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PETITION OF

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VIRGINIA AMERICAN WATER COMPANY,
AQUA VIRGINIA, INC., AND MASSANUTTEN
PUBLIC SERVICE CORPORATION

CASE NO. PUE-2014-00066

For Rulemaking to establish a Water and
Wastewater Infrastructure Service Charge

REPORT OF ALEXANDER F. SKIRPAN, JR., SENIOR HEARING EXAMINER

June 8, 2015

The Petitioners have asked the Commission to adopt a set of rules by which water and wastewater utilities may establish a rate surcharge designed to recover costs associated with the replacement of aging infrastructure. Staff supported the adoption of rules, but recommended a number of changes designed to provide safeguards. Respondents were split on whether the Commission has the authority to adopt such rules, but all opposed adoption of rules by the Commission. Nonetheless, the Respondents offered several changes to the proposed rules if the Commission decides to adopt rules. I find that the Commission has the statutory authority to adopt rules, and that if the Commission decides to adopt rules, the rules as proposed by Staff should be adopted with the exception of adjustments to the language related to limits or caps, notice and hearing, prudent and reasonable standard, rate design, and earnings test. However, on the question of whether the Commission should adopt rules, I find that Petitioners failed to prove the need for the proposed rules and recommend that the Commission deny this Petition.

HISTORY OF THE PROCEEDING

On June 27, 2014, Virginia American Water Company ("Virginia American"), Aqua Virginia, Inc. ("Aqua"), and Massanutten Public Service Corporation ("Massanutten") (collectively, "Petitioners"), filed a Petition for Rulemaking requesting that the State Corporation Commission ("Commission") initiate a rulemaking to establish rules allowing water and wastewater companies in Virginia to apply to the Commission for the establishment of a Water and Wastewater Infrastructure Service Charge ("WWISC") including a plan for investing in eligible infrastructure ("WWISC Plan") and for the recovery of the costs of such a program ("Proposed Rules"). As proposed, each utility would recover the costs associated with the WWISC Plan through a WWISC Rider.

On August 19, 2014, the Commission issued an *Order Establishing Proceeding* that, among other things, directed that notice of the Proposed Rules be given to the public; and that interested persons be provided an opportunity to file written comments on, propose modifications or supplements to, or request a hearing on the Proposed Rules. The Commission further directed that any person commenting on the Proposed Rules also address the authority of the Commission to issue the Proposed Rules and, assuming the Commission has such authority,

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whether it is appropriate for the Commission to exercise such authority absent specific statutory direction from the Virginia General Assembly.

On December 5, 2014, the Commission issued its Order for Notice and Hearing. The Commission noted that it has received many comments on the Proposed Rules and that several interested persons requested that the Commission convene a hearing on the Proposed Rules. Among other things, the Commission scheduled a public hearing for March 10, 2015; set the date for respondents to file direct testimony on or before January 27, 2015; directed each Petitioner to serve a copy of the Order for Notice and Hearing on each of its customers; and appointed a hearing examiner to conduct all further proceedings in this matter on behalf of the Commission and to file a final report.

Notices of participation were filed in this proceeding by: (i) Caroline County, Virginia (“Caroline County”), on January 8, 2015; (ii) Great Eastern Resort Corporation and Great Eastern Resort Management, Inc. (collectively, “Massanutten Resort”), on January 9, 2015; (iii) the Blacksburg Country Club, Inc., the Blacksburg Country Club Estates Homeowners’ Association, Mr. Robert A. S. Wright, and Dr. William G. Foster (collectively, “Homeowners”), on January 12, 2015; (iv) the Office of the Attorney General’s Division of Consumer Counsel (“Consumer Counsel”), on January 13, 2015; (v) City of Alexandria, Virginia (“City of Alexandria”), on January 13, 2015; (vi) Board of Supervisors of Frederick County, Virginia (“Frederick County”), on January 13, 2015; (vii) Concerned Ratepayers in the Eastern District (“CRED”),¹ on January 13, 2015; and (viii) the Massanutten Property Association, Inc. (“Association”), on January 13, 2015. The Lake Monticello Owners Association (“Lake Monticello Owners”), became Respondents during the public hearing held on March 10, 2015.²

During the course of this proceeding, the Commission received written comments from five state legislators, eleven local governments and organizations, and 413 individuals not otherwise participating as Respondents.

The comments received from legislators are as follows: **Margaret B. Ransone**, Member, House of Delegates, and **Ryan T. McDougle**, Member, Senate of Virginia, filed comments opposing the WWISC and stating that any change in the criteria for regulating water and wastewater should be vetted through the legislative process; **Robert B. Bell**, Member, House of Delegates, filed comments requesting the Commission make every effort to preserve the lowest possible rates for consumers since the Aqua rate increases over the last several years are already a burden; **Hyland F. Fowler, Jr.**, Member, House of Delegates, filed comments stating that he is not confident that the Commission has the legislative authority to establish the WWISC and that the Commission usually defers this type of authority to the General Assembly; and **Richard H. Stuart**, Member, Senate of Virginia, filed comments requesting that the

¹ The members of CRED are as follows: the counties of Westmoreland, Northumberland, and Lancaster, and the following entities: Ebb Tide Beach Community Association, Church Point Property Owners Association, Cabin Point Civic Association, Glebe Harbor Civic Association, Potomac-Westmoreland Shores Civic Corporation, Stratford Harbour Property Owners Association, Corrotoman by the Bay Association, and Sherwood Forest Association.

² Transcript at 36.

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Commission reject the Petitioners' request for the administrative establishment of the WWISC and stating that he does not believe that the Proposed Rules are authorized by law due to the lack of directive from the General Assembly.

The comments received from local governments and organizations are as follows: Middlesex County, Virginia; Northumberland County, Virginia; Lancaster County, Virginia; Middle Peninsula Regional Jail Authority; Goochland County, Virginia; Fluvanna County, Virginia; City of Manassas Park, Virginia; Prince William County, Virginia; Lake Holiday Country Club, Inc.; and The Parke at Manakin Woods Homeowners Association, Inc., filed comments in opposition to the Petition and questioned the Commission's authority to adopt the Proposed Rules stating that it would be inappropriate for the Commission to exercise the authority without specific statutory direction from the General Assembly. The County of Powhatan, Virginia, filed comments stating that the Commission probably does have authority to issue the Proposed Rules, but that the Commission should decline absent specific statutory authority from the General Assembly.

Of the 413 individuals that filed comments, 397 comments were filed in opposition to the WWISC. The sixteen other comments included statements explaining how the current rates are burdensome to customers who live on fixed incomes and requested that the Commission keep rates reasonable.

On January 16, 2015, Caroline County filed its Motion for Expedited Extension of Procedural Schedule and Bifurcation of Hearing ("Bifurcation Motion"). Caroline County asked that: (i) the March Hearing be bifurcated such that only legal issues before the Commission would be heard on March 10, 2015; (ii) a second hearing on the Proposed Rules be scheduled for an established future date (i.e., 60 days from March 10, 2015), should such a hearing be necessary; and (iii) the remaining deadlines for the filing of direct testimony, including respondent testimony, Staff and rebuttal testimony, and any other deadlines, be continued until after March 10, 2015, when new deadlines commensurate with the date of the second hearing may be established. Caroline County was joined in its Bifurcation Motion by CRED, the Association, the City of Alexandria, Frederick County, and the Homeowners. On January 28, 2015, the Petitioners and Staff filed responses in opposition to the Bifurcation Motion. On February 2, 2015, Caroline County filed its reply. The Bifurcation Motion was denied in a Hearing Examiner's Ruling dated February 3, 2015.

On February 11, 2015, the City of Alexandria filed its Motion to Dismiss Petition for Rulemaking to Establish a Water and Wastewater Infrastructure Service Charge and Request for Expedited Hearing ("Motion to Dismiss"). The City of Alexandria contended that implementation of Proposed Rules requires that the General Assembly amend or modify §§ 56-235.2 and 56-235.3 of the Code of Virginia ("Code"), because "the Commission has no authority to create a rule that is clearly inconsistent with existing statutes."³ Because the Motion to Dismiss raised both factual and legal issues and because the legal issue posed by the Motion to Dismiss could not be answered without the development of a record, the Motion to Dismiss was

³ Motion to Dismiss at 9.

held in abeyance pending further development of the record in a Hearing Examiner's Ruling dated February 13, 2015.

The public hearing in this matter was convened on March 10, 2015, as scheduled. Timothy E. Biller, Esquire, and Richard D. Gary, Esquire, of Hunton & Williams, LLP, appeared on behalf of the Petitioners. M. Ann Neil Cosby, Esquire, of Sands Anderson appeared on behalf of Caroline County, CRED, and the Association. Michael J. Quinan, Esquire, of Christian & Barton, LLP, and Mark B. Callahan, Esquire, of Clark & Bradshaw, P.C., appeared on behalf of Massanutten Resort. Roderick B. Williams, Esquire, appeared on behalf of Frederick County. Karen S. Snow, Esquire, appeared on behalf of the City of Alexandria. Frank Buck, Esquire, appeared on behalf of the Lake Monticello Owners. C. Mitch Burton, Jr., Esquire, and C. Mead Browder, Jr., Esquire, appeared on behalf of Consumer Counsel. Garland S. Carr, Esquire, and Fred Ochsenhirt, Esquire, appeared on behalf of Staff.

SUMMARY OF THE RECORD

Petitioners' Direct Testimony

On January 6, 2014, the Petitioners filed the direct testimony of William R. Walsh, president of Virginia American; and Gary L. Akmentins, manager of rates and regulations for the Mid-Atlantic Division of American Water Works Service Company. A summary of their testimony is provided below.

William R. Walsh discussed the problem of aging infrastructure in Virginia American's service territories and the benefits of an infrastructure service charge.⁴ Mr. Walsh asserted that water mains should be replaced after 100 years of service.⁵ Mr. Walsh testified that other factors that impact the useful life of a water main include the quality of the pipe, criticality of the pipe, quality of the installation, and the number of main breaks.⁶

Mr. Walsh maintained that replacement facilities are more costly than the replaced infrastructure due to inflation, the removal and restoration of pavement, and limitations or restrictions of working hours.⁷ Mr. Walsh asserted that the replacement of infrastructure in an urban area like Alexandria is a challenge due to the impact such construction has on traffic, residents, and businesses.⁸ Mr. Walsh advised that for Virginia American to replace 1% of its pipeline, it would require the replacement of about 7.6 miles of pipe per year.⁹ Mr. Walsh stated that Virginia American currently replaces about 1.5 miles of pipe per year, or a rate that would require over 500 years "to replace the mains that are expected to last not much more than 100 years."¹⁰

⁴ Exhibit No. 3, at 2.

⁵ *Id.* at 4.

⁶ *Id.*

⁷ *Id.* at 5.

⁸ *Id.* at 5-6.

⁹ *Id.* at 6.

¹⁰ *Id.*

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Mr. Walsh pointed out that the Petitioners must comply with state and federal drinking water standards such as the mandatory national primary drinking water regulations (“NPDWRs”) promulgated by the EPA.¹¹ Mr. Walsh noted that the EPA has established national secondary drinking water regulations that serve as guidelines for aesthetic considerations such as taste, color, and odor.¹² Mr. Walsh maintained that a WWISC will permit the Petitioners to accelerate their ability to address water quality issues.¹³

Mr. Walsh testified that a WWISC in Virginia will help reduce the frequency of costly general rate cases and will allow for more gradual rate increases.¹⁴ Mr. Walsh contended that a WWISC will provide consumer protection and transparency through Commission approval and annual oversight, including annual informational filings.¹⁵ Mr. Walsh maintained that the purpose of the WWISC is to: (i) improve quality and service, (ii) incent private investment, (iii) help create jobs, (iv) smooth the financial impact on customers of necessary rate increases, and (v) maintain regulatory oversight.¹⁶ Mr. Walsh acknowledged that Virginia American must replace its infrastructure as it breaks, but asserted that it is more optimal to replace infrastructure at a rate that matches its useful life.¹⁷ Mr. Walsh stated that “[r]eplacing pipes that are near the end of their useful life in a systematic and responsible manner will result in lower costs to consumers over time”¹⁸

Mr. Walsh asserted that the WWISC does not deprive customers of regulatory protections, but focuses oversight on infrastructure improvement.¹⁹ Mr. Walsh contended that the WWISC would allow the Petitioners to better communicate with customers concerning upcoming infrastructure projects and provide for more gradual and incremental increases, unlike traditional base rate cases.²⁰ Finally, Mr. Walsh maintained that the WWISC is a “best practice” for water and sewer utilities, and listed the fifteen other states that have adopted similar measures for such utilities.²¹

Gary L. Akmentins acknowledged that in Virginia, a utility may recover infrastructure investments “reasonably predicted to occur” in the rate year following a base rate case.²² Mr. Akmentins maintained that this is a very limited horizon for the replacement of infrastructure and requires successive rate cases to recover the carrying costs of continual

¹¹ *Id.*

¹² *Id.* at 7.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ *Id.* at 8.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at 9.

¹⁹ *Id.* at 10.

²⁰ *Id.* at 10-11.

²¹ *Id.* at 11.

²² Exhibit No. 5, at 4.

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investments.²³ Mr. Akmentins stated that the nature of investment for water and wastewater utilities has shifted from plant needed to serve new customers to non-revenue producing infrastructure replacements.²⁴ Mr. Akmentins contended that the proposed WWISC supports accelerating investment in infrastructure replacements.²⁵

Mr. Akmentins offered a resolution adopted by the National Association of Regulatory Utility Commissioners (“NARUC”) in November 2013 as further support for the proposed WWISC.²⁶

Mr. Akmentins testified that adoption of the proposed WWISC would continue Commission oversight of increased or adjusted WWISC service charges.²⁷ Mr. Akmentins also affirmed that there would be opportunities for customers and interveners to participate in the process.²⁸ Mr. Akmentins asserted that accelerating the replacement of aging infrastructure will lower costs to customers over time.²⁹

Mr. Akmentins outlined the proposed rules for the WWISC, and advised that the WWISC is similar in nature to the Steps to Advance Virginia’s Energy (“SAVE”)³⁰ Act for gas utilities in Virginia.³¹ Mr. Akmentins stated that the WWISC process will begin with a utility proposing an infrastructure replacement program.³² Mr. Akmentins advised that Staff and other interested parties will then review the planned investment and cost information.³³ The utility will then propose a WWISC using traditional ratemaking methodology.³⁴ Mr. Akmentins affirmed that investments already included in rate base, and investments to connect new customers are not eligible for the WWISC.³⁵

Mr. Akmentins testified that the WWISC would be based on the most recent rate of return on rate base used to calculate a revenue requirement, and a revenue conversion factor to gross-up for taxes.³⁶ In addition, Mr. Akmentins confirmed that depreciation expense would be based on current authorized rates and that the WWISC would include property taxes related to the investment.³⁷ Mr. Akmentins stated that the “net investment in WWISC-eligible

²³ *Id.* at 5.

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.* at 6.

²⁷ *Id.* at 8.

²⁸ *Id.*

²⁹ *Id.* at 9.

³⁰ §§ 56-603 and 56-604 of the Code.

³¹ *Id.* at 10.

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.* at 11.

³⁶ *Id.*

³⁷ *Id.*

infrastructure is used to reflect the replacement and disposal (retirement) of the original assets.”³⁸ Finally, Mr. Akmentins advised that the WWISC will use rate year average rate base components for net investment, accumulated depreciation, and deferred income taxes.³⁹

Mr. Akmentins stated that the utility will propose the duration of the WWISC Plan and its costs.⁴⁰ Under the Proposed Rules, the Commission may require notice and hearing, but must approve or deny the request within 180 days.⁴¹ Mr. Akmentins confirmed that the WWISC Rider will be updated, reconciled, and calculated annually.⁴²

Mr. Akmentins testified that the Petitioners expect the WWISC to be about 5% to 7% of a customer’s bill.⁴³ Mr. Akmentins contended that utilities should be able to charge a WWISC surcharge consistent with its current base rates.⁴⁴

CRED and Caroline County Testimony

On January 27, 2015, CRED and Caroline County filed the direct testimony of D. Wayne Trimble, president of Trimble & Associates. Mr. Trimble’s testimony is summarized below.

D. Wayne Trimble testified that the WWISC violates the long-standing doctrine in Virginia against single-issue ratemaking.⁴⁵ Mr. Trimble cited to § 56-235.2 of the Code and maintained that rates must be determined in the “aggregate.”⁴⁶ Mr. Trimble contended that the establishment of a surcharge singles out a specific expenditure for recovery with no opportunity for the review and quantification of related cost and revenue categories.⁴⁷ Mr. Trimble asserted that such an approach is “unbalanced.”⁴⁸

Mr. Trimble acknowledged that the General Assembly has authorized single-issue ratemaking but not for water and wastewater utilities.⁴⁹ Indeed, Mr. Trimble argued that the Petitioners have failed to demonstrate that current ratemaking procedures are inadequate or that single-issue ratemaking is required.⁵⁰ Mr. Trimble disagreed with the Petitioners’ contention that the high cost of filing a base rate case supports single-issue ratemaking.⁵¹ Mr. Trimble stated that he was unaware “of any statute or other authority that allows the Commission to consider the

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.* at 12.

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.* at 13.

⁴⁴ *Id.* at 14-15.

⁴⁵ Exhibit No. 6, at 5.

⁴⁶ *Id.*

⁴⁷ *Id.* at 6.

⁴⁸ *Id.*

⁴⁹ *Id.* at 6-7.

⁵⁰ *Id.* at 7.

⁵¹ *Id.* at 8.

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cost of a rate case (*i.e.*, the cost of doing business), as a reason to reject the well-established procedure set forth in [§ 56-235.2 of the Code], in which rates are established in the aggregate.”⁵²

Mr. Trimble maintained that the WWISC could be detrimental to customers who would be required to pay surcharges for infrastructure improvements in other parts of the state where construction costs are higher.⁵³ Mr. Trimble also contended that the WWISC would eliminate a utility’s incentive to control costs.⁵⁴

Mr. Trimble testified that the WWISC will not benefit ratepayers in the long term.⁵⁵ Mr. Trimble pointed out that there is no cap or limit to the amount or size of the surcharge.⁵⁶ Furthermore, Mr. Trimble asserted that “[t]his transfer of business risk must be reflected in the [Petitioners’] rate of return on equity.”⁵⁷

Mr. Trimble distinguished between “safe and reliable service” for a gas utility and a water utility and contended that when a water main breaks, “there is generally little concern for the safety of the general public.”⁵⁸ Mr. Trimble expressed concern that administering the WWISC for all Virginia utilities would require a significant amount of time and resources.⁵⁹ Mr. Trimble asserted that requiring customers to prefund the cost of system replacements “is unwarranted as well as unauthorized.”⁶⁰

Finally, Mr. Trimble pointed to the recent rate history of Virginia American and Aqua and asserted that “the Commission must consider the impact of any rate increase in these difficult times.”⁶¹

Massanutten Resort Testimony

On January 27, 2015, Massanutten Resort filed the direct testimony of Brian C. Collins, an associate with Brubaker & Associates, Inc. Mr. Collins’ testimony is summarized below.

Brian C. Collins took no position on whether the Commission has the authority to issue the Proposed Rules, but supported continued use of traditional cost of service ratemaking.⁶² Mr. Collins asserted that a surcharge, or single-issue ratemaking, can reduce a utility’s incentive

⁵² *Id.*

⁵³ *Id.*

⁵⁴ *Id.* at 9.

⁵⁵ *Id.*

⁵⁶ *Id.* at 10.

⁵⁷ *Id.*

⁵⁸ *Id.* at 11.

⁵⁹ *Id.*

⁶⁰ *Id.* at 12.

⁶¹ *Id.*

⁶² Exhibit No. 7, at 4.

to control or reduce expenses.⁶³ Mr. Collins maintained that a surcharge should be used only when cost and expenses are “largely outside the control of the utility or volatile.”⁶⁴ Mr. Collins stated that maintaining and upgrading infrastructure is neither volatile nor outside the control of a utility.⁶⁵ In addition, Mr. Collins contended that improvements in infrastructure may reduce operation and maintenance (“O&M”) expenses without such savings reducing the surcharge revenue requirement.⁶⁶

Mr. Collins testified that if the Commission adopts the Proposed Rules, Proposed Rule 20 VAC 5-318-20 E should be modified to ensure direct assignment of WWISC costs to the rate class or classes that cause them.⁶⁷ Mr. Collins further maintained that a WWISC be developed for each customer class.⁶⁸ Mr. Collins recommended adding the following language to the end of proposed subsection E:

To the extent possible, direct assignment of costs will occur to the classes that cause a utility to incur them. This will prevent any one class or classes from being subsidized and reflect proper cost causation. A surcharge will be developed for each class and recover that class’s respective costs allocated to it.⁶⁹

Mr. Collins expressed concern that Proposed Rule 20 VAC 5-318-20 F may fail to synchronize a utility’s investment included in base rates with the incremental eligible investment subject to the WWISC.⁷⁰ Thus, Mr. Collins recommended that the following language be added to the end of proposed subsection F:

However, this does not preclude the offset of depreciation expense included in base rates from being applied to the eligible infrastructure revenue requirement to be recovered by a surcharge.⁷¹

Mr. Collins provided an example showing that if a surcharge is implemented to recover the revenue requirement for \$15 million of eligible infrastructure investment without an offset for the \$10 million of depreciation expense included in existing base rates, then the utility would collect an additional \$800,000 from customers each year.⁷²

⁶³ *Id.* at 5-6.

⁶⁴ *Id.* at 6.

⁶⁵ *Id.*

⁶⁶ *Id.*

⁶⁷ *Id.* at 7.

⁶⁸ *Id.*

⁶⁹ *Id.* at 8.

⁷⁰ *Id.*

⁷¹ *Id.* at 9.

⁷² *Id.* at 11-12.

Mr. Collins testified that in approving the proposed WWISC, the Commission should review the makeup of the utility's customer classes to insure that the cost of eligible infrastructure is collected only from the customers who cause the utility to incur such costs.⁷³ Mr. Collins recommended a possible condition for approving a surcharge could be that the utility agree not to file a base rate case for a specified period of time.⁷⁴ Mr. Collins contended that a utility's return on equity should be reduced if a surcharge is approved.⁷⁵ Finally, Mr. Collins stated that the Commission may consider the inclusion of an efficiency factor in the WWISC to reflect increased O&M efficiencies associated with any new infrastructure.⁷⁶

City of Alexandria Testimony

On January 27, 2015, the City of Alexandria filed the direct testimony of Carl W. Eger, energy manager for the City of Alexandria. Mr. Eger's testimony is summarized below.

Carl W. Eger addressed the impact of the WWISC on the ratepayers of the City of Alexandria.⁷⁷ Mr. Eger pointed out that in Virginia American's prior two rate cases, Virginia American failed to indicate the need for infrastructure investment that it deemed exceptional.⁷⁸ Mr. Eger affirmed Virginia American's need to replace aging, non-revenue generating infrastructure, and advised that the City of Alexandria operates 189 miles of storm sewer, 240 miles of sanitary sewer, and six miles of combined sewer lines.⁷⁹ However, Mr. Eger maintained that there is a need for infrastructure investment to be examined in a public process such as a base rate case.⁸⁰ Mr. Eger also maintained that Virginia American has not alleged previously that its infrastructure is in jeopardy due to regulatory lag.⁸¹

Mr. Eger questioned whether the infrastructure replaced through the WWISC is truly non-revenue producing, as such replacements may be designed to increase capacity to meet future growth.⁸² Mr. Eger also contended that infrastructure replacements "will likely have countervailing operating cost reductions."⁸³ Mr. Eger asserted that such cost interdependencies should be weighed together in a base rate case.⁸⁴

Mr. Eger maintained that the effect of the proposed WWISC on ratepayers is uncertain, but "could likely lead to potentially unfair and unreasonable costs to ratepayers."⁸⁵ Mr. Eger

⁷³ *Id.* at 12.

⁷⁴ *Id.* at 13.

⁷⁵ *Id.*

⁷⁶ *Id.* at 13-14.

⁷⁷ Exhibit No. 8, at 4.

⁷⁸ *Id.* at 5.

⁷⁹ *Id.* at 6.

⁸⁰ *Id.*

⁸¹ *Id.* at 7.

⁸² *Id.*

⁸³ *Id.* at 8.

⁸⁴ *Id.*

⁸⁵ *Id.*

testified that the cost of debt and equity determined in the utility's prior base rate case may be five years old and may need to be updated.⁸⁶ Mr. Eger pointed out that the WWISC, as proposed, does not limit the annual increase in the WWISC or cap the total WWISC as a percentage of revenue.⁸⁷

Mr. Eger contended that surcharges such as the WWISC are not favored by ratepayers because they:

- 1) contradict sound rate of return ratemaking principles, 2) circumvent [the] public's right to sufficient regulatory review which evaluates prudence and reasonableness, 3) eliminate[] the incentive for [Virginia American] to control costs between rate cases, 4) reduce[] rate stability from more frequent rate cases, 5) inappropriately reward[] water companies that imprudently fall behind in infrastructure improvements, and 6) shift[] business risk away from water companies to ratepayers.⁸⁸

Mr. Eger asserted that the Petitioners failed to provide any evidence that base rate cases will be filed on a less-frequent basis.⁸⁹ Mr. Eger also contended that the Petitioners failed to provide any evidence that the WWISC is modest, incremental, or limited in magnitude or cost.⁹⁰ Mr. Eger pointed out that under current rate case rules, the Petitioners may recover investment which is reasonably predicted to occur during the rate year.⁹¹ Mr. Eger provided a copy of a resolution adopted on July 14, 2005, by the National Association of State Utility Consumer Advocates ("NASUCA") opposed to infrastructure replacement programs such as WWISC.⁹²

Staff Testimony

On February 10, 2015, Staff filed the direct testimony of Scott C. Armstrong, manager for the Commission's Division of Utility Accounting and Finance; and Marc A. Tufaro, principal utilities analyst for the Commission's Division of Energy Regulation. A summary of their direct testimony is provided below.

Scott C. Armstrong testified that the Proposed Rules are similar in nature to the SAVE program available to natural gas utilities.⁹³ Mr. Armstrong confirmed that under the SAVE program, the Commission has approved specific infrastructure replacement plans, which

⁸⁶ *Id.* at 9.

⁸⁷ *Id.*

⁸⁸ *Id.* at 10.

⁸⁹ *Id.*

⁹⁰ *Id.* at 11.

⁹¹ *Id.* at 14.

⁹² *Id.* at 15-17.

⁹³ Exhibit No. 9, at 3; *See, Application of Washington Gas Light Company, For approval of a SAVE plan and rider as provided by Va. Code § 56-604, Case No. PUE-2010-00087, 2011 S.C.C. Ann. Rep. 345.*

included plan termination dates and yearly plan spending limits.⁹⁴ Mr. Armstrong also compared the Proposed Rules to those established in *Roanoke Gas*.⁹⁵ Mr. Armstrong stated that in *Roanoke Gas*, the Commission established an automatic adjustment clause that lasted three years and was designed to recover costs associated with the replacement of bare steel and cast iron sections of its distribution system.⁹⁶ Mr. Armstrong pointed out that in *Roanoke Gas*, the utility was subject to an annual earnings test and the utility agreed not to file for a non-gas rate increase during the three-year surcharge period.⁹⁷

Mr. Armstrong maintained that if the Commission decides to adopt the Proposed Rules, Staff recommends the changes summarized below:

- information to be included in initial WWISC Plan applications;
- limitations on annual and total eligible expenditures during the WWISC Plan;
- procedures for amending existing WWISC Plans;
- prohibitions on certain cross-subsidizations;
- procedures for filing annual updates and reconciliations of the WWISC Rider;
- recommendations regarding the carrying charge on reconciling amounts;
- procedures for resetting the WWISC Rider to zero following a base rate case;
- the evaluation of WWISC recoveries in the context of overall earnings;
- provisions regarding Staff's ability to review the contractor bidding process; and
- the commencement date for WWISC-eligible investment and the WWISC Rider.⁹⁸

Mr. Armstrong recommended that a petition for a WWISC Plan contain the proposed accounting for the WWISC Plan, including: (i) proposed journal entries; (ii) anticipated current and deferred income tax impacts; (iii) the means for segregating WWISC investment from non-WWISC investment; and (iv) the method for reporting and tracking plant retired from service as a result of WWISC investment.⁹⁹ Mr. Armstrong testified that WWISC filings should include a detailed description of the infrastructure to be replaced and how each investment activity complies with the Proposed Rules.¹⁰⁰

⁹⁴ Exhibit No. 9, at 3.

⁹⁵ *Id.* at 4; *Application of Roanoke Gas Company, For general increase in rates and to revise its tariff*, Case No. PUE-1998-00626, 1999 S.C.C. Ann. Rep. 440 ("*Roanoke Gas*").

⁹⁶ Exhibit No. 9, at 4.

⁹⁷ *Id.* at 4-5.

⁹⁸ *Id.* at 9.

⁹⁹ *Id.* at 10.

¹⁰⁰ *Id.*

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Mr. Armstrong maintained that WWISC Plans should not be open-ended recovery mechanisms and thus stated that a WWISC petition should include proposed investment limits and ranges for the duration of the WWISC Plan.¹⁰¹

More specifically, Mr. Armstrong recommended that Proposed Rule 20 VAC 5-318-20 A of the Proposed Rules be modified as follows:

A. A water or wastewater utility may petition the Commission for the approval of a WWISC Plan. Such a petition for approval of a WWISC Plan shall include, at a minimum:

- 1) A description of the categories, types, locations, plant sub-accounts impacted, targeted plant vintages, targeted material compositions, and cost estimates of eligible infrastructure projects to be included in the WWISC [P]lan.
- 2) Reporting on the projected linear feet and diameter of replacement mains and those replaced, the number of and size of replacement services and those replaced, the number of meters projected to be replaced and other applicable facts.
- 3) Proposed spending limits and ranges on the WWISC-eligible investment for the duration of the WWISC Plan, as well as proposed annual spending limits and ranges.
- 4) Detailed and transparent analysis of how each investment activity complies with the WWISC rules.
- 5) The effective date of the proposed WWISC [R]ider.
- 6) The proposed accounting for WWISC Plan costs, recoveries and deferrals.
- 7) Anticipated current and deferred income tax impacts of WWISC activity, including tax savings resulting from Domestic Production Activity Deductions, if applicable.
- 8) Discussion and illustrative example of how WWISC-eligible investment will be segregated on the books and records from non-WWISC investment.
- 9) Workpapers supporting the WWISC [R]ider revenue requirement including, at a minimum:
 - (a) the depreciable base and applicable depreciation rates by sub-account,
 - (b) property tax rates and the taxable base,
 - (c) capital structure and overall weighted cost of capital,
 - (d) revenue conversion factor, and
 - (e) carrying costs on any over or under-recovery.
- 10) Duration of the WWISC [P]lan.

¹⁰¹ *Id.* at 11.

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- 11) The method by which the utility will provide annual updates of the WWISC [R]ider.
- 12) Proposed tariffs for the WWISC Plan.
- 13) Sample customer impacts by rate schedule, group, and/or district.¹⁰²

Mr. Armstrong reviewed the limits placed on WWISC-like mechanisms in other states and advised that the Commission could view a limit on the WWISC Rider revenues as a percentage of total revenues, or a limit on WWISC investment in a WWISC Rider as a percentage of rate base as appropriate consumer safeguards.¹⁰³ Mr. Armstrong provided calculations of a 5% cap of jurisdictional revenue and a 10% cap on jurisdictional rate base for each of the Petitioners.¹⁰⁴

Mr. Armstrong noted that as proposed, the initial application to establish a WWISC Plan provides for customer notice and an opportunity for a hearing, but subsequent revisions may be handled on an administrative basis.¹⁰⁵ Mr. Armstrong pointed out that under the SAVE Act, natural gas companies modifying an existing SAVE Plan do so in a docketed proceeding with an opportunity for hearing and participation by interested parties.¹⁰⁶ Mr. Armstrong recommended that the language of Proposed Rule 20 VAC 5-318-20 C be modified to read as follows:

C. The Commission shall approve, modify, or deny, within 120 days, a water or wastewater utility's application to amend a previously approved plan. If the Commission denies such a plan or amendment, it shall set forth with specificity the reason for such denial, and the utility shall have the right to refile, without prejudice, an amended plan or amendment within 60 days, and the Commission shall thereafter have 60 days to approve, modify, or deny the amended plan or amendment.¹⁰⁷

Mr. Armstrong testified that WWISC Rider tariff updates based on both changes in the projected level of costs and the true-up of historic costs and recoveries should be combined into one proceeding.¹⁰⁸ Mr. Armstrong maintained that the WWISC Rider should not be administered as an automatic rate adjustment clause because WWISC-eligible investment does not appear to be an activity over which the utility has little control.¹⁰⁹

¹⁰² *Id.* at 12-13 (underlines in original).

¹⁰³ *Id.* at 15.

¹⁰⁴ *Id.*

¹⁰⁵ *Id.* at 16.

¹⁰⁶ *Id.*

¹⁰⁷ *Id.* at 17, Attachment A, at 5.

¹⁰⁸ *Id.* at 17-18.

¹⁰⁹ *Id.* at 18.

Mr. Armstrong acknowledged that the 90-day review period for a utility's proposed WWISC Rider adjustment is consistent with the review period in the SAVE Act.¹¹⁰ Nonetheless, Mr. Armstrong noted that the proposed period "limits the ability to thoroughly audit all associated costs, recoveries, deferrals and rider calculations."¹¹¹ Therefore, Mr. Armstrong recommended that the Proposed Rules state that "[t]he [C]ommission may approve, modify, or deny, within 120 days, a water or wastewater utility's proposed WWISC Rider and WWISC Rider True-up Adjustment."¹¹²

In regard to the potential for cross-subsidization, Mr. Armstrong recommended that Proposed Rule 20 VAC 5-318-20 E include the following, "The WWISC [R]ider should create no cross-subsidization among operations (i.e. water versus wastewater) or among jurisdictions with separate cost of service analyses."¹¹³

In order to prevent overlapping recovery of the costs of WWISC investment through base rates and the WWISC Rider, Mr. Armstrong recommended that Proposed Rule 20 VAC 5-318-20 H read as follows:

A water or wastewater utility that has an approved WWISC Plan and Rider pursuant to this chapter shall file revised rate schedules to cease recovery of the cost of WWISC eligible infrastructure on the effective date of rates, including interim rates as applicable, that incorporate such costs.¹¹⁴

Mr. Armstrong maintained that an earnings-review mechanism "could be an important safeguard for ratepayers."¹¹⁵ Mr. Armstrong recommended that Proposed Rule 20 VAC 5-318-20 F and I of the Proposed Rules be combined as subsection H and state as follows:

- i. Determination of a WWISC Rider shall be made independent of all other costs that the water or wastewater utility is permitted to recover. No other revenue requirement or ratemaking issues may be examined in consideration of the application filed pursuant to the provisions of this chapter.
- ii. Notwithstanding Subdivision H (i) WWISC collections shall be subject to review within annual earnings tests filed by the utility. To the extent the earnings test shows earnings in excess of a Commission-determined benchmark return on equity, the lesser of (a) WWISC collections or (b) the revenue requirement effect of excess earnings shall be returned to ratepayers as determined by the

¹¹⁰ *Id.* at 19.

¹¹¹ *Id.*

¹¹² *Id.*

¹¹³ *Id.* at 20.

¹¹⁴ *Id.* at 21 (as corrected by Exhibit No. 10).

¹¹⁵ *Id.* at 22.

Commission. The amount to be returned shall be subject to carrying costs as addressed in Definition (4).¹¹⁶

Mr. Armstrong testified that if the Commission does not adopt an earnings test, “Staff would recommend that no carrying charge be calculated on under-recoveries.”¹¹⁷

Mr. Armstrong asserted that review of a WWISC applicant’s contractor bidding is key to Staff’s prudency review. Mr. Armstrong recommended that the Proposed Rules be adjusted to include the following language:

The Staff of the Commission shall be allowed access to the internal analysis performed in the water or wastewater utility’s evaluation of contractor bids for WWISC-eligible construction activities.¹¹⁸

Finally, Mr. Armstrong testified that the Proposed Rules be revised to specify that only WWISC-eligible costs incurred on or subsequent to the initial WWISC Plan be eligible for recovery by a WWISC Rider.¹¹⁹ Furthermore, Mr. Armstrong contended that a WWISC Rider should not be assessed for time periods prior to its approval.¹²⁰

Marc A. Tufaro recommended removal of “unreimbursed costs of relocating facilities due to highway projects” from the definition of an eligible infrastructure cost.¹²¹ Mr. Tufaro contended that relocation of facilities due to highway projects may not replace aging infrastructure and may not address primary and secondary water quality issues.¹²²

Mr. Tufaro testified that the definition of “water utility project” should not include water meters and the unreimbursed costs of relocating facilities due to highway projects.¹²³ Likewise, Mr. Tufaro maintained that the definition of “wastewater utility project” should not include the unreimbursed costs of relocating facilities due to highway projects and in-kind replacement of pumps, motors, blowers, tanks, and mechanical equipment.¹²⁴ Mr. Tufaro questioned whether the replacement of a water meter was non-revenue producing.¹²⁵

Mr. Tufaro stated that if the Commission approves a rulemaking for WWISC Plans, the Commission should require applicants to file proposed tariffs and sample customer impacts by

¹¹⁶ *Id.* at 23.

¹¹⁷ *Id.* at 24.

¹¹⁸ *Id.* at 24-25; Attachment A, at 7.

¹¹⁹ *Id.* at 25.

¹²⁰ *Id.*

¹²¹ Exhibit No. 11, at 5.

¹²² *Id.*

¹²³ *Id.* at 7.

¹²⁴ *Id.*

¹²⁵ *Id.*

rate schedule, group, and/or district for the WWISC Plan.¹²⁶ In addition, Mr. Tufaro recommended that the Commission reserve ability to modify, as well as approve or deny, any filing concerning a WWISC Plan, including (i) an initial petition to establish a WWISC Plan and Rider, (ii) an application to amend a previously approved plan, and (iii) a proposed WWISC Rider adjustment.¹²⁷

Petitioners' Rebuttal Testimony

On February 24, 2015, the Petitioners' filed the rebuttal testimony of William R. Walsh and Gary L. Akmentins. A summary of their rebuttal testimony is provided below.

William R. Walsh found it reasonable to provide Staff access to the internal analysis a water or wastewater utility performs in the evaluation of contractor bids for WWISC-eligible investment, but emphasized that not all WWISC-eligible investment requires a contractor of a specific bid by project.¹²⁸ Mr. Walsh stated that employees may complete some projects as part of their routine job responsibilities or may be involved in emergency work.¹²⁹

In response to City of Alexandria witness Eger's comment that Virginia American has not indicated the need for exceptional infrastructure replacement in its prior rate cases, Mr. Walsh advised that in every base rate case, Virginia American has shown and requested recovery for investment in infrastructure replacement.¹³⁰ Mr. Walsh contended that the limitations of a base rate case do not allow a utility to develop a plan and funding mechanism for an ongoing infrastructure program.¹³¹

Mr. Walsh disagreed with Staff witness Tufaro's recommended removal of unreimbursed costs of relocating facilities due to highway projects from the definition of an "eligible infrastructure cost."¹³² Mr. Walsh asserted that the Petitioners have no control over the timing and necessity of such projects.¹³³

Mr. Walsh disagreed with Mr. Tufaro's exclusion of water meters from the definition of "water utility project."¹³⁴ Mr. Walsh maintained that (i) other jurisdictions with a similar WWISC mechanism include water meters; (ii) because meters fail over time is why timely replacements are important and should be encouraged by the Commission; and (iii) any incremental revenue gained from replacement would be small and it is revenue the utility was entitled to.¹³⁵ Mr. Walsh also disagreed with Mr. Tufaro's exclusion of "in-kind replacement of

¹²⁶ *Id.* at 8.

¹²⁷ *Id.*

¹²⁸ Exhibit No. 12, at 2.

¹²⁹ *Id.*

¹³⁰ *Id.*

¹³¹ *Id.* at 2-3.

¹³² *Id.* at 3.

¹³³ *Id.* at 3-4.

¹³⁴ *Id.* at 4.

¹³⁵ *Id.*

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pumps, motors, blowers, tanks, and mechanical equipment” from the definition of “wastewater utility project.”¹³⁶ Although Mr. Walsh acknowledged that there may be circumstances where such equipment is replaced for other purposes, Mr. Walsh asserted that to ensure greater clarity in the interpretation of the Proposed Rules, this equipment should be included in WWISC.¹³⁷

Mr. Walsh pointed to the Commission’s review of the actual projects and associated costs and disagreed with assertions that the WWISC would reduce incentives for the Petitioners to control costs.¹³⁸

Mr. Walsh addressed concerns that cost efficiencies may result from infrastructure plant replacement by stating that any cost efficiencies will be reviewed in the utility’s next base rate case and subject to an earnings test through an Annual Informational Filing (“AIF”).¹³⁹

Mr. Walsh disagreed with Mr. Trimble’s assertion that the WWISC was designed to enhance utility revenues, and contended that “[t]he Petitioners’ main goal is to provide reliable service.”¹⁴⁰ Furthermore, Mr. Walsh continued to point to the cost of a rate case as a reason to approve the WWISC.¹⁴¹ Mr. Walsh took issue with Mr. Trimble’s comment that there is little concern for the safety of the general public during main breaks.¹⁴² Mr. Walsh maintained that public safety concerns are demonstrated by “boil water” or “do not use” notices.¹⁴³

Mr. Walsh disagreed with City of Alexandria witness Eger’s contentions that a base rate case is similar to a city’s budget process and that WWISC would not benefit new customers.¹⁴⁴ Finally, Mr. Walsh failed to follow the logic of Mr. Eger’s statement that a WWISC Plan would not be in response to investment related to sporadic failures and subsequent replacement.¹⁴⁵ Mr. Walsh testified that “[t]o the extent emergency replacement is necessary for infrastructure that is included in the WWISC Plan, a Company may in fact shift its investment in these facilities earlier than planned if a facility fails.”¹⁴⁶

Gary L. Akmentins generally agreed with the additional filing requirements recommended by Staff witness Armstrong, except for recommendations concerning tax savings from domestic production activity and the segregation of WWISC investment in another set of

¹³⁶ *Id.*

¹³⁷ *Id.* at 4-5.

¹³⁸ *Id.* at 5.

¹³⁹ *Id.*

¹⁴⁰ *Id.*

¹⁴¹ *Id.* at 6.

¹⁴² *Id.*

¹⁴³ *Id.*

¹⁴⁴ *Id.* at 7.

¹⁴⁵ *Id.* at 8.

¹⁴⁶ *Id.*

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accounts.¹⁴⁷ Mr. Akmentins advised that the Petitioners were not opposed to a cap of 10% of annual jurisdictional revenues between rate cases.¹⁴⁸

Mr. Akmentins maintained that annual updates to the WWISC Rider should be handled administratively, with more formal proceedings only when they are deemed warranted.¹⁴⁹ Mr. Akmentins opposed a requirement to undertake more costly proceedings regardless of need.¹⁵⁰ Mr. Akmentins disagreed with Mr. Armstrong that 90 days is an insufficient amount of time to review WWISC Rider adjustments and true-ups.¹⁵¹ Mr. Akmentins stated that the Petitioners are not opposed to eliminating the carrying charge from the Proposed Rules, and recommend “a calculation of interest” if the Commission determines that some charge should remain for over collections.¹⁵²

Mr. Akmentins agreed with Staff that a WWISC Rider should end when eligible WWISC infrastructure is included in base rates.¹⁵³ Mr. Akmentins testified that investment in WWISC-eligible infrastructure that is not included in a utility’s rate base should be included in a WWISC Plan and WWISC Rider.¹⁵⁴

Mr. Akmentins disagreed with Mr. Armstrong and asserted that the WWISC should be considered an automatic adjustment clause similar to the distribution system renewal surcharge adopted in *Roanoke Gas*.¹⁵⁵ Mr. Akmentins contended that the Proposed Rules contemplate base rate proceedings while a WWISC is in place.¹⁵⁶

Mr. Akmentins recommended that WWISC rates should be designed consistent with the rate divisions or classes contained in its current base rates.¹⁵⁷

Mr. Akmentins asserted that Mr. Armstrong’s recommendations for an earnings test and a refund of any over-earnings are inappropriate and not necessary.¹⁵⁸ Mr. Akmentins stated that he was unaware of any other jurisdiction with a water or wastewater surcharge “that penalizes a company for over-earning that is unrelated to the surcharge.”¹⁵⁹ Mr. Akmentins testified that the

¹⁴⁷ Exhibit No. 13, at 1-2.

¹⁴⁸ *Id.* at 2.

¹⁴⁹ *Id.* at 3.

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *Id.* at 4.

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.* at 5.

¹⁵⁶ *Id.* at 6.

¹⁵⁷ *Id.* at 7.

¹⁵⁸ *Id.* at 8.

¹⁵⁹ *Id.*

Commission lacks the authority to impose a refund for over earnings for water companies.¹⁶⁰ Mr. Akmentins recommended an earnings review mechanism.¹⁶¹

Public Witnesses

During the March 10th hearing for this matter, seven public witnesses presented testimony. A summary of the testimony of each witness is provided below.

Ida Swenson of Lake Monticello, Virginia, stated that one of her concerns is the increased demand on Staff due to the WWISC.¹⁶² Based on this increased burden, Ms. Swenson questioned how closely WWISC requests and implementations will be monitored by Staff.¹⁶³ Ms. Swenson pointed out that the Petitioners argue that the WWISC should result in fewer rate increase requests, but fail to promise to make fewer increase requests.¹⁶⁴

Ms. Swenson expressed concern that the Petitioners' Proposed Rules would remove opportunities for public hearings.¹⁶⁵ Ms. Swenson maintained that there is a need for greater transparency. Ms. Swenson testified that Aqua serves customers from multiple, disconnected systems.¹⁶⁶ Ms. Swenson asked if the WWISC "[s]hould this be something that is across the whole company or should this be jurisdictional rate increases if this is implemented?"¹⁶⁷

Melissa Hartman of Lacrosse, Virginia, seconded Ms. Swenson's stated need for transparency.¹⁶⁸ Ms. Hartman asserted that since Aqua took over her system two years ago, prices for full-time residents have increased over 250% - 400% to make infrastructure improvements.¹⁶⁹ Ms. Hartman opposed the requested surcharge for infrastructure and maintained that Aqua has not made infrastructure repairs evenly across its Virginia system.¹⁷⁰

Ms. Hartman provided photos of water provided by Aqua that ranged from dark brown to clear to pink.¹⁷¹ Ms. Hartman testified that despite spending \$1.5 million in improving the infrastructure of Aqua's Fox Run systems ("[v]ery little of that \$1.5 million investment went to my particular community . . .") "no one in my local community . . . will drink the water directly from the tap . . ."¹⁷²

¹⁶⁰ *Id.*

¹⁶¹ *Id.* at 9.

¹⁶² Swenson, Tr. at 42.

¹⁶³ *Id.* at 42-43.

¹⁶⁴ *Id.* at 43.

¹⁶⁵ *Id.*

¹⁶⁶ *Id.* at 44.

¹⁶⁷ *Id.*

¹⁶⁸ Hartman, Tr. at 45.

¹⁶⁹ *Id.* at 45-46.

¹⁷⁰ *Id.* at 46-47.

¹⁷¹ *Id.* at 47.

¹⁷² *Id.* at 47-48.

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Ms. Hartman supported the need for a reasonable cap if a WWISC is adopted.¹⁷³ Ms. Hartman pointed out that Aqua has a monopoly, and that customers such as herself, “are forced to pay whatever rates and whatever surcharges are approved to be paid”¹⁷⁴ Ms. Hartman also referred to Aqua being granted a 10% return on equity in its prior case. “That is a pretty good business deal, but it’s not a good deal for the consumers that are having to actually pay to support that.”¹⁷⁵

Ms. Hartman expressed concern for all Aqua customers paying for infrastructure upgrades, even if there are no infrastructure upgrades to her system.¹⁷⁶

Ms. Hartman quoted from Aqua America’s 2013 annual report that the company’s income had increased 13% from the previous year and that the company had increased dividends 23 times in 22 years.¹⁷⁷ Ms. Hartman reported that Aqua America advised that it could internally fund needed investments for customers.¹⁷⁸ Ms. Hartman asked the Commission to deny the request for an infrastructure surcharge and make sure that Aqua provides safe drinking water to its customers at reasonable, affordable rates.¹⁷⁹

Catherine Neelley of Palmyra, Virginia, stated that she is general manager at the Lake Monticello Homeowners Association and a customer of Aqua.¹⁸⁰ Ms. Neelley maintained that customers in Lake Monticello experienced an increase in rates of over 210% since 2005.¹⁸¹ Ms. Neelley contended that the Proposed Rules can only result in an uncapped rate increase.¹⁸² Ms. Neelley questioned whether the Commission has the authority to approve the Proposed Rules.¹⁸³ Ms. Neelley stressed the need for restrictions if rules are adopted, “because otherwise this is like hiring Michael Vick as your dog-sitter.”¹⁸⁴

Colin Hunter of Palmyra, Virginia, stated that he is a director at Lake Monticello, a community of over 4,600 homes and about 10,000 citizens.¹⁸⁵ Mr. Hunter expressed concern that his densely populated community pays some of the highest water and sewer rates in the country.¹⁸⁶ Mr. Hunter asked the Commission to protect consumers “from the reality of monopoly power.”¹⁸⁷

¹⁷³ *Id.* at 49.

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.* at 50.

¹⁷⁷ *Id.*

¹⁷⁸ *Id.*

¹⁷⁹ *Id.* at 51.

¹⁸⁰ Neelley, Tr. at 52.

¹⁸¹ *Id.*

¹⁸² *Id.*

¹⁸³ *Id.* at 53.

¹⁸⁴ *Id.*

¹⁸⁵ Hunter, Tr. at 53-54.

¹⁸⁶ *Id.* at 54.

¹⁸⁷ *Id.*

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Nancy Lovallo of Palmyra, Virginia, testified that she lived in Bryce Resort for 14 years.¹⁸⁸ Ms. Lovallo advised that when she first moved to Bryce Resort, her water bills were \$60 for two months of service, and when she left Bryce Resort she was paying \$90 for two months of service.¹⁸⁹ Ms. Lovallo stated that now in Lake Monticello, she pays over \$100 per month.¹⁹⁰ Ms. Lovallo questioned “allowing this company to have such an exorbitant rate increases when they don’t really seem to be doing a good job with the money that they’re given.”¹⁹¹

Michael A. Calhoun of Palmyra, Virginia, asserted that he has tried several times to contact Aqua, “and it’s like, oh my gosh, very impossible.”¹⁹² Mr. Calhoun expressed concern for the difference in rates he paid while living in Bryce Resort as compared to the rates he pays now at Lake Monticello. “I can’t understand why an hour and a half north, living in Bryce Resort, which is a much more spread out community than Lake Monticello, you should have to pay that significant difference.”¹⁹³

Jeff Black of Ruther Glen, Virginia, appeared on behalf of his constituents, which is the western Caroline district and Caroline County, Virginia.¹⁹⁴ Mr. Black highlighted comments filed by Delegate Ransone and Senator McDougle in which they state that “the General Assembly has the authority to set the standards for the water/wastewater surcharge, if there is one.”¹⁹⁵ Mr. Black also pointed to letters in opposition to the WWISC from the residents of Lake Land’Or, Caroline County, and other counties.¹⁹⁶ Mr. Black expressed concern with the massive increases in rates over the prior ten years, with water rates increasing 100% and wastewater rates increasing over 300%.¹⁹⁷

Mr. Black took issue with the WWISC and the possibility of rates increasing without a public hearing.¹⁹⁸ In addition, Mr. Black questioned whether the WWISC revenues collected from the 1,700 Aqua customers in Lake Land’Or will stay in Caroline County or go to fix a new system purchased by Aqua on the Eastern Shore.¹⁹⁹ Mr. Black noted that this proceeding is one of two cases concerning statewide rates for Aqua.²⁰⁰

¹⁸⁸ Lovallo, Tr. at 55.

¹⁸⁹ *Id.* at 55-56.

¹⁹⁰ *Id.* at 56.

¹⁹¹ *Id.*

¹⁹² Calhoun, Tr. at 57.

¹⁹³ *Id.*

¹⁹⁴ Black, Tr. at 57-58.

¹⁹⁵ *Id.* at 58.

¹⁹⁶ *Id.*

¹⁹⁷ *Id.* at 58-59.

¹⁹⁸ *Id.* at 59.

¹⁹⁹ *Id.*

²⁰⁰ *Id.* at 60.

DISCUSSION

In its Order Establishing Proceeding for this case, among other things, the Commission provided an opportunity for interested persons and Staff to file comments and propose modifications or supplements to the Proposed Rules. In addition, the Commission directed any person commenting on the Proposed Rules to also address whether the Commission has authority under the Code to issue the Proposed Rules, and if the Commission has such authority, should the Commission exercise such authority. This discussion will first address the Commission's authority to adopt a form of the Proposed Rules, will then analyze whether the Commission should adopt a form of the Proposed Rules, and finally examine the recommended changes to the Proposed Rules.

Commission Authority

The threshold question to answer in this proceeding is whether the Commission has the authority to issue rules that establish a rider for the recovery of investments to replace portions of the infrastructure of water and wastewater utilities. Of the participants in this case that filed post-hearing briefs and took a position on this question, the Petitioners, Staff, and Consumer Counsel maintained that the Commission has the authority to adopt such rules.²⁰¹ Caroline County, Frederick County, the City of Alexandria, CRED, and the Association asserted that the Commission lacks the authority to adopt such rules.²⁰² Massanutten Resort did not take a position on the Commission's authority to adopt rules.²⁰³

The Petitioners pointed to the broad authority provided by §§ 12.1-12 and 56-35 of the Code, and highlighted the Commission's authority to fix rates set forth in § 56-235.²⁰⁴ In addition, the Petitioners cited to *City of Norfolk*²⁰⁵ (where the Virginia Supreme Court upheld the authority of the Commission to authorize an automatic rate adjustment clause), and to *Roanoke Gas* (where the Commission implemented a surcharge to recover the costs of replacing aging infrastructure).²⁰⁶ Consumer Counsel offered a similar assessment of the Commission's broad authority to issue the Proposed Rules and the precedent established by *Roanoke Gas*.²⁰⁷

Consumer Counsel maintained that any WWISC Plan or Rider adopted by the Commission would need to comply with §§ 56-234 and 56-235.2 of the Code.²⁰⁸ More specifically, Consumer Counsel stated that "the Proposed Rules must be designed in a manner

²⁰¹ Petitioners Brief at 11; Staff Brief at 4; Consumer Counsel Brief at 3.

²⁰² Caroline County Brief at 3; Frederick County Brief at 1; City of Alexandria Brief at 1; CRED and the Association adopted the Caroline County Brief.

²⁰³ See, Massanutten Resort Brief.

²⁰⁴ Petitioners Brief at 11-12.

²⁰⁵ *City of Norfolk v. Virginia Electric & Power Co.*, 197 Va. 505 (1955) ("*City of Norfolk*").

²⁰⁶ Petitioners Brief at 12.

²⁰⁷ Consumer Counsel Brief at 2-5.

²⁰⁸ *Id.* at 6.

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that ensures that the total revenues of any water or wastewater utility with a WWISC Rider do not exceed such utility's costs plus a fair rate of return."²⁰⁹

Staff referred to the broad authority over rates granted to the Commission by §§ 12.1-12 and 56-235 of the Code, and acknowledged the limitations in § 56-235.2 that rates in the aggregate provide revenues not in excess of the aggregate actual costs incurred by the public utility, and the participation by the public in rate hearings.²¹⁰ Staff also pointed out that § 56-235.4 "generally restricts public utilities to one rate increase in a twelve-month period."²¹¹ Finally, Staff asserted that it was not aware of any provision of the Code or precedent that would forbid the Commission from implementing the Proposed Rules.²¹²

Caroline County argued that unless otherwise expressly prescribed by law, the Commission must follow the "just and reasonable" standard as defined in § 56-235.2 of the Code.²¹³ Thus, for water and wastewater utilities, Caroline County contended that § 56-235.2 of the Code "requires that the public utility demonstrate that aggregate revenues do not exceed aggregate actual costs, including normalization for nonrecurring costs and annualized adjustments for future costs as the Commission finds reasonably can be predicted to occur during the rate year, and a fair return on investment."²¹⁴ In addition, Caroline County pointed to the SAVE Act and maintained that it only applies to natural gas companies and that it demonstrates that such cost recoveries, outside a general rate case, are not authorized by the General Assembly for other types of utilities.²¹⁵ Furthermore, Caroline County took the position that "[i]f public utilities currently have the ability to seek authorization for reimbursements for infrastructure costs outside of a rate case from the Commission in a rulemaking, then the adoption of the SAVE Act would be superfluous and unnecessary."²¹⁶

Frederick County asserted that the Commission is without jurisdiction because "there is no specific enabling legislation that contains any express grant to the Commission of jurisdiction to establish an infrastructure charge such as the WWISC."²¹⁷ Frederick County also referred to the SAVE Act and argued "[t]hat the General Assembly saw a need, in the instance of the infrastructure charge for gas companies, to enact legislation specifically granting the Commission such authority is a clear indication that no such parallel authority exists with respect to an infrastructure charge for water and wastewater utilities"²¹⁸

In its Motion to Dismiss, the City of Alexandria contended that without legislative amendment or modification, the Commission has no authority to create a rule that is inconsistent

²⁰⁹ *Id.* (footnote omitted).

²¹⁰ Staff Brief at 3-4.

²¹¹ *Id.* at 4.

²¹² *Id.*

²¹³ Caroline County Brief at 3-4.

²¹⁴ *Id.* at 4 (footnote omitted).

²¹⁵ *Id.* at 5.

²¹⁶ *Id.* at 6.

²¹⁷ Frederick County Brief at 2-3.

²¹⁸ *Id.* at 3.

with the ratemaking procedures required by §§ 56-235.2 and 56-235.3.²¹⁹ The City of Alexandria noted that Article IX, § 2 of the Virginia Constitution²²⁰ grants “authority, (without further action of the General Assembly) over the rates, charges, and service of ‘railroads, telephone, gas, and electric companies.’”²²¹ The City of Alexandria argued “if the natural gas utilities sought legislation to implement the SAVE Act, and the natural gas companies are explicitly included in the [Article IX, § 2] constitutional provision, for the water and wastewater

²¹⁹ Section 56-235.3 of the Code states:

At any hearing on the application of a public utility for a change in a rate, toll, charge or schedule, the burden of proof to show that the proposed change is just and reasonable, shall be upon the public utility. The Commission shall be authorized to prescribe all necessary rules and regulations for the conduct of such hearings which shall provide for full and fair participation in such hearings by any interested person subject to such guidelines as the Commission may deem appropriate. Upon the conclusion of such hearings, the Commission shall issue an order and such opinion as is necessary to set forth fully the Commission's findings of fact and conclusions of law. Copies of the transcripts of public hearings held to establish a fair rate of return and changes in rates, tolls and charges for investor-owned public utilities involving significant public interest shall be placed in no less than one location nor more than three locations in the geographic area served by the utility. The Commission shall determine which proceedings are of sufficient interest to require the placing of such transcripts and the location or locations to be used; provided, however, that proceedings involving investor-owned utilities serving 25,000 or more customers shall be deemed to be of sufficient public interest.

²²⁰ Among other things, Article IX, § 2 sets the powers and duties of the Commission to be as follows:

... Except as may be otherwise prescribed by this Constitution or by law, the Commission shall be charged with the duty of administering the laws made in pursuance of this Constitution for the regulation and control of corporations doing business in this Commonwealth. Subject to such criteria and other requirements as may be prescribed by law, the Commission shall have the power and be charged with the duty of regulating the rates, charges, and services and, except as may be otherwise authorized by this Constitution or by general law, the facilities of railroad, telephone, gas, and electric companies. The Commission shall in proceedings before it ensure that the interests of the consumers of the Commonwealth are represented, unless the General Assembly otherwise provides for representation of such interests. The Commission shall have such other powers and duties not inconsistent with this Constitution as may be prescribed by law.

²²¹ City of Alexandria Motion to Dismiss at 6.

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companies which are not set forth in the Virginia Constitution, Article IX, § 2, to implement WWISC, legislation is certainly required, not a unilateral rule implemented by the Commission.”²²²

The positions of all of the parties and Staff appear to intersect on a requirement that any WWISC Plan or Rider adopted by the Commission must be consistent with the provisions of Title 56, Chapter 10 of the Code, especially § 56-235.2. To some extent, Caroline County, Frederick County, and the City of Alexandria base their argument that the Commission’s adoption of a WWISC Plan or Rider would violate Title 56, Chapter 10 of the Code on the adoption of the SAVE Act. In their view, the SAVE Act was a grant of authority to the Commission that it did not otherwise possess because if it possessed such power adoption the SAVE Act would be superfluous and unnecessary.

I disagree. As this case demonstrates, the adoption of rules for an infrastructure replacement program raises many policy questions including whether to adopt such rules, what infrastructure will be covered under such a program, and how the infrastructure replacement program will be structured. By providing policy answers to these questions concerning the replacement of specified natural gas infrastructure the SAVE Act has purpose and meaning. If anything, by providing answers to these policy questions, the SAVE Act limits the Commission’s authority in its decisions regarding the replacement programs of the specified natural gas infrastructure. On the other hand, the General Assembly is not constrained or limited by the requirements of Title 56, Chapter 10. Thus, I find that the adoption of or comparisons to the SAVE Act provide little, if any, guidance for determining if the WWISC Plan or Rider is consistent with the provisions of Title 56, Chapter 10 of the Code.

Whether the WWISC Plan or Rider is consistent with the provisions of Title 56, Chapter 10 of the Code depends on the specific provisions adopted by the Commission, and the application of several sections of the Code. For purposes of analysis, the impact of specific provisions will be examined in the Proposed Rules subheading below. This portion of the discussion will focus on the Commission’s ratemaking authority and ratemaking requirements of Title 56, Chapter 10 of the Code.

Generally, the Commission has broad authority over the regulation of public service companies in the Commonwealth, including rates and charges. Section 12.1-12 of the Code provides:

... Subject to such criteria and other requirements as may be prescribed by law, the Commission shall have the power and be charged with the duty of regulating the rates, charges, services, and facilities of all public service companies as defined in § 56-1. . . .²²³

²²² *Id.*

²²³ Section 56-1 of the Code defines a “public service company” to include: “gas, pipeline, electric light, heat, power and water supply companies, sewer companies, telephone companies, and all persons authorized to transport passengers or property as a common carrier.”

Likewise, § 56-35 of the Code states:

The Commission shall have the power, and be charged with the duty, of supervising, regulating and controlling all public service companies doing business in this Commonwealth, in all matters relating to the performance of their public duties and their charges therefor, and of correcting abuses therein by such companies.

Furthermore, the Commission has the authority to promulgate rules and regulations “[i]n the administration and enforcement of all laws within its jurisdiction”²²⁴

The Commission’s power to set or change a rate or rates is further developed in § 56-235 of the Code which provides:

If upon investigation the rates, tolls, charges, schedules, or joint rates of any public utility operating in this Commonwealth shall be found to be unjust, unreasonable, insufficient or unjustly discriminatory or to be preferential or otherwise in violation of any of the provisions of law, the State Corporation Commission shall have power to fix and order substituted therefor such rate or rates, tolls, charges or schedules as shall be just and reasonable. All rates, tolls, charges or schedules set by the Commission shall be valid only if they are in full conformance with the provisions of this chapter.

The above sections of the Code provide the Commission with the general authority to set rates or a rate that otherwise conforms to the requirements of Title 56, Chapter 10 of the Code. These sections eliminate the need for specific enabling legislation containing an express grant to the Commission of jurisdiction to establish an infrastructure charge such as the WWISC. All that is required is that the WWISC rates conform to the requirements of Title 56, Chapter 10, primarily the “just and reasonable” standards outlined in § 56-235.2 of the Code. Just and reasonable rates are defined in § 56-235.2 A to require:

(1) the public utility has demonstrated that such rates, tolls, charges or schedules in the aggregate provide revenues not in excess of the aggregate actual costs incurred by the public utility in serving customers within the jurisdiction of the Commission, including such normalization for nonrecurring costs and annualized adjustments for future costs as the Commission finds reasonably can be predicted to occur during the rate year, and a fair return on the public utility’s rate base used to serve those jurisdictional customers . . . ; and (2) the public utility has demonstrated that such rates, tolls, charges or schedules contain reasonable classifications of customers.

²²⁴ Section 12.1-13 of the Code.

The Petitioners maintained that this section “does not prohibit single issue ratemaking, but instead simply requires that the WWISC mechanism set up under the Proposed Rules does not recover costs already included in base rates and that it not recover more than the cost of the investment plus a fair return.”²²⁵ I agree. If base rates are just and reasonable, and a rate mechanism designed to provide for the just and reasonable recovery of a new cost, not otherwise recovered by base rates, is added, then the rates in the aggregate “provide revenues not in excess of the aggregate actual costs . . . and a fair return.” Section 56-235.2 A of the Code does not limit the Commission to setting solely a base rate, or from developing rates to recovery specifically identified costs.

Moreover, § 56-235.2 A of the Code also provides for the Commission’s adoption of “special charges.”

Notwithstanding § 56-234,²²⁶ the Commission may approve, either in the context of or apart from a rate proceeding after notice to all affected parties and hearing, special rates, contracts or incentives to individual customers or classes of customers where it finds such measures are in the public interest. Such special charges shall not be limited by the provisions of § 56-235.4.²²⁷ In determining costs of service, the Commission may use the test year method of estimating revenue needs.

Requirements for “special rates” are codified in § 56-235.2 B and C as follows:

B. The Commission shall, before approving special rates, contracts, incentives or other alternative regulatory plans under subsection A, ensure that such action (i) protects the public interest, (ii) will not unreasonably prejudice or disadvantage any customer or class of customers, and (iii) will not jeopardize the continuation of reliable electric service.

C. After notice and public hearing, the Commission shall issue guidelines for special rates adopted pursuant to subsection A that will ensure that other customers are not caused to bear increased rates as a result of such special rates.

The Petitioners argued that the Commission’s authority to set “special rates” “can provide an additional or alternative source of authority for issuing the Proposed Rules.”²²⁸ I agree that the “special rates” rules further demonstrate the Commission’s authority to adopt the

²²⁵ Petitioners Brief at 16.

²²⁶ Section 56-234 of the Code creates a duty for public utilities to charge uniform rates for persons using utility service under like conditions.

²²⁷ Section 56-235.4 of the Code generally prohibits multiple rate increases within any twelve-month period, but provides for several exceptions, including automatic rate adjustment clauses.

²²⁸ Petitioners Brief at 17 (footnote omitted).

WWISC Plan or Rider. Based on the above analysis, I find that the Commission possesses the authority to adopt a form of the Proposed Rules.

Proposed Rules

Staff proposed several modifications to the Proposed Rules that were supported by the Respondents and not objected to by the Petitioners. Thus, the discussion of the Proposed Rules will begin with Staff's modifications to the Proposed Rules and focus on (i) Staff modifications to which the Petitioners objected and (ii) proposed changes recommended by the Respondents, not otherwise reflected in Staff's modifications to the Proposed Rules.

Staff contended that to protect ratepayers, the Proposed Rules should be modified to:

- eliminate unreimbursed costs of relocating facilities due to highway projects from the definition of "eligible infrastructure costs;"
- restrict eligible investment to investments made on or subsequent to the effective date of rates in the initial WWISC Plan;
- eliminate "meters" from the definition of "water utility project;"
- eliminate "unreimbursed costs of relocating facilities due to highway projects" from the definition of "water utility project" and "wastewater utility project;"
- eliminate "in-kind replacement of pumps, motors, blowers, tanks, and mechanical equipment" from the definition of "wastewater utility project;"
- require the petition to include the "locations, plant sub-accounts impacted, targeted plant vintages, targeted material compositions" in the description of the infrastructure projects included in the WWISC Plan;
- require the petition to report the projected linear feet and diameter of replacement mains and those replaced, the number and size of replacement services and those replaced, the number of meters projected to be replaced and other facts; require the petition to provide proposed spending limits and ranges on the WWISC-eligible investment annually and for the duration of plan;
- require the petition to provide a detailed and transparent analysis of how each investment activity complies with the Proposed Rules;
- require the petition to provide the proposed accounting for the WWISC Plan costs, recoveries, and deferrals;
- require the petition to provide the anticipated current and deferred income tax impacts of WWISC activity, including tax savings resulting from Domestic Production Activity Deductions, if applicable;
- require the petition to provide a discussion and illustrative example of how WWISC-eligible investment will be segregated on the books and records from non-WWISC investment;
- require the petition to include workpapers supporting the WWISC Rider revenue requirement including at a minimum: the depreciable base and applicable depreciation rates by subaccount, property tax rates and the taxable base, capital structure and overall weighted cost of capital, revenue conversion factor, and carrying costs on any over or under-recovery;
- require the petition to include proposed tariffs for the WWISC Plan;

- require the petition to include sample customer impacts by rate schedule, group, and/or district;
- provide the Commission with the option to modify a proposed WWISC Plan;
- provide the Commission with 120 days to amend a previously approved plan;
- require docketed proceeding for the annual updating of a WWISC Rider;
- clarify the filing of revised rate schedules to cease recovery of WWISC-eligible infrastructure when incorporated into base rates;
- permit the refund of WWISC revenues due to over-earnings;
- eliminate the proposed designation of the WWISC Rider as an automatic rate adjustment clause; and
- provide Staff with access to the utility's internal analysis of contractor bids for WWISC-eligible construction activities.²²⁹

The Petitioners continue to support the Proposed Rules as filed but did not oppose some of Staff's proposed changes.²³⁰ The Petitioners objected to the following Staff modifications: (i) including tax savings from domestic production activities in the petition;²³¹ (ii) including a cap on the WWISC Plan and Rider;²³² (iii) procedures for annual WWISC updates;²³³ (iv) eliminating of the automatic adjustment clause designation;²³⁴ (v) imposing a refund, including carrying charges, of WWISC collections based on an earnings test;²³⁵ (vi) restricting WWISC-eligible investment to on or after the effective date of the WWISC Rider;²³⁶ and (vii) excluding unreimbursed relocations and water meters from eligible investments.²³⁷ The Petitioners generally opposed changes proposed by Caroline County, CRED, and Massanutten Resort.²³⁸

Consumer Counsel asserted that the Proposed Rules, as filed by the Petitioners, should be amended to include additional consumer safeguards, including: (i) eliminating the automatic adjustment clause designation;²³⁹ (ii) docketing annual updates and proposed changes to a WWISC Plan and Rider;²⁴⁰ (iii) providing 120 days for approval of annual updates to a WWISC Plan and Rider;²⁴¹ (iv) permitting the examination of other revenue requirement and ratemaking issues;²⁴² (v) restricting WWISC-eligible investment to the effective date of the WWISC

²²⁹ See, Exhibit No. 9, Attachment A.

²³⁰ Petitioners Brief at 10.

²³¹ *Id.* at 22.

²³² *Id.* at 23-24.

²³³ *Id.* at 24-26.

²³⁴ *Id.* at 26-28.

²³⁵ *Id.* at 18-19, 28-29.

²³⁶ *Id.* at 29-30.

²³⁷ *Id.* at 30-31.

²³⁸ *Id.* at 31, 33.

²³⁹ Consumer Counsel Brief at 9-12.

²⁴⁰ *Id.* at 12-13.

²⁴¹ *Id.* at 13-14.

²⁴² *Id.* at 14-15.

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Rider;²⁴³ (vi) endorsing Staff's earnings test and refund of overearnings;²⁴⁴ and (vii) capping any WWISC Rider to approximately 5% or 7% of a customer's bill.²⁴⁵

Caroline County maintained that the Proposed Rules, as filed by the Petitioners, should be changed to: (i) require a docketed and formal proceeding to amend any WWISC Plan or Rider;²⁴⁶ (ii) reject the proposed "prudent and reasonable" standard;²⁴⁷ (iii) require an annual earnings test;²⁴⁸ (iv) establish a cap on WWISC Rider and investments;²⁴⁹ and (v) prohibit cross-subsidization among operations or among jurisdictions with separate costs of service analysis.²⁵⁰

The City of Alexandria argued that the Proposed Rules as filed by the Petitioners should be changed to: (i) revise the "prudent and reasonable" standard;²⁵¹ (ii) permit the examination of other revenue requirement and ratemaking issues;²⁵² (iii) eliminate designation as an automatic adjustment clause;²⁵³ (iv) require public participation in WWISC petitions;²⁵⁴ (v) require docketed proceedings for changes to an WWISC Plan or Rider;²⁵⁵ (vi) limit the duration of a WWISC Plan to two years;²⁵⁶ (vii) require more detailed information to be filed with a WWISC petition;²⁵⁷ (viii) make any review deadlines to be goals rather than mandatory;²⁵⁸ (ix) overhaul the proposed annual reconciliation process;²⁵⁹ (x) eliminate any capacity expansion projects from the definition of "eligible infrastructure;"²⁶⁰ (xi) limit the breadth of definitions for "water utility project," "wastewater utility project," and "in-kind replacement;"²⁶¹ (xii) limit recovery of a return on WWISC investment to base rate cases;²⁶² and (xiii) cap any WWISC Rider to 2% of annual rates for each customer class.²⁶³

²⁴³ *Id.* at 15-16.

²⁴⁴ *Id.* at 16-18.

²⁴⁵ *Id.* at 18-20.

²⁴⁶ Caroline County Brief at 9.

²⁴⁷ *Id.* at 9-10.

²⁴⁸ *Id.* at 10.

²⁴⁹ *Id.* at 10-11.

²⁵⁰ *Id.* at 11.

²⁵¹ City of Alexandria Brief at 8-11.

²⁵² *Id.* at 11-12.

²⁵³ *Id.* at 12-13.

²⁵⁴ *Id.* at 13.

²⁵⁵ *Id.* at 14.

²⁵⁶ *Id.* at 15.

²⁵⁷ *Id.* at 15-17.

²⁵⁸ *Id.* at 17-18.

²⁵⁹ *Id.* at 18-19.

²⁶⁰ *Id.* at 19-20.

²⁶¹ *Id.* at 20-21.

²⁶² *Id.* at 21.

²⁶³ *Id.* at 21-22.

Massanutten Resort recommended that the Proposed Rules be revised to: (i) prohibit cross-subsidization between rate classes,²⁶⁴ (ii) use depreciation expense as an offset against the surcharge recovery,²⁶⁵ (iii) provide the Commission with the flexibility to approve, reject or modify the terms of any proposed surcharge,²⁶⁶ (iv) include information needed to assess the fairness of the proposed WWISC Plan and Rider,²⁶⁷ (v) provide for customer participation,²⁶⁸ (vi) address the impact of the proposed WWISC Plan and Rider on the ROE and cost of capital,²⁶⁹ (vii) condition approval of a WWISC on an agreement not to seek a base rate increase for a stated period of time,²⁷⁰ (viii) consider savings due to improved efficiency,²⁷¹ and (ix) consider and prevent intra-class subsidies.²⁷²

Staff modifications to which the Petitioners objected and the proposed changes recommended by Respondents, not otherwise reflected in Staff's modifications to the Proposed Rules will be discussed below in the order they appear, or would appear, in the Proposed Rules. Thus, the discussion of changes to the Proposed Rules will be as follows: (i) capacity expansion,²⁷³ (ii) ROE and cost of capital,²⁷⁴ (iii) relocation costs,²⁷⁵ (iv) date for eligible investment,²⁷⁶ (v) meter costs,²⁷⁷ (vi) other limits on definitions,²⁷⁸ (vii) filing requirements,²⁷⁹ (viii) limits or caps,²⁸⁰ (ix) Domestic Production Activity Deductions,²⁸¹ (x) offsetting costs,²⁸² (xi) duration of a WWISC Plan,²⁸³ (xii) notice and hearing,²⁸⁴ (xiii) "prudent and reasonable"

²⁶⁴ Massanutten Resort Brief at 5-9.

²⁶⁵ *Id.* at 9-11.

²⁶⁶ *Id.* at 11-13.

²⁶⁷ *Id.* at 13-14.

²⁶⁸ *Id.* at 14-15.

²⁶⁹ *Id.* at 15.

²⁷⁰ *Id.* at 16.

²⁷¹ *Id.*

²⁷² *Id.*

²⁷³ To cross-reference to the issues raised by the parties and outlined in the preceding paragraphs, reference to the issues raised by the Petitioners will be designated as "P," by Consumer Counsel as "AG," by Caroline County as "CC," by the City of Alexandria as "CA," and by Massanutten Resort as "MR." Each of these designations will be followed by the issue number. For example, the City of Alexandria's recommendation to eliminate any capacity expansion projects from the definition of "eligible infrastructure" is referenced as CA(x).

²⁷⁴ CA(xii); MR(vi).

²⁷⁵ P(vii).

²⁷⁶ P(vi); AG(v).

²⁷⁷ P(vii).

²⁷⁸ CA(xi).

²⁷⁹ CA(vii); MR(iv).

²⁸⁰ P(ii); AG(vii); CC(iv); CA(xiii); MR(vii).

²⁸¹ P(i).

²⁸² MR(ii); MR(viii).

²⁸³ CA(vi).

²⁸⁴ CA(iv).

standard,²⁸⁵ (xiv) flexibility to modify,²⁸⁶ (xv) procedures for annual WWISC updates,²⁸⁷ (xvi) rate design,²⁸⁸ (xvii) annual reconciliation process,²⁸⁹ (xviii) consideration of other ratemaking issues,²⁹⁰ (xix) earnings test,²⁹¹ and (xx) automatic rate adjustment clause.²⁹²

(i) Capacity Expansion

Among other things, Proposed Rule 20 VAC 5-318-10 defines “eligible infrastructure” to exclude projects that increase revenues by directly connecting the infrastructure to new customers.²⁹³ The City of Alexandria maintained that a utility could add additional capacity to serve potential new customers and have existing customers cover the cost through the WWISC Rider.²⁹⁴

City of Alexandria witness Eger testified, based on the City of Alexandria’s experience in infrastructure replacement, that it is unlikely that a utility would replace infrastructure and not enhance capacity to accommodate future system growth.²⁹⁵ Mr. Eger’s remedy was to have an open public process through base rate cases.²⁹⁶

I find that such enhancements to capacity could also be considered in an open and public process associated with the adoption of a WWISC Plan. Indeed, such capacity enhancements may receive more attention in a proceeding devoted solely to addressing infrastructure replacement. Limiting all capacity enhancements by definition may introduce inefficiencies that would not be in the public interest. Therefore, I find that no change to the Staff’s proposed language is required.

(ii) ROE and Cost of Capital

Rule 20 VAC 5-318-10 of the Proposed Rules defines “eligible infrastructure costs,” to include “1. Return on investment.” This subsection generally provides for the use of the utility’s weighted average cost of capital used in determining the utility’s base rates, or if more than five-years old, an updated weighted cost of capital.

In its brief, the City of Alexandria recommended that even with the establishment of a WWISC Plan and Rider, participating utilities should defer recovery of a return on WWISC

²⁸⁵ CC(ii); CA(i).

²⁸⁶ MR(iii).

²⁸⁷ P(ii); AG(ii); AG(iii); CC(i); CA(v); CA(viii); MR(v).

²⁸⁸ CC(v); MR(i); MR(ix).

²⁸⁹ CA(ix).

²⁹⁰ AG(iv); CA(ii).

²⁹¹ P(v); AG(vi); CC(iii).

²⁹² P(iv); AG(i); CA(iii).

²⁹³ Exhibit No. 9, Attachment A, at 1.

²⁹⁴ City of Alexandria Brief at 19.

²⁹⁵ Exhibit No. 8, at 7.

²⁹⁶ *Id.* at 8.

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investment and the issue should be addressed in the next base rate case.²⁹⁷ I find that such a deferral would undercut the incentives and purpose of having a separate WWISC Rider to recover costs associated with infrastructure replacements, and should be rejected.

Massanutten Resort maintained that because the WWISC Rider reduces the utility's risk, the ROE included in the weighted average cost of capital should be "appropriately reduced."²⁹⁸ The Petitioners stated that the determination of ROE is best addressed in a base rate case.²⁹⁹ Moreover, to the extent that ROE is based on comparisons to a peer group, the use of similar mechanisms in other states has the effect of already including the impact of a WWISC Plan or Rider on ROE.³⁰⁰

As the Petitioners pointed out, there are many factors that impact the perceived risks and the ROE of a utility. I agree with the Petitioners that a base rate proceeding is better suited for weighing the many factors that may impact a utility's ROE. Therefore, I find that no change to the Staff's proposed language is required.

(iii) Relocation Costs

As proposed by the Petitioners, Rule 20 VAC 5-318-10 of the Proposed Rules included unreimbursed costs of relocating facilities due to highway projects in the definition for "eligible infrastructure costs." Staff eliminated such relocation costs because these projects may not be related to the replacement of aging infrastructure, or related to addressing primary and secondary water quality issues, or related to reducing inflow and infiltration to the collection system or improvements required by National Pollutant Discharge Elimination System permits.³⁰¹

The Petitioners argued that the relocation of facilities due to highway projects is often at great expense and "typically replace older facilities with newer facilities."³⁰² In addition, Petitioners witness Walsh testified that such projects are outside the control of utilities and inclusion in the WWISC reduces regulatory lag on these required projects.³⁰³

During the hearing, Staff witness Tufaro referred to the lack of control by a utility over such projects and expressed concern "with how a utility will know when to include and also quantify these costs."³⁰⁴

I agree with Staff that unreimbursed relocation costs are not within the stated purpose for establishing a WWISC Plan and Rider and that the lack of control over such projects makes it

²⁹⁷ City of Alexandria Brief at 21.

²⁹⁸ Massanutten Resort Brief at 15.

²⁹⁹ Petitioners Brief at 37.

³⁰⁰ *Id.*

³⁰¹ Exhibit No. 11, at 7.

³⁰² Petitioners Brief at 30.

³⁰³ Exhibit No. 12, at 3.

³⁰⁴ Tufaro, Tr. at 164.

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difficult work such projects into a pre-approved plan. Therefore, I find that no change to the Staff's proposed language is required.

(iv) Date for Eligible Investment

As proposed by the Petitioners, Rule 20 VAC 5-318-10 of the Proposed Rules had no limit on when investments could be made and included in a WWISC Plan. Staff limited the definition of "investment" to capital costs incurred "on or subsequent to the effective date of rates in the initial WWISC Plan."³⁰⁵ Consumer Counsel supported Staff's recommendation and pointed out that as proposed by Petitioners, a WWISC Rider could include capital costs previously included in the utility's earnings test as part of an AIF.³⁰⁶

On brief, the Petitioners asserted that Staff's limitation may delay necessary investment.³⁰⁷ Nonetheless, the Petitioners offered a compromise limitation that permits investment undertaken since the filing of the utility's initial petition.³⁰⁸ The Petitioners acknowledged that under this compromise the utility would bear the risk that the Commission could find investment undertaken prior to the Commission's review is not appropriate to include in the WWISC Plan or Rider.³⁰⁹

The Petitioners contend that "the Proposed Rules will give the Commission multiple opportunities to review a utility's plans for investment and the investment after it has been made."³¹⁰ Indeed, Commission prior approval of infrastructure replacements is one of the arguments presented by the Petitioners for the adoption of the Proposed Rules.

Under the traditional base rate methods, there is nothing to prevent utilities, setting aside financial consideration, from embarking on a massive infrastructure replacement program without any prior review by the Commission. Seeking approval on the infrastructure replacement program under the [P]roposed [R]ules, however, would allow the Commission to review the utility's plans prior to them actually being implemented and would allow the Commission to help craft a program as to scope, financial commitment, and pace to ensure it's in the public's interest.³¹¹

In order to realize the full benefits related to the adoption of the Proposed Rules, I find that WWISC investments should be "on or subsequent to the effective date of rates in the initial

³⁰⁵ Exhibit No. 9, Attachment A, at 2.

³⁰⁶ Consumer Counsel Brief at 15.

³⁰⁷ Petitioners Brief at 29.

³⁰⁸ *Id.* at 29-30.

³⁰⁹ *Id.* at 30.

³¹⁰ *Id.* at 8 (footnote omitted).

³¹¹ Biller, Tr. at 16.

WWISC Plan” as proposed by Staff. Therefore, I find that no change to the Staff’s proposed language is required.

(v) Meter Costs

As filed by the Petitioners, Rule 20 VAC 5-318-10 of the Proposed Rules defined “water utility project” to include “meters (including radio frequency meters).” Staff eliminated this language from its version of the Proposed Rules and maintained that the replacement of a water meter may be a revenue producing investment as water meters may under-register with age.³¹²

The Petitioners argued that water meters would be replaced “to ensure that failure of an aging water meter does not cause a failure in the utility’s system as well as identify leaks and lost or wasteful usage.”³¹³ Petitioners witness Walsh advised that any additional revenue would be very small, and “incremental revenue achieved as a result of a meter replacement is revenue that the utility was entitled to prior to that replacement.”³¹⁴

As I understand the purpose of the WWISC Plan and Rider is for the replacement of infrastructure to accelerate the 300- to 500-year replacement cycle in Virginia to the general industry goal of a 100-year replacement cycle.³¹⁵ The replacement of meters does not appear to be consistent with this purpose, but to be more closely aligned with ongoing system maintenance. The revenue producing nature of meter replacements moves such costs further from the purpose of WWISC-eligible investments. Therefore, I find that no change to the Staff’s proposed language is required.

(vi) Other Limits on Definitions

On brief, the City of Alexandria asserted that the definitions of “water utility project,” “wastewater utility project,” and “in-kind replacement” were worded “so broadly that many inappropriate betterments and ill-advised projects may be included within the scope of costs recoverable by a WWISC [R]ider.”³¹⁶ The City of Alexandria offered no alternative definitions.

Similar to the earlier discussion regarding capacity enhancements, proposed investments to be recovered through a WWISC Rider will be subject to Commission approval in an open and public process, and based on the public interest. Therefore, I find that no change to the Staff’s proposed language is required.

(vii) Filing Requirements

The City of Alexandria maintained that filing requirements of the Proposed Rules as originally filed by the Petitioners failed to provide the information needed for meaningful

³¹² Exhibit No. 11, at 7.

³¹³ Petitioners Brief at 31.

³¹⁴ Exhibit No. 12, at 4.

³¹⁵ Petitioners Brief at 2.

³¹⁶ City of Alexandria Brief at 21.

review.³¹⁷ The City of Alexandria did not address the additional filing requirements proposed by Staff, which were generally agreed to by the Petitioners.

Massanutten Resort recommended deletion of the final sentence in proposed Rule 20 VAC 5-318-20 B, which provides that “[a]n application filed pursuant to this section shall not require the filing of rate case schedules under 20 VAC 5-201-10 *et seq.* of the [C]ommission’s rules.”³¹⁸ Nonetheless, Massanutten Resort agreed that a petition for a WWISC Plan and Rider should not include all of the schedules required in a general rate case, and did not take issue with Staff’s expanded filing requirements. Massanutten Resort contended that a petition for a WWISC Plan and Rider should include “schedules necessary to address the need for, prudence of, and reasonableness of [the applicant’s] proposal, including all of the elements of the ‘Eligible Infrastructure Costs’ it seeks to recover.”³¹⁹

I find that Staff’s expanded filing requirements now included as Proposed Rule 20 VAC 5-318-20 A, generally provide the information necessary for meaningful review of the petition. In addition, I find that the final sentence in Proposed Rule 20 VAC 5-318-20 B should not be eliminated, as such elimination would create confusion as to whether all of the rate case schedules were required. Therefore, I find that no change to the Staff’s proposed filing language is required.

(viii) Limits or Caps

Rule 20 VAC 5-318-20 A 3, as proposed by Staff, provides for the adoption of proposed spending limits and ranges on the WWISC-eligible investment both annually and for the duration of the WWISC Plan.³²⁰ Staff did not propose a mandatory overall limit or cap. The Petitioners recommended against an arbitrary cap set at the rulemaking stage, and maintained that “[i]t is only after the Commission is able to review a utility’s detailed infrastructure needs that it can thoughtfully set a cap.”³²¹ The Petitioners recommended that Proposed Rule 20 VAC 5-318-20 B include the following flexible cap language:

The Commission’s approval may include a limit on the maximum amount of annual investment under a WWISC [P]lan.³²²

Consumer Counsel pointed out that limiting the impact of a WWISC-like surcharge on a customer’s bill is a common feature of similar rate mechanisms used in other states.³²³ Consumer Counsel cited to the testimony of Petitioners witness Akmentins that “the service charge will remain a small percentage of the total customer bill and is not expected to exceed

³¹⁷ *Id.* at 15-17.

³¹⁸ Massanutten Resort Brief at 13.

³¹⁹ *Id.* at 14.

³²⁰ Exhibit No. 9, Attachment A, at 4.

³²¹ Petitioners Brief at 23.

³²² *Id.*

³²³ Consumer Counsel Brief at 19.

about 5% to 7% of a customer's bill."³²⁴ Consumer Counsel recommended setting a cap within this range "would provide customers with a guarantee that this expectation will be met in the future."³²⁵

Based on the testimony of its witness, Wayne Trimble, Caroline County contended that a 5% cap on the WWISC Rider and a 5% cap on investments would "more closely conform to the 'just and reasonable' standard, and is '[a] better balance . . . between the Company and the ratepayers.'"³²⁶ The City of Alexandria asserted that a hard cap on the WWISC would be the "most meaningful limitation on the potential for mischief," and recommended a cap of "no more than [2%] of annual rates for each customer class."³²⁷

Massanutten Resort recommended limiting or conditioning the approval of a WWISC on a utility's agreement not to seek a base rate increase for a stated period.³²⁸ Massanutten Resort asserted that this limitation is consistent with the Petitioners' claim that the WWISC will reduce the frequency of rate cases.³²⁹

Based on the record of this proceeding, I find that a cap on the WWISC Rider would provide some assurance to customers that it will remain a small percentage of the total customer bill and not become the cost recovery mechanism of choice for utilities. Such assurance may be necessary where the utility is given a means to limit regulatory lag and reduce risk. Moreover, I find that a cap on the WWISC Rider of 5% would be consistent with the testimony of Petitioners witness Akmentins, and the recommendations of Consumer Counsel and Caroline County. Finally, in regard to the proposed base rate freeze condition recommended by Massanutten Resort, I find that such a requirement should not be included in the Proposed Rules, but may be explored with the filing of specific WWISC petitions.

Therefore, I find that Proposed Rule 20 VAC 5-318-20 A 3 should have the following sentence added.

The WWISC Rider shall be no more than five percent (5%) of the annual revenues for each customer class.

(ix) Domestic Production Activity Deductions

Staff recommended that Proposed Rule 20 VAC 5-318-20 A 7 require WWISC petitions to include the tax savings resulting from Domestic Production Activity Deductions, if applicable. The Petitioners objected to this "unnecessary complication" and maintained that such deductions generally do not apply and are better handled in a base rate case.³³⁰

³²⁴ *Id.* at 20; Exhibit No. 5, at 13.

³²⁵ Consumer Counsel Brief at 20.

³²⁶ Caroline County Brief at 11; Trimble, Tr. at 112.

³²⁷ City of Alexandria Brief at 22.

³²⁸ Massanutten Resort Brief at 16.

³²⁹ *Id.*

³³⁰ Petitioners Brief at 22.

The WWISC mechanism is designed, in part, to provide for the recovery of WWISC investment. Creating a difference in the timing of the recognition of a tax deduction from the collection of revenues and return that create the tax liability is an unnecessary complication that Staff's recommendation is designed to avoid. Therefore, I find that no change to the Staff's proposed filing language is required.

(x) Offsetting Costs

Massanutten Resort recommended that the calculation of WWISC revenue requirements include offsets for (i) existing depreciation expense, and (ii) savings due to improved efficiency.³³¹

Massanutten Resort asserted that “[i]f existing depreciation expense recovery is not considered in determining the level of surcharge revenue, excessive charges to customers would result.”³³² Very generally, the depreciation expense collected through base rates represents the recovery of a portion of the utility's existing plant investment included in rate base. Thus, the offsetting entry for depreciation expense is a reduction to rate base via the accumulated depreciation account. However, when such funds are collected, they are available to the utility to invest in new plant or otherwise reinvest in utility operations, or return the funds to shareholders. The utility will be provided an opportunity to earn a return on, and to recover through depreciation rates, any of the funds that are used to purchase new plant. This is true regardless of whether the new plant is recovered through base rates or through the WWISC. In essence, the concern raised by Massanutten Resort is that of regulatory lag that may adversely impact ratepayers. Whether the interplay between existing depreciation expense recovery and the level of surcharge revenue creates excessive charges to customers requires consideration of (i) the timing of base rates and the surcharge; (ii) the extent to which the existing depreciation expense is used for operations or to purchase plant that is not supported by the surcharge; and (iii) the net other changes to the cost of service recovered in base rates. To some extent, annual AIFs mitigate the need to undertake such an analysis. However, I disagree with Massanutten Resort's assertion that failure to consider existing depreciation expense will result in excessive charges.

Nonetheless, this is not to say that existing depreciation expense has no bearing on the question of whether the Commission should adopt the Proposed Rules. The Proposed Rules are designed to provide additional investment to replace an aging infrastructure. As discussed in more detail below, existing depreciation expense represents funds currently available to utilities to replace infrastructure and should be considered in determining whether there is a need for the Proposed Rules.

As for offsets for savings due to improved efficiency, Massanutten Resort argued that future maintenance costs may be lowered as infrastructure is replaced.³³³ Massanutten Resort

³³¹ Massanutten Resort Brief at 9-11, 16.

³³² *Id.* at 10.

³³³ *Id.* at 16.

advised that “the Commission may wish to consider the inclusion of an efficiency factor in the WWISC to reflect increased O&M efficiencies associated with new infrastructure.”³³⁴

Under the Proposed Rules, such improved efficiencies are backstopped by the annual earnings test, which measures actual results and captures actual efficiencies. I find the use of an annual earnings test more accurate and easier to apply than the derivation of an efficiency factor as part of the WWISC Rider. Therefore, I find that no change to the Staff’s proposed filing language is required.

(xi) Duration of a WWISC Plan

In its brief, the City of Alexandria proposed to limit the duration of WWISC Plans to two years.³³⁵ The City of Alexandria expressed concern that utilities could use long-term WWISC Plans “with comparatively lax approval standards so as to circumvent the public protection safeguards built into the existing rate case process.”³³⁶

The City of Alexandria fails to consider changes in the Proposed Rules that require annual updates, and fails to properly weigh other safeguards now incorporated in the Proposed Rules that provide the Commission with sufficient means to protect the public interest without imposing an unnecessarily short WWISC Plan duration. Therefore, I find that no change to the Staff’s proposed filing language is required.

(xii) Notice and Hearing

Rule 20 VAC 5-318-20 B of the Proposed Rules includes the following notice and hearing provision:

The Commission may approve the initial petition for establishment of a WWISC [P]lan and WWISC [R]ider after such notice and opportunity for hearing as the Commission may prescribe.

The City of Alexandria argued that under the above-language, “the Commission would make a case-by-case discretionary decision on whether to permit public notice and comment on a regulated utility’s proposed WWISC [P]lan and [R]ider.”³³⁷ I disagree with the City of Alexandria’s reading of this language. Under the language, the Commission is required to prescribe notice and provide an opportunity for hearing. However, the language provides the Commission with some discretion as to the exact form of the notice and hearing. For example, the opportunity for hearing may, as in this proceeding, consist of the filing of written comments in which interested parties could request a public hearing. To clarify, I recommend that the following language be used.

³³⁴ *Id.*

³³⁵ City of Alexandria Brief at 15.

³³⁶ *Id.*

³³⁷ *Id.* at 13.

The Commission may approve the initial petition for establishment of a WWISC [P]lan and WWISC [R]ider after such notice and opportunity for hearing as prescribed by the Commission.

(xiii) “Prudent and Reasonable” Standard

Rule 20 VAC 5-318-20 B of the Proposed Rules includes the following standard for approving the initial petition:

The Commission shall approve the initial petition if the applicant demonstrates that the WWISC is prudent and reasonable.

Caroline County contended that the statutory standard for rates is “just and reasonable.”³³⁸ Caroline County argued that the use of “prudent and reasonable” in the Proposed Rules “shift[s] the objective of consideration from ratepayers to the regulated company in direct contradiction to the statute and regulation.”³³⁹ Similarly, the City of Alexandria asserted that a “prudent and reasonable” standard lowered the threshold for justifying a rate increase.³⁴⁰

I do not find that there is any substantive difference between “prudent and reasonable” and “just and reasonable.” Nonetheless, in order to assure compliance with the “just and reasonable” ratemaking standard of Title 56, Chapter 10, especially, § 56-235.2 of the Code, I find that Proposed Rule 20 VAC 5-318-20 B should include the following standard for approving the initial petition:

The Commission shall approve the initial petition if the applicant demonstrates that the WWISC Plan is prudent and reasonable, and that the WWISC Rider is just and reasonable.

(xiv) Flexibility to Modify

Massanutten Resort offered two recommended changes designed to provide flexibility to the Commission. The first recommended change concerned the sentence from Proposed Rule 20 VAC 5-318-20 B that was discussed in the prior section above in which Massanutten Resort proposed changing the “shall” to “may.”³⁴¹ I find that this recommended change effectively eliminates all standards for the adoption of a WWISC Plan and Rider. Therefore, I find that no change to the Staff’s proposed filing language is required.

The second recommended change concerned changing “shall” to “may” in both sentences in Proposed Rule 20 VAC 5-318 20 D.³⁴² This recommended change would eliminate the

³³⁸ Caroline County Brief at 9.

³³⁹ *Id.* at 10.

³⁴⁰ City of Alexandria Brief at 8-9.

³⁴¹ Massanutten Resort Brief at 12.

³⁴² *Id.* at 12-13.

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calculation methodology for the WWISC Rider, which is at the heart of the Proposed Rules. Therefore, I find that no change to the Staff's proposed filing language is required.

(xv) Procedures for Annual WWISC Updates

The Petitioners agreed with Staff's changes to Proposed Rule 20 VAC 5-318-20 C, but disagreed with Staff's recommended changes to Proposed Rule 20 VAC 5-318-20 D that would require formal docketed proceedings to review annual updates and reconciliations of the WWISC Rider.³⁴³ The Petitioners stressed the need for an efficient process and advised that the Commission retain discretion over procedures, especially when annual updates conform to the original WWISC Plan.³⁴⁴ In addition, for Proposed Rule 20 VAC 5-318-20 F, as filed by Staff, the Petitioners objected to Staff's proposed extension of the time to review annual rider reconciliations to 120 days.³⁴⁵ The Petitioners argued that "[w]here Staff is simply reviewing the calculation of the rider, actual expenses and collections and other accounting entries, four months is an excessive time for review for a rider that is only in place for 12 months."³⁴⁶

Consumer Counsel supported Staff's changes to Proposed Rule 20 VAC 5-318-20 C to require annual updates and proposed changes to a WWISC Plan and Rider be considered in a docketed proceeding.³⁴⁷ Consumer Counsel also supported Staff's extension of the review period from 90 to 120 days and pointed to Staff witness Armstrong's testimony that based on Staff's experience with the SAVE Act, 90 days is insufficient to thoroughly audit the utility's costs recoveries, deferrals, and rider calculations.³⁴⁸

Caroline County took the position that "[p]ublic notice and participation *must* be required in any procedure to increase customer rates, including the WWISC [P]lan, any adjustment to the plan, and any annual reconciliation that may result in rate increases."³⁴⁹

The City of Alexandria concurred with Staff's changes to Proposed Rule 20 VAC 5-318-20 C, and argued that these changes are legally required.³⁵⁰ Furthermore, the City of Alexandria asserted that "[a]ny review deadlines should be goals rather than mandatory deadlines for the Commission."³⁵¹ Nonetheless, the City of Alexandria maintained that "a utility-proposed return to ratepayers of a WWISC overcharge could and should automatically go into effect, subject to the Commission's ongoing review and potential subsequent enlargement order."³⁵²

³⁴³ Petitioners Brief at 24.

³⁴⁴ *Id.* at 25.

³⁴⁵ *Id.*

³⁴⁶ *Id.* (footnote omitted).

³⁴⁷ Consumer Counsel Brief at 12-13.

³⁴⁸ *Id.* at 13; Exhibit No. 9, at 19.

³⁴⁹ Caroline County Brief at 9.

³⁵⁰ City of Alexandria Brief at 14, n.3.

³⁵¹ *Id.* at 17.

³⁵² *Id.* at 18.

Although it offered alternative language for Proposed Rules 20 VAC 5-318-20 B and C, in its brief, Massanutten Resort endorsed Staff's proposed changes.³⁵³

I find that Staff's changes to Proposed Rules 20 VAC 5-318-20 C, D, and F satisfy most of the issues and concerns raised by the Respondents. During the hearing, Staff witness Armstrong noted that time for review must permit time for noticing, Staff review, preparation of Staff's report or testimony, intervener comments or testimony, the applicant's response or rebuttal testimony, a hearing, and time for the Commission to render its decision.³⁵⁴ Mr. Armstrong affirmed that "[d]rawing from Staff's experience with the annual SAVE tariff update, 120 days would be a more appropriate time frame for all these events to occur."³⁵⁵ Based on Mr. Armstrong's testimony, I find that 120 days is the appropriate period for review of the annual rider reconciliations. Therefore, I find that no change to the Staff's proposed filing language is required.

(xvi) Rate Design

Caroline County argued that "[i]t is unjust for residents served by one system to be charged for infrastructure improvements made . . . in another jurisdiction."³⁵⁶ Without recommending any change in language to the Proposed Rules, Caroline County asserted that the Proposed Rules "must provide for a means to differentiate the WWISC among different systems of varying conditions."³⁵⁷

I find that the concern raised by Caroline County is answered by the language filed by Staff.

Massanutten Resort contended that the Proposed Rules should prohibit cross-subsidization between rate classes.³⁵⁸ Rule 20 VAC 5-318-20 E of the Proposed Rules as filed by Staff provides as follows:

Any WWISC petition and rider that is submitted to and approved by the Commission shall be allocated and charged in accordance with appropriate cost causation principles in order to avoid any undue cross[-]subsidization between rate classes. The WWISC Rider should create no cross-subsidization among operations (i.e. water versus wastewater) or among jurisdictions with separate cost of service analyses.

Massanutten Resort recommended replacing the second sentence with the following:

³⁵³ Massanutten Resort at 14-15.

³⁵⁴ Armstrong, Tr. at 142.

³⁵⁵ *Id.*

³⁵⁶ Caroline County Brief at 11.

³⁵⁷ *Id.*

³⁵⁸ Massanutten Resort Brief at 5.

To the extent possible, direct assignment of costs will occur to the classes that cause a utility to incur them. This will prevent any one class or classes from being subsidized and reflect proper cost causation. A surcharge will be developed for each class and recover that class's respective costs allocated to it.³⁵⁹

Massanutten Resort argued that "it only makes sense to provide the same protection against subsidization among rate classes that Staff is proposing to prevent subsidization among operations and jurisdictions."³⁶⁰

I agree with Massanutten Resort that protections against cross-subsidization should be extended to customer classes. However, the language presented by Massanutten Resort attempts to accomplish such protections by mandating the direct assignment of costs. I find that such protections would be more likely realized by adjusting the second sentence of Staff's proposed language as follows:

The WWISC Rider should create no cross-subsidization among operations (i.e. water versus wastewater), among jurisdictions with separate cost of service analyses, or among customer classes.

Finally, Massanutten Resort sought protection against cross-subsidies within a particular rate class.³⁶¹ I find that such an analysis would not be suited to a WWISC proceeding. A cost of service study in a base rate case will assign and allocate costs between operations, jurisdictions, and customer classes and will be used to develop rates for each of those groups. This cost of service study and rate design also can be of help in establishing the cost of service and rate design in a WWISC proceeding. However, a cost of service study and rate design from a base rate case is unlikely to address intra-class subsidies or rates. Thus, any inquiry into intra-class subsidies would likely require significant original analysis that would be unsuited to the nature and timing of a WWISC proceeding.

(xvii) Annual Reconciliation Process

The City of Alexandria took issue with the proposed annual reconciliation process that is addressed in Rule 20 VAC 5-318-20 F of the Proposed Rules as filed by Staff.³⁶² The City of Alexandria seeks a cap "(such as ten percent)" on the amount over the annual WWISC reconciliation to be recovered.³⁶³ The City of Alexandria asserted that "[i]f the utility neglects to include an eligible expense in its WWISC [P]lan, then it should not be able to automatically recover that expense unilaterally after the fact."³⁶⁴

³⁵⁹ *Id.* at 6.

³⁶⁰ *Id.* at 8.

³⁶¹ *Id.* at 16.

³⁶² City of Alexandria Brief at 18. This section of the Proposed Rules was identified as "G" in the Proposed Rules filed by the Petitioners.

³⁶³ *Id.*

³⁶⁴ *Id.*

The City of Alexandria also expressed concern that when a WWISC Rider is set to zero following the establishment of new base rates, the WWISC Rider would remain in place.³⁶⁵ The City of Alexandria contended that “the utility would be free to generate ‘eligible infrastructure costs’ throughout the year and to recoup them through the annual reconciliation process.”³⁶⁶

Both of the concerns raised by the City of Alexandria should be alleviated by changes in language proposed by Staff. The approval of a WWISC Plan has meaning and consequences as evidenced by Staff’s additional filing requirements. Approval of such a plan will not be a blank check for any “eligible infrastructure costs” a utility may decide to undertake. In addition, the annual reconciliation process will take place in a proceeding before the Commission that provides for review by Staff and interested parties. The City of Alexandria cites to no testimony or record or basis for these concerns. Therefore, I find that no change to the Staff’s proposed filing language is required.

(xviii) Consideration of Other Ratemaking Issues

Consumer Counsel opposed language contained in Staff’s filed Proposed Rule 20 VAC 5-318-20 H (i) that states:³⁶⁷

No other revenue requirement or ratemaking issues may be examined in consideration of the application filed pursuant to the provisions of this chapter.

Consumer Counsel maintained that “the Commission should have the discretion to consider the overall revenue requirement of a utility in deciding whether to approve, deny, or possibly modify a utility’s WWISC Plan and Rider.”³⁶⁸

The City of Alexandria raised a similar concern and argued that such language would cause the Commission to abdicate its fundamental statutory responsibility to ensure that rates are just and reasonable in the aggregate.³⁶⁹

I find that the language of Staff’s filed Proposed Rule 20 VAC 5-318-20 H (i) simply limits the issues in a WWISC proceeding to those issues directly related to the WWISC Plan and Rider. This provision does not limit the Commission’s discretion to consider the impact of a WWISC Plan and Rider on the overall costs or rates to customers, which is a direct inquiry into the reasonableness of the WWISC Plan and Rider. Therefore, I find that no change to the Staff’s proposed filing language is required.

³⁶⁵ *Id.* at 18-19.

³⁶⁶ *Id.* at 19.

³⁶⁷ Consumer Counsel Brief at 14-15.

³⁶⁸ *Id.* at 15.

³⁶⁹ City of Alexandria Brief at 11-12.

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(xix) Earnings Test

Staff proposed that the WWISC Rider be subject to refunds based on an AIF earnings test in its Proposed Rule 20 VAC 5-318-20 H (ii), which provides:

Notwithstanding Subdivision H (i), WWISC collections shall be subject to review within annual earnings tests filed by the utility. To the extent the earnings test shows earnings in excess of a Commission-determined benchmark return on equity, the lesser of (a) WWISC collections or (b) the revenue requirement effect of excess earnings shall be returned to ratepayers as determined by the Commission. The amount to be returned shall be subject to carrying costs as addressed in definition (4).

Staff acknowledged that a WWISC Rider subject to true-up will not result in recovery exceeding the amount actually spent by the utility on WWISC-eligible infrastructure.³⁷⁰ Nonetheless, Staff noted that the Petitioners testified that the WWISC would result in lower cost, and asserted that an earnings test is necessary “to ensure that the utility’s overall earnings are not excessive due to reduced base rate operations and maintenance expense.”³⁷¹ Staff contended that its proposal complies with § 56-235.3 of the Code and uses a mechanism already in place in Virginia.³⁷²

Petitioners asserted that the Commission lacks the authority to make Staff’s proposed change to have the WWISC Rider subject to an earnings test with a refund to customers, with carrying charges.³⁷³ The Petitioners argued that because it is impossible for WWISC collections, which are subject to a true-up, to contribute to overearnings, Staff is proposing a refund of base rates for base rate overearnings.³⁷⁴ Petitioners maintained that Staff’s base rate refund proposal “would violate long-established principles regarding how costs are recovered through base rates.”³⁷⁵

Consumer Counsel agreed with Staff’s proposed earnings test, refund, and carrying charge.³⁷⁶ Consumer Counsel contended that operating efficiencies gained through a WWISC Plan and Rider may compound over time and “result in a utility receiving aggregate revenues in excess of aggregate actual costs plus a fair rate of return.”³⁷⁷ In addition, Consumer Counsel argued that Staff’s proposal would help the Petitioners avoid costly rate cases.³⁷⁸ Without a

³⁷⁰ Staff Brief at 9.

³⁷¹ *Id.*

³⁷² *Id.*

³⁷³ Petitioners Brief at 18.

³⁷⁴ *Id.* at 18-19.

³⁷⁵ *Id.* at 19.

³⁷⁶ Consumer Counsel Brief at 16.

³⁷⁷ *Id.* at 17.

³⁷⁸ *Id.* at 18.

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refund mechanism, if the Commission found that a utility was overearning, the Commission would need to institute a general rate case.³⁷⁹

Caroline County supported the use of an earnings test, and contended that such a test “is an important safeguard for ratepayers as it would help prevent the Water Companies from retaining WWISC recoveries while at the same time earning above a specified level.”³⁸⁰ However, Caroline County disagreed with Staff’s proposed incorporation of the AIF process, but recommended that the earning test be performed twelve months after the adoption of the WWISC Rider.³⁸¹

I find that Staff’s Proposed Rule 20 VAC 5-318-20 H (ii) provides an important consumer safeguard against the possibility that operating efficiencies gained through the replacement of aging infrastructure could produce over earnings for utilities. Staff limits possible refunds to the lesser of WWISC collections or excess earnings. While this limitation appears designed to avoid retroactive ratemaking,³⁸² Staff’s proposal counts all over earnings up to the level of WWISC collections as being related directly to the WWISC Plan. There are many other possible causes for a utility to over earn that are not related to its WWISC Plan. Such an analysis likely requires a base rate case. Thus, if an AIF for a utility with a WWISC Plan and Rider shows that the utility is over earning, I find that the Commission should institute a base rate proceeding rather than assume that the over earnings relate to the WWISC Plan and order a refund, with carrying charges. Therefore, I recommend that the second and third sentence in Staff’s Proposed Rule 20 VAC 5-318-20 H (ii) be eliminated.

(xx) Automatic Rate Adjustment Clause

In the Proposed Rules as originally filed by Petitioners, WWISC Riders were designated as automatic rate adjustment clauses for purposes of § 56-235.4 of the Code. Such language was eliminated by Staff in its version of Proposed Rule 20 VAC 5-318-20 I. Generally, § 56-235.4 of the Code limits a utility to one rate increase in any twelve-month period. However, § 56-235.4 of the Code provides for several exceptions, including “any automatic rate adjustment clause approved by the Commission.”³⁸³ In its brief, Staff argued that “automatic adjustment clauses are appropriate only where the utility is subject to ‘rapidly changing costs of which a utility can have no advanced knowledge and over which it can exercise no control.’”³⁸⁴ Indeed, Staff pointed out that in *Old Dominion* the Virginia Supreme Court held that “it would be most unsound policy to permit a utility to pass on to its customers, without review by the Commission, a cost increase which lies, to any extent, within its control.”³⁸⁵ Because WWISC Plans and

³⁷⁹ *Id.*

³⁸⁰ Caroline County Brief at 10 (citations omitted).

³⁸¹ *Id.*

³⁸² *See, Norfolk v. VEPCO*, 197 Va. 505, 516 (1955).

³⁸³ Section 56-235.4 A (ii) of the Code.

³⁸⁴ Staff Brief at 5, quoting language from *Old Dominion Power Company, Inc. v. State Corp. Comm’n*, 228 Va. 528, 533 (1984). (“*Old Dominion*”).

³⁸⁵ *Id.*

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eligible investment are within a utility's control, Staff asserted that a WWISC Rider is not an automatic adjustment clause.

Petitioners maintained that without being designated as an automatic adjustment clause, operation of § 56-235.4 of the Code would prevent the filing of a base rate case while a WWISC Rider is in place.³⁸⁶ Petitioners asserted that the Proposed Rules are designed to accommodate the filing of a base rate case while a WWISC Rider is in place.³⁸⁷ Petitioners took the position that its proposal is consistent with the infrastructure replacement program adopted in *Roanoke Gas*, which was designated as an automatic adjustment clause.³⁸⁸ Finally, Petitioners affirmed that designation of a WWISC Rider as an automatic adjustment clause is not intended to support any procedural determinations, but only to preserve a utility's ability to file a base rate proceeding.³⁸⁹

Consumer Counsel asserted that “[n]ot treating a WWISC as an automatic rate adjustment clause would serve as an additional consumer safeguard by limiting the frequency of rate increases.”³⁹⁰ Consumer Counsel advised that the designation of the infrastructure surcharge in *Roanoke Gas* was fact specific and based on numerous consumer safeguards such as an earnings test; a benchmark return on equity below the authorized midpoint; a limited three-year surcharge period; a limited annual investment; an agreement not to file for a non-gas rate increase during the surcharge period, except under limited, specified circumstances; and the refund of over earnings.³⁹¹ Consumer Counsel argued that the Proposed Rules for WWISC do not have the consumer safeguards to be an exception to § 56-235.4 of the Code.³⁹²

The City of Alexandria maintained that automatic rate adjustment clauses “must be applied rarely and judiciously.”³⁹³ The City of Alexandria cited to *Old Dominion* and pointed out the control a utility has in moving from a 500-year to a 100-year system replacement schedule.³⁹⁴ The City of Alexandria stated that “[i]t would be legal error, and abuse of discretion, and poor public policy for the Commission to approve [the Petitioners’ proposed automatic rate adjustment clause language].”³⁹⁵

In reconciling *Old Dominion* and *Roanoke Gas*, Consumer Counsel framed the automatic rate adjustment clause issue as being driven by an assessment of consumer safeguards. That is, do the Proposed Rules, as they may be adopted by the Commission, include sufficient consumer safeguards that WWISC Riders may be designated as automatic rate adjustment clauses, which will permit utilities to file both (i) a base rate case, and (ii) an application to establish or increase

³⁸⁶ Petitioners Brief at 26.

³⁸⁷ *Id.*

³⁸⁸ *Id.* at 27.

³⁸⁹ *Id.* at 28.

³⁹⁰ Consumer Counsel Brief at 10.

³⁹¹ *Id.* at 11-12; *Roanoke Gas* at 442.

³⁹² Consumer Counsel Brief at 12.

³⁹³ City of Alexandria Brief at 12.

³⁹⁴ *Id.* at 13.

³⁹⁵ *Id.*

a WWISC Rider within a twelve-month period? Unlike the infrastructure replacement program established in *Roanoke Gas* that was designed specifically for that specific instance, the Proposed Rules would be general and applicable to all water and wastewater utilities under the Commission's jurisdiction. Thus, I find that the Proposed Rules are less tailored and provide less consumer safeguards than what was established in *Roanoke Gas*. For example, under the Petitioners' proposal, all water and wastewater utilities would be able to file for both a base rate increase and for a WWISC Rider within a twelve-month period, regardless of the reason for the base rate increase. In *Roanoke Gas*, the utility could file a non-gas rate case only "when 'circumstances make it necessary for the protection of the legitimate interests of the Company's customers or its shareholders.'"³⁹⁶ Therefore, I find that no change to the Staff's proposed filing language is required.

In summary, the changes recommended above to the Proposed Rules as filed by Staff are provided in a redline version in Attachment A to this Report.

Adoption of Rules

The Petitioners pointed to the age of the water and wastewater infrastructure in Virginia and contended that much of this infrastructure "is quickly approaching the end of its useful life, if it has not already done so."³⁹⁷ The Petitioners warned that Virginia is falling behind in replacing this infrastructure, with Virginia on a 300- to 500-year replacement cycle instead of the industry goal of a 100-year replacement cycle.³⁹⁸ The Petitioners referred to a report by the Virginia Section of the American Society of Civil Engineers that "the water systems in Virginia will require nearly \$6.1 billion in investment over the next 20 years and that wastewater systems will require nearly \$6.8 billion."³⁹⁹ The Petitioners maintained that a proactive, more comprehensive infrastructure replacement program will allow "utilities to prioritize the efficient replacement of infrastructure to minimize instances where older facilities actually fail along with the associated impact on service to customers and the potential health hazards associated with these failures."⁴⁰⁰

The Petitioners asserted that a rate mechanism separate from base rates is better for planning and addressing infrastructure replacement as a separate rate mechanism allows for more timely recovery of costs, lower financing costs, and more extensive pre-planning.⁴⁰¹ The Petitioners affirmed that a more efficient process to incorporate infrastructure replacement costs into rates "would incent companies to replace infrastructure in an expedited and efficient manner."⁴⁰² The Petitioners contended that such a replacement program will benefit customers through improved service quality, greater rate stability, reduced number of costly main breaks, less frequent service interruptions, increased safety, reduced levels of unaccounted for water,

³⁹⁶ *Roanoke Gas* at 442 n.8.

³⁹⁷ Petitioners Brief at 2 (footnote omitted).

³⁹⁸ *Id.*

³⁹⁹ *Id.* at 2-3 (footnote omitted).

⁴⁰⁰ *Id.* at 3-4 (footnote omitted).

⁴⁰¹ *Id.* at 5-6.

⁴⁰² *Id.* at 6.

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compliance with primary and secondary water standards, and reduced sewer overflows from inflow and infiltration.⁴⁰³

Staff supported the adoption of the Proposed Rules as adjusted and filed by Staff.⁴⁰⁴

All Respondents recommend against the adoption of a rate mechanism separate from base rates.

Consumer Counsel argued that “traditional cost of service ratemaking is generally preferable to single-issue ratemaking.”⁴⁰⁵ Consumer Counsel contended that single-issue ratemaking makes it difficult to determine the overall financial health of a utility and creates the risk of unfair charges for customers.⁴⁰⁶

Caroline County asserted that the adoption of a rate mechanism separate from base rates would be contrary to sound public policy.⁴⁰⁷ Caroline County maintained that adoption of such a rate mechanism would involve policy considerations affecting ratepayers, utility companies, localities, and other interested entities.⁴⁰⁸ Caroline County advised that “such matters should correctly be addressed and decided by the General Assembly, and not by the Commission.”⁴⁰⁹ In support, Caroline County pointed to Virginia’s SAVE Act and legislation adopted in other states to implement infrastructure surcharge mechanisms.⁴¹⁰

Frederick County contended that “the Commission can best address the Petitioners’ infrastructure needs through the regular rate request process.”⁴¹¹ Frederick County maintained that a base rate case provides for public input, which is essential to proper oversight of water and wastewater utilities.⁴¹² Frederick County pointed out that Petitioners witness Walsh acknowledged that the current ratemaking process permits water and wastewater utilities to accelerate infrastructure replacement, but the Petitioners proposed the WWISC due to the costs of rate cases and regulatory lag.⁴¹³ Frederick County also took issue with the one-size-fits-all approach of adopting the Proposed Rules.⁴¹⁴ Frederick County advised that “the potential application of general WWISC rules to vastly different water and/or wastewater systems is inappropriate and, for this additional reason as well, the Commission should deny the Petition.”⁴¹⁵

⁴⁰³ *Id.* at 6-7.

⁴⁰⁴ Staff Brief at 10.

⁴⁰⁵ Consumer Counsel Brief at 7.

⁴⁰⁶ *Id.* at 8.

⁴⁰⁷ Caroline County Brief at 7.

⁴⁰⁸ *Id.* at 8.

⁴⁰⁹ *Id.*

⁴¹⁰ *Id.* at 7-8.

⁴¹¹ Frederick County Brief at 4.

⁴¹² *Id.*

⁴¹³ *Id.* at 5; Walsh, Tr. at 64.

⁴¹⁴ Frederick County Brief at 6.

⁴¹⁵ *Id.*

The City of Alexandria asserted that “[t]here is no public policy to grant the Petition.”⁴¹⁶ The City of Alexandria advised that both of the Petitioners’ witnesses agreed that water and wastewater utilities could accelerate infrastructure replacements, but seek a better process.⁴¹⁷ The City of Alexandria argued that because the replacement schedules are over hundreds of years they can “be addressed through the normal statutorily-specified rate case process.”⁴¹⁸ In addition, the City of Alexandria pointed to the benefits to be realized by systematically accelerating aging infrastructure replacement and contended that “[r]educing unnecessary costs should be its own incentive—not to mention a legal obligation for a regulated utility seeking to recover costs from its customers.”⁴¹⁹

Massanutten Resort advised that “[s]urcharges that provide dollar-for-dollar recovery of specific costs generally do not reflect good ratemaking policy”⁴²⁰ Massanutten Resort maintained that such mechanisms fail to consider changes in other utility costs, create the risk of over-recovery and of unfair charges to customers, and reduce a utility’s incentive to control or reduce costs.⁴²¹ Massanutten Resort advised that such single-issue ratemaking should be limited to costs that are volatile or outside the control of the utility, and have the potential to adversely impact the utility’s financial health.⁴²²

Based on the record in this case, I find that the Petitioners have failed to prove sufficient need for the Proposed Rules. Generally, I agree with Respondents that single-issue ratemaking should be limited to rare and exceptional situations such as where costs are large, volatile, and outside the control of the utility. As demonstrated by *Roanoke Gas*, single-issue ratemaking also may be employed when it is in the public interest to address a large critical need through a separate rate mechanism with sufficient customer safeguards. In this case, the magnitude of the required infrastructure replacement is unsupported, but within the control of the utilities. Furthermore, the Petitioners failed to establish that all Virginia jurisdictional water and wastewater utilities have a large critical need to replace infrastructure through a separate rate mechanism.

The Petitioners pointed to reports that Virginia will require billions in water and wastewater infrastructure investment over the next 20 years. However, these reports are unsupported in the record. For example, the amounts from these reports do not appear to be specific to Commission-jurisdictional water and wastewater utilities. More importantly, the level of required infrastructure investment, the required timing of such investment, and how critical such investment may be to a system’s operation are fact-based issues specific to each water and wastewater utility. With the exception of the information provided by the Petitioners for

⁴¹⁶ City of Alexandria Brief at 3.

⁴¹⁷ *Id.* at 4; Walsh, Tr. at 64; Akmentins, Tr. at 87.

⁴¹⁸ City of Alexandria Brief at 4.

⁴¹⁹ *Id.* at 5.

⁴²⁰ Massanutten Resort Brief at 3.

⁴²¹ *Id.* at 3-4.

⁴²² *Id.* at 4.

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Virginia American, the Petitioners provided little, if any, evidence concerning the need for infrastructure replacement for the utilities that would be covered by the Proposed Rules.

As to the replacement of the infrastructure being within the control of the water and wastewater utilities, the Petitioners presented a 100-year replacement cycle as an industry standard, or “something that most water systems strive for.”⁴²³ Thus, because this infrastructure has a long replacement cycle, utilities have the flexibility to plan and control its replacement. This control and ability to plan is prominently featured in the Proposed Rules. In addition, there is nothing in the record to indicate that changes in environmental or water quality standards have had a significant impact on the replacement of infrastructure. For example, one of the purposes or benefits of replacing aging infrastructure presented by the Petitioners is the compliance with primary and secondary drinking water regulations. Petitioners witness Walsh testified that the primary drinking water regulations are relatively new, as they became effective in 1986.⁴²⁴

In regard to the need for a separate rate mechanism, there is little, if any, evidence that water and wastewater utilities will be unable to address aging infrastructure concerns through the existing ratemaking process. Indeed, both of the Petitioners’ witnesses acknowledged that the current ratemaking process permits accelerated infrastructure replacement.⁴²⁵ As presented by the Petitioners, under the current ratemaking process, the replacement of aging infrastructure would require a base rate case annually. I disagree. One way the current ratemaking process permits infrastructure replacement is through depreciation of existing plant in service. Massanutten Resort witness Collins illustrated that the depreciation expense collected through base rates can be invested in new plant without having any impact on the utility’s overall revenue requirement.⁴²⁶ More specifically, Petitioners witness Walsh testified that while the useful life and replacement cycles for mains may be more than a hundred years, the cost of these mains are recovered through depreciation expense over “approximately 70 years.”⁴²⁷ This depreciation expense is available for investment in new plant, including the replacement of aging infrastructure, each year without the need to file for a rate increase (all other things remaining equal).⁴²⁸ Moreover, there are other existing ratemaking practices, such as the incorporation of projected rate-year investments, that may also help to adequately accommodate the replacement of aging infrastructure. Thus, I find that the record in this case fails to support a finding that water and wastewater utilities need a separate rate mechanism.

Finally, I find that the differences between water and wastewater utilities, the varying age and quality of each utility’s infrastructures, and differences in each utility’s current rates and history of rate increases weigh against the adoption of the Proposed Rules. As demonstrated in *Roanoke Gas*, the Commission has the authority to adopt a separate rate surcharge mechanism to facilitate the replacement of aging infrastructure when it finds that based on the specific facts and

⁴²³ Walsh, Tr. at 73.

⁴²⁴ *Id.* at 81.

⁴²⁵ Walsh, Tr. at 64; Akmentins, Tr. at 87.

⁴²⁶ Exhibit No. 7, at 9-10.

⁴²⁷ Walsh, Tr. at 80.

⁴²⁸ Upward pressure on rates would result from investment in new plant above the level of depreciation expense.

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circumstances, including customer safeguards, such a rate mechanism is in the public interest and the resulting rates are just and reasonable. Even though the Proposed Rules provide for Commission approval of a WWISC Plan prior to its implementation and would apply similar legal standards, the absence of established rules would provide the water and wastewater companies, Commission, and participants a greater degree of flexibility to tailor the surcharge to the specific utility, facts, and circumstances.

Consequently, I find that the Petitioners have failed to prove sufficient need for the Proposed Rules.

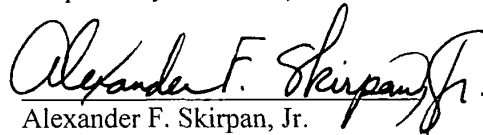
Accordingly, **I RECOMMEND** the Commission enter an order that:

1. **ADOPTS** the findings of this Report;
2. **DENIES** the Petition; and
3. **DISMISSES** this case from the Commission's docket of active cases.

COMMENTS

The parties are advised that pursuant to Commission Rule 5 VAC 5-20-120 C of the Commission's Rules of Practice and Procedure, any comments to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen copies, within twenty-one (21) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P.O. Box 2118, Richmond, Virginia 23218. Any party filing such comments shall attach a certificate to the foot of such document certifying that copies have been mailed or delivered to all counsel of record and any such party not represented by counsel.

Respectfully submitted,



Alexander F. Skirpan, Jr.
Senior Hearing Examiner

A copy hereof shall be sent by the Clerk of the Commission to all persons on the official Service List in this matter. The Service List is available from the Clerk of the State Corporation Commission, c/o Document Control Center, 1300 East Main Street, First Floor, Tyler Building, Richmond, VA 23219.

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Attachment A

CHAPTER 318

WATER & WASTEWATER INFRASTRUCTURE SERVICE CHARGE

20VAC5-318-10. Definitions.

The following words and terms when used in this chapter shall have the following meaning unless the context clearly indicates otherwise:

"Commission" means the State Corporation Commission.

"Eligible infrastructure" means a water utility project or wastewater utility project that: (i) maintains and enhances safety, reliability and efficiency; (ii) addresses primary and secondary water quality standards as defined by Virginia Department of Environmental Quality, Virginia Department of Health, or U.S. Environmental Protection Agency; or (iii) reduces or has the potential to reduce unaccounted-for water; or mitigates negative environmental impacts. Eligible infrastructure shall not include the investment in water utility or wastewater utility infrastructure included in the water or wastewater utility's rate base in its most recent rate case or include projects that increase revenues by directly connecting the infrastructure to new customers.

"Eligible infrastructure costs" includes the following:

1. Return on investment. The utility's rate of return on rate base approved by the Commission in the utility's most recent rate case shall be used in WWISC riders. In calculating the return on the investment, the Commission shall use the water or wastewater utility's regulatory capital structure as calculated utilizing the weighted average cost of capital, including the cost of debt and the cost of equity used in determining the water or wastewater utility's base rates in effect during the construction period of the water and wastewater utility project. If the water or wastewater utility's cost of capital has not been changed by order of the Commission within the preceding five years, the Commission may require the utility to file an updated weighted average cost of capital, or the utility may propose an updated weighted average cost of capital. The utility may recover the external costs associated with establishing its updated weighted average cost of capital through the WWISC rider. Such external costs shall include legal costs and consultant costs;

2. Depreciation. In calculating depreciation, the Commission shall use the water or wastewater utility's current depreciation rates specific to the applicable asset;

3. Property taxes; and

4. Carrying costs on the over or under recovery of the eligible infrastructure costs. In calculating the carrying costs, the Commission shall use the water or wastewater company's regulatory capital structure as determined in subdivision 1 of this definition.

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A revenue conversion factor, including appropriate taxes and an allowance for an uncollectible net charge-off percentage, shall be applied to the required operating income resulting from the eligible infrastructure costs discussed above.

“Investment” means capital costs incurred on or subsequent to the effective date of rates in the initial WWISC Plan for eligible infrastructure projects net of retirements including planning, development, and construction costs; costs of infrastructure associated therewith.

“In-kind replacement” means replacement with new materials and or equipment designed, constructed, and sized to meet current industry standards, and federal, state or local regulation.

“Water utility” means an investor-owned public service company engaged in the business of furnishing water service to the public.

“Wastewater utility” means an investor-owned public service company engaged in the business of furnishing wastewater service to the public.

“Water utility project” means: (i) in-kind replacement of transmission and distribution system mains, valves, utility service lines (including meter boxes and appurtenances), and hydrants; (ii) non-growth related main extensions installed to eliminate dead ends that will address primary and secondary drinking water standards; and (iii) equipment and infrastructure installed to address primary and secondary drinking water standards.

“Wastewater utility project” means: (i) non growth related collection main extensions installed to implement solutions to wastewater problems; (ii) in-kind replacement of infrastructure necessary to reduce inflow and infiltration to the collection system to comply with applicable state and federal law and regulations; and (iii) improvements required by National Pollutant Discharge Elimination System permits.

“WWISC plan” means a plan filed by a water or wastewater utility that identifies proposed types of eligible infrastructure projects and a WWISC rider.

“WWISC rider” means a recovery mechanism implemented on or subsequent to the date of Commission approval of the WWISC rider that will allow for recovery of the eligible infrastructure costs, through a separate mechanism from the customer rates established in a rate case.

20VAC5-318-20. Procedures for filing of petition with Commission to implement a WWISC plan and rider; and for recovery of certain costs.

A. A water or wastewater utility may petition the Commission for the approval of a WWISC plan. Such a petition for approval of a WWISC plan shall include the following:

1. A description of the categories, types, locations, plant sub-accounts impacted, targeted plant vintages, targeted material compositions, and cost estimates of eligible infrastructure projects to be included in the WWISC plan.

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2. Reporting on the projected liner feet and diameter of replacement mains and those replaced, the number of and size of replacement services and those replaced, the number of meters projected to be replaced and other applicable facts.
3. Proposed spending limits and ranges on the WWISC-eligible investment for the duration of the WWISC Plan, as well as proposed annual spending limits and ranges. The WWISC Rider shall be no more than five percent (5%) of the annual revenues for each customer class.
4. Detailed and transparent analysis of how each investment activity complies with the WWISC rules.
5. The effective date of the proposed WWISC rider.
6. The proposed accounting for WWISC Plan costs, recoveries and deferrals.
7. Anticipated current and deferred income tax impacts of WWISC activity, including tax savings resulting from Domestic Production Activity Deductions, if applicable.
8. Discussion and illustrative example of how WWISC-eligible investment will be segregated on the books and records from non-WWISC investment.
9. Workpapers supporting the WWISC rider revenue requirement including, at a minimum:
 - a. the depreciable base and applicable depreciation rates by sub-account,
 - b. property tax rates and the taxable base,
 - c. capital structure and overall weighted cost of capital,
 - d. revenue conversion factor, and
 - e. carrying costs on any over or under-recovery.
10. Duration of the WWISC plan.
11. The method by which the utility will provide annual updates of the WWISC rider.
12. Proposed tariffs for the WWISC Plan.
13. Sample customer impacts by rate schedule, group, and/or district.

B. The Commission may approve the initial petition for establishment of a WWISC plan and WWISC rider after such notice and opportunity for hearing as prescribed by the Commission ~~may prescribe~~. The Commission shall approve the initial petition if the applicant demonstrates that the WWISC Plan is prudent and reasonable, and that the WWISC Rider is just and reasonable. The Commission shall approve, modify, or deny, within 180 days, a water or wastewater utility's initial petition for approval of a WWISC plan. An application filed pursuant

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to this section shall not require the filing of rate case schedules under 20 VAC 5-201-10 *et seq.* of the Commission's rules.

C. The Commission shall approve, modify, or deny, within 120 days, a water or wastewater utility's application to amend a previously approved plan. If the Commission denies such a plan or amendment, it shall set forth with specificity the reasons for such denial, and the utility shall have the right to refile, without prejudice, an amended plan or amendment within 60 days, and the Commission shall thereafter have 60 days to approve, modify, or deny the amended plan or amendment.

D. The WWISC rider shall be calculated to recover the ongoing eligible infrastructure costs of water utility projects and wastewater utility projects projected to be placed in service during the water or wastewater utility's next fiscal year. The WWISC rider shall be calculated and updated on a yearly basis to reflect eligible infrastructure projected to be placed in service during the upcoming annual WWISC period. Such updates shall be conducted in a docketed proceeding requiring Commission approval.

E. Any WWISC petition and rider that is submitted to and approved by the Commission shall be allocated and charged in accordance with appropriate cost causation principles in order to avoid any undue cross subsidization between rate classes. The WWISC Rider should create no cross-subsidization among operations (i.e. water versus wastewater), ~~or among jurisdictions with separate cost of service analyses, or among customer classes.~~

F. At the end of each 12-month period the WWISC rider is in effect, the water or wastewater utility shall reconcile the difference between the recognized eligible infrastructure costs and the amounts recovered under the WWISC rider, and shall submit the reconciliation and a proposed WWISC rider adjustment to the Commission to recover or refund the difference, as appropriate, through an adjustment to the WWISC rider. The Commission shall approve, modify, or deny, within 120 days, a water or wastewater utility's proposed WWISC rider adjustment. The update of eligible infrastructure projected to be placed in service during the upcoming year in Subdivision D and the reconciliation addressed in this subdivision shall be considered in the same annual proceeding before the Commission.

G. A water or wastewater utility that has an approved WWISC Plan and Rider pursuant to this chapter shall file revised rate schedules to cease recovery of WWISC eligible infrastructure on the effective date of base rates, including interim rates as applicable, that incorporate such costs.

H. (i) Determination of a WWISC Rider shall be made independent of all other costs that the water or wastewater utility is permitted to recover. No other revenue requirement or ratemaking issues may be examined in consideration of the application filed pursuant to the provisions of this chapter.

(ii) Notwithstanding Subdivision H (i), WWISC collections shall be subject to review *within annual earnings tests filed by the utility.* ~~To the extent the earnings test shows earnings in excess of a Commission determined benchmark return on equity, the lesser of (a) WWISC~~

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~~collections or (b) the revenue requirement effect of excess earnings shall be returned to ratepayers as determined by the Commission. The amount to be returned shall be subject to carrying costs as addressed in definition (4).~~

I. The Staff of the Commission shall be allowed access to the internal analysis performed in the water or wastewater utility's evaluation of contractor bids for WWISC-eligible construction activities.