

Bill Ferguson's PUC Testimony Aqua's 2024 Pennsylvania Rate Case

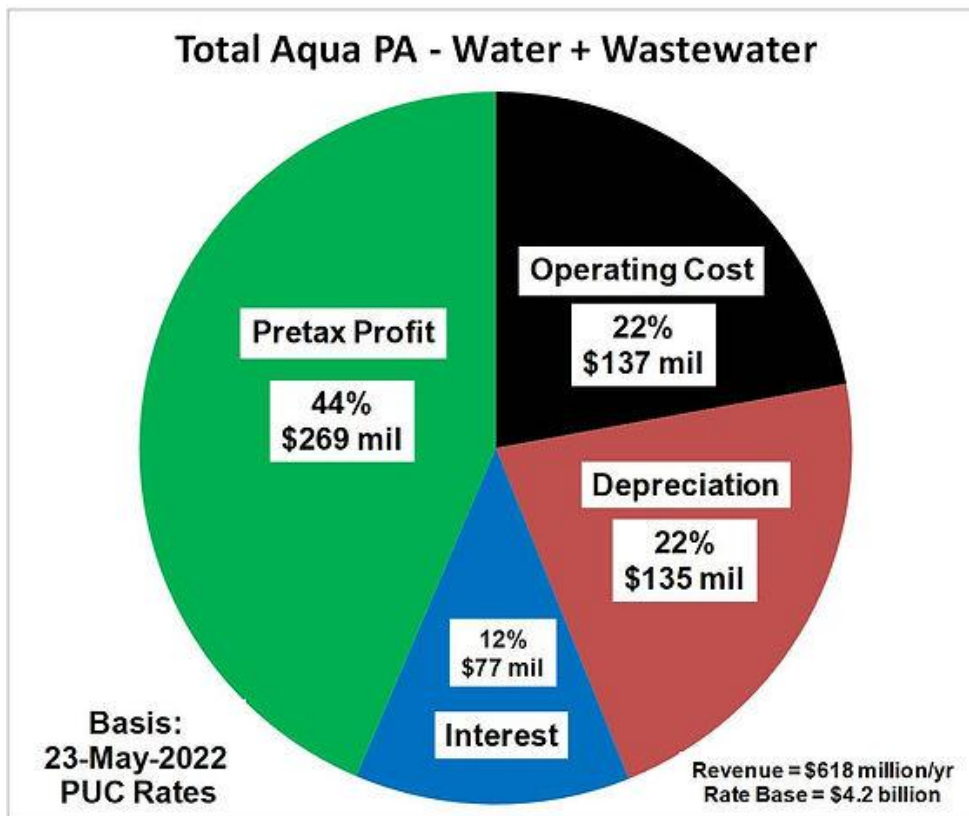
During May-2024 Aqua Pennsylvania filed for a substantial rate increase for both its water and sewer businesses. This must be approved by the Pennsylvania Public Utility Commission (PUC). A routine part of the approval process is to conduct public hearings. At these hearings any citizen can express any desired opinion.

What follows is the public testimony of Bill Ferguson, one of the co-founders of Keep Water Affordable. This testimony was given August 8, 2024 at the New Garden Township hearing conducted by the PUC

Aqua Profitability

The first issue that I want to address is what appears to be excessive profitability of Aqua Pennsylvania. To start, Exhibit A is a picture of how Aqua uses the money we have to pay them.

Exhibit A

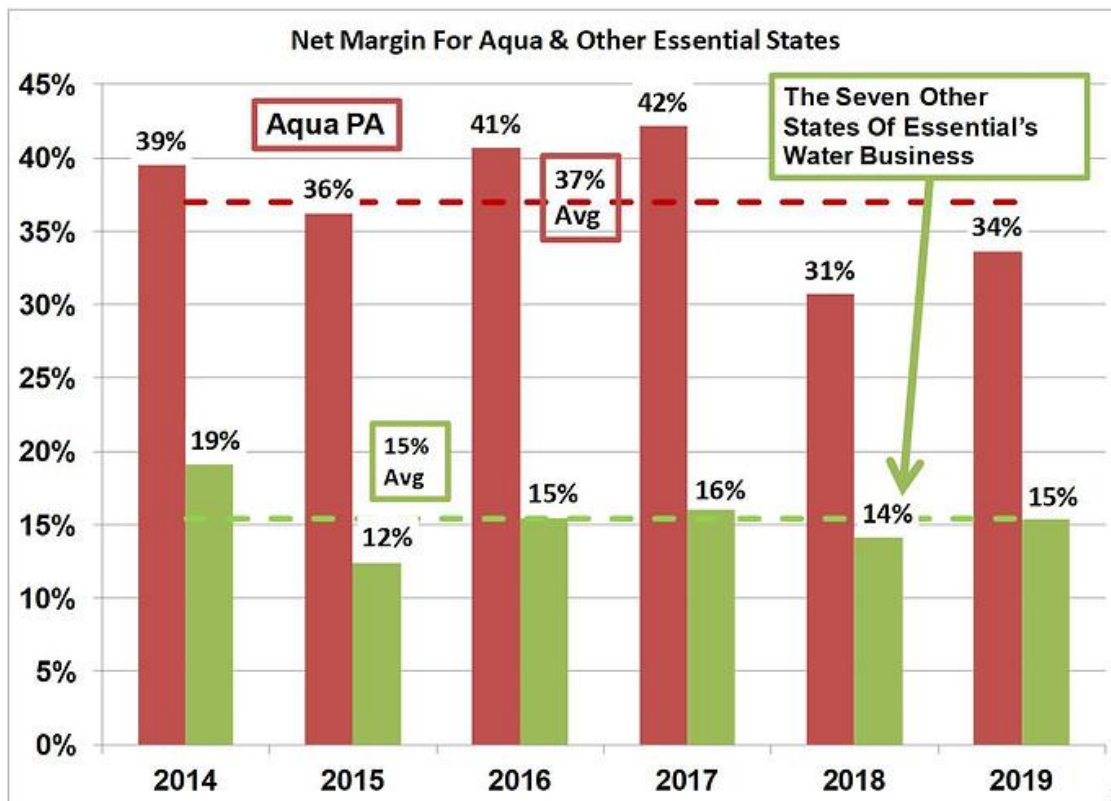


The most striking feature is obviously that huge green profit slice on the left. Forty-four cents of every dollar we pay goes to Aqua's profits. Less than 25 cents goes to actually operating the system. That is a sobering picture.

Benchmark #1

Exhibit B is a chart I have prepared from the annual report data of Aqua's corporate parent.

Exhibit B



It compares the net margins for Aqua Pennsylvania versus the seven other state composite. I find the difference totally shocking. Aqua Pennsylvania has just a tad under 2 ½ times the net margin of the other states: 37% versus 15%. The data ends in 2019 because that is when Essential Utilities stopped reporting that level of detail. However, Aqua's 2021 & 2024 rate filings are in line with a 36% net margin.

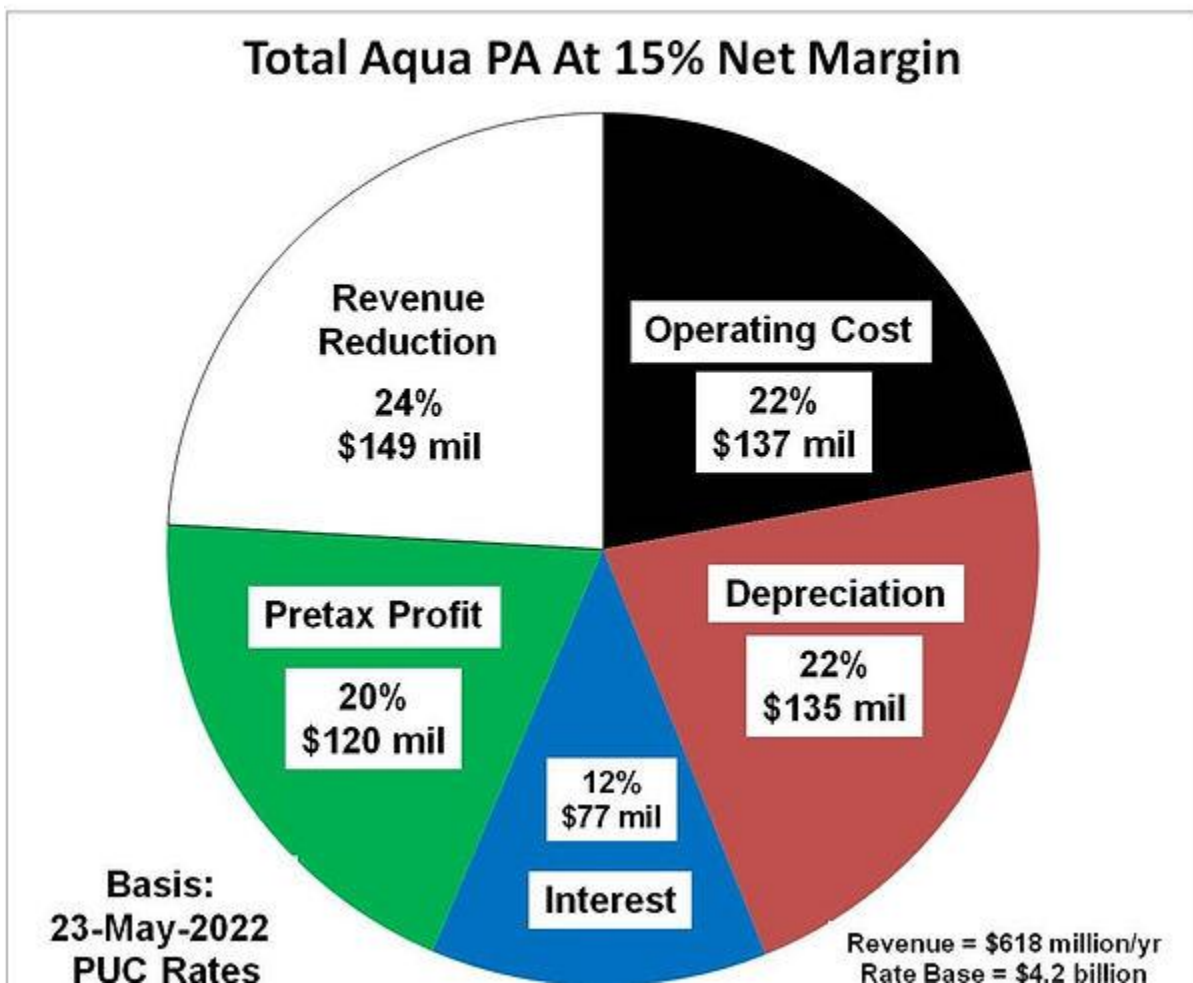
Why the difference? I cannot explain it. What is clear is that Aqua's parent company is doing business in those other states and, apparently, are not planning on pulling out because of low profitability.

[Additional information omitted from my testimony due to time constraints: From 2014 – 2019 Aqua America/Essential Utilities reported both the percentage of revenue and net earnings that Aqua Pennsylvania contributed to the corporation. Given that information, it is simple math to calculate the revenue and net earnings for the other states in the corporate portfolio. From that, profit margins are a simple division calculation. And that is what is shown in the above chart.]

Impact Of A 15% Net Margin In Pennsylvania

What I can show is the difference it would make to Pennsylvania rate payers. Exhibit C replots the first pie chart at my estimate of a 15% net margin.

Exhibit C



It is a pretty dramatic difference. Our bills would go down by almost \$150 million/yr or 25%. The difference needs to be explained.

Benchmark #2

Now I would like to switch to a second bench marking of Pennsylvania versus other states. I researched water and sewer tariff rates for all of the states where both Aqua and American do business. I then calculated the annual cost for a residential customer using 4,000 gallons per month.

Exhibit D shows the results for the water customer. Clearly, Pennsylvania is the most expensive state. Almost 80% higher than the average of the other states.

Exhibit D

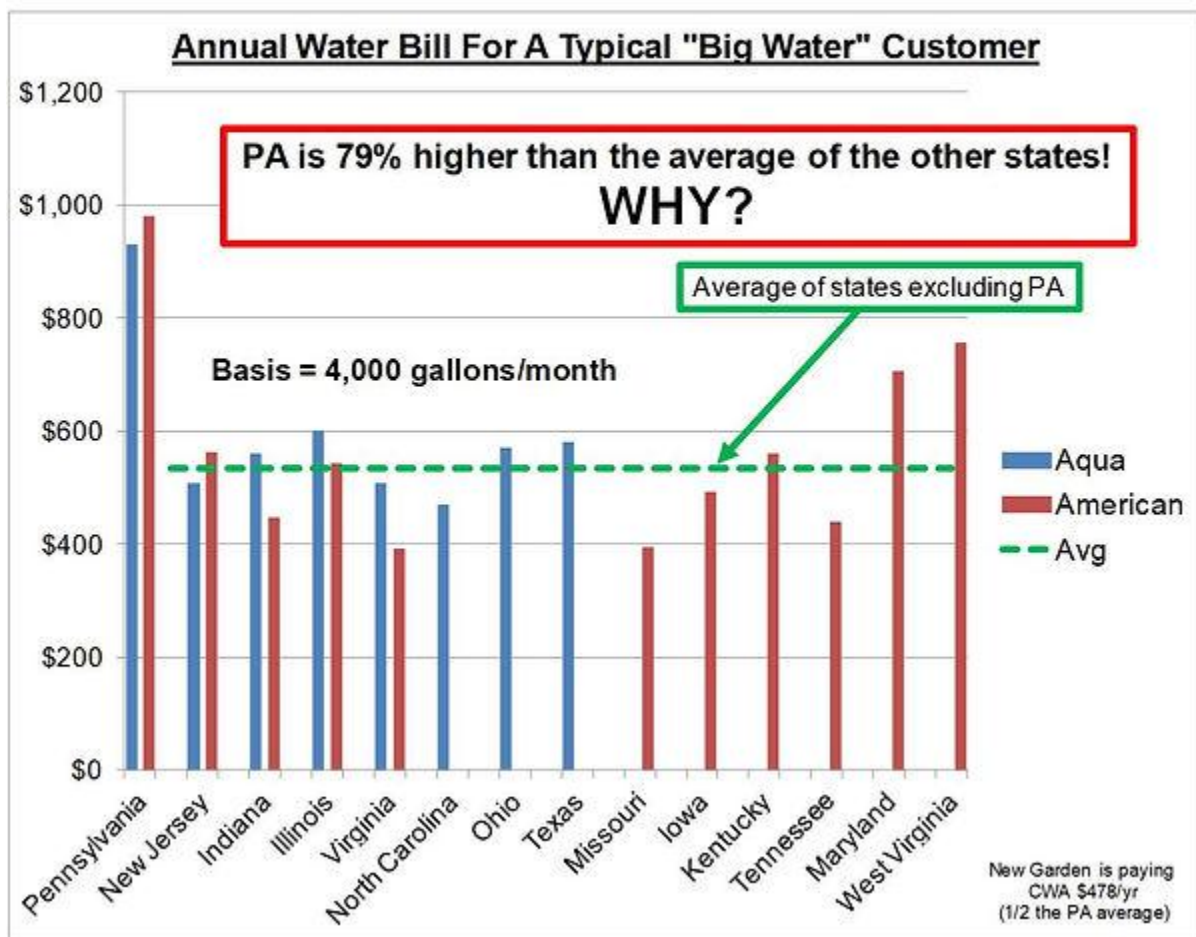
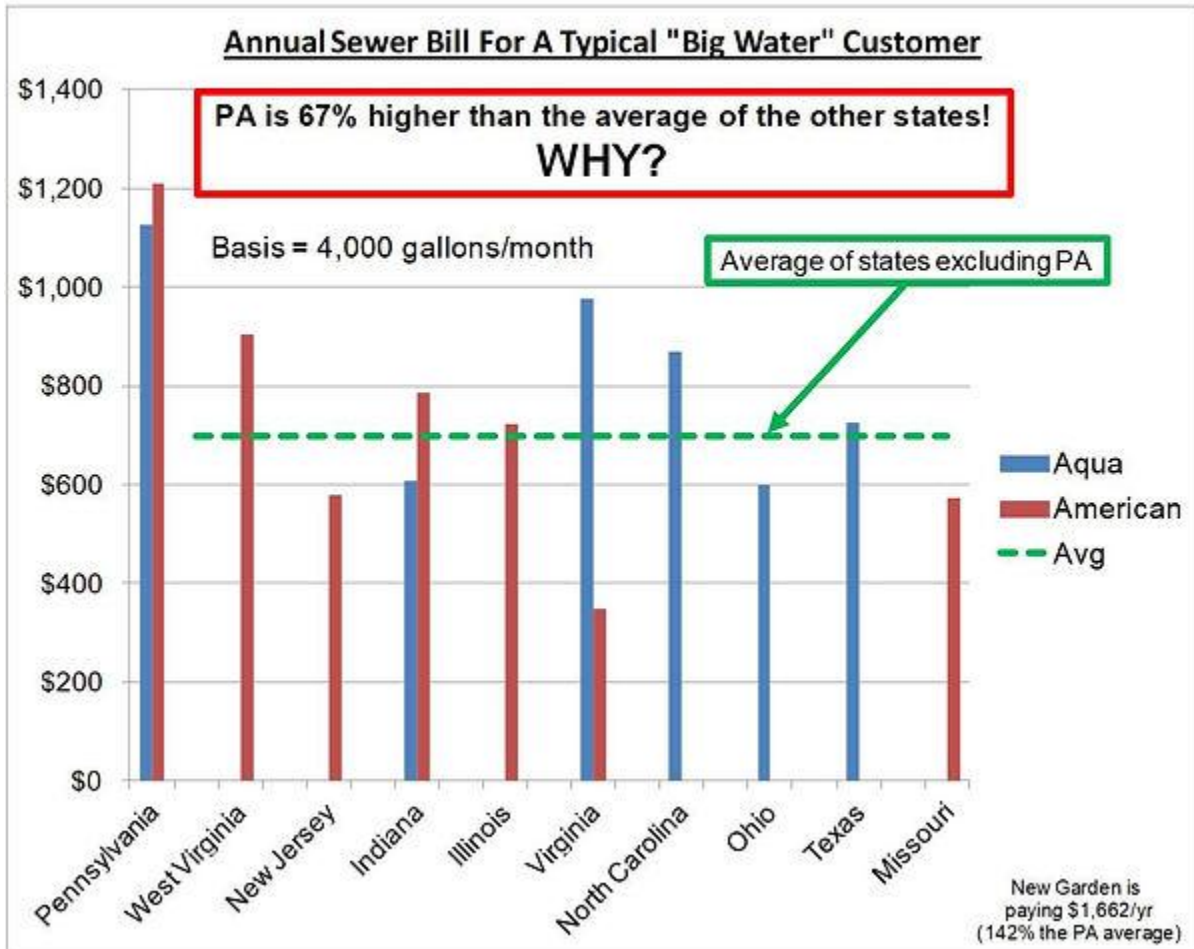


Exhibit E shows the same thing for sewer customers. It shows essentially the same outcome. Pennsylvania is the highest cost state and is 67% greater than the average of the other states.

Exhibit E



I do not know why Pennsylvania stands apart so notably from the other states. However, I do propose that the PUC put any rate increases on hold while thoroughly investigating these issues.

Areas Of Concern

I will suggest two areas of special focus.

First

Setting rates on a “Fully Projected Future Test Year” – FPFTY – a practice enshrined in the Pennsylvania legal code. Still, this is a practice ripe for abuse. The regulated utilities have incentive to under forecast revenue and over forecast costs. The ONLY way a practice like this should EVER be permitted is “square up” actual versus forecast at the end of the test year. If a utility has enriched itself on this system, customers are due refunds.

Second

Aqua is claiming it deserves a return on its investment of 7.90%. Aqua’s rate filings include extensive documentation on rates of return: industry comparisons, cash flow calculations and other “justifications”.

But, the standard that really should be applied is relative risk. Utility regulators are bound by law to essentially guarantee the companies they regulate the ability to recover all of their costs plus earn a “fair” return on investment. You have the power of government ensuring profitability to a publicly owned company. That is about as riskless a business as you will find.

A comparable risk would be a ten year government treasury bond. A reasonable rate of return for a utility should be 1.5% - 2.0% above the ten year bond. That would mean Aqua should be allowed a 5.7% - 6.2% rate of return.

I recommend that the PUC engage appropriate financial experts on this issue who do not have connections to business interests. It is time for an independent fresh look at the issue of fair return.

Risk Reduction Via Revenue Creep

The next two charts, Exhibits F & G are from Aqua's investor presentations. What they depict is revenue creep by changing the rules.

Exhibit F

Favorable Water & Wastewater Regulatory Trends over Last Decade

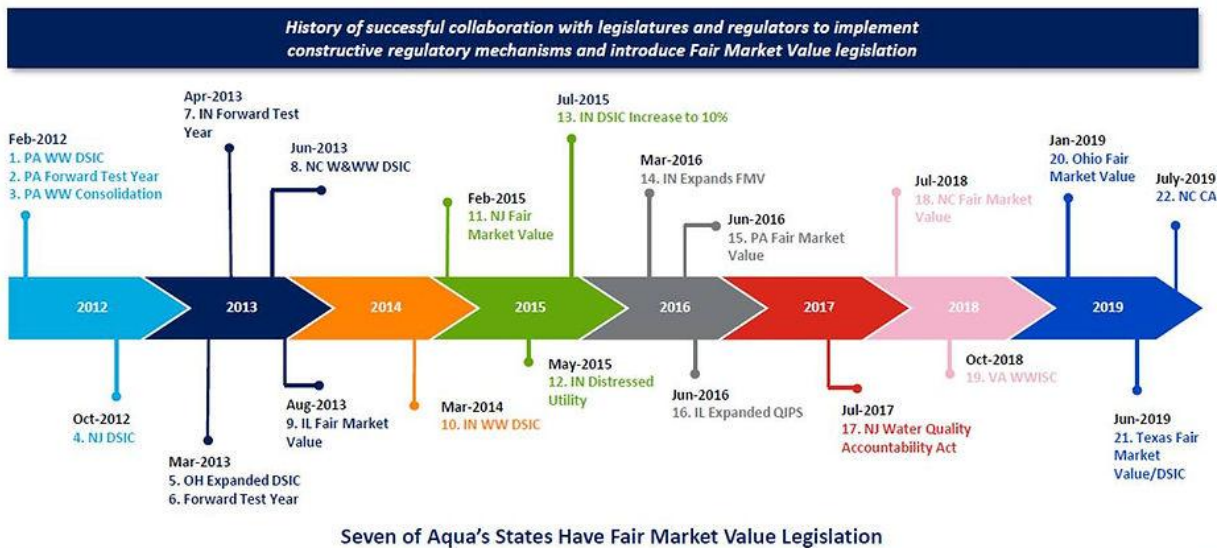


Exhibit G

DSIC Applications



Aqua and the other Big Water companies very effectively work the legislative and regulatory system to milk more revenue from ratepayers quicker. The ratepayer is no match for Big Water in this arena. We depend on the PUC to act on behalf of us. Things that accelerate revenue recovery should be accompanied by lower ROI's because business risk is reduced.

Act 11

Act 11 of 2012 allows the PUC and the Big Water companies to move sewer costs to their water customers. It has been used extensively to temper the “Rate Shock” associated with 1329 sewer acquisitions.

Act 11 does stipulate the shifting of sewer costs be “... in the public interest” (section 1311 c). That “public interest” seems to have evolved two ways:

 Avoiding “Rate Shock” after of a non-profit utility is acquired.

 “Socializing” the cost of infrastructure improvements.

Big Water’s Fair Market Value (FMV) acquisitions and the resulting increases have nothing to do with infrastructure renewal. They are totally about funding Big Water profit’s.

Furthermore, the financial benefits accrued by the seller are all local. Aqua’s water and other sewer customers should not be paying for their FMV acquisition profit growth. For example: Just a short distance from here is a new police station for New Garden. Aqua’s Warren County water customers 300 miles away near Erie are helping pay for it. That is not Act 11 solving sewer infrastructure problems.

Act 11 as it is being used hides the true cost of the acquisitions. For well run systems “socializing” the cost of infrastructure renewal required every 50 – 100 years may be reasonable. But it should not be used to cover up the cost of Big Water’s profits for FMV acquisitions.

Aqua's Current Rate Case

With that background, lets address the current rate case. Exhibit H shows that Aqua is proposing sewer rate increases of \$36 million/yr or about 50%. Aqua also proposes to move \$22 million/yr or 60% of that to their water customers. I do not believe that Act 11 adjustment can be justified and it should go to zero.

Exhibit H

Summary of Aqua's Proposed Sewer Rate Increases						
\$ In Millions	East Whiteland		All Other Zones		Total	
Proposed Increase	\$7.0	198%	\$29.5	43%	\$36.5	50%
Proposed Act 11 Adjustment	\$3.1	45%	\$18.7	63%	\$21.9	60%
Proposed Net Increase	\$3.8	109%	\$10.8	16%	\$14.6	20%

Exhibit I shows the sewer increases zone by zone.

Exhibit I	
Proposed Rate Increase	
\$ - millions	
Zones 1 - 6	(\$0.07)
Limerick	\$1.71
East Bradford	\$0.05
Cheltenham	\$6.38
East Norriton	\$2.14
New Garden	(\$1.36)
Act 12 Total	\$8.93
L Makefield	\$2.57
E Whiteland	\$3.85
Zone 14	\$0.10
DSIC	(\$0.74)
Total	\$14.6

Zones 1 – 6 are essentially unchanged. They represent Aqua's base sewer business pre Act 12. So, Aqua's proposal has their water customers and Act 12 acquisitions paying for the entire sewer increase. [Note: Act 12 = Fair Market Value legislation that essentially doubled the price of acquisitions]

Aqua has restructured their rate zones to mix the first five Act 12 acquisitions in with their previous base zones. This makes it difficult to track who is paying what. But several disparities are apparent:

As noted, the previous base sewer systems will see zero increase.

New Garden will see a big increase or a big decrease, depending on usage.

Cheltenham is getting an especially raw deal. Its full cost of service is about \$10 million/yr. Yet, Aqua proposes to raise its rates to \$18 million/yr – 80% over its full cost. That means Cheltenham is paying a huge premium to fund other systems.

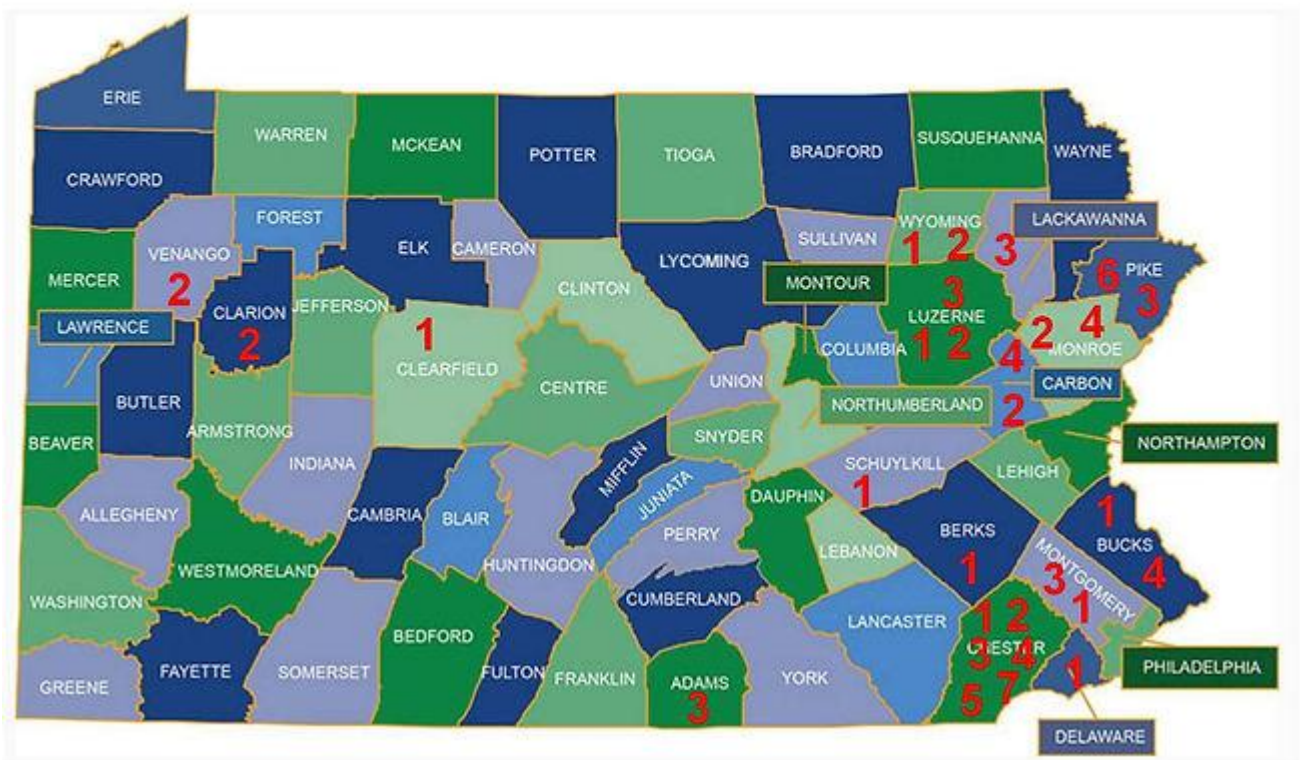
East Whiteland is another special case. The Commonwealth Court has reversed the approval of that acquisition. Until the litigation is complete, NOBODY should be subsidizing East Whiteland. It is quite possible that Aqua will be required to divest or restructure the deal. But, if the subsidy is granted, Aqua would go on collecting it until its next rate case – quite possibly for a system it did not own. That would be totally unfair to Aqua's other customers.

Sewer Rate Zone Restructuring

I conclude that Aqua should re-structure its rate zones to more equitably achieve cost of service, particularly among the Act 12 acquisitions. Exhibit J shows Aqua's proposed sewer tariff zone structure in Pennsylvania. It is clearly not geographic and apparently they have a lot of flexibility. The inequities noted above need to be addressed.

Exhibit J

Aqua's Seven Sewer Tariff Zones In Pennsylvania



Thank You