

BEFORE

THE PUBLIC UTILITIES COMMISSION OF OHIO

In the Matter of the Application of Aqua)
Ohio, Inc. for Authority to Assess a System) Case No. 15-863-WW-SIC
Improvement Charge.)

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 waterworks company, as defined in R.C. 4905.03(A)(8) 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 waterworks improvements in its Lake Erie Division, Masury Division, and the service areas in Ohio formerly served by Ohio American Water Company.
- (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 August 14, 2015.
- (6) On August 14, 2015, the staff of the Commission (Staff) filed comments (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 that it considered warranted by the circumstances.

Staff noted that the applicant is proposing to recover costs associated with system infrastructure improvements for the period July 1, 2013, to March 31, 2015, in the amount of \$14,242,188. 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 waterworks company like the applicant, allowable capital improvements may include:
 - (i) replacement of existing plant including chemical feed systems, filters, pumps, motors, plant generators, meters, service lines, hydrants, mains and valves, main extensions that eliminate dead ends to resolve documented water supply problems presenting significant health or safety issues to then existing customers, and main cleaning or relining;
 - (ii) unreimbursed capital expenditures made by the waterworks company for waterworks 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 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 filing date valuation of that particular infrastructure plant.
- (e) The SIC may not exceed 4.25 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

- (8) During its investigation of the SIC, Staff considered infrastructure plant, depreciation, property taxes, rate of return, revenue distribution, tariff filings, and Aqua's customer notice. As a result of its investigation, Staff makes certain recommendations. Staff recommends that Aqua exclude certain items from its SIC computation. In particular, Staff recommends that Aqua exclude items pertaining to meals and office supplies totaling \$3,220. Staff believes that these items should be expensed rather than capitalized in a SIC case.
- (9) Staff also recommends that Aqua exclude select osmosis membranes, meters, and valves because they are not SIC eligible. Staff highlights that R.C. 4909.172(C)(1) authorizes cost recovery for the replacement of existing plant, main extensions that meet certain criteria, and main cleaning and relining. Staff points out Aqua sought to include in its SIC calculation costs of new infrastructure, as distinguished from replacement of existing infrastructure. The reverse osmosis membranes, which cost \$14,587, are new; they are not replacement membranes. As for the exclusion of meters, Staff relates that Aqua installed new meters at a cost of \$44,311 for previously unmetered customers. At a cost of \$150,853, Aqua installed new valves to address water supply issues to existing customers. Because these costs relate to new infrastructure, Staff recommends that the attending costs of \$212,971 and the accompanying retirements of \$40,100 be excluded from the SIC calculation. (Comments 3-4.)
- (10) Staff reviewed Aqua's depreciation schedules to verify, in part, that Aqua used the correct depreciation accrual rates prescribed in *In re Aqua Ohio, Inc.*, Case No. 13-2124-WW-AIR (*Aqua Ohio*), Opinion and Order (Sept. 10, 2014). (Comments 4.)
- (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 applicant apply its latest known tax rate, not the rate prescribed in its last base-rate case, to calculate the annualized property taxes. Additionally, Staff recommends that Aqua amend its depreciation schedules to identify plant addition totals by year and apply the proper percent for each

year to calculate the true value of taxable property. (Comments 4-5.)

- (12) Aqua's pre-tax rate of return is based on information contained in Aqua's rate filing, the stipulated rate filing, and the Commission's order in Aqua Ohio. Staff finds that Aqua's pre-tax rate of return is correct and consistent with Ohio Adm.Code 4901:1-15-35. Staff concludes that the proposed surcharge will provide a fair and reasonable rate of return on Aqua's valuation of costs associated with the system infrastructure improvements. (Comments 5.)
- (13) Staff states that an infrastructure improvement surcharge must be uniform for each affected customer class pursuant to R.C. 4909.172. In addition, for a waterworks company, the surcharge may not exceed 4.25 percent of the rates and charges applicable to the class and for the tariff in effect on the filing date of the application. No more than three surcharges may be in effect at any time.

Reviewing Aqua's Application for compliance, Staff finds that Aqua filed a tariff with a proposed SIC of 4.25 percent. The surcharge would apply to all bills on a services rendered basis after approval of the tariff for customers in the Lake Erie Division, Masury Division, and the service areas in Ohio formerly served by Ohio American Water Company. The surcharge will apply to all bills. However, three contract customers will be excluded: Whirlpool, Poet, and the Village of Roaming Shores. Agreeing that the surcharge should not be applied to contract customers, Staff concludes that the proposed surcharge does not exceed the 4.25 percent statutory limit, that it is distributed uniformly to all classes, and that it does not exceed the three surcharge maximum. (Comments 5-6.)

- (14) Staff recommends that Aqua revise its tariff language. In *In re Aqua Ohio, Inc.*, Case No. 15-403-WW-ATA, Finding and Order (July 1, 2015), the Commission approved Aqua's request to combine the rules and regulations sections of several existing tariffs and replace them with a single, consolidated tariff. Staff recommends that the following language be placed in the tariff: "In addition to the charges provided for in this tariff for all metered and private fire rates, a surcharge of 4.25 percent will apply to all services rendered on or after [order date], 2015."

Staff believes that the language should be in the proper pages of the new tariff, not the exact pages filed in the May 1, 2015 Application. (Comments 6.)

- (15) 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 7).
- (16) Staff finds that the proposed surcharge does not exceed the 4.25 percent statutory limit for waterworks companies, is distributed uniformly to all classes, and does not exceed the three surcharge maximum (Comments 6). 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 5). Staff concludes, therefore, that the Commission should approve the Application, subject to Staff's recommendations (Comments 7).

Aqua's Response to Staff's Comments

- (17) Aqua filed a reply to Staff's comments on August 24, 2015. Aqua agrees that Staff's recommended adjustments will not impact its requested 4.25 percent surcharge. Therefore, Aqua provided revised schedules in which all of Staff's recommended adjustments were accepted. Aqua noted that it does not agree with Staff's recommendation that the cost of new valves to address water supply issues should be excluded from the surcharge. Aqua has decided not to litigate the issue because it has no impact on the amount of the surcharge. However, Aqua reserves the right to object to the treatment of these costs in a future proceeding, if that proves necessary. (Reply Comments at 1-2.)

Commission's Conclusions

- (18) 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.

- (19) 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, 3).
- (20) As allowed by R.C. 4909.172, the costs of the capital improvements underlying the proposed SIC include depreciation expenses. Staff verified that Aqua used the correct depreciation accrual rates prescribed in *Aqua Ohio*, Opinion and Order (Sept. 10, 2014). In its reply comments, Aqua attached revised Schedules 5.1 and 6.1 to account for Staff's recommendation to use the depreciation accrual rates prescribed in *Aqua Ohio*. Revised Schedule 5.1 shows the annualized depreciation associated with additions. Revised Schedule 6.1 shows annualized reduction in property taxes for retirements. (Reply Comments, Revised Schedules 5.1 and 6.1)
- (21) All of the underlying infrastructure improvement costs were incurred by the applicant during the period July 1, 2013, to March 31, 2015. 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	\$14,029,217	Schedule 2
4	Original Cost Retired	<u>\$ 1,030,966</u>	Schedule 3
5	Net Plant in Service (3-4)	\$12,998,251	
6	Less: Accumulation Provision for Depreciation		
7	Depreciation Expense	\$ 160,423	Schedule 4
8	Original Cost Retired	<u>\$ 1,030,966</u>	Schedule 3
9	Total Accumulated Provision for Depreciation (7-8)	\$ (870,543)	
10	Net Rate Base	\$13,868,794	
11	Pre-Tax Rate of Return	<u>10.58%</u>	Schedule 7
12	Annualized Return on Rate Base (10 x 11)	\$ 1,467,318	
13	<u>Operating Expenses</u>		
14	Annualized Provision for Depreciation for Additions	\$ 279,082	Schedule 5
14	Annualized Reduction in Depreciation for Retirements	\$ (26,939)	Schedule 6
15	Annualized Property Taxes for Additions	\$ 1,056,083	Schedule 5.1
16	Annualized Property Taxes for Retirements	<u>\$ (35,432)</u>	Schedule 6.1
17	Annualized Revenue Requirement (12+13+14+15)	\$ 2,740,112	

The Commission finds that the annual revenue requirement associated with the underlying infrastructure improvements is \$2,740,112, based on the applicant's revised Schedule 1 filed on August 24, 2015. The original revenue requirement was calculated to be \$2,761,098. Staff deemed that certain items, totaling \$212,971 and \$40,100 in accompanying retirements, 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 4.25 percent, applied to annual revenues of \$59,724,431 will yield surcharge revenues of approximately \$2,761,098 (Application, Schedule B, page 2). Because of the 4.25 percent limitation established by R.C. 4909.172(B)(2), Aqua requests only \$2,487,581 (Application, Exhibit B, Page 2; Reply Comments, Revised Schedule 10). The SIC will apply to all water services rendered to customers in the Lake Erie Division, Masury Division, and the Ohio service areas formerly served by Ohio American Water Company (Comments at 5-6).

Staff reports that the pre-tax rate of return is based on information contained in the applicant's rate filing in *Aqua Ohio*, Opinion and Order (Sept. 10, 2014). Moreover, Staff concluded that the rate of return is correct and that it is consistent with 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 5.) 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 4.25 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 7.)

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.

- (22) 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 waterworks equipment on an accelerated basis in order to improve service quality. The Commission notes that the monthly bill of the average residential customer using 4,000 gallons of water per month will increase as follows:

Division	Percentage Increase	Dollar Increase
Former Lake Erie East Division	4.25%	\$1.72
Lake Erie Division	4.25%	\$1.38
Auburn Lakes, Woods of Auburn Lakes, and Auburn Crossing Condominium Development	4.25%	\$1.78
Norlick	4.25%	\$1.72
Seneca (unmetered)	4.25%	\$1.78
Ashtabula, Marion, Tiffin, Franklin County, Mansfield, Portage County, Lake White, Lawrence County, and Preble County	4.25%	\$2.11

Mansfield (unmetered)	4.25%	\$2.23
Masury	4.25%	\$1.72

- (23) 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 at 7). 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.
- (24) The Commission has reviewed the proposed tariff pages that were filed as part of the Application (Application at Schedule 9). The Commission finds that the proposed 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,

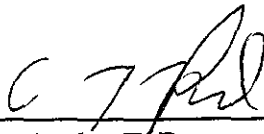
ORDERED, That the applicant file, on an annual basis until such time as the surcharge is eliminated, an updated Schedule 8, as attached as part of Exhibit C of the Application. Schedule 8 shall be filed under this docket, concurrently with the applicant's

filing of its annual report to the Commission, using information for the most recent calendar year. It is, further,

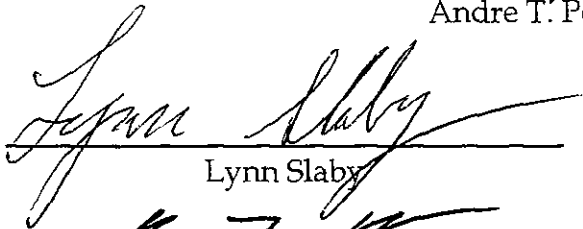
ORDERED, That the customer notice filed with the Application be delivered to each customer affected by the surcharge approved in this Finding and Order with or on each customer's first bill containing the surcharge. It is, further,

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

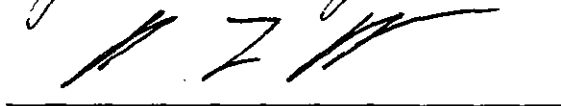
THE PUBLIC UTILITIES COMMISSION OF OHIO



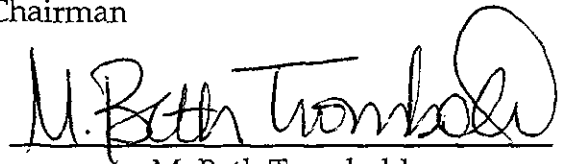
Andre T. Porter, Chairman



Lynn Slaby



Asim Z. Haque



M. Beth Trombold

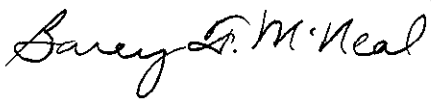


Thomas W. Johnson

LDJ/vrm/sc

Entered in the Journal

OCT 07 2015



Barcy F. McNeal
Secretary