commission recognizes that “if a utility is experiencing an overearning over a successive and consecutive period of time, this suggests that the utility’s existing rates are allowing the utility to recover its costs and expenses and are more than sufficient to provide a fair return to investors and the utility.” Order at 14. As such, it seeks comments on whether it should require the utility to file a rate adjustment under Section 1308(a) to reduce its earnings so the utility can continue to use its DSIC.

Section 1308(a) proceedings may take up to 9 months following a 60-day notice period. 66 Pa. C.S. § 1308(a). The time and resources required to review the utility’s rate filing may be substantial compared to the period of time that the utility is unable to charge a positive DSIC. Further, it is possible that the proposed or resulting base rate reduction may be less than the DSIC rate the utility would charge to ratepayers if it were not overearning. Finally, if the utility is chronically overearning, it is not likely the utility needs to have a positive DSIC rate in effect to support accelerated infrastructure investment. These factors would have to be thoroughly considered before directing a rate adjustment.

4. Residual E-Factor Portion of the DSIC Rate upon a Reset of the DSIC Rate

In addition to the issue of fixed costs, the Commission addresses what happens to the E-factor component of the DSIC calculation during and after the overearnings period. Order at 15. The Commission asks whether the utility should have the ability to recover or refund the ongoing E-Factor and/or the residual E-factor amounts (overcollection or undercollection upon a reconciliation of projected sales and projected revenue from the prior three-month DSIC period) when the DSIC rate is reset to zero. *Id.* at 15-16. The OCA recognizes that the over or under

collection relates to the recovery of costs prior to the reset. However, the over or under collection *also* relates to the period during which the utility began to experience overearnings.

In addition, Section 1358(b)(3) states that the DSIC rate is to be reset to zero if the utility's most recent quarterly or annual earnings report shows that the utility is in an overearning position. The E-factor is a component of the DSIC rate, like the depreciation or pretax return:

$$\text{DSIC} = \frac{(\text{DSI} * \text{PTRR}) + \text{Dep} + e}{\text{PQR}}$$

Tentative Order at 15.

The point of the Act 11 reset provision is to avoid the utility recovering amounts through the DSIC when its base rates are already causing overearnings. It is consistent with this purpose to reduce the DSIC rate below zero to reflect an overcollection. This would also avoid the utility carrying the overcollection and increasing the interest it has to pay to ratepayers.

When it comes to an undercollection, however, it would not be consistent with the purpose of the reset provision to charge a positive DSIC rate. Moreover, if the utility is overearning, it does not need ratepayers to fund infrastructure investment through the DSIC and that includes the undercollected amounts. Accordingly, the utility should not be permitted to carry forward and accrue interest on the undercollection after the overearnings period ceases.

C. Computation of the DSIC Rate Cap

The Commission states that it is unclear whether it has the statutory authority to exclude the E-factor component from the calculation of the DSIC rate cap. Order at 17. It notes that the E-factor component relates to the time period in which the utility was authorized to charge and collect the designated DSIC rate. In the OCA's view, the statute clearly prohibits exclusion of the E-factor from the calculation of the rate cap. The amount "billed" to customers is just that, the bottom line amount of the customer's distribution bill (electric and gas) and total bill (water

and wastewater). 66 Pa. C.S. § 1358(a)(1), (2). The DSIC, by definition, is a distribution rate. Therefore, every component of the DSIC rate is a distribution rate and the DSIC E-factor, specifically, is a distribution rate.

Exclusion of the E-factor from calculation of the rate cap has the same effect as a direct waiver of the DSIC rate cap – to increase rates above the statutory 5% or 7.5%. As such, if the Commission determines that it does have statutory authority to exclude the E-factor, the OCA submits that exclusion of the E-factor should not be permitted unless a utility demonstrates – on a case by case basis – that the increase is necessary to ensure and maintain adequate, efficient, safe, reliable and reasonable service. 66 Pa. C.S. § 1358(a)(1).

D. Water Utility Long-Term Infrastructure Plans

Section 1360(a) of Act 11 provides:

- (a) Acceptance.--The commission may accept a long-term infrastructure plan filed by a water utility prior to the effective date of this subsection in order to comply with section 1352 (relating to long-term infrastructure improvement plan).
- (b) Submission.--The commission may require the submission of a new long-term infrastructure plan by a water utility.

66 Pa. C.S. § 1360. The Commission proposes that all jurisdictional water utilities should file an LTIP by September 30, 2016. Order at 18. It also indicates that it will establish a staggered schedule for filing. The OCA supports standardizing the requirements for water utilities with DSICs established under Section 1307(g) and Act 11. 66 Pa. C.S. § 1307(g) (repealed).

The OCA recommends, however, that the September 30, 2016 deadline for filing an LTIP apply only to those utilities that have an existing DSIC approved under Section 1307(g). In that way, all DSIC-eligible utilities (water and non-water) will follow the same process of filing and receiving approval of an LTIP only as a condition of filing a Petition for approval of a DSIC. 66 Pa. C.S. § 1352(a). The DSIC has been available to water utilities since 1997 and

only six water utilities chose to implement one.⁵ While the DSIC is one mechanism available to utilities to recover the costs of infrastructure investment, it does not replace or eliminate other mechanisms. 66 Pa. C.S. § 1350 (“This subchapter shall provide an additional mechanism for a distribution system to recover costs related to the repair, improvement and replacement of eligible property”).

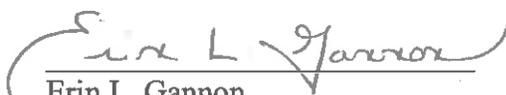
⁵ Pennsylvania-American Water Company, Aqua Pennsylvania, Inc., United Water Pennsylvania, Newtown Artesian Water Company, Superior Water Company and York Water Company. Two additional water and two additional wastewater utilities (all affiliated) filed and withdrew Petitions for Approval of an LTIP and DSIC prior to Commission action. Docket Nos. P-2015-2464237, P-2015-2464242, P-2015-2464236, P-2015-2464251.

III. CONCLUSION

As discussed in these Comments, the OCA supports many of the proposals contained in the Commission's Tentative Order. The OCA makes several recommendations herein, which it submits should be adopted, consistent with Act 11.

WHEREFORE, the Office of Consumer Advocate respectfully submits that the OCA's recommendations should be incorporated in the Final Order.

Respectfully Submitted,



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