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May 25, 2012

VIA HAND-DELIVERY

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

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

Dear Secretary Chiavetta:

Enclosed for filing, please find an original and nine (9) copies of the **Exceptions of Respondent, Aqua Pennsylvania, Inc.**, to the Recommended Decision of Administrative Law Judges Angela T. Jones and Darlene D. Heep issued May 18, 2012 in the above-referenced matter.

Please time-stamp the extra copy of these Exceptions and return to us in the envelope provided.

As indicated on the enclosed Certificate of Service, copies have been served on the Administrative Law Judges, the Office of Special Assistants (hard copy & CD) and all parties of record.

Sincerely,

Thomas P. Gadsden/mmw

Thomas P. Gadsden

TPG/tp
Enclosures

c: Per Certificate of Service (w/encls.)
Cheryl Walker Davis, Director, Office of Special Assistants (w/encls.)

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

PENNSYLVANIA PUBLIC UTILITY
COMMISSION, ET AL.

v.

AQUA PENNSYLVANIA, INC.

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Docket No. R-2011-2267958

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EXCEPTIONS OF RESPONDENT

AQUA PENNSYLVANIA, INC.

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

*To The Recommended Decision Of
Administrative Law Judges
Angela T. Jones and Darlene D. Heep*

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Date: May 25, 2012

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I. INTRODUCTION

On November 18, 2011, Aqua Pennsylvania, Inc. (“AP” or the “Company”) filed with the Pennsylvania Public Utility Commission (“PUC” or the “Commission”) Supplement No. 115 to Tariff Water-Pa. P.U.C. No. 1, requesting an increase in the Company’s total annual operating revenues of \$38.6 million, or approximately 9.4%, based on the level of operations projected for a future test year ending June 30, 2012. By Order entered January 12, 2012, the Commission initiated an investigation at Docket No. R-2011-2267958 to determine the lawfulness, justness and reasonableness of the Company’s existing and proposed rates. The requested rate increase was thereby suspended by law for the seven-month period provided under Section 1308(d) of the Public Utility Code (66 Pa.C.S. § 1308(d)), or until August 18, 2012. This matter was subsequently assigned to Administrative Law Judges Angela T. Jones and Darlene D. Heep (the “ALJs”) for hearing and the issuance of a Recommended Decision.

A total of 22 Formal Complaints and customer objection letters were filed with the Commission opposing the Company’s proposed rates. The Commission’s Bureau of Investigation and Enforcement (“I&E”) entered its appearance and fully participated in this proceeding. Among the Complainants and Intervenor, all elected inactive party status except the Office of Consumer Advocate (“OCA”), the Office of Small Business Advocate (“OSBA”), the Aqua Large Users Group (“Aqua LUG”), and pro se complainants Jerome Linden and Robert Curtius.

The active parties conducted extensive discovery and exchanged direct, rebuttal and surrebuttal testimony. In addition, five public input hearings were held in early March and, on April 10, 2012, an evidentiary hearing was held in Harrisburg to accommodate Mr. Curtius’

request to cross-examine certain witnesses and to provide the parties an opportunity to move their respective pre-filed statements and exhibits into the record.

On April 20, 2012, a Joint Petition for Settlement of Rate Investigation (“Joint Settlement Agreement”) was filed on behalf of the Company, I&E, the OCA and Aqua LUG.¹ Accompanying the Joint Settlement Agreement were Statements of Position submitted by each of the signatory parties explaining why they believed approval of the settlement was in the public interest; a proposed tariff supplement setting forth the settlement rates; and a proof of revenues. The Joint Settlement Agreement was timely served on the non-signatory active parties and on the formal complainants who had elected inactive party status. In the weeks that followed, comments opposing the Joint Settlement Agreement apparently were filed by Messrs. Linden and Curtius and by five of the inactive participants.²

On May 18, 2012, the ALJs issued their Recommended Decision (“R.D.”), proposing that the Joint Settlement Agreement be approved without modification and that the various complaints filed against Supplement No. 115 be dismissed. In so doing, the ALJs carefully considered and properly rejected the various objections lodged by Messrs. Linden and Curtius and the five inactive participants. The Company fully supports the ALJs’ overall resolution of this matter and respectfully submits that the expeditious approval of the Joint Settlement Agreement is in the public interest. These “Exceptions” are being filed for the limited purpose

¹ The OSBA did not execute the Joint Settlement Agreement, but has indicated that it does not oppose it.

² The Company was not served or otherwise provided copies of the comments submitted by Messrs. Linden and Curtius and the five inactive participants and, indeed, did not learn of their existence until it read the ALJs’ Recommended Decision.

of commenting on Attachment 1 to the Recommended Decision in which the ALJs purport to develop an estimate of the return on equity that the settlement rates might generate.

II. ARGUMENT

At page 39 of their Recommended Decision, the ALJs acknowledge that the Joint Petitioners have proposed a “black box” settlement agreement and further observe that the stipulated annual increase in operating revenues of \$16.7 million cannot be correlated to any particular return on equity (“ROE”). Nonetheless, possibly in an attempt to address the reasonableness of allowing the Company to calculate its Distribution System Improvement Charge (“DSIC”) using an equity return rate of 10.2% (*see* Joint Settlement Agreement, paragraph 7e), the ALJs endeavor “to determine what the ROE for the increase could possibly yield.” To that end, the ALJs’ attempt to calculate a “fall-out” ROE “using the methodology provided by [OSBA witness] Kalcic” (R.D., p. 39).

The ALJs’ ROE calculation, which is set forth in Attachment 1 to the Recommended Decision, should be disregarded for several reasons. First, there was no need for the ALJs to go through this exercise because there is no meaningful correlation between the ROE produced by the DSIC, which is reconciled annually and applies only to certain specified categories of plant, and the ROE produced by base rates, which are not “trued-up” and encompass a utility’s entire rate base. Second, base rates seldom generate the authorized ROE because of regulatory lag and the inevitable variability of revenue and expense levels. Third, the DSIC rate stipulation is often included in settlement agreements and is but one term in a comprehensive settlement agreement, which, by definition, reflects compromises on behalf of all parties.

Fourth, Mr. Kalcic never claimed that his “methodology” could be utilized as a proxy for determining a utility’s ROE; indeed, he acknowledged that it was based on certain simplifying

assumptions, i.e. that “all else [was] equal” (OSBA St. 1, p. 6). Moreover, the ALJs misapplied Mr. Kalcic’s “methodology” when they erroneously concluded that the figures appearing on Lines 7-9 of Mr. Kalcic’s Schedule BK-1 were static values which could be imported into their analysis without change. In fact, the avoided uncollectibles and PUC assessments expense (Line 7), state income taxes (Line 8) and federal income taxes (Line 9) on Mr. Kalcic’s Schedule were derived by multiplying the indicated percentages for the three items (1.23%, 9.99% and 35.0%) by the “Difference/Savings” shown on Line 6. When the ALJs substituted a new figure on Line 6 of Attachment 1 (i.e., \$21,900,069 in lieu of Mr. Kalcic’s \$29,960,000), it was incumbent upon them to recalculate the values on Lines 7-9. By failing to do so, the ALJs substantially overstated the “hypothetical” ROE.

Finally, the ALJs imply that because their “hypothetical” base rate ROE, as they calculate it, exceeds the stipulated DSIC ROE of 10.2%, customers “should realize a significant period of a stable DSIC” (R.D., p. 39). The ALJs are correct that the Company will not be able to reactivate its DSIC unless its achieved ROE is below 10.2%. However, that determination will not be made based on the ALJs’ estimate of the ROE the settlement rates are likely to produce, but rather on the actual return levels set forth in AP’s quarterly earnings reports to the Commission. Moreover, while the return rate component of the DSIC will remain relatively “stable” due to the parties’ stipulation, the overall DSIC charge will undoubtedly grow over time if the Company is to continue to promote economic development by accelerating the replacement and rehabilitation of aging infrastructure.

III. CONCLUSION

For the foregoing reasons, the Commission should disregard Attachment 1 to the Recommended Decision, but otherwise approve the Joint Petition for Settlement and allow the Settlement Rates to become effective on one day's notice.

Respectfully submitted,



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Counsel for Aqua Pennsylvania, Inc.

Date: May 25, 2012

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

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

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COMMISSION, ET AL.**

v.

AQUA PENNSYLVANIA, INC.

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Docket No. R-2011-2267958

CERTIFICATE OF SERVICE

I hereby certify and affirm that I have this day served copies of the **Exceptions of Respondent, 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

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**PA PUBLIC UTILITY COMMISSION
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May 25, 2012