

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

Thomas P. Gadsden
215.963.5234
tgadsden@MorganLewis.com

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JAN 27 2012

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

January 27, 2012

VIA FEDERAL EXPRESS

Rosemary Chiavetta, Secretary
Pennsylvania Public Utility Commission
Commonwealth Keystone Building
400 North Street
Harrisburg, PA 17120

Re: **Pennsylvania Public Utility Commission v. Aqua Pennsylvania, Inc.**
Docket No. R-2011-2267958, et al.

Dear Secretary Chiavetta:

Enclosed please find an original and three copies of Aqua Pennsylvania, Inc.'s Prehearing Conference Memorandum in the above-referenced matter. Copies have been served on Administrative Law Judges Angela T. Jones and Darlene D. Heep and the parties of record as well as all complainants in accordance with the attached Certificate of Service.

Kindly time-stamp and return the extra copy of this Memorandum in the enclosed postage-paid envelope.

Sincerely,



Thomas P. Gadsden
Counsel for Aqua Pennsylvania, Inc.

Enclosures
c: Per Certificate of Service

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

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

Thomas P. Gadsden
215.963.5234
tgadsden@morganlewis.com

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VIA ELECTRONIC MAIL & HAND DELIVERY

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

Honorable Angela T. Jones
Honorable Darlene D. Heep
Commonwealth of Pennsylvania
Pennsylvania Public Utility Commission
Office of Administrative Law Judge
801 Market Street, Suite 4063
Philadelphia, PA 19107

Re: **Pennsylvania Public Utility Commission v. Aqua Pennsylvania, Inc.**
Docket No. R-2011-2267958, et al.

Dear Judge Jones and Judge Heep:

Pursuant to your Prehearing Conference Order dated January 20, 2012, enclosed are two copies of the Prehearing Conference Memorandum of Aqua Pennsylvania, Inc. in the above-captioned matter.

As evidenced by the attached Certificate of Service, copies of the enclosed Prehearing Conference Memorandum are being served on all parties of record as well as all complainants.

Sincerely,



Thomas P. Gadsden
Counsel for Aqua Pennsylvania, Inc.

Enclosure

c: Certificate of Service

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JAN 27 2012

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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

**PENNSYLVANIA PUBLIC UTILITY
COMMISSION** :

DOCKET NO. R-2011-2267958

v. :

AQUA PENNSYLVANIA, INC. :

**PREHEARING CONFERENCE MEMORANDUM
OF
AQUA PENNSYLVANIA, INC.**

This memorandum is submitted in response to the January 20, 2012 Prehearing Conference Order issued by Administrative Law Judges Darlene D. Heep and Angela T. Jones.

I. INTRODUCTION

On November 18, 2011, Aqua Pennsylvania, Inc. ("AP" or the "Company") filed with the Pennsylvania Public Utility Commission ("Commission") Supplement No. 115 to Tariff Water – Pa. P.U.C. No. 1. Supplement No. 115 reflects an increase in total annual operating water revenues of \$38,600,000, or approximately 9.4% over the level of revenues anticipated for the future test year ending June 30, 2012. By Order entered January 12, 2012, the Commission instituted a formal investigation to determine the lawfulness, justness and reasonableness of AP's existing and proposed rates, rules and regulations. Accordingly, Supplement No. 115 was suspended by operation of law until August 18, 2012.

Accompanying its tariff filing, AP submitted extensive and detailed supporting information, including the prepared written testimony and exhibits of its seven initial witnesses. During the course of this case, AP may submit additional testimony and exhibits in response to the presentations of, or cross-examination by, other parties and with respect to any specific issues

that might be raised by such parties. In addition, certain testimony and exhibits will be updated to reflect known changes which should be considered in this proceeding.

In support of its proposed rate increase, AP has presented complete and separate data for the historic test year ended June 30, 2011 and the future test year ending June 30, 2012. AP intends, however, to rely primarily on the future test year data. AP submits that the record at the close of this proceeding will fully demonstrate that the proposed rates are just, reasonable and lawful and should be approved in full by the Commission.

II. ISSUES

Generally, every rate case presents two major issues for resolution: (1) the total amount of the revenue increase to which the utility is entitled; and (2) the allocation of the increased revenues among the utility's customer classifications through a rate structure and rate design that will produce the required revenue. As discussed below, the Company's computation of its required revenue increase and its proposed allocation of the increase to each customer classification have been developed by the application of principles and procedures that the Commission has reviewed and approved in numerous prior cases.

A determination of the total revenue increase to which a utility is entitled involves a number of elements which may be grouped under three headings and characterized as the following major sub-issues herein:

A. Total Return. The total return (utility operating income) required by the utility to provide a fair rate of return on its claimed rate base. Fair rate of return involves the determination of the appropriate cost or return rate for the capital employed by the Company to furnish water service. Such return must be sufficient to enable the Company to maintain the financial integrity of its existing capital and to attract additional capital on reasonable terms. In

addition, the Company must be permitted an opportunity to earn, on the portion of its rate base financed by common equity, a return commensurate with the returns on investments in other enterprises having similar risks. The appropriate rate of return for the Company, and in particular the appropriate return rate for the Company's common equity, is an issue which is critical to the well-being of the Company and its ability to continue to provide the service that its customers have been receiving and are entitled to receive in the future.

B. Operating Expenses. The future or ongoing level of the utility's operating expenses, including depreciation, amortizations and taxes, which must be recovered from customers through rates.

C. Revenues. The revenue normally available to the utility under present rates and that which will be produced by the proposed rate levels. By comparing the revenue produced by the utility's present rates with its total required operating income and anticipated operating expenses, depreciation, amortizations and taxes, the necessary increase in revenue and rate levels required to provide a fair rate of return is determined.

D. Allocation of Increase. The allocation of the proposed revenue increase and the Company's proposed rate structure and rate design are explained in the Statement Of Specific Reasons For Proposed Increase In Rates submitted with the Company's initial filing and in detail in the direct testimony of Mr. Packer and Mr. Herbert. As set forth therein, the Company's proposed rate structure continues to implement, where appropriate, the Commission-approved concept of establishing a uniform set of rates to apply Company-wide. However, in certain instances where the implementation of uniform rates is not appropriate given the unique characteristics of the customers served, AP continues to propose "seasonal" tariff designs. In

addition, the Company proposes various rate structure changes, the most notable of which include:

- (1) The implementation of a Purchased Water Adjustment clause to reflect changes in the cost of purchased water.
- (2) The implementation of an Energy Cost Adjustment clause to reflect changes in the cost of energy.
- (3) Revisions to the Company's tariff to eliminate the multi-unit rate structure in the Company's Honesdale Division.
- (4) Increases in public fire hydrant rates in those divisions where present charges are below 25% of the indicated cost of service.
- (5) The resetting of the Company's Distribution System Improvement Charge to zero at the effective date of new base rates.

III. WITNESSES AND EVIDENCE

Listed below are the initial witnesses for AP, together with a brief summary of the subject matter of their testimony.

1. **William C. Packer.** Mr. Packer is the Manager of Rates – Northeast Division for the Company. His written testimony, which is identified as AP Statement No. 1: (1) addresses certain revenue, expense and rate base claims; (2) provides an overview of recent acquisitions; (3) describes matters related to rate structure and rate design; and (4) discusses the Company's satisfaction of the terms of settlement agreements reached with certain parties in its last water base rate case. Mr. Packer will sponsor portions of AP Exhibit 1-A, the Company's principal accounting exhibit; AP Exhibit 3-A, which contains original cost data for water systems acquired

since the Company's last base rate water proceeding; and various volumes comprising AP's response to the Commission's rate case minimum filing requirements.

2. **David P. Smeltzer.** Mr. Smeltzer is Senior Vice President – Finance and Chief Financial Officer (“CFO”) of AP. He is also CFO of AP's parent, Aqua America, Inc. Mr. Smeltzer's written testimony is set forth in AP Statement No. 2. He will sponsor AP Exhibit 2-A as well as portions of AP Exhibit 1-A. Mr. Smeltzer's testimony and exhibits relate to the financial data filed by AP, including its claimed rate of return, rate base and operating expenses. Mr. Smeltzer's testimony also describes the Company's consideration of a tax accounting change that would categorize certain expenditures as repair or maintenance expenses, deductible in the year incurred, rather than as capital costs deductible ratably over the tax-depreciable life of the capital asset to which they relate.

3. **Nameer A. Bhatti.** Mr. Bhatti is employed by Aqua Services, Inc. as a Rate Analyst. His written testimony is identified as AP Statement No. 3 and he will sponsor portions of Exhibit 1-A dealing with customer service costs, lobbying fees, uncollectible accounts, chemical costs, and rate case expense.

4. **Paul R. Moul.** Mr. Moul, Managing Consultant of P. Moul and Associates, presents expert testimony concerning the cost of equity and overall fair rate of return. His written testimony is identified as AP Statement No. 4, and the various supporting schedules discussed in his testimony are set forth in AP Exhibit 4-A. On the basis of Mr. Moul's study, the Company requests the opportunity to earn the following overall fair rate of return:

Type of Capital	Ratio	x	Cost Rate	=	Weighted Cost Rate
Long-Term Debt	47.02%		5.41%		2.54%
Common Equity	52.98%		11.75%		<u>6.23%</u>
Overall Rate of Return					8.77%

5. **Paul R. Herbert.** Mr. Herbert is President of the Valuation and Rate Division of Gannett Fleming, Inc. His written testimony is set forth in AP Statement No. 5 and he sponsors AP Exhibits 5-A (Parts I and II), 50-A and 50-B. Mr. Herbert presents: (1) AP's cost allocation study (including its analysis of customer demand); (2) the application of present rates to the results of a bill frequency analysis; and (3) the Company's proposed rate design.

6. **John J. Spanos.** Mr. Spanos is a Vice President in the Valuation and Rate Division of Gannett Fleming, Inc. Mr. Spanos' written testimony is identified as AP Statement No. 6 and he sponsors AP Exhibit 6-A (Parts I and II). Mr. Spanos' testimony and exhibit address AP's claim for accrued depreciation and annual depreciation expense.

7. **William J. Jerdon.** Mr. Jerdon is Tax Manager for AP. His written testimony is provided as AP Statement No. 7. Mr. Jerdon's testimony concerns AP's capital stock tax, federal income tax and state income tax claims and related rate base adjustments. Mr. Jerdon is responsible for portions of AP's Exhibit 1-A.

IV. DISCOVERY

To date AP has been served with over 425 interrogatories, including numerous subparts. AP will work with the other parties and the Administrative Law Judges to develop a reasonable schedule for ongoing discovery. In addition, AP encourages informal exchanges of information and is prepared to meet with representatives of the Bureau of Investigation and Enforcement

("I&E"), Office of the Consumer Advocate ("OCA") and/or Office of the Small Business Advocate ("OSBA") to discuss issues of interest to them.

V. PROPOSED SCHEDULE

AP has prepared and attached as Appendix "A" to this Memorandum a proposed schedule for the submission of testimony, the conduct of evidentiary hearings, and the filing of briefs. It is the Company's understanding that the attached schedule has the support of I&E, the OCA and the OSBA. In addition, the OCA and the Company have agreed to hold public input hearings at the following locations: (1) Radnor, Delaware County, Pennsylvania; (2) Hatboro Borough, Montgomery County, Pennsylvania; (3) East Goshen Township, Chester County, Pennsylvania; and (4) Shavertown, Luzerne County, Pennsylvania. AP also proposes a telephonic public input hearing for the customers in its Northwest territory, which covers Mercer, Lawrence, Crawford, Warren, Forest and Venango counties. AP will work with the other parties and the Administrative Law Judges to develop a reasonable schedule for the public input hearings between February 27 – March 2, 2012 and March 5 – 7, 2012.

VI. SETTLEMENT

AP is willing to pursue with the parties the possible stipulation of individual issues and/or more far-ranging settlement discussions that might lead to a comprehensive resolution of this matter.

VII. CONCLUSION

Based on the evidence referenced above, AP submits that the rates proposed in Supplement No. 115 to Tariff Water – Pa. P.U.C. No. 1 are just, reasonable and lawful in all respects. Accordingly, the requested rate increase should be approved by the Administrative Law Judges and the Commission at the close of this proceeding.

Respectfully submitted,



Thomas P. Gadsden (Pa. No. 28478)

tgadsden@morganlewis.com

Anthony C. DeCusatis (Pa. No. 25700)

adecusatis@morganlewis.com

Brooke E. Leach (Pa. No. 204918)

bleach@morganlewis.com

Morgan, Lewis & Bockius LLP

1701 Market Street

Philadelphia, PA 19103-2921

215.963.5034

877.432.9652 (fax)

Kimberly A. Joyce (Pa. No. 86605)

KAJoyce@aquaamerica.com

Aqua Pennsylvania, Inc.

762 W. Lancaster Avenue

Bryn Mawr, PA 19010

610.525.1400

610.519.0819 (fax)

Counsel for Aqua Pennsylvania, Inc.

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Dated: January 27, 2012

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SECRETARY'S BUREAU

APPENDIX A

**PENNSYLVANIA PUBLIC
UTILITY COMMISSION**

V.

AQUA PENNSYLVANIA, INC.

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:
:
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:
:

DOCKET NO. R-2011-2267958

PROPOSED SCHEDULE

Rate Filing	November 18, 2011
Prehearing Conference	January 30, 2012
Complainant/Intervenor Direct Testimony	February 17, 2012
Public Input Hearings	Late February/Early March 2012
Settlement Conference	Week of March 5, 2012
Rebuttal Testimony	March 12, 2012 (Rate of Return) March 19, 2012 (All Other Issues)
Surrebuttal Testimony	March 28, 2012 (Rate of Return) April 5, 2012 (All Other Issues)
Evidentiary Hearings	April 3, 2012 (Rate of Return) April 9, 2012 (Revenue Requirement) April 10, 2012 (Cost of Service, Rate Design, Quality of Service)
Initial Briefs	May 3, 2012
Reply Briefs	May 14, 2012

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

PENNSYLVANIA PUBLIC UTILITY COMMISSION : **DOCKET NO. R-2011-2267958**
:
vs. :
AQUA PENNSYLVANIA, INC. :

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served copies of the **Prehearing Conference Memorandum of Aqua Pennsylvania, Inc.**, upon the following persons in the manner specified in accordance with the requirements of 52 Pa. Code § 1.54:

VIA ELECTRONIC AND HAND-DELIVERY

Administrative Law Judge Angela T. Jones
Administrative Law Judge Darlene D. Heep
Commonwealth of Pennsylvania
Pennsylvania Public Utility Commission
Office of Administrative Law Judge
801 Market Street, Suite 4063
Philadelphia, PA 19107
angeljones@pa.gov
dheep@pa.gov

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

VIA ELECTRONIC AND FIRST CLASS MAIL

Carrie B. Wright
Pennsylvania Public Utility Commission
Bureau of Investigation and Enforcement
P.O. Box 3265
Harrisburg, PA 17105-3265
carwright@pa.gov

Dianne E. Dusman
Shaun A. Sparks
Office of Consumer Advocate
555 Walnut Street, 5th Floor
Forum Place
Harrisburg, PA 17101-1921
ddusman@paoca.org
ssparks@paoca.org

Daniel G. Asmus
Assistant Small Business Advocate
Office of Small Business Advocate
300 North Second Street
Commerce Building, Suite 1102
Harrisburg, PA 17101
dasmus@pa.gov

Bran Kalcic
Excel Consulting
225 South Meramec Avenue, Suite 720
St. Louis, MO 63105
excel.consulting@sbcglobal.net

Max E. Stoner
Glance Associates, Inc.
3705 Trindle Road
Camp Hill, PA 17011
max@glanceeng.com

VIA FIRST CLASS MAIL

Said Shafik
507 Larchwood Avenue
Upper Darby, PA 19082

Emilio Rende
108 Jefferson Street
Bala Cynwyd, PA 19004

Rikki Renz
202 Windsor Avenue
Melrose Park, PA 19027

Thomas E. Pektas
233 Kutenai Trail
Mercer, PA 16137

Daniel H. McElreavey
27 Pleasant Road
Broomall, PA 19008

Laurence J. Colfer
609 E. Pleasant Grove Road
West Chester, PA 19382

Michael Silvestri
709 14th Avenue
Prospect Park, PA 19076

William & Kathleen Whiting
11879 Lake Drive
Connlaut Lake, PA 16316

Linda Palmisano
508 Towanda Street
White Haven, PA 18861

John Dillon
485 N. Buhl Farm Drive
Hermitage, PA 16148

Jerome Linden
201 Cornell Drive
Bryn Mawr, PA 19010

Arnold M. Kring
83 Winterberry Drive
Downingtown, PA 19335

Robert W. Curtius
949 Foss Avenue
Drexel Hill, PA 19026

Barry D. Polland
128 N. Wayne Street
West Chester, PA 19380

Stanley Lemond
2 Whitesell Court
Summit, NJ 07901

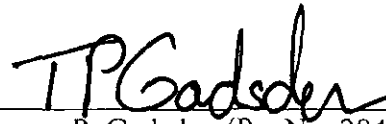
Honorable Kevin Murphy
Pennsylvania House of Representatives
118 East Wing
P.O. Box 202113
Harrisburg, PA 17120-2113

Honorable Phyllis Mundy
Pennsylvania House of Representatives
36 East Wing
P.O. Box 202120
Harrisburg, PA 17120-2120

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Thomas P. Gadsden (Pa. No. 28478)

tgadsden@morganlewis.com

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adecusatis@morganlewis.com

Brooke E. Leach (Pa. No. 204918)

bleach@morganlewis.com

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877.432.9652 (fax)

Kimberly A. Joyce (Pa. No. 86605)

KAJoyce@aquaamerica.com

Aqua Pennsylvania, Inc.

762 W. Lancaster Avenue

Bryn Mawr, PA 19010

610.525.1400

610.519.0819 (fax)

Counsel for Aqua Pennsylvania, Inc.

January 27, 2012

