

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Aqua)
Ohio, Inc. for Authority to Assess a System)
Improvement Charge for Sewage Disposal) Case No. 15-864-WS-SIC
Service in the Franklin County District.)

FINDING AND ORDER

The Commission finds:

- (1) Aqua Ohio, Inc. (Aqua or applicant) is a public utility as defined in R.C. 4905.02 and a sewage disposal system company as defined in R.C. 4905.03(A)(13) and, as such, is subject to the jurisdiction of this Commission.
- (2) Senate Bill 44, which became Ohio law on January 6, 2004, created an infrastructure improvement surcharge, known as the System Improvement Charge (SIC), to assist water and sewer companies to fund the replacement and rehabilitation of infrastructure including aging mains and plant that are crucial to service reliability and water quality.
- (3) Pursuant to R.C. 4909.172, waterworks and sewage disposal companies are authorized to file an application with the Commission for approval to collect a SIC. The surcharge mechanism is designed to recover, and provide a return on, specified costs associated with certain plant investments. Ohio Adm.Code 4901:1-15-35 provides for the filing requirements for an application for authorization to collect a SIC.
- (4) On May 1, 2015, Aqua filed an application (Application) for authority to collect a SIC for Sewage Disposal Service in its Franklin County District.
- (5) By attorney examiner Entry issued May 29, 2015, a schedule was established, requiring that any interested party wishing to comment on the Application must file comments with the Commission by no later than July 15, 2015.
- (6) On July 15, 2015, the staff of the Commission (Staff) filed comments detailing the process and results of the Staff's

investigation. Staff conducted interviews of the applicant's key personnel and reviews of internal reports. Staff examined the applicant's continuing property records to evaluate the reasonableness of the original cost of property. Through physical inspections, Staff verified the existence and used and useful nature of assets. Staff performed other independent analyses warranted by the circumstances.

Staff noted that the applicant is proposing to recover costs of distribution system infrastructure improvements for the period May 1, 2012, to March 31, 2015, in the amount of \$862,317. Staff examined supporting documentation, including task orders, continuing property records, and selected invoices. (Comments at 3.)

Summary of Applicable Law:

- (7) R.C. 4909.172 includes several requirements that must be met before the Commission may approve a proposed SIC:
 - (a) The costs of infrastructure plant upon which a proposed SIC may be based may only include the costs of certain capital improvements. For a sewage disposal system company like the applicant, allowable capital improvements may include:
 - (i) replacement of existing infrastructure including chemical feed systems, filters, pumps, motors, sludge-handling equipment, plant generators, mains and lift stations, main extensions that resolve documented sewage disposal problems presenting significant health or safety issues to then existing customers, and main cleaning, inflow, and infiltration elimination, or relining;
 - (ii) unreimbursed capital expenditures made by a sewage disposal system company for facility relocation required by a governmental entity

due to a street or highway project;
and

- (iii) minimum land or land rights acquired by the company as necessary for any service line, equipment, or facility previously described.
- (b) The Commission must determine that the covered capital improvements are used and useful in rendering public utility service.
- (c) The cost of those capital improvements may include depreciation expenses.
- (d) The proposed SIC must be just and reasonable and must be sufficient to meet, but not exceed, the revenue requirement necessary to both:
 - (i) cover such infrastructure plant costs as are described in the statute, incurred after March 1, 2003, and before the date of filing, and not already reflected in schedules filed under R.C. 4905.32; and
 - (ii) provide a fair and reasonable rate of return on the valuation (as of the date of filing of the application) of that infrastructure plant.
- (e) The SIC may not exceed 3 percent of the rates and charges applicable to any affected customer class and, as to the allowed percentage increase, must be uniform for each such class.
- (f) No more than three SICs under this section may be in effect at any given time.
- (g) The Commission is prohibited from authorizing a SIC under this section if it would cause the applicant to earn an excessive rate of return on its rate base.

Staff's Review and Recommendation

- (7) During its investigation of the SIC, Staff considered infrastructure plant and depreciation, rate of return, revenue distribution, tariff filings, and the customer notice. As a result of its investigation, Staff recommends that Aqua remove the project costs associated with the replacement of pumps at the Chatterton Lift Station and the Lake Darby Wastewater Treatment facility. Staff explains that Aqua completed these projects in 2012, prior to the March 27, 2013 effective date that the General Assembly changed the law to allow the recovery of such costs through a SIC. Consequently, Staff recommends that Aqua remove \$30,973.43 in project costs and \$13,443.04 in the accompanying retirement costs from the company's SIC calculation. For the same reason, Staff recommends that Aqua remove the \$4,565.21 in costs for replaced parts on its belt press and \$1,572.45 in accompanying retirements from its SIC calculation. The work associated with these projects was completed before the change in law that would now allow for the inclusion of the costs in a SIC calculation. (Comments 3-4.)
- (8) Staff also recommends that Aqua remove the costs of smoke tests totaling \$81,931.36 from its SIC calculation. Staff explains that smoke tests are used to detect excessive inflow and infiltration. Inflow is the entry of non-wastewater into the sanitary system through improper connections. Infiltration is the entry of non-wastewater into the sanitary system indirectly through joints or breaks in pipes. Either condition places a strain on system capacity and may lead to environmental protection violations. A smoke test is conducted by forcing smoke into the sewer line. Breaks in the line are identified by the location of rising smoke. (Comments 4-5.)

Staff regards smoke tests as operating expenditures, not costs subject to capitalization. Therefore, Staff believes that the costs should be excluded from the SIC calculation. Aqua disagrees with Staff. However, because the exclusion of smoke test costs will have no

impact upon the amount of the surcharge, Aqua chooses not to litigate the issue. Nevertheless, Aqua reserves the right to object in a future proceeding. (Comments 4-5; Reply Comments 1-2.)

- (9) Next, Staff asserts that Aqua received a rebate from AEP-Ohio in exchange for decreased future demand on the grid. The reduced demand stems directly from the electrical system replacement at the Lake Darby waste water treatment plant. To recognize the rebate, Staff recommends adjusting the project cost by \$19,500 for a new project cost of \$348,898.40. (Comments 6.)
- (10) Staff further reviews Aqua's depreciation schedules to verify, in part, that Aqua used the correct depreciation accrual rates prescribed in *In re Ohio American Water Company*, Case No. 11-4161-WS-AIR (*Ohio American*), Opinion and Order (June 13, 2012).¹ For Account 372 Treatment and Disposal Equipment, Aqua used a 3.29 percent accrual rate (Application, Schedule 6). Staff recommends that the accrual rate be adjusted to reflect the authorized accrual rate of 3.28 percent (*Ohio American*, Stipulation, Schedule B-3.2c). Staff also discovered a minor error of \$197.00 in the calculation of the total depreciation expense. With these exceptions, Staff verified that all calculations were correct. (Comments 6.)
- (11) In its review of property taxes, Staff analyzes Aqua's Schedules for Annualized Addition in Property Taxes for Additions and Annualized Reduction in Property Taxes for Retirements. Staff recommends that the schedules be amended to apply the latest known tax rate to calculate the annualized property taxes. Aqua applied rates from its last base-rate case. Staff also recommends that Aqua amend its schedule to identify plant addition totals by year and apply the proper percent for each year to calculate the true value of taxable property. (Comments 6-7.)

¹ Aqua purchased the properties of Ohio American Water Company in Ohio and inherited its depreciation accrual rates.

- (12) With its Application, Aqua provided a notice to inform its customers about the SIC. Staff recommends that language be added to the notice to point out that, in Ohio, system improvement charges may apply to both water and sewer companies (Comments 8-9).
- (13) Staff finds that the proposed surcharge does not exceed the three percent statutory limit for sewage disposal companies, is distributed uniformly to all classes, and does not exceed the three surcharge maximum (Comments at 8). Staff finds that the proposed surcharge will provide a fair and reasonable rate of return on the applicant's valuation of costs associated with the system infrastructure improvements (Comments at 7). Staff concludes, therefore, that the Commission should approve the Application, subject to Staff's recommendations (Comments at 9).

Aqua's Response to Staff's Comments

- (14) Aqua filed a reply to Staff's comments on July 22, 2015. Aqua agrees that Staff's recommended adjustments will not impact its requested three percent surcharge. Therefore, Aqua provided revised schedules in which all of Staff's recommended adjustments were accepted. As a final matter, the applicant clarified that although it does not support Staff's exclusion of the smoke-test costs from the requested surcharge, Aqua is not opposing these adjustments for purposes of this case as the adjustments have no impact on the amount of the surcharge. Aqua does, however, reserve the right to object to this treatment in a future proceeding, if that proves necessary. (Reply Comments at 1-2.)

Commission's Conclusions

- (15) Based upon the applicant's books of record and Staff's identification of those accounts, the Commission finds that the projects contained in the proposed SIC are infrastructure improvements and projects upon which a SIC may be based, pursuant to R.C. 4909.172.
- (16) The Commission determines that the infrastructure improvements upon which the proposed SIC is based are used

and useful in rendering public utility service to the customers of the applicant (Comments at 2).

- (17) As allowed by R.C. 4909.172, the costs of the capital improvements underlying the proposed SIC include depreciation expenses. As adjusted in accordance with Staff's recommendation, the Commission finds that the depreciation expenses were based on rates approved in *Ohio American* and are, therefore, proper and accurate. In its reply comments, Aqua attached revised Schedules 5 and 6 to account for Staff's recommendations. Schedule 5 shows the annualized depreciation associated with additions. With the adjusted accrual rate of 3.28 percent, the depreciation expense for Account 372 is \$2,675. Revised Schedule 6 shows the annualized reduction in depreciation for retirements. The application of a 3.28 percent accrual rate for Account 372 results in a depreciation expense of \$1,901. Revised Schedule 6 also recognizes the \$197 error discovered by Staff in Account 351. (Reply Comments, Revised Schedules 5 and 6.)
- (18) All of the underlying infrastructure improvement costs were incurred by the applicant during the period May 1, 2012, to March 31, 2015. Moreover, all projects were concluded prior to the filing of the Application. (Application at Schedule 2.) The following summarizes the costs of the infrastructure improvements underlying the proposed SIC and the fair and reasonable return on the valuation of that infrastructure (Reply Comments, Revised Schedule 1):

1	<u>Return on Investment</u>		
2	Plant in Service		
3	Additions	\$725,348	Schedule 2
4	Original Cost Retired	<u>\$148,746</u>	Schedule 3
5	Net Plant in Service (3-4)	\$576,602	
6	Less: Accumulation Provision for Depreciation		
7	Depreciation Expense	\$10,816	Schedule 4
8	Original Cost Retired	<u>\$148,746</u>	Schedule 3
9	Total Accumulated Provision for Depreciation (7-8)	\$(137,930)	
10	Net Rate Base	\$714,532	
11	Pre-tax Rate of return	<u>10.58%</u>	Schedule 7
12	Annualized Return on Rate Base (10x11)	\$75,597	
	<u>Operating Expenses</u>		
13	Annualized Provision for Depreciation for Additions	\$27,543	Schedule 5
14	Annualized Reduction in Depreciation for Retirements	(\$4,458)	Schedule 6
15	Annualized Property Taxes for Additions	\$54,238	Schedule 5a
16	Annualized Property Taxes for Retirements	(\$3,439)	Schedule 6a
17	Annualized Revenue Requirement (12+13-14+15)	\$149,481	

The Commission finds that the annual revenue requirement associated with the underlying infrastructure improvements is \$149,481, based on the applicant's revised Schedule 1 filed July 20, 2015. The original revenue requirement was calculated by the applicant to be \$177,052. This was an overstatement that was the result of including project costs that were ineligible for SIC recovery.

The Application sets forth the anticipated annual revenues resulting from the proposed SIC. The Commission finds that the proposed SIC of three percent, applied to annual revenues of \$3,651,395 will yield surcharge revenues of approximately \$149,481 (Reply Comments, Revised Schedules 1 and 10). Because of the three percent limitation established by R.C. 4909.172(B)(2), Aqua requests only \$109,542. (Application,

Exhibit B, Page 2; Reply Comments, Revised Schedule 10.) The SIC will apply to all sewer services rendered to customers in the Franklin County District (Comments at 8).

Staff reports that the pre-tax rate of return is based on information contained in the applicant's rate filing in *In re Aqua Ohio, Inc.*, Case No. 13-2124-WW-AIR, Opinion and Order (Sept. 10, 2014). Moreover, Staff concluded that the rate of return is correct and that it is consistent with the Commission's Guidelines in Ohio Adm.Code 4901:1-15-35. Staff believes that the surcharge will provide a fair and reasonable rate of return on the applicant's valuation of costs associated with the improvements. (Comments at 7.) The Commission agrees with Staff's assessments.

The Commission is required by R.C. 4909.172 to ensure that any authorized SIC will not cause a company to earn an excessive rate of return on its rate base. As calculated by both Staff and the applicant, the proposed SIC will not exceed the three percent limitation imposed by R.C. 4909.172(B)(2). In addition, Staff has verified that the proposed surcharge will recover only the costs specifically related to the applicant's infrastructure improvements. The surcharge will not provide additional base revenue to the company. (Comments at 9.)

The appendix to Ohio Adm.Code 4901:1-15-35 states that "[i]f a surcharge is granted by the Commission, the company's actual and pro forma profitability will be reviewed on an annual basis to determine whether a reduction or elimination of such surcharge or subsequent surcharges is required by this restriction" (appendix at 4). In order to make the required annual review, the applicant will be ordered to file its SIC Schedule 8 on an annual basis concurrent with the applicant's filing of its annual report to the Commission, using the most recent calendar year.

- (19) The Commission finds that the proposed SIC is just and reasonable. It is sufficient to meet (subject to the statutory maximum SIC percentage), but not to exceed, the statutorily mandated revenue requirement associated with the cost of, and the fair and reasonable return on, the underlying infrastructure improvements. The Commission is aware that the resulting improvement charge will place an additional financial burden

on the affected customers. However, the Commission believes that, on balance, it is in the best interest of customers to fund the replacement of old sewage disposal equipment on an accelerated basis in order to improve service quality. The Commission notes that the monthly bill of the average residential sewer customer using 4,000 gallons of water per month will increase by \$1.48 in the Franklin County district.

- (20) The applicant proposed a form of the customer notice. Staff recommended that the applicant include language to notify customers that, in Ohio, system improvement charges may apply to both water and sewer companies (Comments 8-9). The customer notice should be completed with applicable dates and case numbers. With these modifications, including the modifications recommended by Staff, the notice will be adequate. The customer notice should be forwarded to all customers affected by the SIC surcharge approved in this proceeding, on or with the first bill that contains the surcharge.
- (21) The Commission has reviewed the proposed revised tariff pages that were filed as part of the Application (Application at Schedule 9). The Commission finds that the proposed revised tariff pages should be approved, conditioned upon compliance with Staff's recommendations and the addition of the date on which the revised tariff pages are filed in final form.

It is, therefore,

ORDERED, That the system improvement charge proposed by the applicant in this proceeding be approved. It is, further,

ORDERED, That Aqua be authorized to file tariffs, in final form, consistent with this Finding and Order. Aqua shall file one copy in its TRF Docket No. 89-7028-WW-TRF (or may make such filing electronically as directed in Case No. 06-900-AU-WVR) and one copy in this case docket. It is, further,

ORDERED, That the proposed tariff sheets be effective upon filing in final form, on a services rendered basis. It is, further,

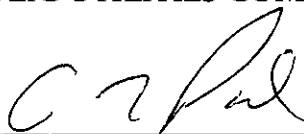
ORDERED, That nothing in this Finding and Order shall be binding upon this Commission in any future proceeding or investigation involving the justness or reasonableness of any rate, charge, rule, or regulation. It is, further,

ORDERED, That the applicant file, on an annual basis until such time as the surcharge is eliminated, an updated Schedule 8, as attached as part of Exhibit C of the Application. Schedule 8 shall be filed under this docket, concurrently with the applicant's filing of its annual report to the Commission, using information for the most recent calendar year. It is, further,

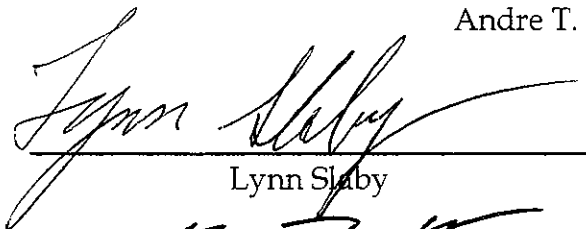
ORDERED, That the customer notice filed with the Application be delivered to each customer affected by the surcharge approved in this Finding and Order with or on each customer's first bill containing the surcharge. It is, further,

ORDERED, That a copy of this Finding and Order be served upon all parties and interested persons of record.

THE PUBLIC UTILITIES COMMISSION OF OHIO



Andre T. Porter, Chairman



Lynn Slaby



Asim Z. Haque



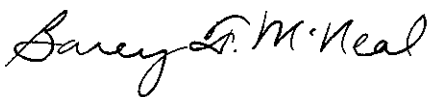
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Thomas W. Johnson

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Secretary