

STATEMENTS OF POLICY

Title 4—ADMINISTRATION

Public Meeting held
December 14, 1995

PART II. EXECUTIVE BOARD

[4 PA. CODE CH. 9]

Reorganization of the Liquor Control Board

The Executive Board approved a reorganization of the Liquor Control Board effective March 20, 1996.

The organization chart at 26 Pa.B. 1378 (March 30, 1996) is published at the request of the Joint Committee on Documents under 1 Pa. Code § 3.1(a)(9) (relating to contents of *Code*).

(Editor's Note: The Joint Committee on Documents has found organization charts to be general and permanent in nature. This document meets the criteria of 45 Pa.C.S. § 702(7) as a document general and permanent in nature which shall be codified in the *Pennsylvania Code*.)

[Pa.B. Doc. No. 96-482. Filed for public inspection March 29, 1996, 9:00 a.m.]

[4 PA. CODE CH. 9]

Reorganization of the State Police

The Executive Board approved a reorganization of the State Police effective March 18, 1996.

The organization chart at 26 Pa.B. 1379 (March 30, 1996) is published at the request of the Joint Committee on Documents under 1 Pa. Code § 3.1(a)(9) (relating to contents of *Code*).

(Editor's Note: The Joint Committee on Documents has found organization charts to be general and permanent in nature. This document meets the criteria of 45 Pa.C.S. § 702(7) as a document general and permanent in nature which shall be codified in the *Pennsylvania Code*.)

[Pa.B. Doc. No. 96-483. Filed for public inspection March 29, 1996, 9:00 a.m.]

Title 52—PUBLIC UTILITIES

PENNSYLVANIA PUBLIC UTILITY COMMISSION

[52 PA. CODE CHS. 53, 69 AND 93]

[L-950107]

Rescission of Obsolete Policy Statements

The Pennsylvania Public Utility Commission (Commission) adopted an order rescinding obsolete policies that either no longer serve a useful purpose or relate to a procedure that has been completed or soon will be completed. The contact person is Patricia Krise Burket, Assistant Counsel, Law Bureau (717) 787-3464.

Commissioners Present: John M. Quain, Chairperson, Statement follows; Lisa Crutchfield, Vice Chairperson; John Hanger; David W. Rolka; and Robert K. Bloom

Order

By the Commission:

By Order entered May 23, 1995, we issued an Advance Notice of Proposed Rulemaking To Review And Rescind All Obsolete And Excessive Rules And Regulations at Docket No. L-950103. The advance notice was published in the *Pennsylvania Bulletin* on June 3, 1995, 25 Pa.B. 2188, and a 60-day comment period set.

We received comments from Pennsylvania Electric Association, the Pennsylvania Gas Association, the Office of Consumer Advocate and our own Bureaus of Law and CEEP specific to the electric, gas and transportation industries which reflect the need to eliminate policy statements appearing in Chapters 53, 69 and 93. We are setting forth proposed changes and we believe these changes will clarify, simplify and remove excessive and burdensome requirements from our policy statements.

Our review of the affected sections was careful and meticulous. We are well aware of our duty to ensure the safety of utility service, and our proposed changes will not result in any lapse in our mandate.

What follows is a summary of the changes.

Chapter 53. Appendix I and Appendix II. Pennsylvania Public Utility Commission Policy Statement on Procedure for Implementing Normalization of Federal Income Tax Benefits of Accelerated Cost Recovery System.

The policy statement was issued to permit utilities to obtain for tax years 1981 and 1982 the benefits of a form of accelerated tax depreciation established under the Federal Economic Recovery Act of 1981 for post-1980 assets. It is obsolete and will be deleted.

§ 69.41. Vacation resort developments.

§ 69.43. Notice and lead-time.

The Commission's proposed amendment of Subchapter H, 52 Pa. Code §§ 57.81—57.88 at Docket No. L-950103, which makes underground installation of electric distribution and service lines in new residential developments voluntary and not mandatory, eliminates the need for exemptions. Accordingly these sections should be deleted.

§ 69.61. Competent evidence for certification; policy statement.

This section is eliminated as unnecessary since age of the supporting data is always a factor in weighing the probative value of technical evidence in Commission proceedings; moreover, a 5-year bright line standard is overly restrictive.

§ 69.62. Relocation of high voltage electric transmission lines.

This policy statement, which sets out criteria that should be included in a petition for waiver of the transmission line siting regulations, is deleted as redundant since § 57.72(e) of the Commission's siting regulations provides the utility with the authority to petition for a waiver of the siting application process for relocating an existing transmission line.

LIQUOR CONTROL BOARD ORGANIZATION CHART HERE

STATE POLICE ORGANIZATIONAL CHART HERE

Federal Residential Conservation Service Program,
Policies and Procedures.

§ 69.71. *General.*

§ 69.72. *Direct charges to ratepayers.*

§ 69.73. *General utility expenses recovery.*

§ 69.74. *Accounting.*

§ 69.75. *Periodic evaluation.*

The Federal Residential Conservation Program policy statement at these sections established guidelines for accounting for and recovery of expenses in utility Residential Conservation Services (RCS) Programs and the method of allocation of such costs to ratepayers through direct charges and rates. The RCS Program was a Federal program directed to residential energy conservation which was terminated effective June 30, 1989. Since the sole purpose of the five-section statement was the RCS Program's implementation, then it is eliminated as obsolete.

Recovery of Take-or-Pay Expenses

§ 69.181. *Recovery of take-or-pay expenses—policy statement.*

Since every natural gas local distribution company has completed or will soon complete its take-or-pay recovery process, this section is no longer needed and should be eliminated.

Chapter 93. Policy statement regarding Motor Carrier Advisory Counsel. §§ 93.1—93.5.

The Motor Carrier Advisory Council no longer exists, and its regulations are rescinded as obsolete.

In making these changes, we believe that our efficiency as a regulatory agency will be enhanced. We are eliminating those sections which no longer serve a useful purpose and we are modifying others to promote the ease of application as well as fairness.

Accordingly, pursuant to sections 501, 504, 505, 506, 1301 and 1501 of the Public Utility Code, 66 Pa.C.S. §§ 501, 504, 505, 506, 1301 and 1501, and the Commonwealth Documents Law, 45 P.S. § 1201 et seq., and the regulations promulgated thereunder, we shall institute a proceeding to accomplish the objectives described in the body of this order. *Therefore,*

It is Ordered that:

1. A policy statement proceeding is hereby instituted at this docket.

2. The Commission's policy statements are hereby amended by deleting Appendix I and Appendix II in Chapter 53; and by deleting §§ 69.41, 69.43, 69.61, 69.62, 69.71—69.75, 69.181 and 93.1—93.5 to read as set forth in Annex A.

3. The Secretary shall submit this order and Annex A to the Governor's Budget Office for review of fiscal impact.

4. The Secretary shall deposit this order and Annex A with the Legislative Reference Bureau for publication in the *Pennsylvania Bulletin*.

5. A copy of this order shall be served upon all persons who submitted comments in this rulemaking proceeding.

JOHN G. ALFORD,
Secretary

Fiscal Note: 57-165. No fiscal impact; (8) recommends adoption.

Statement of Chairperson John M. Quain

Before us today are two significant rulemakings that when combined, will delete or rescind 62 obsolete and redundant sections of our regulations and revise another 43 sections. Furthermore, when this Commission again meets on January 11, 1996, we will consider another 58 sections pertaining to Chapters 63, 64 and 56 for possible rescission or revision.

I wish to express my appreciation to all of the staff of the various bureaus, and those public commentators who contributed to this massive undertaking.

Annex A

TITLE 52. PUBLIC UTILITIES

PART I. PUBLIC UTILITY COMMISSION

Subpart C. FIXED UTILITY SERVICES

CHAPTER 53. TARIFFS FOR NONCOMMON CARRIERS

APPENDIX I (RESERVED)

APPENDIX II (RESERVED)

CHAPTER 69. GENERAL ORDERS, POLICY STATEMENTS AND GUIDELINES ON FIXED UTILITIES

§ 69.41. **(Reserved).**

§ 69.43. **(Reserved).**

§ 69.61. **(Reserved).**

§ 69.62. **(Reserved).**

§ 69.71. **(Reserved).**

§ 69.72. **(Reserved).**

§ 69.73. **(Reserved).**

§ 69.74. **(Reserved).**

§ 69.75. **(Reserved).**

§ 69.181. **(Reserved).**

CHAPTER 93. (RESERVED)

§ 93.1. **(Reserved).**

§ 93.2. **(Reserved).**

§ 93.3. **(Reserved).**

§ 93.4. **(Reserved).**

§ 93.5. **(Reserved).**

[Pa.B. Doc. No. 96-484. Filed for public inspection March 29, 1996, 9:00 a.m.]

PENNSYLVANIA PUBLIC UTILITY COMMISSION

[52 PA. CODE CH. 69]

[M-950686]

Incentives for the Acquisition and Merger of Small, Nonviable Water and Wastewater Systems

The Pennsylvania Public Utility Commission (Commission) at its February 22, 1996, public meeting adopted a policy statement regarding incentives for the acquisition and merger of small, nonviable water and waste water systems. The policy seeks to strengthen the viability of jurisdictional water and waste water systems. The contact persons are Stanley E. Brown, Assistant Counsel, Law

Bureau, (717) 783-3968 and Judith Koch Carlson, Supervisor, Office of Special Assistants, (717) 783-5392.

Public Meeting held
February 22, 1996

Commissioners Present: John M. Quain, Chairperson; Lisa Crutchfield, Vice Chairperson, statement follows; John Hanger; David W. Rolka, concurring and dissenting in part—statement follows; and Robert K. Bloom, statement follows

Order

By the Commission:

On July 10, 1995, the Commission issued a proposed policy statement at this docket which set forth the Commission's objective of increasing the number of mergers and acquisitions of small, nonviable water companies to foster regionalization. In the order adopting the proposed policy statement, the Commission first defined a viable water system as one that is economically self-sustaining and has the capability to continue to operate into the future. Then, the Commission identified the most critical problem associated with small water companies; namely, service which does not meet regulatory standards, specifically those of the Public Utility Code and the Pennsylvania Safe Drinking Water Act, 66 Pa.C.S. § 1501 and 35 P.S. §§ 721.1—721.17, respectively.

The Commission's order noted that over the past decade, the Commission has endorsed regionalization, which is the consolidation of two or more water systems as a mechanism to promote increased viability. While the Commission has approved a number of acquisitions by viable water companies, it appears now that only a few additional acquisitions are likely to occur at a time when many are sorely needed. Accordingly, the Commission, in the order adopting the proposed policy statement, set forth five acquisition incentive proposals to foster acquisitions of water companies which are in violation of applicable health and safety legal standards. Specifically, the proposed policy statement listed the following acquisition incentives: (1) rate of return premiums; (2) acquisition adjustments; (3) deferral of acquisition improvement costs; (4) plant improvement surcharge; and (5) operating ratios. § 69.711(b).

In addition to the aforementioned regulatory incentives, the Commission indicated that it would consider other appropriate incentives if they also met the following summarized parameters: (1) that the acquisition serves the public interest; (2) that the acquiring company meet viability criteria which will not be impaired by the acquisition; (3) that the acquired company is not viable; (4) that the acquired company's ratepayers will be provided with necessary plant improvements; (5) that the acquisition was conducted through arm's length negotiations and that the purchase price is reasonable; and (6) that single tariff pricing will be applied to the rates of the acquired company with consideration given to a phase-in of rates if affordability concerns exist.

Finally, by way of statements attached to the order, Chairperson Quain and Commissioner Rolka invited interested parties to respond to four specific questions, to wit:

(1) Whether the rate of return premium should be available under 66 Pa.C.S. § 523(b)(7) with specific criteria established as it has been for § 523(b)(5) at 52 Pa. Code § 65.20?

(2) Should a rate of return premium be available for accelerated accomplishment of system improvements?

(3) Whether the Commonwealth Court decision in *Popowsky v. Pa. P.U.C.*, 1315 C.D. 1993 on deferrals of Financial Accounting Standards Board 106 would be a barrier to a phase-in or deferred recovery of plant improvement costs?

(4) What is the relationship between Section 327 and 523 in defining our jurisdictional boundaries to implement incentives for acquisitions and mergers of small nonviable water utilities?

As we noted in our order adopting the proposed policy statement:

Water companies are encouraged to utilize these options or may submit others, provided they are consistent with the guidelines set forth within the Proposed Policy Statement at subsection (a). Each request for an acquisition incentive will be considered on a case by case basis. In order to allow for public comment, this document will first be issued as a Proposed Policy Statement.

On August 19, 1995, the order and proposed policy statement were published in the *Pennsylvania Bulletin* at 25 Pa.B. 3352. Comments were received from the Office of Consumer Advocate (OCA), the Pennsylvania Chapter of the National Association of Water Companies (PA-NAWC), Pennsylvania-American Water Company (PAWC), York Water Company (York), Glendale Yearound Water Company (Glendale), the Independent Regulatory Review Commission (IRRC), former Commission Chairperson Bill Shane, and two individuals, William V. Bottonari and E. J. Knittel.

The comments received were largely in support of the Commission's efforts to increase the number of acquisitions of small, nonviable water companies. However, not all of the commentators agreed that all of the regulatory incentives proposed in the policy statement were within the statutory authority of the Commission. Because of the importance of the proposed policy statement and the overall interest in the proposed regulatory incentives, we shall first identify the comments of each of the commentators and then address them as they relate to the specific acquisition incentives proposed.

A. Office of Consumer Advocate

The OCA filed comments which supported the Commission's goal of increasing the number of mergers and acquisitions of small, nonviable water companies to foster regionalization. In addition, the OCA agreed with the parameters established by the proposed policy statement and supported some, but not all of the proposed incentive mechanisms. In response to the parameter that the acquired company be "nonviable," the OCA stated:

There should be no need for an acquisition incentive to be granted for a utility to take over a viable utility. The acquisition incentives should be used *solely* to aid the acquisition of nonviable utilities so that service is improved for the acquired company without causing service to the acquiring company's customers to deteriorate. OCA Comments, p.3 (emphasis supplied).

As to the five possible methods of providing incentives for the acquisition of nonviable water utilities, the OCA supports, with caution, the proposed rate of return acquisition incentive noting that a rate of return approach for acquisitions or associated improvements is consistent with section 523 of the Public Utility Code. The OCA emphasizes in its comments that section 523 requires that "[a]ny adjustment made under this section shall be

made on the basis of specific findings upon evidence of record, which findings shall be set forth explicitly with their underlying rationale, in the final order of the Commission." 66 Pa.C.S. § 523(a). The OCA also supports the proposed acquisition adjustment incentive as long as it is applied consistent with section 1327 of the Public Utility Code.

The OCA suggested a need for clarification as to whether the deferral of acquisition improvements costs incentive is a deferral of rate recovery similar to a phase in of a rate request or a proposal to use deferred accounting for the cost of plant improvements. To this end, the OCA supports the former interpretation and opposes the latter.

As to the plant improvement surcharge incentive, the OCA submits that this proposed acquisition incentive "may be contrary to the Public Utility Code and in any case is inconsistent with the goal of single tariff pricing." OCA Comments, p.6. According to the OCA, this proposed incentive could be read to allow the use of a surcharge for improvements that are not used and useful at the time the surcharge is implemented. Such a use, in the opinion of the OCA, would be violative of several appellate court decisions which prohibit customers from paying rates that include costs for plant not used and useful. Instead of a surcharge, the OCA suggests the use of a separate tariff or rate zone if the circumstances involve an extraordinary plant improvement.

Finally, the OCA opposes the use of an operating ratio as an acquisition incentive. According to OCA, the use of an operating ratio in setting rates for a fixed utility is outside the Commission's authority under the Public Utility Code.

As to the procedural implementation of the acquisition incentives, the OCA supports the requirements in the policy statement that the acquisition incentives be requested during the next filed rate case and that the utility retain the burden of proof. The OCA further suggests that the request and the support for an acquisition incentive should be made as part of the acquiring company's original filing.

B. The Pennsylvania Chapter of the National Association of Water Companies

PA-NAWC filed comments in support of the Commission's goal of fostering regionalization by increasing the number of mergers and acquisitions of small, nonviable water companies. However, according to PA-NAWC, there are specific provisions of the proposed policy statement which should be clarified and/or strengthened to improve its effectiveness.

First, it is the opinion of PA-NAWC that the proposed policy statement strongly implies that the incentives are only to apply to the acquisition and/or merger of *small* nonviable water utilities. Significantly, however, PA-NAWC asserts that the policy statement makes no reference to the size of the acquired system but instead focuses exclusively on the issue of viability. Therefore, according to PA-NAWC, it is unclear as to whether the availability of the acquisition incentives is premised upon the size of the system or the viability of the system. In light of the recent amendments by the Legislature to section 1327 of the Public Utility Code, PA-NAWC suggests that size should not be the sole determinant for the availability of the acquisition incentives. To this end, PA-NAWC asserts that public policy should encourage the acquisition of troubled systems regardless of the number of customer connections. Pointing to section 1327 again,

PA-NAWC also suggests that the proposed policy statement should apply to water and waste water utilities.

As to specific comments to the proposed policy statement, PA-NAWC asserts that in order to avoid confusion in the future, the words "company" or "utility" should be changed to "water system." According to PA-NAWC, this change would ensure that the acquisition of a municipal system, homeowners' association or a defacto water system would be similarly eligible for incentive treatment.

Next, PA-NAWC avers that the proposed policy statement incentives should be broadened to include the "prospective inability of a system to meet statutory and regulatory standards." As an alternative, PA-NAWC suggests that the acquired system should not have to be in violation of statutory or regulatory standards *and* have failed to comply with an order of the Commission or Department of Environmental Protection (DEP). Consistent with the aforementioned assertion concerning the prospective inability of the acquired company to provide adequate service in the future, PA-NAWC recommends that the acquiring company should only be required to provide "adequate service" and not "improved service."

The proposed policy statement states at § 69.711(a)(6)(relating to acquisition incentives) that under certain circumstances of extreme differences in rates, or of affordability concerns, or both, consideration should be given to a phase-in of the rate difference over a reasonable period of time. Based upon considerations for the customers of similar financial means of the acquiring company, PA-NAWC recommends that the phrase "or of affordability concerns, or both" should be deleted.

For clarification and consistency, PA-NAWC states that if the Commission intends the "acquisition adjustment" premium at § 69.711(b) to be consistent with the parameters set forth at 66 Pa.C.S. § 1327, the phrase "included in the costs of base rates" should be changed to "added to the rate base."

As to the "deferral of acquisition improvement cost" incentive in the proposed policy statement, PA-NAWC believes that it is deficient in its present form because it implies a deferral of cost recovery without any offsetting benefit. According to PA-NAWC, if the improvement costs are to be "recovered in phases," then there must be a provision for the accrual of carrying charges *and* deferral of depreciation expense.

The "upon connection" phrase in the plant improvement surcharge incentive is, in the opinion of PA-NAWC, "ambiguous" because the acquiring company may not be contiguous. Therefore, PA-NAWC recommends that "upon connection" be revised to "upon completion of the acquisition." PA-NAWC also suggests that the use of a plant improvement surcharge should not be limited to "extraordinary" plant improvements costs.

As to the procedural implementation of an acquisition incentive, PA-NAWC believes that there should be a mechanism in place whereby a potential acquiror can obtain a pre-acquisition determination of whether it will qualify for incentive treatment. According to PA-NAWC, requiring utilities to wait until their next rate case to implement a surcharge would be a disincentive to embarking on needed plant improvements on a timely basis.

In response to the questions posed by Chairperson Quain and Commissioner Rolka, PA-NAWC states that while a rate of return premium should be available under section 523(b)(7) of the Public Utility Code, there should not be specific standards. In the opinion of PA-NAWC, spelling out specific standards would limit the intended

discretion for the Commission to consider "any other relevant and material evidence. . ." As to the availability of a rate of return premium for accelerated accomplishment of system improvements, PA-NAWC is "cautiously optimistic." As to whether the Commonwealth Court decision *Popowsky v. Pa. P.U.C.*, 164 Pa. Cmwlth. 594, 643 A.2d 1146 (1994), would be a barrier to a phase-in of deferred recovery of plant improvement cost, PA-NAWC believes that Commonwealth Court's decision merely held that the Commission could not preapprove the future recovery of costs outside of the context of rate proceeding. Thus, the Commission, in the opinion of PA-NAWC, can still allow the recovery of such costs when properly claimed in rate proceeding. Finally, in response to Commissioner Rolka's question as to whether section 1327 of the Public Utility Code limits the Commission's discretion to award acquisition incentives under section 523 of the Public Utility Code, PA-NAWC responds that section 1327 of the Public Utility Code was designed to deal with the extremely narrow issue of rate base treatment of the purchase. Accordingly, PA-NAWC asserts that section 1327 of the Public Utility Code should not be construed as precluding the use of other acquisition incentive mechanisms found appropriate by the Commission under section 523 of the Public Utility Code.

C. *York Water Company*

York's comments focused upon the suggested expansion of the proposed policy statement to include language as follows:

In cases when the acquisition costs are less than the depreciated original cost, no amortization or other pass-through to ratepayers of the difference between depreciated original cost acquisition cost is required.

York's Comments at p. 1. In this regard, York notes that the Commission has previously proposed treatment of acquisition costs lower than depreciated original in York's general rate increase at Docket No. R-922168 entered on January 21, 1993.

D. *Pennsylvania-American Water Company*

The comments filed by the PAWC recognized the proposed policy statement as another important step which would facilitate the efforts of PAWC and other capable water utilities to bring quality water service to all citizens in the Commonwealth.

Initially, PAWC expressed its concurrence in the comments filed by PA-NAWC. Specifically, PAWC suggested that if the objective of the Commission is to bring quality water service to all citizens in the Commonwealth, then viability, and not size, should be the controlling factor. To this end, PAWC submits that the critical issue for the Commission to address is whether the system to be acquired is capable of meeting its service obligations on a *prospective* basis.

As to the procedural implementation of the proposed incentives in the policy statement, PAWC recommends two changes. First, PAWC asserts that there must be pre-acquisition determination that an intended purchase will qualify for acquisition incentive treatment. Second, the acquiring company should not be forced to wait until its next rate filing before receiving relief. According to PAWC, mechanisms should be included in the policy statement which will permit the acquiring company to either: (1) implement surcharges to recover improvement costs contemporaneously upon making required investments; or (2) accrue carrying charges on and defer depreciation expense related to such investment.

In response to the questions posed by Chairperson Quain and Commissioner Rolka, PAWC believes the Commission should embrace the broad authority and the discretion granted by the General Assembly. Pointing to section 523 of the Public Utility Code and the recent amendments to section 1327 of the Public Utility Code which relaxed the standards required for rate base recognition of acquisition premiums, PAWC submits that the Commission should take maximum advantage of its discretion in addressing the challenges which confront the water supply industry in the Commonwealth.

E. *Glendale Yearround Water Company*

Comments to the proposed policy statement were filed by the Glendale, a small water system serving less than 1,200 customers with annual revenues of approximately \$100,000. In its comments, Glendale asserts:

We are economically self sustaining, well managed, provide high quality water, meet all regulatory mandates and have the capability to continue to operate into the future. Our tariffs are about 50% lower than the prevailing rates charged by water authorities in this area. As the attached certificate issued by PA DER attests, we are meeting all MCL Monitoring and Treatment performance requirements under the Safe Drinking Water Act.

Glendale Comments at p. 1.

In general, Glendale's comments challenge the perceived notion in the policy statement and, according to Glendale, "the underlying assumptions" in the policy statement that "larger is better" and that mergers and acquisitions of small systems into larger entities are "necessary, desirable or the most efficient solution to the problem of nonviability of small water systems." Glendale Comments at p. 1. Specifically, Glendale submits that the proposed policy statement does not address the role played by the Commission and DER (now DEP) in causing small water systems to become nonviable.

In support of its position that there are "PUC imposed burdens," Glendale notes the following significant costs:

1. Legal services to respond to ratepayers who do not appear at the hearing;
2. PUC audits to examine a plant improvement project which had already been inspected by DEP and PennVest;
3. PUC Annual Assessments which in some years have exceeded the profit level for the company; and
4. Costs to file a rate request which carry huge financial and administrative burdens for a small company.

Glendale Comments at pp. 2—3.

In conclusion, Glendale suggests that the PUC and DEP should examine their internal procedures which will in turn reduce the burdens on small water systems.

F. *Independent Regulatory Review Commission*

The comments filed by IRRC were in support of the Commission's goal of encouraging the acquisition of non-viable water systems. However, IRRC challenged the Commission's statutory authority for one of the five regulatory acquisition incentives suggested in the proposed policy statement.

In the opinion of IRRC, the Public Utility Code does not permit water and waste water companies to establish rates based upon an operating ratio methodology. Moreover, IRRC submits that the operating ratio methodology

does not guarantee that the water utility will reinvest the revenue in excess of expenses into needed capital improvements. Finally, IRRRC raises the question as to whether an operating ratio will actually encourage the efficient operation of these utilities.

G. *Former Commission Chairperson Bill Shane*

Supportive comments to the proposed policy statement in general and the specific rate of return premium incentive were filed by former Commission Chairperson Bill Shane. In the opinion of the former Chairperson, return on equity is the most potent factor in a rate case because it magnifies other decisions in the case. Accordingly, he strongly suggested that the rate of return premium should be available under section 523(b)(7) of the Public Utility Code. Finally, the former Chairperson submits that the Commission should recognize the return on equity as a powerful tool of positive or negative reinforcement of behavior.

H. *William V. Bottonari*

Comments to the proposed policy statement were filed by William V. Bottonari, a customer of a large water utility. According to Mr. Bottonari, the concept and application of single tariff pricing to water rates is inappropriate because it obscures the actual cost of providing service to customers in different areas. Mr. Bottonari believes that while single tariff pricing may be appropriate for the customers of an electric company that has a common source of generation, such a pricing concept is not appropriate for a "regionalized" water utility which has several sources of supply.

I. *E. J. Knittel*

Similar comments were filed by E. J. Knittel, the Borough Manager in Camp Hill, Pennsylvania. According to Mr. Knittel, the Borough Council is extremely concerned with the practice of single tariff pricing which, in the opinion of Mr. Knittel, places an unfair burden upon the residents of Camp Hill. Mr. Knittel also believes that established rates in a given area should reflect the actual operating costs in that area and should not be spread among the noncontiguous service territories of a large utility.

Discussion

In preparing our final policy statement, we have carefully reviewed and considered all of the comments filed by the interested parties. Although not all of the concerns and viewpoints can be satisfied, we believe that we have developed a meaningful policy statement which will enable the Commission to foster acquisitions of water utilities and wastewater utilities that are currently nonviable.

The following discussion will summarize the changes and refinements made to the proposed policy statement published on August 19, 1995, and shall generally follow the chronology of the aforementioned comments filed to the proposed policy statement.

Parameters of the Proposed Policy Statement—§ 69.711(a)

Upon review of the comments which addressed the applicability of the proposed acquisition incentives, we agree with the OCA that the proposed acquisition incentives should be applied consistent with the latest amendment to section 1327 of the Public Utility Code. Specifically, the acquired system should have 3,300 or fewer customer connections. Moreover, we believe the acquisition incentives should be available for the acquisition of water and wastewater systems that are currently nonviable.

We also agree with the suggestion of PA-NAWC that the words "company" or "utility" should be changed to "water system" and as stated above, the proposed policy statement should apply to water and wastewater systems. Accordingly, we shall reflect these changes in the final policy statement.

The parameter in the proposed policy statement at § 69.711(a)(6) suggests that under certain circumstances of extreme differences in rates, or of affordability concerns, or both, consideration should be given to a phase-in of the rate difference over a reasonable period of time. PA-NAWC has recommended that the phrase "or of affordability concerns, or both" should be deleted in the final policy statement. Although we can certainly appreciate PA-NAWC's expressed concern for existing customers who may be similarly financially challenged, we are of the opinion that affordability concerns are indeed a relevant consideration of the Commission in fulfilling our statutory obligation to establish just and reasonable rates. Therefore, the phrase "or of affordability concerns, or both" will remain in the final policy statement.

The aforementioned parameter at § 69.711(a)(6) also recognizes our previously endorsed concept of single tariff pricing. Single tariff pricing is a concept applied to allocate revenue requirements on a company-wide basis so that each customer within its usage classification pays the same water rate regardless of location. In the 1986 case of *Pa. P.U.C. v. Western Pennsylvania Water Co.*, 72 PUR 4th 103 (1986), justification for the Commission's endorsement of single tariff pricing was pronounced as follows:

1. A larger rate and revenue base ameliorates the impact of major capital additions needed from time to time in every service area;
2. A larger revenue base promotes flexibility in timing and financing major capital additions;
3. The impact of instability resulting from changes in sales volumes is mitigated when the effect of such volumetric factors is spread over a larger economic base; and
4. The reduction of the number of accounting units and the number of individual rate filings results in administrative efficiency with a potential to reduce costs to ratepayers.

74 PUR 4th at 147-148.

Both Mr. Bottonari and Mr. Knittel have presented comments which further confirm our opinion that the Commission must always be cognizant of the rate impact of any increase in rates even if it is spread among a large number of customers in a large geographical region. In this regard, we firmly believe that every system and every ratepayer in the Commonwealth will eventually be in need of specific service improvements and at that point, the true benefits of single tariff pricing will be realized by all citizens in the Commonwealth.

As previously stated, the proposed policy statement set forth five possible methods of providing incentives to the acquisition of nonviable water utilities. We shall address these *seriatim*.

Rate of Return Premiums—§ 69.711(b)(1)

The first proposed incentive is additional allowed rate of return basis points for acquisitions and associated improvements. This incentive, which is consistent with section 523 of the Public Utility Code, was generally supported by several commentators and thus shall be

included in the final policy statement. However, it should be emphasized that any claim for a rate of return premium must be supported by evidence of record submitted by the utility within its rate case filing. The utility must prove that the tangible service improvements have been completed or will be completed within 6 months beyond the test year. In our review of a rate of return premium claim, the Commission will endeavor to balance the impact of the application of a rate of return premium with the reasonableness of the resulting rates.

Acquisition Adjustment—§ 69.711(b)(2).

In the proposed policy statement, it was suggested that in cases where the acquisition costs are greater than the depreciated original cost, that reasonable excess may be included in the costs of base rates of the acquiring utility and amortized as an expense over a 10-year period, consistent with the parameters set forth at 66 Pa.C.S. § 1327. At the outset, it should be stated that while it was our intention that this proposed acquisition incentive would be applied consistent with section 1327 of the Public Utility Code, we believe that an amortization period of 10 years is generally reasonable for acquisition costs. However, as suggested by PA-NAWC, the phrase "included in the costs of base rates" will be changed to "added to the rate base." This change is required so that this proposed acquisition incentive is not violative of section 1327 of the Public Utility Code.

On a similar basis, we must decline the invitation of York to expand section 1327 of the Public Utility Code in manner which would preclude amortization or other pass through to ratepayers of the difference between depreciated original cost and lower acquisition costs. In this regard, it should be noted that the Commission actually rejected such a pass through proposal by the OCA in the proceeding at Docket No. R-922168. Contrary to York's assertion, in the final order, the Commission concluded that the pass through proposal was outweighed by "matters of a substantial public interest" which is an expressed criterion under section 1327 of the Public Utility Code.

Deferral of Acquisition Improvement Costs—§ 69.711(b)(3)

This proposed acquisition incentive states, "In cases where the plant improvements are of too great a magnitude to be absorbed by ratepayers at one time, improvement costs may be deferred, to be recovered in phases."

This proposal was intended to be an incentive to allow the phase-in of rate increases associated with a large capital improvement program due to the acquisition as opposed to using deferred accounting for the cost of plant improvements. In response to an appropriate suggestion for clarification by the OCA, we will make the necessary clarification in the final policy statement to reflect not only the intended meaning of this proposed incentive but also our statutory obligation to balance the interests of the utility investors and the ratepayers. To this end, we shall also state that there may be a one time treatment (in the initial rate case) of the improvement costs but a phasing-in of the acquisition, improvements and associated carrying-costs may be allowed over a finite period of years.

Plant Improvement Surcharge—§ 69.711(b)(4)

This proposed acquisition incentive states, "collection of a surcharge from each customer of the acquired utility upon connection could be implemented to offset extraordinary improvement costs."

Based upon the comments filed by the OCA and PA-NAWC, two revisions will be made to this incentive in

the final policy statement. First, we will make the necessary revision of the phrase "upon connection" to "upon completion of the acquisition." As observed by PA-NAWC, the acquiring company may not be contiguous to the acquired company.

The second revision will reflect our determination that it may be more appropriate from an equitable standpoint for the Commission to allow the acquiring company to allocate to the new customers a greater than average level of the extraordinary improvement costs. Specifically, collection of a different rate from each customer of the acquired system upon completion of the acquisition could be implemented to temporarily offset extraordinary improvement costs. In cases where the improvement benefits only those customers who are newly acquired, the added costs may be allocated on a greater than average level (but less than 100%) to the new customers for a reasonable period of time, as determined by the Commission.

Operating Ratios—§ 69.711(b)(5)

The proposed policy statement suggests that the use of an operating ratio may be allowed as an interim measure in cases where little or no rate base exists. Although the use of an operating ratio was suggested as a possible incentive for acquisitions, no commentator advocated support for the use of an operating ratio. In fact, the comments submitted on this incentive were in opposition to an operating ratio. In the opinion of the OCA and IRRC, the use of an operating ratio is beyond the statutory powers of the Commission.

As stated by the OCA, the use of an operating ratio in setting rates for a water or waste water utility is currently on appeal to the Commonwealth Court in a case involving LP Water and Sewer. *See Popowsky v. Pa. P.U.C.*, 1912 C.D. 1993. Although the Commission remains of the opinion that there is nothing in the Public Utility Code which prohibits the Commission from exercising its discretion and expertise in setting rates that are just and reasonable, we will delete from the final policy statement the provision regarding the use of an operating ratio as an incentive to regionalization.

Questions Posed By Chairperson Quain and Commissioner Rolka

As stated previously, there were four questions which interested parties were invited to address in their comments.

In response to the first question concerning the availability of a rate of return premium with specific criteria established, we believe that it would be inconsistent with Legislative intent for the Commission to attempt to identify the specific standards for a rate of return premium. While the Commission has identified in this proposed policy statement the parameters for this incentive, it is our opinion that the Legislature intended the Commission to exercise its discretion, based upon material evidence of record, as to whether a rate of return premium was appropriate.

As to the second question concerning the availability of a rate of return premium for accelerated accomplishment of system improvements, we merely state that any system improvement must be used and useful to ratepayers.

In light the aforementioned clarification of the deferral of rate recovery of the acquisition improvement costs incentive, the third question is rendered moot. As stated previously, this incentive was not intended as a proposal to use deferred accounting for the cost of plant improvements.

In response to the final question as to whether section 1327 of the Public Utility Code limits the Commission's discretion to award incentives under section 523 of the Public Utility Code, we agree with PA-NAWC that section 1327 was designed to deal with one of the regulatory barriers to the acquisition of a nonviable system. Indeed, this policy statement is an attempt to deal with several other regulatory barriers to acquisitions. As such, the Commission shall cautiously exercise the broad authority and the discretion granted by both sections 523 and 1327 of the Public Utility Code.

Procedural Implementation

In the proposed policy statement, it was suggested that the appropriate implementation procedure for the acquisition incentives would be to submit the claim as part of a company's next filed rate case. The proposed policy statement further provided that the burden of proof would rest with the acquiring utility.

PA-NAWC and PAWC have both presented strong arguments that there should be a mechanism in place whereby a potential acquiror can obtain a pre-determination as to whether it will qualify for incentive treatment. To this end, PA-NAWC asserts that requiring a utility to wait until its next rate case would be a disincentive to embarking on needed plant improvements on a timely basis.

In response to these arguments, we appreciate the fact that most of the large utilities do not file general rate requests on an annual or semiannual basis and we would hope that the acquisition of a nonviable system would not automatically precipitate the filing of a rate increase. While the Commission does not routinely issue declaratory orders, we believe that it would be appropriate for the Commission to consider a petition for a declaratory order provided that the standards for the issuance of such an order are clearly satisfied by the acquiring company.

Accordingly, pursuant to sections 501, 1301 and 1501 of the Public Utility Code, 66 Pa.C.S. §§ 501, 1301 and 1501, and the Commonwealth Documents Law (45 P.S. § 1201, et seq.), the Commission has the authority to adopt the policy statement as set forth in Annex A; *Therefore, It is Ordered that:*

1. The policy statement regarding incentives for the acquisition and merger of small, nonviable water and wastewater systems, as set forth in Annex A, is hereby adopted upon publication.

2. The Secretary shall serve this order and Annex A upon all jurisdictional water and wastewater utilities, the Office of Consumer Advocate, the Office of Small Business Advocate, the Office of Trial Staff, the Department of Environmental Protection, the National Association of Water Companies-Pennsylvania Chapter and the Pennsylvania Rural Water Association. This order and Annex A shall also be served upon all persons who submitted comments to the proposed policy statement.

3. The Secretary shall duly certify this order and Annex A and deposit them with the Legislative Reference Bureau for publication in the *Pennsylvania Bulletin*.

4. The Secretary shall submit this order and Annex A to the Governor's Budget Office for review of fiscal impact.

5. This final policy statement shall be effective upon publication in the *Pennsylvania Bulletin*.

6. Alternate formats of this document are available to persons with disabilities and may be obtained by contact-

ing Shirley M. Leming, Regulatory Coordinator, Law Bureau, at (717) 772-4597 or through the AT&T Relay Center at (800) 654-5988.

JOHN G. ALFORD,
Secretary

Statement of Vice Chairperson Lisa Crutchfield

Before us for consideration is the Policy Statement regarding incentives for the acquisition and merger of nonviable water and wastewater systems. Today's action by the Commission marks the culmination of the process which began in July, 1995, with the Policy Statement first being adopted as a proposal and later published in the *Pennsylvania Bulletin* for public comment. Nine sets of comments have since been filed. The Commission is appreciative of the insightful remarks received and the revisions in today's Order reflect the public input.

Following Staff's thorough review of the comments, a number of modifications and clarifications have been made to the Policy Statement. Among these changes are: 1) the Policy Statement now also will apply to waste water systems, and 2) the clarification has been made that the Deferral of Acquisition Improvement Costs incentive is similar to a phase-in of a rate increase and it does not refer to deferred accounting for the cost of the plant improvements.

One substantive change was the deletion of the use of an operating ratio as an incentive to regionalization. The decision to delete this incentive was due to: 1) no comments were received supporting its inclusion, while 2) the Independent Regulatory Review Commission (IRRC) and the Office of Consumer Advocate (OCA) opposed its inclusion; both agencies believe that its application is prohibited by the Public Utility Code. Both noted the (then) pending Commonwealth Court case on appeal involving the Commission's allowance of an operating ratio for the LP Water and Sewer Company.

However, in a Memorandum Opinion filed February 15, 1996, the Commonwealth Court affirmed the Commission's Order to use an operating ratio. The Court held that the Commission's allowance of an operating ratio was appropriate, that the Commission "did not err in utilizing an operating ratio, since it is within the discretion of the PUC and its expertise." No. 1912 C.D. and No. 2028 C.D. at page 12.

While I am not at this time compelled to advocate the use of an operating ratio as an acquisition incentive, I am compelled to address the concerns of IRRC and the OCA that the Commonwealth Court affirmed that the Commission can use an operating ratio where we deem it appropriate.

Statement of Commissioner David W. Rolka

I dissent with respect to the proposed inclusion of a rate of return premium under section 523 of the Public Utility Code as an acquisition incentive set forth in § 69.711(b). After reviewing the report and parties' comments regarding the issue of the interplay between sections 523 and 1327, I remain unconvinced that the Legislature contemplated that section 523 would be used as an acquisition incentive in light of the passage of section 1327.

Second, neither the proposed Order nor any of the parties' comments discuss the interplay between the two sections and reconcile my statutory construction concerns. Consequently, my concern as detailed in my Statement issued when this docket was first opened, has not been met. In addition, rate of return premiums are available

by law; you do not need a policy statement to restate the law. At the very least, there should be an "either/or" clarification imposed so that either an acquiring company could qualify for an acquisition adjustment or a rate of return premium but not both. For these reasons I dissent with respect to the inclusion of a section 523 rate of return premium within the Policy Statement.

Statement of Commissioner Robert K. Bloom

Before us for consideration is the Policy Statement regarding incentives for the acquisition and merger of small, nonviable water and wastewater systems which will become final upon publication.

I support the goals of the Policy Statement. It is imperative that this Commission take the necessary actions to encourage companies to acquire troubled companies. It is the best interest of the Commonwealth that Pennsylvania has a safe and reliable water industry.

I have concerns that the Policy Statement is vague in setting forth the regulatory incentives. The Policy Statement does not explain how the deferral of rate recovery for significant plant improvements will occur. Will the Commission allow recovery of carrying costs and deferral of depreciation before rates go into effect? This knowledge is critical for the acquiring company.

Parties should file a Petition for Declaratory Order at the time the acquisition is being contemplated. This should remove the uncertainty of whether the acquisition will satisfy the requirements set forth in the Policy Statement. While specific dollar adjustments would not be granted, the Commission could and should set forth the guidance to the acquiring company as to the rate making treatment it can expect if the acquisition occurs (such as whether there will be recovery for carrying costs—not the dollar amount). The Commission should provide a commitment on the treatment of these issues rather than requiring the acquiring utility to "wait and see" a Commission determination in a rate application proceeding.

Fiscal Note: Fiscal Note 57-161 remains valid for the final adoption of the subject regulations.

Annex A

TITLE 52. PUBLIC UTILITIES

PART I. PUBLIC UTILITY COMMISSION

CHAPTER 69. GENERAL ORDERS, POLICY STATEMENTS AND GUIDELINES ON FIXED UTILITIES

SMALL NONVIABLE WATER AND WASTEWATER SYSTEMS—STATEMENT OF POLICY

§ 69.711. Acquisition incentives.

(a) *General.* To accomplish the goal of increasing the number of mergers and acquisitions to foster regionalization, the Commission will consider the acquisition incentives in subsection (b). The following parameters shall first be met in order for Commission consideration of a utility's proposed acquisition incentive. It should be demonstrated that:

(1) The acquisition serves the general public interest.

(2) The acquiring utility meets the criteria of viability which will not be impaired by the acquisition; that it maintains the managerial, technical and financial capabilities to safely and adequately operate the acquired

system, in compliance with 66 Pa.C.S. (relating to the Public Utility Code), the Pennsylvania Safe Drinking Water Act (35 P. S. §§ 721.1—721.17)) and other requisite regulatory requirements on a short and long-term basis.

(3) The acquired system has less than 3,300 customer connections; the acquired system is not viable; it is in violation of statutory or regulatory standards concerning the safety, adequacy, efficiency or reasonableness of service and facilities; and that it has failed to comply, within a reasonable period of time, with any order of the Department of Environmental Protection or the Commission.

(4) The acquired system's ratepayers should be provided with improved service in the future, with the necessary plant improvements being completed within a reasonable period of time.

(5) The purchase price of the acquisition is fair and reasonable and the acquisition has been conducted through arm's length negotiations.

(6) The concept of single tariff pricing should be applied to the rates of the acquired system, to the extent that it is reasonable. Under certain circumstances of extreme differences in rates, or of affordability concerns, consideration should be given to a phase-in of the rate difference over a reasonable period of time.

(b) *Acquisition incentives.* In its efforts to foster acquisitions of suitable water and sewer systems by viable utilities when the acquisitions are in the public interest, the Commission seeks to assist these acquisitions by permitting the use of a number of regulatory incentives. Accordingly, the Commission will consider the following acquisition incentives:

(1) *Rate of return premiums.* Additional rate of return basis points may be awarded for certain acquisitions and for certain associated improvement costs, based on sufficient supporting data submitted by the utility within its rate case filing.

(2) *Acquisition adjustment.* In cases when the acquisition costs are greater than the depreciated original cost, that reasonable excess may be included in the rate base of the acquiring utility and amortized as an expense over a 10-year period.

(3) *Deferral of acquisition improvement costs.*—In cases when the plant improvements are of too great a magnitude to be absorbed by ratepayers at one time, rate recovery of the improvement costs may be recovered in phases. There may be a one time treatment—in the initial rate case—of the improvement costs but a phasing-in of the acquisition, improvements and associated carrying-costs may be allowed over a finite period.

(4) *Plant improvement surcharge.*—Collection of a different rate from each customer of the acquired system upon completion of the acquisition could be implemented to temporarily offset extraordinary improvement costs. In cases when the improvement benefits only those customers who are newly acquired, the added costs may be allocated on a greater than average level—but less than 100%—to the new customers for a reasonable period of time, as determined by the Commission.

(c) *Procedural implementation.*

(1) The appropriate implementation procedure for the acquisition incentives listed would be to file the request during the next filed rate case. In the case of the first

incentive, for example, the rate of return premium, appropriate supporting data should be filed within the rate of return section for Commission evaluation of its applicability. The rate of return premium as an acquisition incentive may be the most straightforward and its use is encouraged.

(2) Other appropriate incentives may be considered by the Commission, if they meet the parameters listed at

subsection (a). Acquisition incentive requests will be considered on a case-by-case basis. In acquisition incentive filings, the burden of proof rests with the acquiring utility.

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