

**BEFORE THE PENNSYLVANIA HOUSE
CONSUMER AFFAIRS COMMITTEE**

Representative Joseph Preston, Jr., Chairman

Testimony of

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**Regarding
Water And Wastewater Utilities**

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Chairman Preston and Members of the House Consumer Affairs Committee

My name is Sonny Popowsky. I have served as the Consumer Advocate of Pennsylvania since 1990, and I have worked at the Office of Consumer Advocate since 1979. Thank you for inviting me to testify here today regarding Pennsylvania's regulated water and wastewater utilities. My testimony will focus primarily on water service because there are substantially more Pennsylvania consumers who receive water service from utilities that are regulated by the Pennsylvania Public Utility Commission than is the case with wastewater service. As you may know, my Office only has authority to represent customers of water and wastewater utilities that fall within the jurisdiction of the PUC. We have no authority with respect to customers of municipally-owned utilities who live within those municipalities, or to customers served by municipal authorities, regardless of where they reside.

When I first litigated water utility rate cases in the early 1980's, water bills were a relatively minor concern and represented a minimal part of a household budget for most customers. Indeed, even some of our larger water utilities at that time did not meter their residential water usage. What that meant was that it was cheaper for a customer to let a leaky faucet or a running toilet go on forever, rather than calling a plumber to fix it, because the customer was charged by the fixture, not by the gallon. Today, the bills paid by many water utility customers are comparable in magnitude to the bills that they pay for some of their other utility services, and, year after year, it has been water rates that have been increasing at the fastest pace.

In addition, twenty years ago, there were literally hundreds of investor-owned water utilities across Pennsylvania, with some serving just a handful of customers. The number

of water utilities regulated by the Pennsylvania Public Utility Commission has gone from 437 in the early 1990's to 125 in 2006. The days of the "mom and pop" water utility are coming to an end, as it is increasingly difficult for small under-capitalized companies to meet the increasingly complex and costly requirements that are needed in order to provide safe and adequate water service.

Overall, I believe the policies that have been undertaken by the General Assembly, the Public Utility Commission, and the water industry itself have been generally positive for Pennsylvania water utility customers. For example, consistent with legislative authority contained in the Public Utility Code, the Commission has encouraged the acquisition of small troubled water companies by larger healthier companies. And, in many cases, our larger water companies have stepped up to the plate to provide needed service. In addition, the Commission's policy of "single tariff pricing" – in which all the customers in the same class (residential, business, etc.) of a large water utility pay the same rates -- enables all customers to have an opportunity to pay reasonable rates, as the costs of service are spread evenly over a large customer base and a large geographic area.

That is not to say that every water utility merger or acquisition is a good one, or that in some cases a utility cannot get too big. In 2003, for example, our largest water utility, Pennsylvania American Water Company (PAWC), and its parent company American Water Works, were acquired by RWE, a multi-national diversified holding company based in Germany. My Office did not support that acquisition, and we unsuccessfully sought the imposition of a number of conditions to protect customers. Today, PAWC is back before the Commission, and is seeking to unravel that acquisition through the establishment of a separate publicly-traded

water-only utility here in the United States. Our Office has entered into a proposed settlement agreement, supporting the Company's new restructuring. We agree that re-establishing this Company's focus as a domestic water company that is not part of an international diversified conglomerate will be a benefit to Pennsylvania consumers. Importantly, that settlement also includes an agreement by PAWC to extend service to three communities in Washington and Allegheny Counties that have long needed public water service, without demanding prior advance construction payments from the customers in those communities.

The most significant challenge facing many of our water utilities is the cost of system improvements needed to meet the requirements for safe and adequate water service, including potable drinking water. I recognize that these costs will likely lead to higher rates for consumers, but I do not support proposals to make it easier for utilities to raise rates through ratemaking changes such as the further expansion of our existing distribution system improvement charge (DSIC). With a DSIC, a utility can increase its rates without the need to file a base rate case in order to reflect the costs of new plant additions. There is currently pending before the PUC a request by PAWC to increase its maximum DSIC rate from 5% to 7.5%; and PAWC has also sought to impose a similar charge – a collection system improvement charge (CSIC) on its wastewater customers. Our Office successfully appealed the PUC Order granting approval of the wastewater CSIC. The Commonwealth Court agreed with us that the Commission had no statutory authority to approve such a charge for any type of utility other than water companies, for which the General Assembly gave specific permission in 1996. Our Office also opposes expansion of the PAWC water surcharge from 5% to 7.5%, and for that matter, we have opposed efforts by our natural gas and electric utilities to impose similar surcharges.

Why are we so opposed to allowing utilities to increase their rates every quarter, or every six months, or every year to reflect the cost of new distribution facilities? Because, in our view, such charges are one-sided and are unfair to customers. Unlike a traditional base rate case, in which all costs and all revenues are considered simultaneously, a DSIC is a one-way street that can only raise rates between rate cases, even if a utility's other costs are going down or its revenues are going up.

Consider this example: I own a \$100,000 home with a 10% interest rate mortgage. I decide to finance a \$20,000 addition to my home, but at the same time, I refinance my entire mortgage at an 8% interest rate. So now, I am paying an 8% rate on a \$120,000 debt, rather than a 10% rate on a \$100,000 debt. Charging customers a DSIC between rate cases is like charging the homeowner in this example the \$20,000 cost of the new home improvement, but ignoring the 2% lower interest rate on the entire mortgage. In a full base rate case, customers who pay the cost of a new investment will also receive the benefit of the lower interest rate. With a DSIC, the customers only see the bad, but not the good.

In the utility ratemaking context, customers who pay a DSIC pay for the utility's distribution improvements, but do not get the benefit of the utility's reduced investment in depreciated or retired plant. In a base rate case, these changes would offset each other. With a DSIC, only the increase is reflected in rates and the decrease is ignored. In addition, because the DSIC only deals with new capital investments, it gives the utility an incentive to add new infrastructure, even where it might be more economical to perform additional maintenance to improve or extend the lives of existing facilities.

In my mind, it is no great benefit to make it easy for utilities to raise their rates between rate cases. Yes, utilities have a right to be compensated for investments in plant that is prudently added and that is used and useful in serving customers. But that is best accomplished through a base rate case, in which all the utilities' costs, revenues, and required rate of return are measured at the same point in time, and only the net increase in revenue requirement is added to rates at the end of the case.

As I noted above, water rates have become a larger part of the typical household's monthly budget. This is a hardship for many consumers, but for low-income consumers, these additional costs can be devastating. Unlike in the case of our electric and natural gas utilities, there is no specific statutory authorization or requirement for our water utilities to develop programs to assist low income customers either to pay their bills or to help them conserve water. Fortunately, each of our major water utilities has implemented voluntary programs that provide some assistance to low income customers. These programs are relatively small, however. At the same time, after the passage of Chapter 14, we saw a sharp increase in terminations of water service, particularly for customers of Pennsylvania American Water Company. According to statistics supplied by the PUC, the number of customers terminated by PAWC increased from 7,502 in 2004 to 23,302 in 2005, a 211% increase in the first year in which Chapter 14 was in effect. Water terminations declined slightly in 2006. The loss of water service can be as harmful to a household as the loss of electricity or natural gas. I would urge our water utilities – with the support of the PUC and the General Assembly -- to focus even greater efforts on helping low income customers to lower their bills through cost-effective conservation and to help them to pay the bills when they are unaffordable. One example of such an effort in Pennsylvania is the

Conservation Assistance Program implemented by the municipally-owned Philadelphia Water Department, which contracts with Philadelphia's Neighborhood Energy Centers to help low-income and payment-troubled customers to reduce usage through repairs and the installation of water saving devices.

Finally, I would like to comment on the PUC's jurisdiction with respect to water service and quality issues. There has been some debate over the years as to whether the PUC has jurisdiction to ensure that water quality of regulated water utilities is adequate, or whether such jurisdiction lies wholly within the Pennsylvania Department of Environmental Protection (DEP). While DEP has the primary authority to promulgate regulations defining the measures for water quality, my Office has long argued that the PUC has concurrent jurisdiction to consider these regulations with respect to water utilities that are regulated by the PUC. The PUC's standard -- that water service must be adequate for normal household purposes, such as drinking, cooking, bathing, and laundry -- is reasonable, and is consistent with the requirement that service must be "safe and adequate" under Section 1501 of the Public Utility Code. One of the factors that the PUC may consider in applying this standard is whether the utility is meeting the applicable water quality standards that have been promulgated by DEP. Under Sections 523 and 526 of the Public Utility Code, the Commission may also take service and water quality into account when setting rates for the utility, particularly in setting the rate of return or profit level that the company should receive. And, in the most drastic cases, the Commission can order the sale of a company and its acquisition by another utility in a case where water quality is wholly inadequate to serve the public. I am not suggesting that additional legislation is needed on this point, but I believe it is incumbent on the Public Utility Commission to continue to exercise its concurrent jurisdiction,

along with DEP, over water quality matters, and to reject any claims by water utilities that the Commission is powerless to act on these matters.

Thank you again for the opportunity to testify today on these matters of great importance to Pennsylvania utility consumers. I would be happy to try to answer any questions you might have at this time.

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