

**PENNSYLVANIA  
PUBLIC UTILITY COMMISSION  
Harrisburg, PA 17105-3265**

Public Meeting held July 11, 2007

Commissioners Present:

Wendell F. Holland, Chairman  
James H. Cawley, Vice Chairman  
Terrance J. Fitzpatrick, Concurring Statement attached  
Tyrone J. Christy  
Kim Pizzigrilli, Statement attached

Petition Of Pennsylvania-American Water	:	P-00062241
Company For Approval To Implement A Tariff :		
Supplement To Tariff Water-PA P.U.C.	:	
No. 4 Revising The Distribution System	:	
Improvement Charge	:	

Irwin A. Popowsky, Consumer Advocate	:	P-00062241C0001
v.	:	
Pennsylvania-American Water Company	:	

Marlane A. Pizzi	:	P-00062241C0002
v.	:	
Pennsylvania-American Water Company	:	

Jamin Benson	:	P-00062241C0003
v.	:	
Pennsylvania-American Water Company	:	

Frank J. Paris	:	P-00062241C0004
v.	:	
Pennsylvania-American Water Company	:	

Richard O. Adams : P-00062241C0005  
v. :  
Pennsylvania-American Water Company :

D. Wintermeyer : P-00062241C0006  
v. :  
Pennsylvania-American Water Company :

## **OPINION AND ORDER**

### **BY THE COMMISSION:**

Before the Commission for consideration and disposition are the Exceptions of Pennsylvania-American Water Company (Petitioner), filed on June 5, 2007, to the Recommended Decision of Administrative Law Judge (ALJ) Wayne L. Weismandel, which was issued on May 16, 2007. Reply Exceptions were filed on June 15, 2007, by the Office of Trial Staff (OTS), the Office of Consumer Advocate (OCA), the Office of Small Business Advocate (OSBA) and the Pennsylvania-American Water Large Users Group (PAWLUG).

### **History of Proceeding**

The following is an abbreviated history of the proceeding, most of which has been obtained from pages 2-6 of the ALJ's Recommended Decision.

On October 17, 2006, the Petitioner filed, at the above-captioned docket, a Petition For Approval To Implement A Tariff Supplement To Tariff—Water Pa. P.U.C. No. 4 Revising The Distribution System Improvement Charge (Petition), seeking authority from the Commission to increase its maximum allowable Distribution System Improvement Charge (DSIC) from 5% of billed revenues to 7.5% of billed revenues.

Formal Complaints were filed by the Office of Consumer Advocate (OCA) at Docket No. P-00062241C0001, and by various individuals, at Docket Nos. P-00062241C0002-C006.<sup>1</sup> The Office of Small Business Advocate (OSBA) filed a Complaint in the Form of an Answer to the Petition. The Office of Trial Staff and the Pennsylvania-American Water Large Users Group (PAWLUG) participated as Intervenor.

Notice of the filing of the Petition was published in the *Pennsylvania Bulletin* on December 2, 2006, with protests or petitions to intervene due on or before December 18, 2006. On December 18, 2006, the OSBA and the OCA each filed a Protest to the Petition.

An Initial Prehearing Conference was held on December 20, 2006. Representatives on behalf of the Petitioner, the OTS, the OSBA, and the OCA attended. A transcript of the proceeding containing sixteen pages was produced. By Order Granting Petition to Intervene dated December 20, 2006, the ALJ granted PAWLUG intervenor status.

On January 10, 2007, the Petitioner filed Answers to the Formal Complaints of Marlane A. Pizzi, Jamin Benson, and Frank J. Paris. On January 17, 2007, the Petitioner filed an Answer to the Formal Complaint of Richard O. Adams. On January 24, 2007, the Petitioner filed an Answer to the Formal Complaint of D. Wintermeyer.

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<sup>1</sup> The names of the Complainants, the date filed and the associated docket numbers are as follows: Marlane A. Pizzi, filed December 13, 2006, at Docket No. P-00062241C0002; Jamin Benson, filed December 7, 2006, at Docket No. P-00062241C0003; Frank J. Paris, filed December 1, 2006, at Docket No. P-00062241C0004; Richard O. Adams, filed December 18, 2006, at Docket No. P-00062241C0005; and D. Wintermeyer, filed December 2, 2006, at Docket No. P-00062241C0006.

An Initial Hearing was held on March 14, 2007. The Petitioner, OCA, OSBA, OTS, and PAWLUG participated. The Petitioner presented two witnesses, OCA presented one witness, OSBA presented one witness, and OTS presented one witness.<sup>2</sup> A transcript of the proceeding containing 138 pages was produced.

The Petitioner, OCA, OSBA, OTS, and PAWLUG each filed both Main and Reply Briefs. In accordance with the provisions of Section 5.502(d) of the Commission's Rules of Practice and Procedure, 52 Pa. Code § 5.502(d), Aqua Pennsylvania, Inc. (Aqua) filed an Amicus Curiae Brief. The record closed on April 26, 2007. As noted above, ALJ Weismandel's Recommended Decision was issued on May 16, 2007. The ALJ determined that the Petitioner had not met its burden of proving, by a preponderance of the evidence, that the proposed DSIC increase is in the public interest and that it would be just and reasonable. The ALJ, therefore, recommended that the Petition be denied. Exceptions and Replies were then filed as noted above.

### **Background**

As stated earlier, the Petition filed by the PAWC is a request to raise the surcharge cap from 5% of billed revenues to 7.5% on DSIC-eligible infrastructure. ALJ Weismandel issued a Recommended Decision which denied the Petition. We disagree with the Recommended Decision and instead will grant PAWC's Exceptions which succinctly clarify the Petition's consistency with the purpose of DSIC, along with

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<sup>2</sup> The Parties introduced into evidence PAWC Statements 1 (with accompanying Exhibits SLK1 through SLK3), 2 (with accompanying Exhibits DRK-1 through DRK-4), 1R, and 2R; OCA Statement 1 and cross-examination Exhibits 1-5, and 7-9; OSBA Statements 1 and 2; and, OTS Statements 1 and 1-SR, Exhibit 1, and cross-examination Exhibits 1 and 2.

providing ample support as to the benefits expected to accrue to ratepayers with a 7.5% DSIC cap.

The DSIC is a regulatory tool created in Pennsylvania that has since been adopted, in similar versions, in seven states.<sup>3</sup> The purpose of the DSIC is to provide the Company with the resources to accelerate the rate of aging water distribution system infrastructure replacement in a timely, cost-effective manner. Water utilities with an approved DSIC tariff may charge a sliding scale of rates collected through a quarterly surcharge that enables the recovery of the fixed costs (depreciation and pre-tax return) of certain non-revenue producing, non-expense reducing distribution system improvement projects completed and placed in service between base rate cases. DSIC approved projects include main and valve replacement, main cleaning and relining, fire hydrant replacement, main extensions to eliminate dead ends, solutions to regionalization projects and meter change outs. Customer safeguards include an auditing process, an annual reconciliation of over or under collections, with over collections being refunded with interest, and resetting the charge to zero at the time of new base rates or if the company is over earning, and customer notice of rate changes. A cap of 5% of a customer's total billed revenue for the month has also been one of the safeguards.

Prior to the implementation of the DSIC in 1997, the total rehabilitation of PAWC's distribution system would have taken approximately 225 years to complete.<sup>4</sup> Since the DSIC tariff has been utilized, at a maximum of the 5% cap of a customer's total bill for the month, the Company has reduced the timeframe to 170 years.<sup>5</sup> Since increasing its investment in DSIC in 2006 (the most recent quarterly filing of January 1, 2007 showed a level of 6.36%, although recovery has been limited to 5%),<sup>6</sup> PAWC

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<sup>3</sup> Indiana, Illinois, Ohio, Delaware, Missouri, New York, and Connecticut.

<sup>4</sup> (PAWC M.B. at 8).

<sup>5</sup> (*Id.*).

<sup>6</sup> (PAWC Quarterly DSIC filing).

estimates that an increased cap of 7.5% of a customer's total bill for the month will enable it to reduce the timeframe from approximately 170 years to 112 years, thus enabling improvements to aging infrastructure at a pace more reflective of actual service lives.<sup>7</sup> PAWC asserts that its request to increase the maximum 5% cap to 7.5% of a customer's total bill for the month will further achieve the intent of the DSIC.<sup>8</sup> PAWC stated that the public interest benefits to accrue when infrastructure upgrades are made include improved water quality, pressure and fire protection; fewer main breaks and service interruptions; lower levels of unaccounted-for water; and greater rate stability.<sup>9</sup> We agree.

We will now consider the Exceptions filed to the Recommended Decision.

### **Discussion**

Section 332(a) of the Public Utility Code (Code), 66 Pa. C.S. § 332(a), provides that the party seeking a rule or order from the Commission has the burden of proof in that proceeding. It is axiomatic that “[a] litigant’s burden of proof before administrative tribunals as well as before most civil proceedings is satisfied by establishing a preponderance of evidence which is substantial and legally credible.” *Samuel J. Lansberry, Inc. v. Pa. PUC*, 578 A.2d 600, 602 (Pa. Cmwlth. 1990).

We note that any Exception, which we do not specifically address herein, has been duly considered and will be denied without further discussion. It is well settled that we are not required to consider expressly or at length each contention or argument raised by the parties. *Consolidated Rail Corp. v. Pa. PUC*, 625 A.2d 741 (Pa. Cmwlth.

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<sup>7</sup> (Id. at 9-10).

<sup>8</sup> (Id. at 10, 12-13).

<sup>9</sup> (Id. at 1).

1993); also *see, generally, Univ. of Pennsylvania v. Pa. PUC*, 485 A.2d 1217 (Pa. Cmwlth. 1984).

The ALJ made forty-two Findings of Fact and reached twelve Conclusions of Law. The Findings of Fact and Conclusions of Law are incorporated herein by reference and are adopted without comment unless they are either expressly or by necessary implication rejected or modified by this Opinion and Order.

#### **A. Broad Policy Issue**

The Petitioner excepts to the ALJ's characterization of the Petition. The Petitioner believes that the ALJ misidentified the question presented in this case as a "policy determination." (Exc. at 2, R.D. at 13). The Petitioner states that it has not requested an increase to its DSIC cap as a matter of policy (which infers that an increase in the cap should apply to all jurisdictional water companies). Rather, it wishes the Commission to determine whether or not it has demonstrated, by a preponderance of the evidence, that an increase in its DSIC cap is justified given the Commission's statutory and the Commission's existing DSIC policy. (Exc. at 2).

The OSBA states that the ALJ based his recommendation on whether or not the Petitioner's DSIC cap should be raised from 5% to 7.5%, and not on whether *all* water company DSIC caps should be raised from 5% to 7.5%, as the Petitioner claims. (OSBA R.Exc. at 3). The OSBA notes that the ALJ specifically stated, "[w]hile the question in this case is a policy determination (whether or not *petitioner's DSIC cap* should be raised from 5% to 7.5%), petitioner has the burden of proving that the policy position it advocates should be adopted by the Commission." (R.D. at 13, emphasis added). The OSBA submits that the ALJ made no mention that the instant Petition should be denied because the Petitioner failed to prove that other water company DSIC caps should also be raised from 5% to 7.5%. (OSBA R.Exc. at 3).

The OTS contends that the Petitioner's first Exception misinterprets the entirety of the ALJ's Recommended Decision and that the relief requested in the Petitioner's filing is inconsistent with the Commission's prior policy. Noting that the cap has been set at 5% ever since the establishment of the DSIC, the OTS posits that raising the DSIC cap would indeed be a deviation from a well-established Commission policy that has been followed for over a decade. Moreover, the OTS believes that it is abundantly clear that the ALJ ruled on the merits of the case presented by the Petitioner and did not simply deny the Petitioner's requested relief based on general policy grounds. Finally, the OTS opines that the ALJ specifically, and correctly, cited the Petitioner's failure to satisfy its burden of proof based on the record evidence that was presented. Accordingly, the OTS believes that the Petitioner's Exception must be denied. (OTS R.Exc. at 2 – 3).

As determined by ALJ Weismandel, any change to the DSIC mechanism cap is policy related. However, the Petitioner's request to raise its DSIC collection so that it may accelerate the replacement of aged mains in its service territory must be considered based on the evidence presented in **this** proceeding and not simply as a broad policy. The Petition at hand seeks approval of a tariff supplement revising the DSIC for PAWC only, not all jurisdictional water utilities. The Petitioner has convinced us that the 5% limitation, as applied to PAWC, should be revisited. We reach this conclusion not only on a policy basis, but more importantly, based on the facts specific to this proceeding. As such, the Exception on this issue is granted.

## **B. Burden of Proof**

In the Recommended Decision the ALJ found that the burden of proof to establish the justness and reasonableness of every element of Petitioner's requested DSIC increase rests solely upon the Petitioner. Additionally, the ALJ found that the Petitioner has not met its burden of proving, by a preponderance of the evidence, that its proposed DSIC



increase is in the public interest and that it would be just and reasonable. (Conclusions of Law No. 8 and 12).

In its Exceptions, the Petitioner states that the ALJ's Conclusions of Law No. 4, 5, and 6 cumulatively establish that the Petitioner's burden of proof is simply to demonstrate, through evidence, that increasing the DSIC cap will result in an "appropriately funded DSIC [that] provides the Petitioner with the resources to address the problems presented by its aging water distribution system in an orderly and comprehensive manner." (Exc. at 6). These Conclusions of Law state:

4. An appropriately funded DSIC provides petitioner with resources to address the problems presented by its aging water distribution system in an orderly and comprehensive manner.

5. The Commission has statutory authority to permit a sliding scale of rates or other automatic adjustment method for water utilities to recover the cost of distribution system improvement projects completed and placed in service between base rate proceedings.

6. The Commission has the legal authority to approve a DSIC with a cap that exceeds 5% of billed revenues.

(R.D. at 18). As such, the Petitioner asserts that it is within the Commission's discretion to grant the Petition if it is determined that the Petitioner has established, by a preponderance of the evidence, that increasing its DSIC cap to 7.5% would provide sufficient funding to address the problems with the Petitioner's aging water distribution system. (Exc. at 5).

PAWLUG rejects the Petitioner's argument that its burden is only to demonstrate that increasing the maximum percentage cap will appropriately fund the DSIC. (PAWLUG R.Exc. at 3).

The OCA rejoins that, contrary to the Petitioner's assertion, Conclusions of Law 4, 5, and 6 do not, by any reading, establish the Petitioner's burden of proof. According to the OCA, these Conclusions of Law deal with the purpose of the DSIC itself and the authority of the Commission. Accordingly, the OCA asserts that the Petitioner's argument on this issue is without merit. (OCA R.Exc. at 5).

The OTS asserts that the Petitioner's interpretation of its burden of proof in this proceeding violates basic ratemaking tenants. Under the argument presented by the Petitioner, it is only necessary to demonstrate that an increase to the DSIC cap will result in an appropriately funded DSIC. However, OTS submits that the Petitioner fails to recognize that the law also requires all rates must be just and reasonable. The OTS opines that base rate review is necessary because solely focusing on the DSIC cap increase, without the opportunity to put it in context of all the components that comprise the Petitioner's revenue requirement, fails to produce an accurate picture of the Petitioner's operations. (OTS R.Exc. at 4 – 5).

We agree with the OCA that Conclusions of Law 4, 5, and 6 do not establish the Petitioner's burden of proof. These Conclusions of Law deal with the purpose of the DSIC itself and the authority of the Commission. A more appropriate question is whether or not PAWC has proved that its DSIC cap should be raised from 5% to 7.5%. As stated above, a litigant before this Commission must prove its case with a preponderance of evidence which is substantial and legally credible. *Samuel J. Lansberry, Inc. v. Pa. PUC, supra*. The ALJ correctly determined that the Petitioner bears the burden of proving by a preponderance of the evidence that the position it advocates should be adopted by the Commission. (R.D. at 13). That being said, while the ALJ did not misstate the burden of proof applicable to this proceeding, as discussed *infra*, the ALJ erred in finding that the Petitioner did not meet that burden. Accordingly, the Petitioner's Exception on this issue is granted consistent with this discussion.

### C. Ratepayer Safeguards

The Petitioner also argues that the Commission addressed the ALJ's concerns regarding ratepayer protection when it stated, "[t]he earnings disclosure reports mandated by the final regulations adopted herein will improve substantially the Commission's ability to monitor the financial performance of Pennsylvania's public utilities and, further, will assist greatly in assuring that the rates charged to customers are just and reasonable."<sup>10</sup> Thus, the Petitioner opines that the earnings test safeguard and other DSIC safeguards are included in the recurring DSIC audits and provide ratepayers with adequate protection under the DSIC. (Exc. at 5).

The OSBA objects to the Petitioner's contention that the ALJ erred by considering that, "reduced costs and unrecognized revenue between rate cases may produce earnings above a company's authorized rate of return."<sup>11</sup> According to the OSBA, the ALJ was not mistaken to take these factors into consideration because the safeguards previously established by the Commission to protect ratepayers from single-issue ratemaking would otherwise be weakened if the Petitioner's request were granted. (OSBA R.Exc. at 6).

PAWLUG asserts that the ALJ appropriately noted that, "[o]ne of the keystone protections of consumers' interests cited by the Commission in developing the DSIC was that 'the DSIC will be capped at a relatively low level to prevent any long-term evasion of a base rate review of these plant costs.'" (R.D. at 14). In other words, the Commission viewed the 5% level as the appropriate safeguard for ensuring that the Commission would have the opportunity to review these costs via a base rate proceeding. (PAWLUG R.Exc. at 3). PAWLUG believes that the 5% cap is arguably the most

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<sup>10</sup> (Docket No. L-910061, PAWC Supplement No. 22 to Tariff Water PA P.U.C. No. 4 at Rev. 12B3).

<sup>11</sup> (Exc. at 5).

important safeguard implemented by the Commission to protect customers from the dangers of single-issue ratemaking. (*Id.*).

Additionally, the OTS states that the Commission adopted the 5% maximum rate based upon the Petitioner's recommendation. In its 1996 Petition, the Petitioner represented that, "[t]he DSIC will be capped at 5% of the amount billed to customers under otherwise applicable rates and charges. If the cap were reached, no further increases in the DSIC would be permitted." (1996 DSIC Petition at 4). Despite the Petitioner's express language and assurance to the contrary, OTS claims it is now requesting a significant DSIC cap increase. As such, the OTS argues that the ALJ properly rejected this requested increase because the Petitioner failed in its burden of showing that the requested increase is just and reasonable. (OTS R.Exc. at 6).

The Code, 66 Pa. C.S. § 101 *et seq.*, grants the Commission the legal authority and power to establish the Petitioner's DSIC rate cap at either 5% or 7.5% or, conceivably, at a higher percentage. (R.D. at 13). Subsection 1307(g) of the Code provides, in relevant part:

Recovery of costs related to distribution system improvement projects designed to enhance water quality fire protection reliability and long-term system viability.—Water utilities may file tariffs establishing a sliding scale of rates or other method for the automatic adjustment of the rates of the water utility as shall provide for recovery of the fixed costs (depreciation and pretax return) of certain distribution system improvement projects, as approved by the commission, that are completed and placed in service between base rate proceedings. The commission, by regulation or order, shall prescribe the specific procedures to be followed in establishing the sliding scale or other automatic adjustment method.

66 Pa. C.S. § 1307(g).

ALJ Weismandel aptly described the standard this Commission must employ in our review of the instant Petition to revise PAWC's DSIC:

The parameters of petitioner's DSIC and the procedure for its implementation and review established by the Commission in the PAWC DSIC Order are an "other method for the automatic adjustment of the rates of" petitioner as provided for in the Statute. The Legislature granted the Commission both the authority and the power to exercise discretion in determining the specifics of a distribution system improvement cost recovery program and did **not** establish a numerical percentage rate cap. However, the Commission remains bound by the provisions of the Public Utility Code that require that all rates "shall be just and reasonable" and non-discriminatory, 66 Pa.C.S. §§1301, 1304.

(R.D. at 13 (emphasis added)).

Prior to DSIC's implementation in 1997, PAWC's timeframe to upgrade its existing, aging infrastructure was 225 years.<sup>12</sup> Following DSIC's implementation, the timeframe was reduced by nearly 25% to 170 years. A critical factor is that, with its current increased investments in DSIC-eligible projects over the 5% cap (the most recent<sup>13</sup> quarterly filing reached 6.36%), the Company estimates a 33% reduction to 112 years, which more realistically reflects actual service lives. (PAWC M.B. at 9). Matching replacement with service life substantially improves service reliability. Infrastructure remediation and improved service and service reliability directly benefits customers. Upgrades of deteriorated mains are essential to reduce main breaks, service interruptions and unaccounted for water and improve water quality, improve pressure, enhance fire protection, and achieve rate stability. Additional ratepayer benefits include the achievement of these essential goals:

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<sup>12</sup> Other jurisdictional water companies faced similar or worse timeframes.

<sup>13</sup> As of January 1, 2007.

Promoted the acquisition of small and non-viable water systems, consistent with Commission policy (see 52 Pa. Code §§ 69.711 (relating to small and nonviable systems));

Promoted the regionalization of water systems, consistent with Commission policy; see 52 Pa. Code § 69.721 (relating to acquisitions);

Reduced rate case expense by decreasing the frequency of base rate case filings;

Allowed water utilities to afford remediation projects that would have otherwise been cost-prohibitive; and

Decreased main breaks, service interruptions, low pressure problems, and discolored water.

(Aqua Correction to Amicus Curiae Brief at 4).

When DSIC's implementation was approved by the Commission, several critical safeguards were established, including a cap of 5% of billed revenues.<sup>14</sup> Additional safeguards include: resetting the DSIC to zero at the time of the next base rate case or if the utility is over-earning; providing notice to customers of any change in the DSIC rate; audits are conducted as needed and an annual reconciliation audit is conducted to ascertain any over or under-collections, with any over-collections being refunded with interest at the time of the next DSIC calculation. All mains or other DSIC-eligible projects have been placed into service prior to DSIC charges being issued to customers and meet used and useful parameters, which are among the foundations of utility ratemaking principles.

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<sup>14</sup> *Petition of Pennsylvania-American Water Company for Approval to Implement a Tariff Supplement Establishing a Distribution System Improvement Charge*, Docket No. P-00961031 (August 16, 1996), see Attachment A, "Sample Tariff Language," p. 4.

The Company's argument that these safeguards remain in place and effective even with a higher cap is correct. Therefore, we will grant PAWC's Exception on this issue.

#### **D. Recent Infrastructure Study**

The ALJ noted that the Petitioner has not done an infrastructure study in the last three years. The ALJ stated that the Petitioner's current accelerated replacement might or might not be sufficient or that the previous replacement and improvement rate might even be enough to discharge the Petitioner's responsibility to render adequate, efficient, safe, and reasonable service. The ALJ reasoned that, without a recent infrastructure study having been presented by the Petitioner, the adequacy of any of these replacement rates is speculative. Accordingly, the ALJ concluded that that increasing the Petitioner's DSIC cap is not permissible. (R.D. at 17).

The Company points out that under the ALJ's criteria, there would not be a need for a DSIC at all, so long as a minimal level of adequate service was being rendered. The General Assembly had a broader vision and has provided the Commission with the tools to replace aging infrastructure in the Commonwealth. PAWC simply requests that the Commission use this tool and permit the Company to increase its DSIC percentage so that the purpose of the law can be realized. (PAWC Exc. at 11).

The Petitioner objects to the ALJ's conclusion on this matter and argues that the need for an infrastructure study is illusory. The Petitioner contends that requiring such a study would elevate form over substance. (Exc. at 7). The Petitioner argues in detail that the findings refute the ALJ's observation that a study is necessary to justify acceleration in the rate of replacement of aging infrastructure. (Exc. at 8-10). Furthermore, the Petitioner argues that the requirement of an infrastructure study is not required by the DSIC Regulations and is not a requirement of generally accepted utility practices. (Exc. at 10).

The Petitioner recognized that its ideal spending level for infrastructure remediation “should be adequate to keep pace with the anticipated remaining useful life of the distribution system infrastructure.” (PAWC M.B. at 9). The Company explained that, in 2006, it accelerated its infrastructure upgrade program by over 50% and replaced 82 miles of mains. This can be compared with the pre-DSIC figure of replacing 25 miles per year. From DSIC’s inception in 1997, until 2005, the Company replaced 47 miles of main, or 0.56%. The 2006 increased rate of 0.90% has been maintained in 2007 at a DSIC level of 6.36% for all of 2007. As previously stated, the current accelerated rate should enable the Company to significantly reduce, by 34%, the amount of time it would take to make all of the needed improvements, from approximately 170 years to 112 years. (PAWC M.B. at 8-9).

The Petitioner also noted its current focus on replacing smaller diameter mains due to its discovery that they were found to be a more frequent source of main breaks than larger diameter mains. (PAWC M.B. at 11). The Company states that an increased DSIC cap to 7.5% will support its efforts to accelerate the systematic replacement of its older small-diameter mains. The Petitioner estimates it can reduce by about 20 years, the time in which it will be able to make the needed improvements to this segment of its distribution system. The Company points out that, in comparison, “an under-funded DSIC is more likely to result in more significant costs associated with unplanned or more extensive system repairs in the future (*e.g.*, more main breaks and service interruptions, higher levels of unaccounted for water, etc.).” (PAWC M.B. at 12). The Petitioner has determined that a higher investment level is essential for it to keep pace with the anticipated remaining useful life of the distribution system infrastructure. (PAWC M.B. at 9).

The OCA replies that the absence of an infrastructure study reflecting the appropriateness of the Petitioner’s main replacement rate is not the only troubling omission from the Petition. The OCA notes that the Petitioner has no system-wide



method for consistent prioritization and assessment of the need for infrastructure replacement and rehabilitation. (OCA M.B. at 19-22). Furthermore, the OCA submits that the Petitioner's current prioritization tool is being used only on a trial basis, and as acknowledged by the Petitioner, no studies have been conducted between 1990 to 2006 to address the reasonable and prudent process or procedure for replacing distribution mains.<sup>15</sup> (OCA R.Exc. at 6).

The OSBA also agrees with the ALJ on this issue. The OSBA replies that the Petitioner is seeking to increase the DSIC cap without providing evidence of why the main replacement acceleration is necessary and why the current DSIC mechanism is inadequate. Additionally, the OSBA noted that the Petitioner does not have a system-wide method for consistent prioritization and assessment of the need for infrastructure replacement and rehabilitation. (OSBA R.Exc. at 10). The OSBA opines a conclusion cannot be made that the Petitioner needs a DSIC cap increase and that the DSIC dollars currently being collected from ratepayers are being used in the most efficient manner as possible. (OSBA R.Exc. at 12).

The OTS states that the requested DISC increase represents a 50% increase over the current maximum DSIC rate. The OTS argues that to support the requested increase, the Petitioner should have performed an analysis showing: (1) the overall condition of the plant; (2) plant that should be rehabilitated or replaced; (3) cost estimates; and, (4) a prioritization of DSIC projects and locations. According to the OTS, the Petitioner simply failed to do so and instead argued that its presentation of service lives and the problematic nature of small diameter pipe satisfied its burden of proving that the proposed DSIC increase is warranted. (OTS R.Exc. at 7).

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<sup>15</sup> (M.B. at 20-21).

As stated by PAWC, the legislature has provided the Commission with the tools to replace aging infrastructure in the Commonwealth. PAWC simply requests that the Commission use this tool and permit the Company to increase its DSIC percentage so that the purpose of the law can be realized. Our review of the record persuades us that currently, a higher DSIC rate for PAWC is consistent with the legislative intent to economically accelerate infrastructure remediation:

The DSIC more accurately reflects the ongoing investments and improvements that are made in the water distribution system versus the less frequent but larger step increases that would result from base rate increases without an appropriately funded DSIC. The timely recovery of the fixed costs of infrastructure replacement through the DSIC provides an incentive for increased and continued levels of capital infusion. This results in a stronger and more reliable water distribution system for both current and future customers.

(PAWC M.B. at 13). In our view, the Petitioner has presented sufficient evidence to support the requested increase of the DSIC rate. We note that PAWC's customers' rates at the 5% DSIC rate average \$1.75 a month. With a 7.5% DSIC, that rate will increase by an average of \$1.00 a month. It should be kept in mind that this rate will be reset to zero following the next base rate case (or at any time that the Company is over-earning) and it takes a number of billing cycles of progressive increases over a few years to rise to the allowed level of the cap. Most importantly, DSIC represents a dollar-for-dollar recovery of prudent expenses incurred for improving reliability to customers. Accordingly, we shall grant the Petitioner's third Exception.

#### **E. Frequency of Base Rate Filings / Necessity of DSIC Increase**

The ALJ determined that Petitioner failed to provide evidence in support of its assertions: (1) that an increase of 50% in its DSIC cap is required to maintain its accelerated water main replacement program; and (2) that a higher DSIC cap would

potentially lengthen the period between its filing of general rate increase cases, thereby delaying the large costs involved. (R.D. at 15).

The Petitioner claims that the ALJ erred in finding that it must prove that increasing the DSIC is necessary to maintain its accelerated improvement program or to lengthen the time between base rate case filings. (Exc. at 11). It argues that it has not maintained, and it is not the Company's burden to prove that increasing the DSIC cap is necessary to maintain its accelerated improvement program or to lengthen the time between the filing of base rate cases. Rather, the Petitioner asserts that it simply must prove that increasing the DSIC cap to 7.5% will provide the Company with adequate resources to achieve the Commission's objective to accelerate the replacement of its aging infrastructure, and that the "modest requested increase to PAWC's DSIC cap accomplishes this goal." (Exc. at 12).

The Petitioner also submits that the fact that it filed a base rate case is irrelevant to whether the Commission should exercise its discretion to increase the DSIC percentage. The Petitioner notes the necessity for sufficient resources to achieve the Commission's long term objective of accelerating the replacement of its aging infrastructure while encouraging the Company to make less frequent base rate case filings. (Exc. at 12).

The OCA replies that the DSIC was not capped at 5% to deter companies from making infrastructure improvements as those costs can still be recovered in a base rate proceeding. Instead, the cap was instituted to protect ratepayers from the potential pitfalls of the surcharge mechanism. The OCA posits that it is the responsibility of the Petitioner to manage its operations, and it should not expect to recover returns above those authorized by the Commission simply because it chooses to spend more than it could recover via the surcharge mechanism. (OCA R.Exc. at 7).

Regarding the frequency of base rate case filings and an increase in the DSIC cap, the Petitioner stated that the requested 50% increase in the DSIC cap would not guarantee that the Petitioner will not file another base rate case within two years.<sup>16</sup> The OSBA points out that with the 5% DSIC cap, the Petitioner has been able to avoid a base rate increase for more than three years, and at the same time, accelerate its DSIC-eligible spending. (OSBA R.Exc. at 14; PAWLUG R.Exc. at 6 -7). Therefore, the evidence supports that the Petitioner does not need an increase in its DSIC cap in order to move to a three-year base rate case filing cycle. (OSBA R.Exc. at 15).

PAWLUG states that while the Petitioner asserts the claimed increase in its DSIC cap is modest (from 5% to 7.5%) and an approval of that 50% increase will support a three-year or longer base rate case filing cycle, the ALJ found that the requested increase is not in the public interest. (PAWLUG R.Exc. at 6, 7). PAWLUG noted that the increase in DSIC cap were to be granted, the monthly billing for one of the Petitioner's largest customers would increase by approximately \$3,000 while the average residential customer would pay approximately \$12.00 more annually. (R.D. at 11, 12). PAWLUG also points to the fact that the Petitioner could not affirm a greater time span between the filing of base rate cases if its increase in the DSIC were permitted. (PAWLUG R. Exc. at 7).

The OTS contends that instead of recognizing that the current 5% DSIC cap helps the Petitioner complete infrastructure projects between base rate case filings, the Petitioner is treating the DSIC as a funding source to achieve infrastructure goals set by management rather than as a regulatory tool that has accomplished exactly what it is supposed to accomplish. (OTS R.Exc. at 11).

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<sup>16</sup> On April 27, 2007, the Petitioner filed a base rate case with the Commission, which upon completion will reset the DSIC to zero. The base rates established in this most recent base rate case will become effective on or before January 28, 2008. (R.D. at 16).

We agree with the Petitioner that the evidence presented in the instant case reveals a choice between:

(1) providing the Company with adequate resources (a 7.5% DSIC cap) to support a three-year or more base rate case filing cycle, or (2) providing the Company with more limited resources (a 5% DSIC cap) that would encourage a more frequent base rate case cycle – every year or two.

(PAWC Exc. at 12; Tr. at 98-100). The current DSIC cap of 5% will not provide the Company with resources adequate to achieve this Commission's long term objective, accelerating the replacement of aged water distribution systems throughout the Commonwealth. Increasing the DSIC cap to 7.5% would achieve a reasonable balance between supporting the Company's efforts to improve its distribution system while encouraging it to make reasonably frequent base rate filings. PAWC has used the funds available to it under the current 5% cap consistent with the legislative intent. We believe that the incremental increase in the cap to 7.5% will permit the Company to accelerate its replacement of this critical distribution infrastructure.

In addition, a response is necessary to the argument put forth by the OCA that simple presentation of expenses virtually guarantees recovery without the oversight of a base rate case proceeding. (OCA M.B. at 12). Expense recovery is granted only for those DSIC-eligible projects that are prudently incurred, in service, and used and useful. In raising the level of DSIC expense recovery, we clearly intend to continue its cautious use. Contrary to the OCA's reference to the reasoning of the Commonwealth Court in the recent Collection System Improvement Charge Appeal, the DSIC review and audit process includes a determination of compliance and prudence.<sup>17</sup> Hence, the OCA's reference to the recovery of projects being relatively automatic (using the example of a solid gold manhole cover being allowed, provided the expense was made and submitted)

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<sup>17</sup> *Popowsky v. Pa. PUC*, 869 A.2d 1144, 1156 (Pa. Cmwlth. 2005).

is simply not accurate nor reflective of the extensive and thorough DSIC review process. Accordingly, we will grant the Petitioner's Exception on this issue.

### **Conclusion**

Based upon the foregoing discussion, we shall grant the Petitioner's Exceptions and reverse the ALJ's Recommended Decision; **THEREFORE,**

### **IT IS ORDERED:**

1. That the Exceptions filed by Pennsylvania-American Water Company on June 5, 2007, are granted, consistent with this Opinion and Order.
2. That the Recommended Decision of Administrative Law Judge Wayne L. Weismandel is reversed, consistent with this Opinion and Order.
3. That the Petition of Pennsylvania-American Water Company for Approval to Implement a Tariff Supplement to Water Tariff Water-PA P.U.C. No. 4 Revising the Distribution System Improvement Charge filed October 17, 2006, is granted.
4. That Pennsylvania-American Water Company shall place into effect Supplement No. 23 to Tariff Water-PA P.U.C. No. 4 First Revised Page 12B3, on one days notice, the same having been found to be just, reasonable, and in the public interest.
5. That the formal Complaint filed by Irwin A. Popowsky, Consumer Advocate, at Docket Number P-00062241C0001 is dismissed.
6. That the Protests filed December 18, 2006, by the Office of Consumer Advocate and by the Office of Small Business Advocate are dismissed.

7. That the formal Complaints filed by Marlane A. Pizzi at Docket Number P-00062241C0002, Jamin Benson at Docket Number P-00062241C0003, Frank J. Paris at Docket Number P-00062241C0004, Richard O. Adams at Docket Number P-00062241C0005, and D. Wintermeyer at Docket Number P-00062241C0006 are dismissed for lack of prosecution and the records marked closed.

8. That the record in this case be marked closed.

**BY THE COMMISSION,**

James J. McNulty  
Secretary

(SEAL)

ORDER ADOPTED: July 11, 2007

ORDER ENTERED: August 14, 2007

