STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 13-W-0295 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of United Water New York Inc. for Water Service.

NOTICE OF SCHEDULE FOR FILING EXCEPTIONS

(Issued April 8, 2014)

Attached is a Recommended Decision of Administrative Law Judges Rafael A. Epstein and David R. Van Ort in the above-referenced proceeding. Briefs on exception are due to be filed electronically with the Secretary at secretary@dps.ny.gov and served on all parties by 4:30 p.m. on Monday, April 28, 2014. There will be no briefs opposing exceptions in this case. Thus, the parties should address arguments anticipated to be made by other parties in their briefs on exception.

United Water New York Inc. is directed to include, as an appendix to its brief, tables showing the bill impact, for each service classification, of the rate changes proposed by the Recommended Decision. The Company should consult with Department Staff as necessary in preparing this appendix.

The parties’ briefs must adhere to the requirements of 16 NYCRR 4.10, 3.5 and 4.8, unless modified by the Secretary in response to a party’s showing that its presentation would be prejudiced by enforcement of such limitation(s). Appendices of financial schedules and similar information in tabular form shall not be counted for purposes of the page limitation.

KATHLEEN H. BURGESS
Secretary

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 13-W-0295 – Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of United Water New York Inc. for Water Service.

RECOMMENDED DECISION

BY

RAFAEL A. EPSTEIN AND
DAVID R. VAN ORT
ADMINISTRATIVE LAW JUDGES

April 8, 2014

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

CASE 13-W-0295 – Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of United Water New York Inc. for Water Service.

RECOMMENDED DECISION

(Issued April 8, 2014)

RAFAEL A. EPSTEIN and DAVID R. VAN ORT,
Administrative Law Judges:

I. INTRODUCTION

United Water New York Inc. (UWNY or the Company) provides water service to approximately 74,000 customers in Orange and Rockland Counties. The Commission last set rates for UWNY in 2010, establishing a three-year rate plan for the period September 1, 2010 through August 31, 2013.[1] Notwithstanding the expiration of the explicit term of the rate plan, the Company has continued to operate pursuant to the rates and terms established therein. On July 2, 2013, it filed tariff schedules designed to increase the Company's base rates by 28.9% and to provide it with additional revenues of about $21.3 million for a rate year beginning June 1, 2014 and ending May 31, 2015 (the Rate Year). Operation of the tariff schedules was suspended by Commission orders and extension agreements of the Company through June 30, 2014.[2]

The Company's rate filing has been fully litigated, with that litigated process culminating in this Recommended

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[1] Case 09-W-0731, United Water New York Inc.- Rates, Order Adopting Joint Proposal as Modified and Establishing a Three-Year Rate Plan (issued July 20, 2010).

[2] Untitled Order (issued July 12, 2013), Untitled Order (issued November 8, 2013), and letters from UWNY counsel dated January 24, 2014 and February 21, 2014.

Decision. This represents our recommendation to the Commission as to the resolution of all the issues raised by the Company's rate request.

II. SUMMARY OF RECOMMENDATIONS

Our recommendation results in a total revenue requirement increase for the Company of $11,101,845, representing a 15.0% increase in total revenues. Summary schedules detailing our recommended levels of revenues, expenses, and rate of return are attached as the Appendix to this Recommended Decision. Some issues initially contested by the parties were resolved through the litigation process, as indicated here. Some of our findings on key contested issues are as follows:

Expenses: We recommend the expense level for Management and Service Company expenses be set at the level of the allowance for the final year of UWNY's most recent rate plan, escalated by the 3.7% inflation rate, to arrive at an amount less than the Company proposes but greater than the amount advocated by Department of Public Service Trial Staff (Staff). We would establish a property tax allowance by factoring in an economic obsolescence level of 10%. We adopt the Staff position regarding employee level to arrive at a total of 115 employees. We accept the Company's proposed allowance for a 3% increase in non-union employee salary expense. We adopt half of Staff's adjustment to UWNY's proposed increase in employee health and benefit expenses. We recommend the Commission impose its usual 1% productivity adjustment to labor expense, employee benefits and payroll taxes. We conclude the Company has not met its burden of proof to justify recovery of incentive pay. We recommend the Commission use a stand-alone 34% federal income tax rate, applied consistently to expenses,

additional tax deferral expense, and deferred income, and that the Commission adopt Staff's proposal to impute a tax deduction for domestic production activities. We support UWNY's request in full for a contribution to the R&I Alliance. We adopt Staff's position with respect to uncollectibles expense.

Rate of Return: We recommend that return on equity be set at 9.0% and that the Commission assume, for ratemaking purposes, that the Company's capital structure consists of 46% equity.

Rate Design: We recommend the Staff position with respect to meter charges and retention of UWNY's inclining block rate structure. We recommend elimination of the discount tail block for the SC-7 non-residential class.

Customer Service: This Recommended Decision adopts Staff's proposed allowance for outreach and education expenses. We support the Staff proposal for the institution of a Customer Service Performance Incentive mechanism, but, due to several problematic implementation issues, we recommend that the CSPI mechanism not be implemented until the end of 2015. We recommend immediate implementation of an Appointments Kept mechanism that would provide a $25 credit to a customer if the Company misses a service appointment with that customer; we reject UWNY's proposal to implement a reciprocal provision that would bill a customer $25 if the customer misses a service appointment or if the appointment proves to be unjustified because the problem originates from a cause unrelated to UWNY and its facilities. We recommend against adoption of UWNY's proposal for authority to terminate service to customers in situations involving the Company's inability to gain access to a meter. We agree with the Company, however, that its position in this rate case can constitute a proper request to the Commission for a waiver of regulations necessary to implement the Company's termination proposal.

Non-Revenue Water: We recommend denial of the Municipal Consortium's proposed incentive mechanism or revenue adjustment.

Reconciliations: With the exception of the property tax reconciliation, we recommend continuation of the revenue reconciliation mechanism with the additional stipulated language addressing dispute resolution.

Fire Service Issues: We recommend additional steps to improve communication of outage and service problems between the Company and the Fire Chiefs' Association. We do not support the Municipal Consortium's proposed postponement of a rate increase pending completion of fire service projects in certain locations, its recommendation that the Company prepare a fire service pressure project plan with milestone dates, or its recommendation for institution of a penalty mechanism.

Management Audit: We do not recommend that the Commission institute a management audit of UWNY in response to allegations of mismanagement by some of the parties; and we decline to make any recommendation as to whether the Commission should exercise its inherent discretion, regardless of such allegations, to institute a management audit of UWNY under PSL §89-c(15).

III. PROCEDURAL HISTORY

In addition to UWNY, the parties to this case are the Staff, the Department of State Utility Intervention Unit (UIU) and the Municipal Consortium (MC). The Municipal Consortium is an ad hoc group composed of municipal entities and schools served by UWNY. Its members include: Rockland County; Rockland County Waste Management Authority; Rockland County Sewer District No. 1; Rockland County Fire Chiefs Association; the Towns of Clarkstown, Haverstraw, Orangetown, Ramapo and Stony

Point; the Villages of Grandview-on-Hudson, Haverstraw, Sloatsburg and West Haverstraw; Nyack Union Free School District; and Ramapo Central School District.

In a ruling issued August 19, 2013, the request of the Village of Suffern for party status was denied, without prejudice, and a provisional protective order was adopted to expedite discovery while protecting potential Company interests pending a formal ruling on eligibility for confidential status.[3]

Pursuant to a September 9, 2013 Procedural Ruling, on November 8, 2013, Staff and the Municipal Consortium filed testimony and exhibits in response to the Company's filing. The Company filed rebuttal testimony and exhibits on December 6, 2013. On February 11, 2014, Staff filed supplemental testimony and exhibits, updating its prior filing based on new information and to correct it for prior errors and omissions. Staff's updated recommendation is for an increase in UWNY's sales revenues of approximately $8.756 million, or about 12.4%.[4]

The parties commenced settlement negotiations on November 20, 2013.[5] On December 9, 2013, counsel for UWNY, Staff, and the Municipal Consortium asked that the evidentiary hearing, scheduled to begin on December 11, 2013, be postponed due to continuing negotiations and that substantial progress

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[3] Ruling on Confidential Materials and Party Status (issued August 19, 2013). The protective order identified confidential materials that could be exchanged among the parties without requiring the Administrative Law Judges to make a prior determination on alleged confidentiality merits.

[4] In a letter filed in this case on March 6, 2014, with accompanying revenue schedules, Staff indicated that the filing reflected correction of an error identified by Staff at the evidentiary hearing, as well as Staff's post-hearing economic obsolescence recommendation.

[5] A Notice of Impending Settlement Negotiations, pursuant to 16 NYCRR 3.9, was filed on November 12, 2013.

toward settlement had been made. That request was granted.[6] Subsequent hearing dates were also rescheduled at the parties' request to permit additional time for settlement negotiations.[7] In a prehearing conference held by phone on January 31, 2014, the parties informed us that they were unable to agree on a joint proposal.

The evidentiary hearing, required by Public Service Law §89-c(10)(f), was ultimately held on February 13 and 14, 2014. Testimony and exhibits of UWNY, Staff, and the Municipal Consortium were placed into the record at that time and the parties were permitted an opportunity to cross-examine the witnesses for the other parties. Post-hearing briefs were filed by each of the parties. Initial briefs were submitted on March 4, 2014 by all four parties. UWNY, Staff, and MC submitted reply briefs on March 14, 2014.

On March 18, 2014, Staff filed a motion in opposition to three elements of the Company's reply brief. In sum, Staff seeks to exclude the Company's post-hearing 1) request to mark two documents as exhibits, 2) arguments regarding certain overtime charges, and 3) request for a waiver of the Commission's regulation (16 NYCRR 14.4) governing termination of service. The Company and MC filed responses to Staff's motion on March 20, 2014 and March 21, 2014, respectively. As discussed in greater detail below, we grant Staff's motion to

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[6] Notice of Postponement of Evidentiary Hearing (issued December 9, 2013).

[7] Notice of Evidentiary Hearing and Procedural Conference (issued January 13, 2014) ("setting the January 21, 2014 hearing date") and Notice Rescheduling Evidentiary Hearing and Procedural Conference (issued January 17, 2014) ("rescheduling the January 21, 2014 hearing and procedural conference date, the latter in the event of a joint proposal, to February 5, 2014"). The February 5, 2014 hearing date was postponed due to an impending snow storm and the unavailability of witnesses and counsel.

exclude the additional factual statement in UWNY's reply brief and the attached documents that attempt to introduce new documents into the record. We deny Staff's motion insofar as it objects to UWNY's characterization of the Company's position as a request for a waiver. While we do not recommend granting the waiver, our recommendation is based on substantive, not procedural, grounds.

IV. PUBLIC COMMENTS

The Commission received several letters and e-mails asking that the Company's requested rate increase be denied.[8] The comments noted, in general, concerns over the proposed rate increase, asserting adverse economic impact on ratepayers should a rate increase be granted. The comments also discussed UWNY's proposed desalination plant and a pending related surcharge request in Case 13-W-0246, noting the additional economic impact on ratepayers that would result if the Company is allowed project cost recovery.

V. FORECASTED SALES AND REVENUES

There is no dispute among the parties regarding the forecasted volume of water to be sold and revenues from those sales to be used in the rate year forecast to determine UWNY's revenue requirement. Following its audit of the Company's initial filing, Staff opined that the methods used by the Company were generally reasonable, but Staff proposed three adjustments. (Staff IB pp. 67-68) These adjustments corrected

[8] The number of comments received is not representative of the overall level of public participation in pending UWNY cases. Hundreds of comments have been received in Cases 13-W-0246 and 13-W-0303, which are proceeding concurrently. In addition, the comment period in this rate case remains open. A notice of public statement hearings will be issued separately from this Recommended Decision.

for errors in rounding, in accounting for the 14-month bridge period between the test period and the forecast rate year, and in allocating among classes (Staff IB pp. 68-69). The Company accepts the Staff adjustments; consequently, the sales and revenue forecasts to be used are those set forth on Exhibit 71.

VI. OPERATION AND MAINTENANCE (O&M) EXPENSES

A. Management & Services Company Fees

United Water Management & Services Company Inc. (M&S), a subsidiary of United Water (UWNY's parent), provides various services to UWNY and other United Water regulated and non-regulated affiliates in North America, charging for the services pursuant to intercompany agreements with the affiliates. Such services can include Tax, Accounting, Treasury, Communications, Asset Management, Engineering, Information Technology, Environmental Health & Safety, Internal Audit, Technical Services, Human Resources, Procurement, Accounts Payable, Payroll, Legal, Regulatory Business, as well as other General Management and Administration (Tr. 1086, UWNY IB p. 5). The Company states that M&S provides a significant benefit to UWNY and its customers because M&S is a zero profit entity that charges out only the expenses it incurs (UWNY IB p. 5, UWNY RB p. 8). It notes that all charges to UWNY are made pursuant to the M&S agreement with UWNY, which was filed with the Commission in October of 1995 and used from that point forward (UWNY IB p. 6).[9]

The Company projects a rate year expense level of $4.272 million in M&S charges, which is approximately $336,000

[9] Agreement Between United Water Management & Services Inc. and United Water New York Inc. (dated October 20, 1995) ("M&S Agreement").

above the $3.936 million historic test year (test year)[10] expense reported by UWNY (Tr. 1086). According to UWNY, the increase is due to its inflation of the test year's actual expense level by the 2.39% average salary increase during the bridge period,[11] thereafter applying an anticipated 3% salary increase during the rate year (Tr. 1086, UWNY IB p. 6). Staff, on the other hand, advocates a $1.467 million reduction to the Company's recommended rate year M&S fee allowance, producing a $2.805 million level. According to Staff, its allowance proposal was arrived at by reducing the $2.919 million level, established for the rate year that ended August 31, 2013, by $214,000 to account for overcharges from the use by M&S of the three factor allocation methodology, and increasing the balance by 3.7% (Tr. 1001, Staff IB p. 8).

UWNY makes several arguments to support its M&S recommendation. It states, initially, that M&S is staffed with highly talented people who supply high-quality services, services that UWNY would have to perform either itself or with the aid of a third party vendor in the absence of M&S (UWNY IB P. 5). UWNY highlights two cases[12] in support of its claim that most major utilities in New York utilize affiliate service companies.

The Company cites two factors for the increase in M&S charges to UWNY. First, it notes that the allocation factors have changed over time, with UWNY's share of the factors

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[10] The test year is the 12-month period ending March 31, 2013.

[11] April 1, 2013 through May 31, 2014.

[12] Case 06-M-0878, National Grid PLC and KeySpan Corporation - Stock Acquisition and Other Regulatory Authorizations - Compliance Filing (filed Oct. 12, 2011; Case 09-E-0082 et al., New York State Electric & Gas Corporation – Electric Rates, Order Dismissing the January 2009 Rate Filings (issued April 8, 2009).

increasing. Specifically, it points out that the number of UWNY employees has increased as a share of the total number of United Water employees, and this percentage of employees is a factor in allocating charges for the M&S Human Resources and Payroll Departments (UWNY IB pp. 6-7; UWNY RB pp. 9-10). UWNY claims the percentage of its employees to total employees has increased from 5% to 6.1%, or more than 20% (Tr. 580, UWNY IB p. 7).

Second, the Company asserts that, although the overall M&S employee headcount decreased from 253.4 in 2011 to 250.3 in 2013, the M&S Corporate and Regulated Divisions employee levels increased from 206.0 to 218.8 (UWNY IB p.7).[13] And, the Regulated and Corporate Divisions are the source of 99% of the M&S fees charged to UWNY (UWNY IB p.7).

Staff offers four principal arguments in opposition to UWNY's recommended M&S allowance. First, it points out that the $2.919 million allowance for the rate year ending August 31, 2013, is $1.0 million or 35% less than the M&S fee level charged to UWNY in the test year (Tr. 1087, Staff IB p. 3). Staff argues that UWNY's justification for the M&S increases are inadequate and inaccurate. Aside from the payroll cost increase due to correcting for an employee medical cost error during these years, the payroll related costs for pensions and OPEBs have actually decreased from 2011 through 2013, Staff says (Tr. 1088, Staff IB p. 3). Staff does not dispute UWNY's claims that the M&S headcount for the corporate and regulated companies increased and that there was an increase in UWNY's portion of allocation factors (Staff IB p. 4). However, the Company provided no explanation of the need for the higher regulated employee headcount and what new positions were added, asserts

[13] The Company also cites increases to pension costs, post-employment benefits other than pensions, and employee medical expenses as part of these payroll associated costs.

Staff. Staff, therefore, questions whether the regulated affiliates are assuming fees that should be allocated to the non-regulated affiliates (Staff IB p. 5). And, it argues that UWNY has not identified any additional services that the Company is receiving that support the increase in M&S costs (Staff IB p. 5).

Staff notes, secondly, that it found from a random sampling of 17 transactions out of over 6,000 M&S charges in the test year, a number of inappropriate charges to UWNY, including costs incurred for individual affiliates that were charged to all affiliates, double counted costs that should have been normalized out of the test year, and charges for alcoholic drinks and non-employee family member meals (Tr. 1092-95, Staff IB p. 5). Although Staff acknowledges that the errors found in its review of these transactions are individually immaterial, it states, in essence, that the high percentage of inappropriate charges in comparison to the sample size indicates that the total number of inappropriate charges in the test year could be significant (Staff IB p. 5); and, Staff complains that there is a lack of transparency in the M&S charges to UWNY and the Company lacks an understanding of what is actually driving the M&S charges (Staff IB p. 8).[14]

Third, Staff claims that regulated affiliates are unfairly allocated fees for general and administrative costs of M&S. According to Staff, the M&S agreement provisions -- covering administrative, purchasing, insurance and general services allocates costs to affiliates -- are based on the affiliates' number of employees, number of customers and operation and maintenance (O&M) expenses, with each component

[14] Staff estimates the M&S charges to represent about 15% of UWNY's operations and maintenance (O&M) expenses (Staff IB p. 8). MC projects the M&S charges to be approximately 14% (MC IB p. 11).

weighted one-third (1/3)(Tr. 1097, Staff IB p. 6). This approach is used because these costs are more general in nature and do not have a cost causative allocator. Staff notes, with respect to contract services, that if an affiliate does not provide billing or collection services, it is treated as having only one customer, resulting in regulated affiliates' assuming more of the allocated costs and effectively subsidizing unregulated affiliates (Tr. 1097, Staff IB p. 6). In contrast to UWNY's 72,000 customers, a "one customer" affiliate, NACO, had more than two times the O&M expenses ($39.484 million vs. $19.109 million) and three times as many employees (351 vs. 112) in 2009 (Tr. 1098, Staff IB p. 6).[15] Staff maintains that the M&S three factor allocation formula does not fairly balance the interests of the regulated affiliates against the non-regulated affiliates (Staff IB p. 7).

Staff's final argument supporting its adjustment to UWNY's recommended M&S fee allowance is that the Company's fee was improperly calculated by using wage increases during the bridge period (2.39%) and rate year (3.0%) to forecast the M&S fee increase (Tr. 1100, Staff IB p.7). Since a significant portion of the M&S fees relate to costs for other goods and services, and not payroll, Staff contends that the best method of forecasting these costs is to apply the inflation rate.

The Company argues that Staff erroneously concluded there should have been a decrease in supervisory labor, based on its comparison of the employee levels for the Customer Care and IT Infrastructure Departments as of March 31, 2011 and March 31, 2013 (UWNY IB p. 7). According to UWNY, it is more appropriate to use the average headcount for the twelve months ending each

[15] Staff also testified that in 2009 approximately 40 affiliates with active contracts were consolidated into one entity, UW Environmental Services (Tr. 1097-1098).

of those years, which illustrates increased employee levels of 3.3 (Customer Care Department) and 3.6 (IT Infrastructure Department) (UWNY IB p. 7). In its reply, Staff concedes that average, rather than end-of-year, headcount should be used. (Staff RB p. 1).

UWNY contends that the three factor allocation formula (1/3 employees, 1/3 customers and 1/3 Operations & Maintenance expense) for the M&S Administrative, Purchasing, Insurance and General Services Departments equitably allocates M&S costs to the regulated affiliates (UWNY IB p. 8). It reiterates that such costs have been properly allocated and charged in accordance with the terms of the M&S Agreement since 1995, and utilized in setting the M&S fees in each of the Company's rate cases since that time (Tr. 583, UWNY IB p. 8, UWNY RB pp. 10-12). In light of the Commission's failure to disapprove the M&S Agreement and the use of the allocation factors in several rate cases, the Company asserts that Staff has the burden to demonstrate why the formula is unreasonable and to offer an alternative. The Company argues that Staff has offered only unproven conclusory statements which should be given no weight (UWNY RB p. 12).

The Company argues that Staff's use of the inflation rate to calculate the rate year M&S fee allowance was improper because it grossly underestimates UWNY's actual costs (UWNY IB p. 8-9). It stresses that approximately 80% of the M&S costs consist of payroll and benefits, which have historically escalated at a rate greater than inflation (UWNY IB p. 8).

In its Reply Brief, the Company further challenges Staff's reliance on improperly allocated charges. It asserts that Staff's discoveries were not solely based on a random sample (UWNY RB p. 10, citing Tr. 1112). It notes that Staff conceded that these improper charges were immaterial, and it

argues that the identification of this small number of mistaken allocations does not demonstrate a systematic problem with the M&S fees or the historical allocation methodology (UWNY RB p. 10).

In addition to reducing the Company's M&S fee allowance, Staff recommends that a detailed cost accounting manual be developed to explain the allocation process and how charges are accounted for;[16] there be improved transparency and document retention so that transactions can be readily traced from costs incurred at M&S to the UWNY charges; the three factor allocation formula (number of employees, number of customers and operation and maintenance (O&M) expenses) be modified to eliminate cross-subsidization; and, the Company conduct benchmarking studies to determine whether the services received from M&S are the most cost effective for UWNY (Staff IB pp. 8-9).

UIU points to the Staff findings of improper charges (for services to other affiliates, spouses' breakfasts, and alcohol) in the random sample of 17 transactions in support of its recommendation that a comprehensive cost accounting manual be prepared and implemented to govern the accounting practices for the M&S transactions and charges (UIU IB p. 8). It focuses on the Company's witness, a senior manager of M&S, who UIU states had no idea about corporate policies or practices regarding charging to ratepayers expenses for employees' spouses and alcohol, or who approved the charges (UIU IB p. 8).

UIU expresses concern over UWNY's willingness and ability to comply with standard utility practices, claiming that it is not in the Company's corporate parents' interest to reduce the M&S charges to UWNY (UIU IB p. 8). According to UIU, it is

[16] Staff indicates that the only guidance available is a three page discussion in an accounting practices document.

not uncommon for an entity with regulated and non-regulated subsidiaries to shift excessive proportions of common expenses to the regulated affiliate filing for a rate increase next (UIU IB p. 6). UIU urges that the Commission direct an audit of M&S charges to UWNY be made and that temporary rates be established, similar to the process established in a National Grid case.[17] Therein, it states, the Commission decided that rates would become permanent if, and when, they were supported by the results of an audit conducted of the service company (UIU IB pp. 8-9). UIU concludes that the rate award in this case should be designated as temporary, subject to refund based on the audit of the M&S charges and practices.

The Municipal Consortium position generally supports UIU and the Staff findings and recommendations. MC notes, however, that it considers Staff's recommended $1.467 adjustment to the M&S allowance to be conservative (MC IB p. 12). MC echoes Staff's concern regarding lack of transparency and oversight of M&S charges. It states that if Staff is unable to determine after a concerted effort how a particular invoice is charged, the charges should not be included in rates, because rates cannot be predicated on unproven charges (MC IB p. 13). According to MC, the absence of a transparent allocation process, oversight and a comprehensive cost allocation manual, indicates that just and reasonable rates would not support the M&S charges (MC IB p. 14). MC follows up the six Staff recommendations with a seventh, recommending that the revenue impact of 50% of the rate year allowance (approximately $1.4 million) be made temporary, subject to refund, pending the results of an audit of the direct and allocated charges to UWNY

[17] Case 10-E-0050, Niagara Mohawk Power Corporation – Rates, Order Establishing Rates for Electric Service (issued January 24, 2011).

(MC IB pp. 14-15). MC also refers to the National Grid case in which the temporary rate process was employed by the Commission to investigate allocation errors from a service company.

Discussion and Recommendation

Charges made by service companies, pursuant to contracts with the regulated New York affiliates, is an area of heightened Commission sensitivity since they are not the product of "arms length" bargaining and potentially limit the Commission's ability to directly and fully audit the foundation and reasonableness of those charges. Conversely, the Commission has the ability to review the operating expenses of its regulated utilities and ensure that unreasonable charges for materials and services are not passed on to ratepayers.[18] Rate recognition of overpriced service company costs will result in excessive rates. These concerns are highlighted in the M&S charges to UWNY.

According to the Company's M&S witness, approximately 90% of the charges the Company receives from M&S are also allocated to other affiliates, which may include non-regulated entities (Tr. 621). And, UWNY is not informed of M&S fees that are allocated to the other affiliates (Tr. 622). Thus, the Company has no way to assess whether the fees charged to UWNY are reasonable in comparison with those charged to the other affiliates. Audits conducted by M&S are likely of little assistance in this regard since they are designed to determine whether M&S is adhering to the allocation methodology and the agreements with its affiliates (Tr. 623). Such lack of transparency is particularly problematic given the improper charges to UWNY -- which included individual affiliate costs charged to all affiliates, double counted costs that were not

[18] Matter of Niagara Mohawk Power Corporation v. Public Service Commission, 69 N.Y.2d 365 (1987).

normalized out, charges for alcoholic drinks and non-employee family member meals -- that were uncovered in the random sample of only 17 transactions out of over 6,000 charges to UWNY by M&S in the test year. The nature and number of errors calls into question whether they are symptomatic of more prevalent and costly improper charges to the Company.

In addition, UWNY has experienced a drastic increase in M&S fees between the $2.919 million allowance in the last year of the most recent rate plan[19] and the actual charges in the test year. A large portion of the change is attributable to the increased regulated side M&S headcount between 2011 and 2013, and UWNY's escalation of M&S expenses using actual salary increases in the bridge period and projected salary increases during the rate year. The Company, however, failed to identify any additional services it received that support the higher headcount. Therefore, we are not convinced that there is a need for the additional employees.

We also do not accept UWNY's escalation of the M&S expense level based on average salary increases and projected salary increases. The Company's acknowledgement that about 80% of the M&S income statement comprises expenses for payroll and benefits, also means that a substantial portion of those expenses (about 20%) are unrelated to payroll and benefits. Moreover, UWNY does not have control over the employees' salaries or the number of employees added to the M&S regulatory side. If such services were performed by Company employees, any proposed new employee positions would be subject to a thorough review in rate filings to determine whether they are needed, and the salary and payroll related benefits would be subject to a productivity adjustment. The Commission does not set M&S rates and allowances for proposed new employee positions.

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[19] Case 09-W-0731, supra. The rate year ended August 31, 2013.

Based on the evidence presented, we cannot determine whether the three factor equal weighting (number of employees, number of customers and O&M expenses), to allocate administrative, purchasing, insurance and general services costs, results in an inequitable skewing of charges toward regulated entities and a cross-subsidization of other affiliates by UWNY. However, merging of multiple affiliate contracts into one entity would have an impact on the weighting of allocation factors. The merging of 40 unregulated affiliates into UW Environmental has the potential to cause a significant impact on allocations to the regulated companies. The testimony presented by UWNY confirms that it cannot compute the cost impact that the merger of contracts could have on allocations from M&S. And, UWNY did not offer any M&S accounting or policy manuals or other information that details the allocation process among affiliates.

We conclude that the M&S allowance for this case should be set at $3.027 million, based on the $2.919 million allowance in the final year in UWNY's most recent rate plan[20] escalated by the 3.7% inflation rate.[21] UWNY should be required to conduct a comprehensive audit of M&S charges to UWNY in the test year, and report the audit findings as part of its next rate filing.[22] We also recommend that the Company provide a cost/benefit analysis as part of its next rate case which assesses whether the services received from M&S are the most cost effective alternative for UWNY and ensures no cross subsidization of other affiliates. Although we support the

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[20] Case 09-W-0731, supra.

[21] We reject Staff's $214,000 recommended adjustment to the $2.919 million allowance level "due to an alleged overcharge to UWNY from using the three factor methodology."

[22] The Company should be directed to consult with Staff regarding the scope of the audit and preliminary findings.

development of a detailed cost accounting manual, we do not assume that the Commission cannot direct M&S to develop one. The Commission's remedy rests in denying UWNY from recovering in rates the M&S costs that are unsupported or unreasonable.

We are not recommending that the Commission set a portion of the Company's rates as temporary rates and subject to refund due to there being the potential for additional undiscovered erroneous charges made by M&S to UWNY. The audit of the M&S charges should disclose whether the erroneous charges are limited to those found by Staff or are more pervasive and symptomatic of M&S operations, thus warranting further Commission action. Staff is not precluded from bringing the matter to the Commission in advance of the Company's next rate filing if the preliminary audit information indicates that additional measures are needed to protect ratepayers.

We agree with Staff and hereby grant its motion regarding the statement in UWNY's reply brief that an M&S company employee may only charge up to eight hours of his or her time per day to UWNY, even when the employee, in fact, works more than eight hours for UWNY. As Staff notes, this allegedly factual statement is made without reference to the record and cannot be supported by either the transcript or the marked exhibits. It is particularly notable that, even with its unauthorized bolstering of the record with the various appendices attached to its reply brief, UWNY did not submit any support for this statement. The allocation practice referenced, rather than supporting the Company's arguments, simply raises more questions about allocations that could and should have been explored through cross-examination. For example, if an M&S employee works 11 hours in a day on a project that is to be allocated one third to UWNY, does the employee allocate one third of the first eight hours to UWNY, two thirds of the eight

hours to non-regulated affiliates, and the full amount of the additional three hours to the non-regulated affiliates? Does the employee write off without allocation one third of the three hours after the first eight? Or does the employee allocate one third of the total 11 hours to UWNY (which effectively would allocate a portion of the overtime to UWNY)? Given the uncertainties as to how the process works in practice and whether it works properly, we have not accorded any weight to the assertion regarding overtime in the Company's reply brief.

We also grant Staff's motion to exclude Appendix 2 attached to the Company's reply brief, which UWNY also offers in support of its discussion of the M&S issue. This appendix consists of UWNY responses to information requests (IRs) propounded by Staff. Such responses present an opportunity for the Company to make self-serving statements, which Staff and the intervenors chose not to offer into the record. Even if UWNY had proffered these responses during the hearing itself, we would have sustained an objection from the other parties or, at a minimum, insisted that the author of the IR response be made available for cross examination and that the parties have an opportunity to conduct such cross. At this late stage, there is considerable prejudice to all the parties from a lack of opportunity to address these Company statements.

B. Property Tax Expense

The Company and Staff are in agreement on using Staff's calculated $23,107,582 property tax expense level for the rate year, with the exception of the parties' proposed adjustment to that amount as a result of economic obsolescence (UWNY IB, p. 10).[23] Staff's property tax calculation was arrived at by updating the Company's three-year average tax calculation

[23] Staff calculates the property taxes to represent about 27% of the Company's overall revenue requirement (Exh. 66, p. 1).

for latest known changes (Staff IB, pp. 9-10) and applying Staff's current economic obsolescence adjustment to yield a property tax expense of $20,894,489.[24]

1. Economic Obsolescence Adjustment

Economic obsolescence or "EO" is a New York State Office of Real Property Tax Services (ORPTS) property tax provision that offers water and other regulated utilities a means to lower the assessed value of their special franchise taxes.[25] It is founded on the theory that a loss in property value is caused by impairment in the desirability or useful life of property resulting from factors external to the property. The EO calculation compares the utility's five-year average actual rate of return on rate base to a five-year average required return based on the utility's capital structure.[26] Utilities can apply for an economic obsolescence determination and adjustment as part of the annual financial and inventory reports they are required to file with ORPTS in April of each year. The economic obsolescence issues in this case arose out of UWNY's: 1) failure to file an application with ORPTS for an EO adjustment in years past; 2) making a late filing for an EO adjustment this year; 3) alleged use of information in its EO application that was atypical and had inaccuracies; and, 4) recent receipt of a 7% EO award from ORPTS and the implication of that award in setting the property tax rate expense level in this case.

[24] Staff IB, Attachment A, p. 1.

[25] In contrast, functional obsolescence occurs when the assets' system capacity or efficiency is impaired because the property can no longer meet needs or where there exists excess operating capacity. No functional obsolescence adjustments were made in this case (Tr. 987).

[26] Calculations are based on rolling five-year averages.

Staff initially proposed that the EO adjustment be set at 12.88% (Tr. 1010). Staff updated its recommendation to 15.19% in its post-hearing brief to account for errors it claims were acknowledged by UWNY during cross-examination (Staff IB pp. 16-17). UWNY asserts that the economic obsolescence level should be set at the 7% level approved by ORPTS. MC agrees with Staff's recommended EO threshold, presumably referring to the 12.88% level (MC IB p. 17). UIU simply recommends that the Commission commence a prudence investigation (UIU IB p. 6). The property tax expense reduction associated with the economic obsolescence levels of 7% and 12.88% would be about $1.02 million and $1.603 million, respectively (Tr. 587, Exh. 23, Tr. 1010). Utilizing the 15.19% level, Staff calculates a $2,458,994 EO adjustment.[27]

Staff offers several reasons why the Commission should impute an EO percentage and adjustment well in excess of the 7% set by ORPTS. To begin with, UWNY did not apply for an ORPTS EO adjustment prior to this year, submitting its extremely late application only in response to Staff discovery questioning why the application was not made (Tr. 586; Staff IB, pp. 10-12). Staff also finds the Company at fault for not even inquiring of ORPTS whether UWNY is eligible for the EO award. According to Staff, ratepayers should not be required to pay for unnecessary expenses caused by UWNY's failure to properly manage its business (Staff RB, p. 2). The Company states in rebuttal that it did not consider itself qualified for the adjustment because UWNY had "net operating income sufficient to meet taxes which were not included in the determination of net operating income, interest on indebtedness and fixed charges" as noted in ORPTS

[27] Staff IB; Attachment A p.1. The new EO amount was then reduced by 10%, to arrive at the final Staff EO adjustment of $2,213,095.

regulations (Tr. 1016).[28] It further comments that ORPTS developed an EO process which appears to use an economic obsolescence calculation different from that provided for in the applicable regulations (Tr. 585-586). Staff rejects UWNY's implication that the ORPTS policies and procedures were not clear, noting that ORPTS sends out annual reminder letters to utilities explaining when annual reports are due, the availability of economic obsolescence, and that information is available on the ORPTS website that will assist in completing the EO calculation template (Staff IB, p. 12). And, it notes that economic obsolescence has a long-standing role in the State's property tax law, and other utilities managed to file for and receive EO adjustments to their special franchise taxes (Tr. 998).

Staff claims, secondly, that the 7% ORPTS EO allowance is insufficient because it was wrongly determined based on information provided to ORPTS by UWNY that contained errors and other problems that reduced the EO award (Staff IB pp. 10, 14). It notes, specifically, that the Company's stated net income was inaccurate because UWNY incorrectly recorded above-the-line the tax effect flowing from the Company's allowance of funds used during construction (AFUDC); the Company erroneously utilized the capital structure adopted in the Commission's rate orders rather than the Company's actual capital structure; and UWNY mistakenly adjusted its net income to account for certain expenses which were disallowed in the 2008 rate case,[29] such as incentive pay, M&S fees and R&I membership (Staff IB p. 14). Staff maintains that UWNY acknowledged that since the AFUDC was recorded below-the-line, the tax effects should have been

[28] Citing 9 NYCRR 8185-1.1 (186).

[29] Staff is apparently referring to the 2009 rate case (09-W-0731); there was no rate case filed by UWNY in 2008.

similarly recorded below-the-line (Staff IB p. 16). In addition, Staff asserts that the EO formula is designed to use data from the PSC Annual Report.

UWNY responds to Staff's claims, pointing out Staff was aware from prior Company rate cases that UWNY was not making EO filings, which suggests that Staff also believed UWNY was ineligible for the economic obsolescence adjustment (UWNY RB p. 18). It insists that the text of the ORPTS regulations does not appear to make UWNY eligible for an economic obsolescence award (UWNY RB p. 18). Further, UWNY says the calculations needed to complete the ORPTS form are complex, somewhat arbitrary and subject to interpretation (UWNY RB p. 18). The complexity is evident, it says, from the three separate EO recommendations offered by Staff (UWNY RB p.18).

UWNY claims that Staff is improperly seeking the 12.88% imputation to reduce the Company's property tax allowance (UWNY IB p. 11). It asserts that the 7% ORPTS award was based on proper adjustments to the Company's earned return. Moreover, UWNY points out that ORPTS allowed the Company to use the UWNY's capital structure set forth in the Commission's rate order rather than the actual capital structure (UWNY IB p. 11). UWNY notes that Staff also used the capital structure from the rate case to determine the EO recommendation in Staff's Initial Brief (UWNY RB p. 19).

ORPTS is not bound to consider only results produced using information indicated on its website, observes UWNY; ORPTS retains the discretion to allow adjustments to the template's input factors (UWNY IB p. 10). Although Staff may dispute the methodology ORPTS permitted for calculating the utility's earned return, ORPTS is an independent agency responsible for making the EO level determination, and its determination must be used for calculating the Company's special franchise tax (UWNY IB p.

12l; UWNY RB p. 20). Thus, UWNY concludes that there was nothing improper in its filing with ORPTS and there is no record basis to use an economic obsolescence adjustment factor other than the 7% level set by ORPTS.

The Company and Staff also disagree on whether UWNY made an error in reporting "paid in capital" to ORPTS that affected the EO award granted. According to Staff, UWNY substantially underreported its total paid in capital, a form of equity derived from cash transferred from a parent corporation (Staff IB p. 15). Utilization of the proper paid in capital amount would have significantly increased UWNY's total capitalization amount, Staff reasons, decreasing the portion of the Company's capitalization related to deferred taxes from 22% to 17% (Staff IB pp. 15-16). And, the effect of the error is that the Company's earned return as reported to ORPTS allegedly was greater than it should have been, thereby decreasing the economic obsolescence percentage (Staff IB p.16). The Company paints out in response that the paid in capital used in its EO filing, and which ORPTS accepted, mirrored the adjustments that Staff made in the ORPTS template which it included in discovery of UWNY and Staff's in initial testimony (UWNY RB p. 19).

Staff and MC state that UWNY overspent millions of dollars, at ratepayer expense, due to the Company's failure to timely and correctly file for annual EO adjustments. UIU and MC suggest that the Company's failure to file for several years is tantamount to negligence. UIU advocates the Commission instituting a prudence investigation to review UWNY's conduct (UIU IB p. 3). Conceding that it is impossible to determine the amount of money that would have been saved if the Company had made regular economic obsolescence applications and that the Commission cannot retroactively capture the effect of past inflated property tax costs, Staff and MC, nevertheless, support

the Commission adopting an additional adjustment (Staff IB p. 13; MC IB p. 17). Staff believes the adjustment "would have come from an annual refining of successive Company filings" and would provide ratepayers assurance that the Company will be more attentive in the future (Staff IB p. 13). UWNY characterizes the Staff and MC recommendation as an unlawful attempt at retroactive ratemaking to recover past excess property tax payments (UWNY RB p. 21).

Discussion and Conclusion

We recommend that the Commission establish the Company's property tax allowance by factoring in an economic obsolescence level of 10%. Ratepayers very likely have been funding an excess level of property taxes as a result of the Company's failure to seek and obtain the EO awards from ORPTS. The Company improperly attempts to deflect some of the responsibility to Staff by first, noting with respect to UWNY's failure to file the EO application previously that Staff was aware in prior cases UWNY did not file for an award, and secondly, pointing out that Staff also used the allegedly incorrect capital structure to calculate its EO recommendation. Staff is not responsible for managing the day-to-day operations of the Company. Moreover, UWNY utilizes the services of tax professionals. UWNY's failure, at the very least to conduct a basic inquiry of ORPTS to see if it might be eligible for the EO award until questioned by Staff during discovery in this case, is inexcusable. And, the Company failed to make inquiry despite receiving notice of the EO option in annual reminders about filing annual reports. In addition to there being adequate information on the ORPTS website for the utility or its tax professionals to calculate EO, the ORPTS reminder letters included the name and contact information of an ORPTS staff person from which the utilities can obtain additional

information and assistance. Whether the Company's actions and omissions, in delaying its filing for an economic obsolescence determination and in using incorrect or alternative inputs in its EO calculation, rises to the level of mismanagement would require a more in-depth investigation than available in the course of this proceeding. We believe that our recommendation provides ratepayers with adequate protection in this one year rate plan.

We do not find the Company's claim that ORPTS allowed it to use the capital structure from the most recent case to be persuasive, nor its suggestion that the ORPTS 7% decision has a binding effect or limitation on the property tax expense allowance set by the Commission. The evidence provided does not convince us that UWNY's use of the rate case capital structure resulted in the Company receiving the full amount of EO benefit that it would be entitled to. And, just as ORPTS is not bound by a Commission determination setting an EO level, the Commission is similarly not bound in setting the property tax rate allowance by an ORPTS EO decision, if the Commission believes there is a reasonable basis to conclude that the ORPTS decision does not capture the full benefit of the economic obsolescence available. We believe that the evidence in this case regarding errors made by UWNY and factored into the Company's EO application support the conclusion that the 7% economic obsolescence award recently granted to UWNY does not fully capture the EO level that the Company should be entitled to. The testimony, however, does not provide an estimate of what the proper EO level should be with any degree of certainty. We do not find Staff's updated calculations based on statements of the Company's witness during cross-examination to provide any greater certainty of what the EO level should be than the award UWNY received based on its EO calculation. The 10% threshold

that we recommend should provide UWNY with sufficient incentive to continue pursuing economic obsolescence adjustments and maximize the award utilizing ORPTS approved processes and procedures.

We further recommend that the Commission require UWNY to submit to the Director of Accounting, Audits and Finance (or her designee) a copy of its EO filing within 10 days after submission to ORPTS and include an analysis comparing the results that UWNY reached using both actual and rate-case capital structures. We would expect the Company also to provide a more detailed presentation in its next rate case regarding the ORPTS EO process, communications it may have had with ORPTS and any ORPTS determinations. Finally, we recommend, to the extent not currently being performed, that Staff survey the other Commission-regulated large utilities to ascertain whether they applied for EO determinations and the results, if any.

C. Labor Expense

1. Employee Level / New Hires

UWNY's filing assumes a rate year headcount of 124 employees, comprising the actual employee level of 114 at the end of the historic test year at March 31, 2013, plus four vacant positions at that time, plus six employees to be added at the start of the rate year. Staff would disallow the four vacancies and five of the six additional rate year hires, for a total of 115 employees. MC would disallow all six rate year additions, for a total of 114. We recommend that the Commission adopt Staff's estimate, and thus disallow $251,167 in labor expense (Tr. 210).

This issue is best considered as two questions: what headcount fairly represents the historic test year level; and what growth, if any, should be projected for the rate year? Regarding the test year, UWNY argues that the four vacancies

unrealistically reduce the historic level because they represent intended hires, i.e., temporary vacancies which by happenstance were filled only after the test year ended in March 2013 because prudent recruitment takes time.

However, as Staff observes, the four vacancies should instead be attributed to ordinary employee additions and departures ("churn") which, in any organization, typically cause headcount to fluctuate upward and downward from a normal level. This is confirmed by the fact that actual headcount has varied from (for example) an average of 113 for the 44 months January 2010 through August 2013, including the 114 noted above for year-end March 31, 2013, to 117 as of June 30, 2013, to 111 for the year ending December 31, 2013 (nine months after the end of the test year). In other words, there is no historic trend to demonstrate that all vacancies will remain filled so as to produce a normal level as high as the 118 that UWNY would impute to the historic test year. On the contrary, none of the historic levels just cited has reached 118; and indeed the 2013 decline from 117 to 111, despite the addition of three new customer service representatives in the third quarter of 2013, could be taken as evidence of a trend toward a level well below the 115 we are recommending.

To justify both the imputation of the four nonexistent employees in the currently vacant positions and the rate year growth through the addition of six new hires, UWNY cites supposedly incremental workforce requirements beyond those satisfied by the 115 employees Staff would allow. Specifically, the Company says "the Sanitary Code's regulatory requirements mandate very stringent and onerous licensing requirements for operators"; and under "the Ground Water Rule . . . any ground water source of supply that is deemed to be under the influence of surface water will require the Company to invest and install

filtration and ultra violet disinfection" (UWNY IB p. 14, citing Tr. 212). However, the Company already was complying with these standards during the test year, so they do not create new burdens for the rate year.

In addition, UWNY argues that without an increased headcount, it cannot successfully manage the transition to monthly billing, and the Company's failure to achieve the metrics of Staff's proposed new customer service performance incentive (CSPI) mechanism would be preordained. However, UWNY provides no quantitative evidence that either monthly billing or the CSPI would cause a net increase in staffing requirements. The Company's testimony that 12 monthly bills require three times ("200%") as much labor as four quarterly bills (Tr. 976) is obviously simplistic in presuming that work hours increase in direct proportion to the number of bills, with no offsetting efficiencies of scale. In fact, the Company's projection of 75,000 customer calls annually with monthly billing is slightly less than the historic call volume under quarterly billing, a decrease that will not only mitigate the workforce impact of monthly billing but also facilitate achievement of the CSPI metrics.

Indeed, as Staff explains, the forecasted decrease in call volume means that the addition of three customer service representatives is even less justified than during the ten years of steady growth in call volumes from 2002 to 2012, culminating in a sharp increase in 2012, during which the base year level of nine representatives sufficed. Moreover, regardless of whether calls decrease, the overall burden on the customer representative workforce will decrease insofar as the expansion of UWNY's automated collections process creates efficiencies in terms of first call resolution, appointment scheduling,

complaint handling, preemptive monitoring, and improved billing services (Exh. 87 pp. 7-8).

The prospect of these efficiency gains refutes UWNY's contention that the historic level of nine customer service representatives has been maintained only by exhausting all possible efficiency gains and that a staffing increase therefore is inescapable. Meanwhile, the CSPI, if properly designed, by hypothesis will not demand that UWNY's service performance exceed the Company's capabilities at current staffing levels.

In sum, by recommending Staff's proposed allowance of one new hire, we accord UWNY's arguments some credence by accepting that slight increase over a historic level that already may be generous in view of the recent headcounts noted above. While we acknowledge MC's theory that any headcount increase can be completely obviated by efficiency gains and declining call volumes, we are not convinced that such an outcome is likely. As discussed above, efficiency gains are an assumption on which we already have relied in recommending the reduction of UWNY's estimated new hires from six to one. Further, UWNY has adequately shown that projected call volumes cannot properly be used to mathematically justify an additional disallowance in the manner proposed by MC, because call volumes and workload will not vary in perfect correlation.

2. Non-union Payroll Expense

UWNY seeks an allowance for a 3% increase in non-union employee salary expense (Tr. 217). Staff, supported by MC (MC IB p. 17), proposes to limit the increase to 2.75% (Tr. 972). UIU would allow no increase (UIU IB 19-20). We recommend that the Commission adopt the Company's proposed allowance.

According to UWNY, the 3% increase is necessary so the Company can compete for qualified employees under market conditions indicated by a survey of eight utilities and other

employers in UWNY's region; provide an inflation allowance; and maintain a progression whereby more experienced employees can be paid more than new hires.[30] Staff, in contrast, would disallow any increase exceeding 2.75% because that is the increase established for union employees through collective bargaining.

Staff's case here suffers from the same flaw as in a National Fuel rate case cited by UWNY.[31] Staff presumes that the negotiated cost of hourly labor subject to collective bargaining is a reasonable proxy for that of non-union labor (Tr. 972). The presumption is arbitrary and unsupported by evidence because, as the Commission observed in National Fuel, union and non-union labor differ in critical respects such as the nature of the employees' work; the number of hours for which they can be compensated; and the criteria that determine a reasonable hourly pay rate, in negotiations establishing either union or non-union pay and benefits.

Moreover, in two respects this case presents an even stronger basis than National Fuel for rejecting Staff's theory of equivalence between union and non-union compensation. First, the pay premium the Company proposes here for non-union labor over the union rate is only 0.25 percentage points (3.00% versus 2.75%), as compared with 0.75 or 0.95 points in National Fuel (3.5% versus 2.75% or 2.55%, depending on the year).

Second, Staff here seeks to prevail on the ground that UWNY failed to provide the studies the Company used in determining a market rate for non-union labor (citing UWNY's interrogatory response in Exh. 33). However, there is no indication that Staff requested the studies after UWNY cited

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[30] The revenue requirement necessitated by this progression is separate, as we understand it, from the costs of the incentive programs discussed below ("Incentive Pay").

[31] Case 07-G-0141, National Fuel Gas Distribution Corporation - Rates, Order Establishing Rates (issued December 21, 2007).

them in response to discovery. Thus, Staff is relying on the very same criticism that was found vague and unsupported in exactly the same circumstances in National Fuel, where the Judge properly declined to recommend parity between union and non-union labor rates merely because the company had not been asked to provide its market based studies:

> There is no basis for simply believing, or finding here, that whatever is right for weekly employees is also proper for the management complement. If in fact, the Company should have provided to Staff additional information to support its proposed management salary increase, Staff should fully detail what information was provided to it, what information was omitted, and what information it needs to examine . . . . Without a clear statement of the Staff method of analysis, and the Company's failings, I recommend that the Company's proposal be allowed.[32]

Like the Judge, the Commission in National Fuel found insufficient evidence to support either Staff's proposed disallowance or its complaint about nondisclosure by the Company, and we recommend the same conclusion here.

UIU opposes any increase in the non-union employee expense allowance, on the ground that management has not performed at a level deserving what UIU calls "a merit raise." (UIU Brief p. 19.) To support that objection, UIU cites its allegations of UWNY's "failure to apply for Economic Obsolescence ("EO") awards, improper charges, cost shifting to ratepayers, absence of knowledge about corporate policies and practices regarding gifts and purchases of alcohol, failure to respond on a timely basis to customers and DPS Staff regarding complaints, failure to resolve fire flow issues, and assigning blame to others" (ibid. pp. 1-2). UIU also claims there is no

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[32] Case 07-G-0141, supra, Recommended Decision (issued September 28, 2007), p. 16.

evidence that the labor expense increase is necessary for employee retention; any additional revenue allowance attributable to employee expense will aggravate customers' economic stress, uncollectibles, and theft of service; and the expense increase must be disallowed in order to strike a reasonable balance between customers' rate burdens and shareholders' dividend growth, with due regard for the economic environment in which the Company operates.

UIU's reasoning lacks adequate record support. To begin, even assuming for argument's sake that management has failed as described by UIU and that other remedies recommended herein are inadequate, UWNY's proposed employee expense increase is based only partly on individual salary advances, which in turn are based only partly on recognition of improvements in individuals' skills or performance (Tr. 217-18). To the extent that UIU’s criticisms relate to the justifications UWNY asserts on behalf of its proposed Short-Term and Long-Term Incentive Plans (STIP and LTIP), we discuss that allowance elsewhere ("Incentive Pay," below).

However, if UIU means to characterize the entire 3.0% expense increase as an unearned performance award, UIU's argument disregards that, again, no party requested the surveys that UWNY relied on and cited in discovery. Had the surveys been requested, they might have validated UWNY's rationale that labor as a commodity cost will increase independently of any performance award. Similarly, in claiming that UWNY did not show it would lose employees absent an increase in the labor expense allowance, UIU leaves unanswered UWNY's argument that an inadequate allowance will unacceptably impair UWNY's ability to compete for qualified labor even if employees are not literally abandoning the Company.

As for economic impact and the balance of customer and shareholder interests, while we acknowledge the theory seemingly advanced by UIU that economic inequality may raise fairness issues and deter economic growth, UIU has not linked labor expense and economic impact in the manner contemplated in the Commission's policy statement on that subject.[33] Although the Policy Statement cites examples of regulatory determinations that can properly ameliorate customers' rate burdens, the Commission is legally precluded from denying a utility a revenue allowance sufficient under the Hope standard.[34] As the Appellate Division has explained, this means that prudent expenses must be allowed unless they are a type of cost that requires estimation within a range of reasonableness.[35]

Here, however, UIU cites only customer impact without offering other evidence that might discredit UWNY's proposed method of estimation based on market surveys and thereby establish a reasonable lower estimate. In fact, a UWNY witness opined that, all else equal, economic weakness in the service territory might as readily be seen as increasing rather than decreasing the cost UWNY must incur to attract and retain an

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[33] Statement of Policy Concerning Evidence of Economic Impact in Rate Cases (issued January 14, 1980).

[34] Regulated rates are calculated to provide the utility a reasonable opportunity to meet investors' return requirements for a comparably risky investment and thereby attract capital. FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944).

[35] "The [Policy Statement] properly recognizes that economic hardship upon customers may not justify reducing rates below the minimum necessary for a utility to recover its prudently incurred costs, including a reasonable rate of return on its investment [citing Hope, etc.]. . . To be sure, the connection between some economic impact factors and certain components of a rate decision will be self-evident, e.g., revenue forecasts or rate design. On other issues, however, the relationship of such evidence will be remote or nonexistent." Cohalan v. Gioia, 88 A.D.2d 722, 723 (3d Dept. 1982).

effective labor force. Thus, there is no record basis providing the Policy Statement's required nexus between economic impact and a labor expense disallowance.

3. Employee Health and Welfare Expense

To account for increases in employee medical and benefit expense from the historic base year to the rate year, UWNY proposes an allowance 27.69% higher than the base year (representing a compounded annual increase of about 13%). Staff and MC advocate that the Commission continue its practice of including this item in the pool of expenses subject to a generic inflation allowance, thus limiting the increase to 2.26%. We recommend that the Commission adopt half ($76,491) of the disallowance sought by Staff and MC.

The only stated basis for the disallowance proposed by Staff and MC is Staff's observation that the Commission found this type of expense amenable to inclusion in the inflation pool in a 2008 Con Edison electric rate decision.[36] However, that decision and others like it are based on the concept that a utility company can effectively manage numerous unknown future expenses in the aggregate, anticipating that each pooled expense item may to one degree or another be increasing or decreasing, material or immaterial, and controllable or uncontrollable. In such circumstances it is reasonable to conclude that regulated companies should "apply their [rate case] resources more productively to other matters" than trying to isolate and forecast the pooled expenses individually (ibid).

Nonetheless, UWNY realistically may be correct that medical and benefit expense are commonly understood to be evolving into a sui generis cost element because of changes in

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[36] Case 07-E-0523, Consolidated Edison Company of New York, Inc. – Rates, Order Establishing Rates (issued March 25, 2008), p. 43.

the selection and pricing of medical procedures and in the regulatory environment in which medical insurers operate. UWNY also is correct that, if this cost category is indeed increasing at a qualitatively higher rate than other items in the inflation pool, the utilities least able to manage such aberrations would be smaller companies such as UWNY rather than the extremely large company under review in Con Edison.

These considerations argue for accepting UWNY's proposed allowance. On the other hand, the rationale underlying the 2008 Con Edison decision has not become totally inapt, as the costs in question continue to be uniquely unpredictable; they may continue to be managed through the Company's efforts; and they may be offset by unidentified decreases in other items, especially during a period of economic stagnation that can be anticipated in the rate year. Since the inflation pool by its nature represents at best only a judgmental prediction that numerous costs collectively will gravitate around the general inflation rate, it seems equally reasonable to seek only approximate accuracy by relegating half the projected increase to the inflation pool while accepting half of UWNY's unrebutted forecast. We recommend that the Commission adopt this approach provisionally, i.e., subject to reconsideration--or closer investigation of forecasting methods -- in future UWNY rate cases where the evolving regulatory environment for medicine and health insurance presumably will have become more clear.

4. Productivity Adjustment

Staff and MC would disallow 1% of projected labor expense, employee benefits, and payroll taxes, pursuant to the Commission’s usual practice of using that amount as a proxy for achievable reductions in those expenses and others through unidentified or unquantifiable efficiency gains (Tr. 982). UWNY

opposes the adjustment. We recommend that the Commission adopt it.

According to UWNY, a productivity adjustment would ignore that (1) "the Company's performance through five major storm events, including Hurricanes Irene and Sandy, has been exemplary if not herculean" (UWNY IB p. 24; similarly, UWNY RB p. 29); (2) UWNY already has achieved many enumerated productivity gains; (3) UWNY is relatively small, meaning presumably that it must work within a narrower range of potential efficiency opportunities than a larger company; and (4) a general productivity adjustment combined with other, specific labor expense disallowances proposed by the parties would be an improper double count.

We find each of UWNY's arguments unconvincing. As described by UWNY, the Company's achievements in extreme weather events have consisted essentially of maintaining reliable service by virtue of employees' exceptional efforts exceeding the normal demands of the workplace. It does not diminish the employees' dedication to note that severe storms, even if some might subjectively consider them "extraordinary," may be "normal" for the rate year; or, stated another way, revenue requirement forecasts going forward will have to somehow account for climate change relative to conditions that prevailed in the past. To suggest that future conditions will obviate productivity adjustments misjudges the intent and nature of such adjustments. Their purpose is to capture unforeseeable future savings, not to modulate the revenue allowance in reaction to the favorability or unfavorability of the Company's physical environment. And UWNY's argument here, that success in dealing with a hostile environment in the past can take the place of future productivity gains, is even further removed from the

theory of a valid productivity adjustment in prospective rate setting.

UWNY's second point, that the Commission should set rates in recognition of the Company's past achievements, is only a variation on the argument about recent storms. A productivity adjustment is, again, a tool for improving the accuracy of expense forecasts, and not a reward or penalty for past service quality. UWNY's attempted reliance on past efficiency gains is especially tenuous considering Staff's comparison between the Company's testimony here and in the previous case, showing that nearly all the efficiency improvements the Company now invokes were cited in the previous case as well (Staff RB, pp. 4-5). The third point, that UWNY is relatively small, is clearly misguided, since a percentage based productivity adjustment by its nature is proportioned to the Company's labor costs which in turn reflect its size.

The fourth and final issue, whether a productivity adjustment for prospective gains would unjustly double count a labor expense disallowance based on identified productivity savings, is more problematic because of a National Fuel decision cited by UWNY which does reach that result. That decision rejected a generic 1% productivity adjustment on the ground that the Commission was adopting a Staff adjustment of the company's projected headcount.[37] That reasoning, and UWNY's argument here, implies that in some circumstances a 1% disallowance can be so draconian that it eliminates the possibility of net productivity savings exceeding the disallowance itself.

We see no way to reconcile the concern about a double count of foreseeable or accomplished efficiencies, with the

[37] Case 07-G-0141, supra, Order Establishing Rates, p. 10, denying Staff's exception to Recommended Decision issued September 28, 2007, pp. 14-15.

principle that the regulator never can identify all possible productivity gains in advance of the rate year. In fact, as far as we are aware, National Fuel is unique in its treatment of this issue.[38] As Staff argued in National Fuel, rejection of the productivity adjustment because of a supposed double count "is in error. The purpose of Staff's recommended labor complement adjustment is to forecast the complement level in the rate year. That is, it is a specific 'known' item forecasted out into the rate year. The Commission's standard 1% productivity adjustment is to capture unknown and unquantified productivity savings that are not explicitly identified in the rate year."[39] Similarly, the 1% adjustment here is not duplicated either by the proposed rate year headcount disallowances or by the efficiencies asserted by UWNY for historic periods.

5. Incentive Pay

UWNY has incentive pay programs for both union and non-union employees. Two performance award programs -- the Long Term Incentive Plan (LTIP) and Short Term Incentive Plan (STIP) -– exist under which its non-union employees can receive incentive compensation. In contrast to the LTIP program, which is only offered to employees in salary grades 22 through 24, the STIP program is offered to those non-union employees not covered by another incentive plan (Exh. 34, pp. 17, 30). According to Staff, $456,940 of the Company's projected $557,021 rate year incentive pay expense is for the non-union LTIP and STIP programs (Tr. 966; Exh. 89). The approximate $100,000 balance

[38] For a contrary analysis consistent with our recommendation here, see, e.g., Case 10-E-0050, Niagara Mohawk Power Corp. – Rates, Recommended Decision (issued November 17, 2010), pp. 89-92, and Order Establishing Rates (issued January 24, 2011), pp. 29-32.

[39] Case 07-G-0141, supra, Staff's Brief on Exceptions (filed October 17, 2007), p. 14.

is for the union employee incentive program, which Staff is not contesting (Tr. 966).

The STIP is based on financial as well as personal objectives, with the financial objectives determined each year by Suez Environment and United Water's Compensation Advisory Group (Exh. 34, pp. 30-31). The LTIP program concentrates on corporate performance measures including: Return on Capital Employed; Earnings before Interest, Taxes, Depreciation and Amortization; and Net Company results (Exh. 34 pp. 17-18).

Staff and the Company cite the Commission's decision in Case 10-E-0362[40] to support their respective positions, Staff citing it to support denial of UWNY's request for recovery of LTIP and STIP expenses and the Company citing it to support recovery. Both acknowledge that the Commission adopted a two pronged test[41] for determining whether incentive pay can be recovered, noting specifically that recovery is available in circumstances where a utility either: 1) demonstrates a very clear affirmation that the incentive costs are designed to return quantifiable or demonstrable benefits to ratepayers in a financial sense or in terms of reliability, environmental impact, or customer service; or 2) demonstrates that the overall compensation provided to those employees, including incentives, is reasonable relative to similarly situated companies (UWNY IB p. 26; Staff IB pp. 26-27).

The Company maintains that its incentive pay program satisfies both prongs of the Commission's test (UWNY IB p. 26). To illustrate satisfaction of the first prong of the Incentive Pay Test, UWNY claims that it provided exemplary service in five

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[40] Orange and Rockland Utilities, Inc., Order Establishing Rates for Electric Service (issued June 17, 2011).

[41] For ease of reference the two pronged test will be referred to as the Incentive Pay Test.

major storm events, pointing out that it continued to treat and deliver water in the face of a loss of power, significant property damage, flooding, restricted access and significant safety issues, with non-bargaining management sacrificing time with their own families and working for days on end (UWNY IB p. 26). UWNY concludes that its employees' actions during those storms demonstrate the pay structure's benefit to customers. In addition, UWNY states that the Company is one of a select handful of companies to have received the International Standards Organization (ISO) accreditation for the Environmental standard 14001 and the Quality standard 9001 at the Lake DeForest treatment plant (UWNY IB p.26). According to the Company, receipt of that award illustrates outstanding achievement directly related to environmental impact and quality of service requirements, which in turn are employee achievements supported by the Company's incentive pay program. UWNY further states that some elements of incentive compensation are directly tied to achieving the ISO certification (UWNY RB p. 30).

To support its claim to satisfaction of the Incentive Pay Test's second prong, requiring a demonstration that total compensation (including incentive pay) is reasonable in comparison to similarly situated companies, UWNY states that its annual compensation package has base pay and incentive pay components, the latter being a pay for performance provision designed to attract qualified new employees and retain existing qualified staff (UWNY IB p. 27).[42] Incentive pay is important to the Company's workforce efficiency initiative, it says, and efficiency initiative savings are already captured in the reduced expense levels incorporated into the instant rate filing

[42] The management employee compensation is based on compensation surveys that were reviewed and ultimately approved by the Company's Compensation Committee.

(UWNY IB p. 27). UWNY asserts that absent those efficiency gains normalized expense levels would have been higher.

The Company also argues that because the nature of incentive pay is to be pay at risk, incentive pay is not included into salary related benefit calculations (UWNY IB p. 27). And, since fringe benefits are not added on to the incentive pay, ratepayers benefit by the decrease in the Company's overall revenue requirement.

Staff notes, initially, that there is only one UWNY employee currently eligible for LTIP; therefore, most of the rate year funding request is for the STIP program. Staff argues that the program measures are not based on safety, reliability or customer service goals (Exh. 104A, p. 8; Staff IB p. 25). Moreover, Staff contends that the STIP program is exclusively designed to support United Water's business objectives (Staff IB p. 26). In particular, the objectives are defined as:

- Providing an annual incentive strategy that drives performance towards objectives critical to creating shareholder value.
- Offering competitive cash compensation opportunities to all eligible employees.
- Awarding outstanding achievement among employees who can directly impact United Water's results.
- Providing cash awards for both qualitative and quantitative results.
- Providing cash compensation opportunities for making sound business decisions that impact the company's performance and the overall success of SUEZ (Exh. 34 pp 30-34).

Those objectives are intended to enhance shareholder value, not benefit ratepayers, claims Staff.

Staff also rejects UWNY's claim that it provided exemplary service in five major storm events in satisfaction of the customer benefit of the Incentive Pay Test. According to

Staff, there is nothing in the record that demonstrates the employees' performance during the storms would warrant the incentive pay because UWNY did not provide any criteria used (Staff RB p. 6). As a result, Staff contends that the STIP program fails to meet the first prong of the Incentive Pay Test.

Regarding the second prong of the Incentive Pay Test, Staff indicates that as part of its discovery in this case it requested UWNY to provide a compensation study that identifies UWNY's overall compensation levels in comparison to other similarly situated companies (Exh. 34 p. 1; Staff IB p. 27). Staff reports that the Company not only failed to provide any studies, but its response was limited to meeting notes on pay increases (Exh. 34 pp. 10-11; Staff IB p. 27).[43] Staff concludes, therefore, that UWNY has not satisfied either prong of the Incentive Pay Test and that Staff's adjustment removing the LTIP and STIP expense allowance should be accepted.

Although conceding that it did not produce any independent compensation studies, UWNY states that it provided internal compensation analyses with a market survey summary that included projected salary increases for water companies and other public utilities (UWNY RB pp. 30-31).

Discussion and Conclusion

We find that UWNY has not met its obligation under either prong of the Incentive Pay Test. The Commission made it clear that the level of scrutiny required of incentive programs is high, and that it is the Commission's objective to ensure that ratepayers are responsible only for those costs that are

[43] The notes contain a two page summary from a Compensation Advisory Committee Meeting.

reasonably necessary to provide the ratepayers with safe and adequate service.[44]

The LTIP and STIP program documentation offered by the Company for the first prong of the Incentive Pay Test does not demonstrate a clear affirmation that incentive costs are designed to produce quantifiable or demonstrable financial, reliability, environmental or customer service benefits to ratepayers. Although ratepayers might receive some indirect or fallout benefits from non-union employees participating in these programs, ratepayer benefits are not the focus of the LTIP and STIP programs. The primary goals of the programs are geared toward enhancing corporate business objectives. UWNY provided no evidence regarding how program goals would be accomplished. That absence of the objectives demonstration cannot be cured by UWNY's conclusory statements, after the fact, that it managed to continue treating and supplying water during five major storms.

We further find the Company's allegation that the ISO accreditation for the Environmental standard 14001 and the Quality standard 9001 at the Lake DeForest treatment plant fails to satisfy the Incentive Pay Test's first prong provision regarding a very clear affirmative demonstration that incentive costs are designed to return quantifiable or demonstrable financial benefits to customers. Although the accreditation may illustrate outstanding achievement related to environmental impact and quality of service, there is no clear nexus between the LTIP and/or STIP program objectives, the award received and the resulting benefits.

The Company also failed to satisfy the second prong of the Incentive Pay Test. UWNY offered no studies that compare the Company's total compensation plan package (with incentive pay) to other similarly situated utilities to show the

[44] Case 10-E-0362, supra, p. 38.

reasonableness of the UWNY compensation plan. The summary of the Compensation Advisory Committee Meeting notes containing a market survey chart indicating the projected market movement of salaries for certain executive, professional and non-exempt positions, falls woefully short of meeting the Company's burden under the Incentive Pay Test.

The Company's statements that the incentive pay part of compensation packages is needed to attract and retain qualified employees, workforce efficiency initiative savings are already embedded in reduced rate filing expense levels, and there is a ratepayer (and revenue requirement) benefit from incentive pay because there are no salary related fringe benefits factored into incentive pay, are conclusory and unsupported.

We, therefore, recommend that the Commission reject UWNY's request for an allowance for the LTIP and STIP programs.

D. Federal Income Taxes[45]

1. Tax Rates and Related Adjustments

To determine its revenue requirement, UWNY proposed to calculate both current and deferred Federal income tax (FIT) expense on the basis of the consolidated United Water companies' actual 35% FIT rate. Staff would instead use a 34% rate purporting to represent UWNY's hypothetical FIT liability on a stand-alone basis, i.e., disregarding tax deductions and profits and losses other than those properly attributable to UWNY for ratemaking purposes. The Company opposes this treatment on the

[45] At the evidentiary hearing, Staff updated its testimony by withdrawing a proposal to impute a deduction for amortization of Accumulated Deferred Income Taxes (ADIT) for Cost of Removal (COR) incurred by the Company when retiring plant (Tr. 324, 333). Accordingly, in the Appendix accompanying this R.D., the Judges' adjustments to Revenue Requirement Per Staff include a corresponding increase in FIT Expense.

grounds that (1) 35% represents the actual FIT expenses and (2) Staff would impute the 34% rate inconsistently, applying it only in circumstances where it serves to minimizes the revenue requirement but otherwise applying the 35% rate. We recommend that the Commission apply a 34% rate, but also make the associated adjustments advocated by UWNY so as to apply that rate consistently. The net effect of these recommendations is a revenue requirement reduction of $176,521.[46]

In arguing that the "actual" consolidated 35% FIT rate is reasonable for ratemaking purposes, UWNY disregards the Commission's well established principle that the actual FIT rate is inappropriate because its use would not accurately allocate, among the regulated company and its affiliates, the financial costs and benefits of the intercompany affiliations.[47] As Staff correctly observes, UWNY's persistence in filing consolidated FIT returns, despite the Company's full awareness that the Commission's ratemaking policy traditionally disregards the higher consolidated tax rate, demonstrates that shareholders derive other benefits from UWNY's filing method regardless of Commission ratemaking policy and therefore may not reasonably extract a further reward from customers in the form of an expense allowance based on the higher tax rate.

On the other hand, Staff has not shown why it is rational to acknowledge the consolidated return selectively,

[46] As shown in the accompanying Appendix, the FIT rate reduction to 34% decreases the revenue requirement by $286,753; and this decrease is partly offset by a $110,232 increase, because the FIT rate reduction necessitates a $1,149,669 increase in ADIT in rate base.

[47] Tr. 328, citing Case 29432, New York Water Service Corp. – Rates, Opinion No. 87-16 (issued July 17, 1987). As illustrated by the cases cited in that Opinion at pp. 26 and 27, the Commission has followed this practice for at least 40 years.

i.e., assume a consolidated filing only insofar as it tends to diminish the regulated revenue requirement but not insofar as customers would fare better with a stand-alone filing. Thus, Staff had to concede on cross-examination (and, on brief, has not explained or disavowed its concessions) that the hypothetical stand-alone filing imputed for expense purposes also necessitates countervailing rate base ratemaking adjustments.

2. Domestic Production Activities

Staff would reduce UWNY's revenue request by imputing a tax deduction for Domestic Production Activities under 26 USC §199, an Internal Revenue Code provision designed to reward companies for conducting manufacturing and production activities in the United States. UWNY objects on the ground that the United Water companies' consolidated return establishes a net operating loss (NOL) which renders them ineligible for the deduction. We recommend that the Commission adopt Staff's proposal, thereby reducing UWNY's claimed revenue requirement by $982,716. As discussed above, no reason has been offered for carving out exceptions to the Commission's general policy of imputing a stand-alone FIT return. In this context, the assumption of a stand-alone filing eliminates the NOL as a barrier to UWNY's eligibility for the §199 deduction.

E. Outside Services Employed

1. R&I Alliance

R&I Alliance (R&I) is a partnership, established in 2005, consisting of Suez Environment and its subsidiaries or affiliates: Lyonnaise des Eaux, M&S and Aguas de Barcelona in Spain. It operates to select and fund various types of common research projects including water quality and treatment, metering, wastewater and sludge management, asset management and energy efficiency (Tr. 161). R&I is funded through annual

contributions from each of the R&I members. The United Water companies, in turn, contribute funds toward United Water's portion of the cost based on company size. UWNY has been contributing about $270,000 per year toward R&I (Tr. 161).[48]

Staff recommends a rate year R&I expense level of $138,519, resulting from its $153,475 adjustment to the Company's initial rate year level of $291,994 (Tr. 644; Exh. 50). Staff's allowance was determined by escalating the expense level set in the Company's most recent rate case by the rate of inflation (Staff IB p.30). In rebuttal testimony, UWNY proposed setting the rate year expense level at $306,950 (Tr. 234). That amount, however, appears to be based on the witness's misinterpretation of Staff's $153,475 adjustment to mean one-half of $306,950 (Tr. 232, 234). The Company did not advocate the $306,950 funding level in its briefs, instead arguing in favor of its $291,994 proposal (UWNY IB pp. 32-33; UWNY RB p. 33). We recommend adopting the $291,994 allowance in the Company's initial filing.

The parties' dispute centers on whether the Company has substantiated the customer benefits resulting from UWNY's participation in R&I. Staff contends that the benefits from the Company's participation are speculative and unsupported, alleging UWNY failed to provide a cost/benefit analysis supporting its claim that the R&I projects delivered $2.4 million in savings (Tr. 644, Staff IB p. 31). The Company states that the savings were calculated as the difference between the Company engineer's estimate of the cost to install stilling basins at several wells versus the actual cost to install hydrophobic membranes (UWNY IB p. 33). It argues that

[48] According to Staff, United Water's share in the test year was approximately $2.7 million, of which UWNY's share was $298,261 (Tr. 643-644).

absent R&I's research and development of the hydrophobic membranes, the Company would have had no choice but to construct stilling basins which are much more expensive (UWNY RB p. 32). According to UWNY, $2.4 million in savings were generated by constructing the hydrophobic membranes at the Willow Tree and Hempstead wells; and hydrophobic membranes were installed on two other wells (Tr. 232). Staff emphasizes that there were no outside estimates or independent documents provided to support the actual costs or estimate (Staff IB p. 31; Exh. 7).

UWNY points to information it submitted as confidential, which includes a list of the 2012 R&I projects, their budgets and goals (Exh. 6 – Confidential). R&I coordinates a network that provides continuous sharing of research and innovation knowledge gained which, UWNY states, allows it access to a global network of experts in every field related to water and wastewater operations (UWNY IB p. 31). The Company identified a number of research projects that it took advantage of, such as asset life deterioration curves, network leakage monitoring, an assessment tool to measure energy consumption in water operations, software developed for modeling water treatment, management techniques to improve aquifer storage and recovery, and others (UWNY IB pp. 31-32).

According to UWNY, the record substantiates its claim that the approximate $291,994 annual investment in R&I resulted in a $3.75 million R&I investment in projects, producing $4.07 million in direct savings to UWNY (UWNY IB p. 31).

2. Additional Outside Services

Staff also proposes adjustments totaling $48,348 to additional categories of Outside Services employed by the Company (Accounting & Auditing; Legal; Information Services; and, Outside Services – Other) (Exh. 50). UWNY indicated that

it is not contesting those adjustments (Exh. 104B, p.2). Therefore, we adopt Staff's recommendations.

Discussion and Conclusion

We believe that the evidence in the record supports the conclusion that UWNY is receiving significant benefits from its annual contribution to fund R&I projects and that the increase, to $291,994, in the R&I component of outside services is reasonable. Staff does not contest the technological benefits that R&I projects might offer, and did not take issue with any of the projects in the 2012 project list submitted by the Company. The issue is whether UWNY's internal estimates of savings and quantification of benefits is sufficient.

The R&I project innovations have the potential to provide a broad range of improvements in UWNY's operations and quality of service. We recognize, however, that such research projects generally do not provide immediate results. The R&I projects may also have no comparable alternatives. Thus, quantification of savings and benefits from R&I projects may be difficult. And, there could come a point in time where the benefits to UWNY and its customers are outweighed by the cost of the annual contributions made. We, therefore, recommend that the Company be directed to submit annual reports identifying the ongoing and completed R&I projects, the quantifiable and qualitative savings and other benefits produced for UWNY and its customers, and, how the savings and benefits were calculated. This should assist Staff in closely monitoring R&I project developments and ensure that the Company and its ratepayers continue to receive a reasonable amount of benefit from the costs incurred.

F. Uncollectibles Expense

UWNY's forecast of uncollectibles expense is based on the average uncollectibles rate (i.e., net write-offs divided by revenues) for three years ending December 31, 2012. In contrast, Staff bases its forecast on the average rate for the three years ending July 31, 2011. To reflect an expected reduction in uncollectibles as a result of the proposed transition from quarterly to monthly billing, Staff and UWNY agree that either three-year rate should be reduced by subtracting a 0.3% decrement.[49] Similarly, Staff's proposed historic average of 0.645% would be adjusted to 0.345%. After uncontested corrections of UWNY's case, the resulting Staff and Company forecasts are $255,000 versus $347,761 respectively. We recommend that the Commission adopt Staff's forecast.

Staff objects to the three-year period chosen by UWNY because it includes a period when collections fluctuated, and declined overall, following implementation of a new Customer Care and Billing (CC&B) system in August 2011. Staff observes that collections and write-offs were suspended from then until December 2011; and that customer payments collected from December 2011 through 2012 remained erratic and substantially lower than in 2010 and 2011. Staff therefore would move the three-year historic base period back so that it would end in July 2011, just before the CC&B system was instituted. In addition to excluding the CC&B effects, Staff reasons that the earlier period is a "conservative" choice in that it starts in August 2008, and thus incorporates any uncollectibles increase attributable to the start of the recession in 2008 regardless of future economic recovery.

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[49] Thus, UWNY's proposed historic average rate of 0.771% (after corrections) would be adjusted to 0.471% (0.771% minus 0.3%).

UWNY offers no adequate argument against Staff's rationales. The Company says use of the more recent base period would ensure a more realistic forecast because it captures recent effects of intensified collection efforts and water rate increases. However, regarding collection efforts, the Company seems to vacillate between arguing that intensified efforts have minimized the uncollectibles rate historically, and the contrary proposition that they will not minimize uncollectibles prospectively in the rate year.

As for water rate increase effects, Staff's uncollectibles allowance of 0.645% (prior to the 0.3 monthly billing adjustment -- and, a fortiori, the Company's 0.771% -- should fully account for a water rate increase following this case because the 0.645% substantially exceeds the uncollectibles levels experienced in the aftermath of previous water rate increases, at least until the three-year period 2009 through 2011 relied upon by the Company. For those three years overall, uncollectibles sharply increased over previous levels even though their initial spike following the 2011 CC&B implementation was short-lived. While the Company's observation that rate increases drive up bills and uncollectibles is intuitively credible, it explains neither quantitatively nor intuitively the high uncollectibles rate for 2009-2011 and why it was anything but aberrational. To that extent, the historic base period Staff has chosen, designed to exclude the identifiable distortion in the immediate aftermath of CC&B implementation and the seemingly abnormal high levels after that, is preferable to the base period favored by UWNY which would give more weight to the insufficiently explained high uncollectibles from 2009 onward.

G. Production Costs; Purchased Water

The Company's production costs generally comprise costs for water, chemicals, sludge removal, and power, with power representing well more than half the total. For example, UWNY's initial filing forecasted production costs of $5.13 million, including power costs of $3.40 million; Staff's production cost forecast is $5.09 million, including power costs of $3.38 million. On brief, UWNY accepts all of Staff's adjustments (UWNY IB pp. 55-56), except for a technical discrepancy regarding purchased water expense.

To help meet summer demand in the Stony Point area, UWNY obtains a small portion of its supply from the water supply system at the former Letchworth Village state residential institution in Thiells. The Letchworth system uses water from reservoirs in nearby Harriman State Park, for which UWNY pays the Palisades Interstate Park Commission. UWNY forecasted this purchased water expense by estimating a volume equal to a three-year historic average, priced out at the unit cost payable under the Park Commission contract. This methodology is uncontested.

An additional uncontested element of the calculation is that the Park Commission will increase the unit cost in the contract by the same percentage as the base revenue increase authorized by the Public Service Commission in this proceeding. The resulting purchased water expense allowances sponsored by Staff and UWNY are proportional to the base revenue increases advocated by each party respectively. Analogously, our revenue requirement calculations apply the agreed upon methodology by forecasting that the Park Commission contract price will increase proportionally to the base revenue increase in our Recommended Decision. Accordingly, our calculations increase Staff’s proposed purchased water forecast by $5,935, to $196,155. To the extent that this Commission's overall base

revenue allowance differs from our recommendation, the Commission should modify our recommended purchased water allowance accordingly.[50]

H. Inflation Index

This issue has become uncontested. In their respective initial cases regarding a general inflation adjustment applicable to expenses that are not individually forecasted, UWNY proposed an adjustment based on Consumer Price Index (CPI) forecasts in the April 1, 2013 Blue Chip Financial Forecasts, whereas staff advocated using the Gross Domestic Product chain-type price index (GDPCTPI) in the October 10, 2013 Blue Chip Economic Indicators. On brief, no party opposes Staff's position; and UWNY and MC recommend that it be adopted, as do we.

VII. RATE BASE: CONSTRUCTION BUDGET

By the time briefing was completed, UWNY and Staff had resolved their few disagreements regarding items to be included in the rate base investment to which we will apply UWNY's allowed rate of return. Thus, Staff no longer takes issue with UWNY's methodology for developing its capital expenditure forecast (UWNY IB p. 35; Staff IB pp. 35-36); and UWNY has accepted Staff's proposed rate base adjustments related to main replacement and fire hydrant programs, storage tank painting, non-interest-bearing construction work in progress (NIBCWIP), and material and supplies expenditures (UWNY IB pp. 36-37). MC

[50] We agree with Staff and UWNY that this expense item should be subject to reconciliation, and refund or recovery, of any difference between forecast and actual levels. Therefore, the allowance adopted at the conclusion of this case need not exactly equal the actual amounts subsequently paid to the Parks Commission.

likewise is satisfied with Staff's tank painting, NIBCWIP, and material and supplies adjustments (MC IB pp. 21-22).

Consequently the only outstanding rate base controversies arise from MC's contention that UWNY's capital investment program needs a comprehensive overhaul. According to MC, UWNY does not conduct cost/benefit analyses for any of its intended capital projects; and MC alleges that UWNY has neglected mains repair and replacement while pursuing an "unnecessary" desalination project, thus missing an opportunity to reduce losses associated with non-revenue water and mitigate simultaneously both its water supply needs and its revenue requirement (Ibid).[51]

We reserve for a separate discussion ("Management Audit," below) whether, as MC and UIU allege, UWNY's operating deficiencies -- including but not limited to capital planning and budgets -- are so pervasive that they must be addressed by initiating a comprehensive management audit independent of this proceeding. Without prejudging that issue, however, we find that MC's criticisms of UWNY's capital planning decisions are unsupported by the evidence in this case, regardless of what a separate management audit might conclude.

Most critically, to begin, MC's assertion that UWNY's capital project planning involves no cost/benefit analyses grossly misreads the testimony. In the cross-examination on which MC relies, what UWNY's witness said is that *not all* the

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[51] In keeping with the theme that UWNY's plant investment has not been adequately examined, MC adds that Staff's punctiliousness in making a rate base correction in UWNY's favor with regard to tank painting could better have been directed toward minimizing the revenue allowance (MC IB pp. 21-22). We read this as more a rhetorical point than a recommendation, as there is no dispute that Staff's responsibility is to advocate just and reasonable rates rather than take advantage of known errors by an opposing party.

Company's projects undergo a cost-benefit analysis (Tr. 424). That is manifestly different from MC's proposition that *none* of them do (MC IB pp. 9-10).

In view of MC's faulty premise, further discussion of the evidence may be unnecessary. Nevertheless, we note UWNY is correct that its entire prefiled testimony at Tr. 395-411, and the related exhibits, concern the justifications and benefits associated with the Company's proposed plant additions (UWNY RB p. 34). UWNY also is correct that not every project needs a systematic cost benefit analysis.[52] Instead, some plant additions may satisfy relevant standards of reasonableness because they are indispensable for reliability, there is no alternative option, or they offer the least cost solution by design and through competitive bidding.

We do not share UWNY's view that MC's position is inherently untenable insofar as MC complains of excessive capital investment while insisting on more investment in mains. UWNY's witness seemed to concede, albeit ambiguously, that mains expenditures have been deferred to mitigate the financial burdens of the desalination plant (Tr. 414-17), and MC seeks to reverse that policy. Thus, MC is simply advocating a reordering of priorities within the capital budget, as could UWNY or any other party.

The problem however is a lack of evidentiary support for MC's analysis that UWNY has given its customers "the worst of both worlds" by financing a costly desalination plant in preference to investment that would curtail water losses in deteriorating mains (MC IB p. 21). MC errs in presuming, with no quantitative analysis, that accelerated mains investment

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[52] Citing as an example a capital project approved in Case 05-E-1222, New York State Electric and Gas Corporation - Rates, Order Adopting Recommended Decision (issued August 23, 2006), pp. 122-24.

would be both a cost-effective and sufficient alternative to the desalination plant as a means of increasing the available water supply. And it is all the more unlikely that MC's theory could be sustained by evidence, when we consider UWNY's countervailing testimony that system losses controllable through mains repair and replacement are only an insignificant percentage of non-revenue water as compared with the percentage lost through unavoidable Company and fire department activities (Tr. 313-17).

VIII. RATE OF RETURN

A. Return on Equity (ROE)

The Company, Staff and MC testified to a recommended return on common equity for the rate year. The financial experts for UWNY and Staff advocate setting the rate year allowed return on equity at 10.85% and 8.75%, respectively (Tr. 482, 696; UWNY IB pp. 38-39, Staff IB pp. 40-41).[53] UIU and MC did not sponsor independent ROE analyses, instead choosing to critique the Company's and/or Staff's analysis (UIU IB p. 13; MC IB p. 23; MC Reply pp. 16-17). MC proposes that UWNY's authorized ROE be set no higher than 7.93%, MC and UIU noting that the 7.93% ROE earnings ceiling is consistent with a consultant witness's testimony in recent Con Edison rate cases[54] (Tr. 1179; MC IB p. 23). In any event, MC argues that the

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[53] In its rebuttal presentation, the Company proposed a 9.97% ROE level, representing an equal weighting of UWNY witness Ahern's (DCF) and (CAPM) calculations plus a business risk adjustment of 0.25% to reflect the additional risk to UWNY due to its small size relative to the Company's proxy group. Exh. 24 (UWNY Rebuttal Exhibit TJM-5; Schedule 7; UWNY IB p. 46). On brief, however, the Company continues to argue for its original 10.85% calculation as its primary position (UWNY IB pp. 38-39).

[54] Cases 13-E-0030 et al., Consolidated Edison Company of New York, Inc. – Electric, Gas and Steam Rates, Testimony of Basil Copeland, filed May 31, 2013.

Commission has wide latitude to set the ROE within a range of reasonableness and that, given what it characterizes as poor management and economic hardship within the service territory, the ROE should be set at the low end of that range (MC RB p. 16).

Significant differences between the Company and Staff exist in the proxy groups employed and the specific methodology utilized in calculating the ROE. UWNY says that if the Commission decides to adopt Staff's methodology, certain modifications or corrections are warranted (UWNY IB p.39).[55] The parties' respective proposals are discussed in more detail below.

The results of the Company's ROE analysis based on its proxy group are indicated below:

Discounted Cash Flow Model (DCF)	9.02%
Risk Premium Model (RPM)	11.26%
Capital Asset Pricing Model (CAPM)	10.42%
Cost of Equity models applied to Comparable Risk, Non-price Regulated Companies	10.73%
Indicated Common Equity Cost Rate	10.60%
Business Risk Adjustment	0.25
Recommended ROE	10.85%

Staff's ROE conclusions, from application of its ROE analysis to its proxy group, are summarized as follows:

DCF	8.35%
Traditional CAPM	9.21%
Zero Beta CAPM	9.86%

[55] The changes refer to the alleged circularity of Staff's DCF sustainable growth methodology, use of Value Line data to calculate its ROE and without considering Value Line's estimate of the investor-expected ROE, and, equal weighting of DCF and CAPM (UWNY IB pp. 43, 46).

Generic (average) CAPM	9.54%
2/3 DCF, 1/3 CAPM weighting	8.75%
Recommended ROE	8.75%

Staff's calculation utilizes a two-stage DCF and an average of two CAPM methodologies (Staff IB p. 41). UWNY's ROE product is predicated on nine cost of equity analyses, five of which were conducted on the Company's water proxy group and four conducted on a proxy group of 30 non-regulated competitive companies (Tr. 436). To each of these groups it applied the DCF, CAPM and RPM methodologies (Tr. 436). Staff, UIU and MC object to the Company's ROE calculation on the basis that UWNY's cost of capital consultant deviated from the well-established methodology that has been employed in litigated Commission cases and formed the basis for the Commission decisions (Staff IB pp. 41-42; UIU IB p. 12; MC IB p. 22). Although in rebuttal it acknowledged that the Commission has regularly used the 2/3 DCF and 1/3 CAPM weighting supported by the co-facilitators' recommendation in the Generic Finance Case,[56] UWNY claims, as discussed more fully in the DCF section below, that a vast amount of knowledge gained since then indicates use of the 2/3 DCF 1/3 CAPM is no longer appropriate (Tr. 531).[57] UWNY notes further that the Generic Finance Recommended Decision expressly stated that parties would not be precluded from sponsoring new cost methodologies and different weighting (Tr. 530).[58]

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[56] Case 91-M-0509, Proceeding to Consider Financial Regulatory Policies for Utilities, Recommended Decision (issued July 19, 1993), p. 97.

[57] According to Staff, UWNY's DCF and CAPM results reflect a weighting of approximately 26% and 37%, respectively (Staff IB, p. 42). UWNY indicates that they are weighted equally (UWNT IB p. 46).

[58] Case 91-M-0509, supra, Recommended Decision, p.60.

The Company attacks Staff's overall ROE methodology, alleging that it does not produce a fair rate of return on UWNY's investment, in violation of the Supreme Court's mandate,[59] and will impair the Company's ability to attract capital (UWNY IB p. 39). It also notes, by comparison, that the Commission recently authorized ROEs of 9.2% to 9.3% in other recent cases.[60] UIU counters by stating that UWNY is part of a large multi-layered corporate entity that does not raise its own capital but rather receives financing from affiliates (UIU IB p.13). Staff claims that it identified several problems with UWNY's methodologies, adjustments and data -- the Commission having consistently rejected them -- and the Company provided no evidence that its methodology and analyses sufficiently address those shortcomings (Staff IB p. 43).

1. Proxy Group

The Company's rate of return analysis is based on a proxy group consisting of nine water companies. Seven criteria were used in the selection of each company: 1) listed in the water company group in the June 2013 AUS Utility Reports; 2) has 70% or more of its 2012 total operating income derived from regulated water business and 70% or more of its assets devoted to the regulated water operations; 3) not currently involved in or having announced merger plans; 4) has not cut or omitted its common dividends during the five years ending 2012 or through

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[59] 320 U. S. 591, supra.

[60] Cases 13-E-0030 et al., supra, Order Approving Electric, Gas and Steam Rate Plans in Accord with Joint Proposal (issued February 21, 2014); Case 12-E-0201 et al., Niagara Mohawk Power Corporation d/b/a National Grid - Rates, Order Approving Electric and Gas Rate Plans in Accord with Joint Proposal (issued March 15, 2013). UWNY also referenced Case 13-G-0136, a National Fuel Gas Distribution Corporation rate case; however, the Commission has not rendered a final decision in that case.

the time of the preparation of this testimony; 5) has a *Value Line* adjusted beta; 6) has a positive *Value Line* five year dividends per share growth rate projection; and 7) has *Value Line*, Reuters, Zacks or Yahoo! Finance, consensus five-year earnings per share (EPS) growth rate projections (Tr. 449-450). According to UWNY, the nine companies constitute all of the publicly traded water companies (Tr. 502).

Staff used a proxy group consisting of 34 electric utilities and one water company (Tr. 673). Staff notes that since the Company's common equity is not publicly traded, DCF and CAPM data and analysis specific to UWNY is not possible (Tr. 666). Moreover, use of the proxy group's data would be a superior approach even if UWNY specific data existed, Staff says, because analysts' estimates are inaccurate and occasionally biased, and having a large proxy group mitigates the impact of inaccurate estimates (Tr. 666). Staff concludes that if all proxy group members meet the selection criteria, a larger group is beneficial because there is less sensitivity to a single outlier company causing a disparity in the return (Tr. 793). The five features in Staff's selection criteria are: 1) an investment grade rating of at least BBB- by Standard and Poor's Financial Services (S&P) and Baa3 by Moody's Investor Service (Moody's); 2) received at least 70% of its total 2012 revenues from regulated service; 3) currently pays stock dividends; 4) has had no involvement of its assets in merger or acquisition activities during the last 12 months; and, 5) is covered as an electric or water utility by the Value Line Investment Survey (Tr. 668-670).

UWNY contends that it is inappropriate to use 34 electric companies and only one water company for UWNY's proxy group (Tr. 501). Each of the water companies in UWNY's proxy group meets Staff's proxy group selection criteria, UWNY says,

with the exception of the S&P and Moody's credit ratings (Tr. 502). It asserts that Staff's requirement that a utility meet both S&P's and Moody's ratings is overly restrictive since they are generally similar, and requiring both simply ensures that the number of water companies in the proxy group will be limited to only one (Tr. 503). Further, UWNY argues, a proxy group dominated by electric transmission and distribution utilities is inappropriate, because, following the restructuring of the electric industry and divestiture of generation, the T&D companies face much lower risks than do water companies, which continue to be responsible for supplying the water commodity as well as distributing it (UWNY RB p. 38).

According to Staff, the Company's challenge to Staff's use primarily of electric companies in the proxy group is misplaced, because the Commission has recognized the use of a proxy group composed of a broad sample of electric utilities in calculating returns for water companies in the past.[61] Staff maintains that established practice of using the electric proxy groups is still reasonable and should be adopted in this case because it provides transparency to investors (Staff IB pp. 45-46). Staff further asserts that UWNY is incorrect in asserting that all nine companies in UWNY's proxy group would meet Staff's criteria if Staff accepted ratings by either Moody's or S&P; rather, Staff states, only five of the companies in UWNY's proxy group would qualify (Staff RB p. 9).

2. DCF

UWNY claims that Staff's continued reliance on dividend growth and sustainable growth is unnecessary and inappropriate. It asserts that a single-stage constant growth

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[61] Case 88-W-113, New Rochelle Water Company – Rates, Opinion and Order Determining Revenue Requirement (issued April 19, 1989), p. 28.

DCF model should be adopted, because it is most widely used in utility rate regulation in the U.S. and reflects the fact that the public utility industry is stable and mature (UWNY IB p. 42; UWNY RB pp. 41-42). Given that maturity, it says, the industry is not engaged in transitioning from one growth stage to another (Tr. 452). UWNY also claims that the sustainable growth methodology is faulty because it is inherently circular. This, the Company explains, is because the methodology relies on an expected ROE on book common equity, which is used in the DCF analysis to establish the common equity costs rate related to market value of common stocks which, if accepted as the ROE in this case, will become UWNY's book common equity (UWNY IB p. 43). According to the Company, Staff uses Value Line data to calculate its DCF and ignores Value Line estimates of investor expectations, resulting in Staff's ROE based on book-to-common-equity ratio being substantially below investor expectations (8.96% versus 10.04%) (UWNY IB p. 43). The DCF conclusions of Staff need to be revised, the Company says, to correct for these infirmities.

Staff counters the Company's claims, simply pointing out that the two-stage DCF model is the Commission's preferred approach, one that has been revised since first adopted to address changing market conditions (Staff IB p. 49). Staff asserts that the model should produce reliable results whether UWNY is considered to be a mature company with stable growth or whether it is considered vulnerable to significant changes in the near future (Staff RB pp. 11-12). Evidence that the methodology is still reliable exists in the fact that the State's utility companies have either maintained or improved their credit ratings, reports Staff (Staff IB pp. 49-50).

The Company acknowledges that the Commission has altered the Generic Finance Case methodology to address changed

circumstances. It encourages the Commission to modify the 2/3 weighting of the DCF analysis in the ROE calculation, pointing out that the CAPM was adopted when there was little experience with the CAPM, primarily as a check on DCF. With the almost 20 years of knowledge that the Commission has gained in use of the CAPM, the Company insists that there is no reason why DCF and CAPM should not be weighted equally (UWNY IB p. 45; UWNY RB pp. 45-46). It states, furthermore, that the DCF approach tends to produce higher returns than necessary when stocks are selling below book value and lower returns when stocks are selling above book. And, stocks in the water company proxy group have been selling above book value (UWNY IB p. 45; UWNY RB pp. 44-45).

3. CAPM

The CAPM operates under the premise that market or systematic risk cannot be eliminated by diversification and, as a result, investors require compensation. UWNY states that the model is applied by adding a risk-free rate of return to a market risk premium, which is adjusted proportionately to reflect the systematic risk of the individual security relative to the total market as measured by beta (Tr. 474). Moreover, it asserts that because the cost of capital and rate making are forward looking, use of a forecasted risk-free rate in CAPM analysis is appropriate (UWNY IB p.43).

Staff indicates that its CAPM recommendation is the result of averaging a traditional CAPM estimate and a zero beta CAPM (Staff IB p. 56). Staff asserts that its data inputs (risk-free rate and market return) to determine the market risk premium comport with the Commission’s determination that use of the Merrill Lynch forecasted indicator of the S&P 500’s return

on the market is a reasonable method for determining a risk premium (Staff IB p. 56).[62]

UIU takes issue with one component of Staff's CAPM calculation, alleging that the technique Staff used to estimate the market risk premium is no longer viable as evidenced by UIU witness testimony in the recent Con Edison cases.[63] That testimony, it states, revealed that using the Generic Financing approach with a more realistic market risk premium factor produced results indicating that Staff's ROE was 80 basis points higher than necessary (UIU IB p. 13). To support its position, UIU says there is a flaw in the Merrill Lynch assessment of the S&P 500 risk premium, because in the last decade Merrill Lynch's risk premium increased about 700 basis points while the volatility of the S&P 500 declined significantly from late 2008 to 2013. It is illogical, UIU asserts, for the premium to rise while market volatility declines (UIU IB pp. 13-14). UIU also argues that Staff failed to make a downward risk adjustment to account for the lower risk of American Water Works being part of Staff's proxy group. UIU offers Exhibit 105 to support its claim that Merrill Lynch determined that required returns for water companies are less than those required for electric companies (UIU IB p. 14). Staff replies that UIU has improperly compared volatility with market risk, when in fact the two are conceptually different and no particular correlation between them should be expected (Staff RB pp. 9-10). Moreover, Staff asserts that Exhibit 105 improperly measures returns only for utilities rather than the entire market, as should properly be done for this aspect of the CAPM analysis.

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[62] Case 95-G-1034, Central Hudson Gas & Electric Corporation, Opinion and Order Concerning Revenue Requirement and Rate Design (issued October 3, 1996).

[63] 13-E-0030 et al., supra, Testimony of Basil Copeland.

According to the Company, in determining its CAPM analysis, Staff erroneously developed a risk-free rate by averaging the yields of 10- and 30-year U.S. Treasury Bonds, thereby producing incorrect CAPM results (UWNY IB p. 44). It says the 10-year bonds should not be used because their term is inconsistent with the long-term cost of capital to utilities, as measured by the A-rated public utility bond yields. The Company asserts that the current interest rate environment is not typical, because the Federal Reserve is artificially keeping rates low; therefore, it asserts, its use of historical data was a better proxy for investors' expectations of future Treasury yields (UWNY RB pp. 46). The Company asserts that its CAPM is more accurate than Staff's and should be used. And, as noted above, the Company believes the CAPM analysis should carry equal weight with the DCF analysis.

4. Business Risk Adjustment

The Company indicates that its 0.25% business risk adjustment is warranted due to UWNY's small size in comparison to the nine companies in its proxy group. The adjustment was applied after the DCF and CAPM calculations were concluded and weighed equally (UWNY IB p. 46). The basis for the adjustment emanates from UWNY's assessment of the market capitalization of common equity of the proxy group companies, which the Company states is over seven times greater than the estimated market capitalization of UWNY (Tr. 484). It argues that UWNY's smaller size means that it has a greater business risk (Tr. 484). Based on its comparison of the average size premiums in the proxy group companies, UWNY's financial consultant concluded that the 0.25% business risk adjustment is reasonable and conservative (Tr. 485; Exh. 19).

Staff and MC address the Company's business risk adjustment by highlighting the risk of UWNY's parent -- United

Water New Jersey (UWNJ) -- in comparison to Staff's proxy group, and pointing out alleged infirmities in the Company's arguments. They note that a recent S&P report shows UWNJ as having excellent credit and business risk ratings from S&P (Staff IB p. 45; MC IB p. 23). Staff and MC dispute the Company's claim that Staff's proxy group electric companies are less risky than UWNY, with MC noting that Merrill Lynch data also confirms water companies are less risky than gas and electric companies. Staff asserts that, from a revenue per dollar of capital expenditure perspective, UWNY compares to water, electric, and combination gas and electric companies as follows: UWNY - \$0.23, water - \$0.27, electric - \$0.39, and combination gas and electric companies - \$0.47. The analysis, Staff states, indicates that the Company is a lower risk relative to the other companies. Nevertheless, Staff insists that no adjustment was made to the Company's ROE to account for the reduced risk (Staff IB p. 45).

Additional evidence that water companies' risk is lower than that of gas and electric companies can be gleaned from Commission sessions where it is not unusual for Commission to deal with issues of gas explosions and electric stray voltage problems, says UIU. But, Commission discussion at session of dangerous water conditions is rare (UIU IB p. 13).

Discussion and Conclusion

We recommend that the Commission set the allowed ROE level at 9.0%. We reject UWNY's ROE methodology, as well as its water utility proxy group recommendation.

We find no basis for the Commission to shift away from using the Generic Finance Case methodology and weighting of

results to determine the Company's ROE in this case.[64] This approach has been used consistently by the Commission with little to no change since the early 1990s. Recent cases bear out that the Commission continues to rely primarily on the DCF method, and CAPM to a much lesser degree. Several financial experts have testified in prior Commission cases to methodologies and weighting that differ somewhat from that which UWNY is sponsoring in this case. And, similar claims of Generic Finance Case methodology drawbacks have been put forth and been consistently rejected by the Commission. The case that UWNY put in here is no more compelling. As the Company admits, all methodologies have weaknesses.

UWNY presents arguments related to how the investing community would perceive the ROE calculated from continuing to use the various methodologies and weighting results. The Company ignores an important benefit of employing the same methodology for utilities. We believe that the investing community prefers to evaluate New York utilities in light of ROE levels established using a uniform methodology, rather than various ad hoc methodologies presented in individual cases. And, we do not believe from the evidence presented that the Commission should institute a proceeding to consider whether the methodologies in use and weighting applied should be altered.

In recent Con Edison and National Grid rate cases, the Commission adopted 9.2% to 9.3% ROE allowances as reasonable, which contrasts with the testimony of Staff in those cases

[64] Our recommendation obviates a recommendation on UWNY's claims that changes are needed to the Staff supported DCF sustainable growth methodology to address the Company's claim of inherent circularity, use of Value Line data to calculate its ROE without Value Line's estimate of the investor-expected ROE, and, equal weighting of DCF and CAPM.

recommending ROEs of 8.7% and 8.9%, respectively.[65] We note that each of those cases established multi-year rate plans. Multi-year rate plans typically incorporate stay-out premiums which may or may not be specifically identified in the Commission's order. The rate plan before us is for one year. Although the recommended 9.0% ROE could arguably be lower based on the lower risk of UWNY, we believe that it is within a range of results that would be reasonable for this case.

We accept Staff's use of a proxy group consisting of 34 electric companies and one water company. The Commission has had a long-standing practice of using large proxy groups composed primarily of electric utilities. That practice, coupled with its past decisions based on the consistent use of proxy group selection criteria, provides investors with a level of transparency to compare regulated utilities. The Company's proxy group proposal does not. Staff's larger proxy group also mitigates the possibility that an outlier could have a significant impact on the ROE results. In sum, the Company has not persuaded us that the Commission should abandon the practice in favor of the UWNY's proxy group with nine water companies.

The request of UIU and MC that the Company should be allowed to recover from ratepayers the $40,000 costs for the services received from UWNY's ROE expert should be denied. The issue comes down to whether retaining consultants to advocate ROE methodologies and weighting different from the Commission's long-standing practice of using the Generic Finance Case methodology should be considered wasteful and imprudent. We

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[65] Cases 13-E-0030 et al., supra, Testimony of Craig Henry (Tr.200, July 22, 2013); Cases 12-E-0201 & 12-G-0202, Niagara Mohawk Power Corp. (National Grid) — Rates, Order Approving Electric and Gas Rate Plans in Accord With Joint Proposal (March 15, 2013), p. 7 (description of Staff recommendation), Appendix A, Joint Proposal, p 5 (JP provision of 9.3%, "which includes a stay-out premium for the Term").

note that many large utilities in the State have incurred substantial rate case expenses for financial consultant services in sponsoring methodologies and weighting which have been consistently rejected by the Commission. The instant proceeding is no different from the other rate cases, where an extensive record becomes clouded with various ROE methodology recommendations and the criticisms of those recommendations by other parties. Since the Commission has not formally ruled on the ROE methodologies and weighting of results that will apply in rate proceedings going forward, the utilities are not precluded from offering different methodologies and weighting. With respect to the recommendations put forth by UWNY's consultant, we do not find them so outlandish as to characterize the Company's expenditure for the witness' services as imprudent.

5. MC Witness St. Lawrence's Testimony

We note that the Company devoted several pages to briefing which, in sum, challenges the authorization of Mr. St. Lawrence to testify on behalf of MC, and his qualifications as an expert ROE witness. The Company also contends that its cross-examination of Mr. St. Lawrence was improperly restricted, due to limitations we imposed on questioning with respect to a 2012 Office of the New York State Comptroller's (Comptroller) report dealing with the financial activities of the Town of Ramapo (UWNY IB pp. 46-51).

We reject UWNY's assertions for several reasons. First, the prefiled testimony of Mr. St. Lawrence indicated that he was not sponsoring an ROE analysis, but rather simply proposing an earnings ceiling based on testimony provided by Basil Copeland in a recent Con Edison case.[66] Secondly, the

[66] Case 13-E-0030 et al., supra.

Comptroller's report was an analysis of the financial activities of the Town. UWNY's highlighting provisions in the report that it claims questions the witness's oversight of the Town would have had little, if any, probative value with respect to the witness's qualifications to testify as to a reasonable ROE for UWNY. Finally, the cross-examination that the Company was allowed to conduct evidenced the fact that the witness was unqualified to perform an ROE analysis in accordance with the various methodologies available. We have considered Mr. St. Lawrence's testimony but have not adopted his proposals or otherwise relied on his testimony in reaching our ROE recommendation.

B. Capital Structure

UWNY supports using the following capital structure:

Long-term Debt	45.58%
Short-term Debt	2.21%
Customer Deposits	0.07%
Common Equity	52.13%

Both UWNY and Staff acknowledge that the capital structure of SuezE, UWNY's ultimate corporate parent, is unsuitable for setting rates in this case (Tr. 501; Staff IB p. 62). The Company's proposed capital structure is assertedly based upon the consolidated capital structure of UWNY's corporate parent, United Water New Jersey, Inc. (UWNJ), which the Company says has been consistently used to set UWNY's rates in previous cases (Tr. 434; Exh. 19, PMA-1 p. 1).[67] Staff claims, however, that the last time the Commission used the Company parent's capital structure in setting rates in a

[67] UWNY is a wholly owned subsidiary of UWNJ, and UWNJ is wholly owned by United Water Resources, Inc. (United Water). Thus, UWNY common stock is not publicly traded (Tr. 449).

litigated case was 1993.[68] And, Staff says, the corporate structure under which UWNY and UWNJ operate has changed drastically since UWNJ's capital structure was last used in setting rates.

According to Staff, the Company's use of its parent's capital structure also may not reflect the actual common equity employed by the parent, or rational capitalization policies, and can result in a circumstance in which ratepayers pay increased rates based on higher equity ratios than warranted (Tr. 682). Examples where this might occur, Staff says, include a "double leverage" circumstance where the corporate parent finances the subsidiary's common equity with proceeds from debt issued by the parent, or when the financial strength of the subsidiary is used to subsidize financing of more risky non-utility operations (Tr. 682-683; Staff IB p. 65). It suggests that UWNY (or UWNJ) ratepayers might effectively subsidize the parent corporation's riskier non-regulated investments because there are no strong corporate mechanisms in place to protect the capital structure and financial standing of UWNY and UWNJ (Tr. 683-684).

UWNY answers Staff's concerns by stating that not only would reflecting double leveraging in setting rates be discriminatory because it singles out a sole corporate shareholder, application of double leveraging ignores the risk to which the common equity investment in a subsidiary's rate base is exposed, and, the overall rate of return established in this case will only be applied to UWNY's rate base (Tr. 522). Thus, the Company should be viewed on its own merits, it says, regardless whether the source of its capital is UWNJ or corporate grandparents (Tr. 559).

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[68] Case 92-W-0645, Spring Valley Water Company, Inc. - Rates, Opinion No. 93-3 (issued May 25, 1993).

Staff says that since credit rating agencies base utility credit ratings on the parent company's (UWNJ) capital structure there is no benefit to setting a higher equity level and requiring ratepayers cover the associated higher costs, because the utility will not receive a higher credit rating and reduced borrowing costs (Staff IB p. 65).

Staff's hypothetical capital structure,[69] which MC endorses, based upon the reported data for the 34 electric companies and one water company in its proxy group (Staff IB pp. 40-41; MC IB p.25) is as follows:

Debt	55.91%
Customer Deposits	0.09%
Common Equity	44.00%

Staff reports that the Commission has used hypothetical structures in past cases where the common equity ratio of the corporate parent was uncharacteristic of the regulated subsidiary's risk (Tr. 687). The common equity component reflects the proxy group's equity ratio after factoring in a subsidiary adjustment, arriving at 43.69%, which was rounded up to 44.00% (Staff IB p. 63). Applying a subsidiary adjustment is consistent with Commission practice, Staff says, the procedure being designed to remove the effects of unregulated operations on the proxy group's capitalization and ensure that the non-regulated company receives adequate funding (Tr. 689). It concludes that applying the subsidiary adjustment to the proxy group's data removes the capitalization that supports the non-regulated operations, thus making those companies more comparable to UWNY and its risks as a pure utility operation.

UWNY criticizes Staff's recommended 44% equity ratio, succinctly stating that it is significantly below the 50.88%

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[69] Exh. 52 (CCP-1), Schedule 1.

total equity average of the Company's proxy group, 3% lower than the median equity ratio in Staff's proxy group and, well below the 48% common equity level recommended by Staff for other companies in recent cases (UWNY IB pp. 51-52).[70] The Company cites to a statement of the Department of Public Service staff in an unrelated case for the proposition that it is recent Commission policy to require utilities to carry less debt, and that reducing debt decreases the utility's risk.[71] It complains that Staff inexplicably supports a hypothetical capital structure with a significantly lower equity level than exists for the companies in Staff's proxy group or other water companies (UWNY IB p. 52). And, not only is Staff's recommended structure at odds with the stand-alone nature of the cost of capital, the Company argues, but it is inconsistent with prior Commission determinations for UWNY (Tr. 501-502). Moreover, UWNY argues that it experiences higher investment and business risks than do the companies in Staff's proxy group, due to a) the lower depreciation rates experienced by water companies, b) its small size, which means it can be disproportionately hurt by the loss of a large customer, and c) the risks of weather or other threats to its aquifer, among other factors. (UWNY RB p. 50). Given these higher risks, it is logical to have more equity in the capital structure, the Company asserts (Id).

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[70] Cases 13-E-0030 et al., supra.; Case 12-E-0201, supra; and, Cases 12-E-0201 and 12-G-0202, Niagara Mohawk Power Corp. d/b/a National Grid – Rates, Order Approving Electric and Gas Rate Plans in Accord with Joint Proposal (issued March 15, 2013).

[71] Case 12-G-0544, Brooklyn Union Gas Co. d/b/a National Grid NY – Rates, Staff Statement in Support of the Joint Proposal (filed March 15, 2013).

Discussion and Conclusion

We recommend that that the Commission set a 46% equity ratio for the Company. This level represents an increase over the 45% equity level that was adopted by the Commission for the three-year rate plan in the Company's most recent case.[72] We are concerned about UWNY's claim that the UWNJ capital structure has been consistently used to set UWNY's rates in previous cases. If true, the Company did not adequately explain what caused the drastic increase in UWNJ's equity level, from 45% to 52.13%, since UWNY's last case.

We do not agree with Staff that the Company's equity level should be 44%. The Commission has the discretion to adjust the allowed capital structure for rate setting purposes to ensure the reasonableness of rates. And, we recognize that the Commission has expressed an interest in having utilities carry less debt in appropriate circumstances. We believe that our 46% equity level recommendation offers some measure of balance between the Commission's interest in having utilities carry less debt and the fact that UWNY, as wholly owned subsidiary of UWNJ, has no actual stand-alone capital structure. As the Company points out, UWNY must be considered on its own merits, regardless of the source of its capital (Tr. 514). Although this equity ratio may be slightly below the median threshold for Staff's proxy group, the proxy group is almost exclusively composed of electric companies which we generally consider to be more risky than the large water companies. Thus, the electric proxy group companies would tend to warrant having higher equity ratios.

[72] Case 09-W-0731, supra, Order Adopting Joint Proposal as Modified and Establishing a Three-Year Rate Plan, Attachment, p. 5.

Staff raises legitimate concerns about whether using a corporate parent's capital structure reflect the parent's actual common equity level, due to circumstances such as the double leveraging in which a corporate parent finances a subsidiary's common equity with proceeds from debt, or using the subsidiary to subsidize financing of more risky non-utility operations. These issues are not new to the Commission. Certainly, it would be a basis for inquiry, particularly with the 52.13% common equity recommendation that UWNY is advocating. But, there was no evidence presented in this case to indicate such practices are taking place and involve UWNY or UWNJ. Obviously the Commission and Staff will need to remain attentive to these concerns and initiate appropriate inquiries, as necessary.

The ROE level established by the Commission in other cases is frequently offered to support an ROE level in a pending proceeding. This case is no different as indicated by the Company's reference to the ROE levels set by the Commission in the recent Con Edison and National Grid rate cases. Obviously, the Commission's ROE determinations are not binding as to this case, but they may be informative of whether the recommended ROE in a pending case is within a range of reasonable results. We believe that our recommendation herein is comparable to the ROE levels adopted by the Commission in the Con Edison and National Grid cases given that our recommendation is not adjusted upward to account for the additional risk that a utility may be subject to in a multi-year rate plan. Multi-year rate plans traditionally incorporate stay-out premiums that may or may not be specifically identified in the Commission's order.

C. Cost of Debt

Initially, the Company's witness proposed that the cost of long-term debt be set at 5.08% based on a pro forma capital structure of UWNJ (Tr. 434). Staff adjusted this

proposal slightly, resulting in a rate year forecast cost of long-term debt of 5.05% (Exh. 63, Schedule 7). The Company reflected the Staff adjustment in its rebuttal presentation (Exh. 24, Schedule 7) and did not brief the issue, from which we conclude that it has accepted the Staff adjustment and that no further issue remains between the parties regarding the cost of long-term debt. Staff notes, however, that UWNY plans a private placement issuance of $45 million, which has not yet occurred (Staff IB pp. 66-67; Exh. 62 p. 1). We agree with the Staff recommendation that, should this issuance occur before the Commission decision in this case, the cost of debt be updated to reflect the actual cost of the new debt issued.

IX. REVENUE ALLOCATION AND RATE DESIGN

A. Cost of Service Study

Several parties to the case complain about UWNY's presentation of and reliance upon a 1991 cost of service study in its rate filing. UIU objects to any reliance upon the study, arguing that it is much too out of date, and appears to seek a Commission order requiring the study, including workpapers, and a report explaining rate design as part of the next filing (UIU IB pp. 16-17). Staff, supported by MC, relies upon the study as the basis of its revenue allocation recommendations and its rate design for meter charges, stating that reliance upon the study is reasonable in the absence of a more recent study (Staff IB pp. 72-74; MC RB p. 21). Both Staff and MC assert, however, that the Company should update the study before its next rate filing. UWNY replies that it fully intends to conduct a new study, but asserts that its statutory right to file for a rate increase cannot be infringed if it cannot complete the study before its next rate filing. In the event that the study is not

complete in time, the 1991 study will continue to be a relevant guidance document, the Company says.

We do not agree that a Commission order requiring a new cost of service study would infringe upon the Company's statutory right to file for new rates. UWNY is a sophisticated utility, part of a large international conglomerate, and has operated under Commission regulation for decades. It is well aware of regulatory requirements and the fact that it bears the burden of proof in any case examining a rate request to show that any requested increase is necessary and reasonable.[73] If a rate filing is so inadequately supported that it becomes impossible to design rates to meet a revenue requirement, the Company runs considerable risk that its request will be rejected for a failure to meet the burden of proof and otherwise to comply with Commission regulatory requirements. Therefore, we believe the Commission should feel free to impose such a requirement as a condition for the next rate filing by the Company.

B. Revenue Allocation

Staff proposed a revenue allocation shift to align its proposed rate increase more closely with the revenue allocation results of the 1991 cost of service study. As it explains in its initial brief, Staff did not fully realign revenues to correspond to the cost of service study, but rather moved some of the revenue shifts only partway, in order to avoid too drastic a change for any one service classification (Staff IB pp. 73-74). As discussed below with respect to the rate design changes to move more costs to fixed charges, this gradual shift is particularly important in a case such as this one, where rates are being set for a year on a litigated record, and there

[73] 16 NYCRR Part 61.

are limited opportunities to phase in change over a multi-year period. Staff's revenue allocation proposals are set forth at Exhibit 78. Staff's revenue allocation proposals are supported by the Municipal Consortium (MC RB p. 21).

We assume from the Company's lack of response to the Staff proposal in either its initial or reply brief that the Company does not object to Staff's proposed revenue allocation. We agree that Staff has followed a standard methodology, and Staff has further set forth its rationale for reliance upon the 1991 cost of service study. Given the reasonableness of Staff's proposals and the lack of any objection from the Company or any other party, Staff's revenue allocation proposal should be adopted.

C. Rate Design

1. Meter Charges

Both Staff and the Company propose to move from a customer charge to a meter charge based on the size of the customer's meter (Staff IB pp. 75-76; UWNY IB p. 59). They employ slightly different methodologies, although each party concedes that the other's method is reasonable and could be used (Id). The Company's method, based upon American Water Works Association data, results in a greater shift of revenue from volumetric to fixed components -- from the current 13% of revenue from fixed charges to 30%, according to the Company -- whereas Staff's method, based upon the 1991 cost of service study, is a less dramatic shift that results in 15% of revenue from fixed charges, according to the Company, including 19% of revenue from fixed charges attributable to the residential class, according to Staff (UWNY IB p. 59; Staff IB p. 77; Staff RB p. 13).

UWNY asserts its method is preferable because the greater fixed revenue provides it with greater revenue

stability; it also asserts this shift responds to concerns expressed by Staff in the prior rate case (UWNY IB p. 59). Staff, in turn, argues that its method is preferable because it results in a less dramatic change to customers, while still increasing the percentage of fixed revenue (Staff IB p. 76). Also, Staff says, the resulting meter charges are comparable to those established for other water companies in the state (Id). MC supports the Staff proposal, asserting that the Company's proposal moves too far too fast (MC RB p. 22). UIU objects to the changes proposed by Staff and the Company and argues instead that more revenue should be recovered from volumetric charges, as a conservation measure (UIU IB p. 18).

We recommend the Staff proposal be adopted here. It makes the Company's desired change to a meter charge and moves slightly toward increasing the percentage of revenue attributable to fixed charges. We agree this design is consistent with classic rate setting principles of matching rates to costs and provides an appropriate level of revenue stability to the Company. At the same time, it avoids any dramatic impacts on individual customers, such as those that might result under the Company's proposal. This result seems most appropriate for rates being set in the absence of a multi-year plan, where some sort of phase-in of higher fixed charges might be accomplished. In future cases, if supported by an up-to-date cost of service study, the Company will be free to argue for further shifts of revenue toward fixed components.

2. Inclining Block Rate and the Non-Residential Discount Block

Currently, the Company's rate structure features inclining block rates, with the exception of a discount tail block for the SC-7 non-residential class. The Company proposes to eliminate the inclining block structure and instead to create

a single block rate based on the current higher second block, while Staff proposes to maintain the inclining block structure and to eliminate the SC-7 discount (UWNY IB p. 58; Staff IB p. 75). Staff asserts that retention of the inclining blocks and elimination of the discount are both motivated by a desire to promote conservation (Staff IB p. 75). MC supports the Staff proposals as consistent with its goal of establishing a conservation rate (MC RB p. 22). UIU similarly supports retention of the inclining block structure as a conservation measure (UIU IB p. 18).

On brief, UWNY does not continue to advocate for the change from its inclining block structure. Instead, it limits its objections to the proposals to eliminate the SC-7 discount. The Company argues that the SC-7 customers are "constant use" customers who have little ability to reduce their usage (UWNY IB p. 60). UWNY cites the example of a brewery, which, it says, must use a certain quantity of water in its beer-making operations (UWNY RB p. 55). It argues that retention of the discount is an important measure to preserve jobs and promote economic development in its service territory (UWNY IB p. 60; UWNY RB p. 55).

We recommend retention of the inclining block rate structure and elimination of the SC-7 discount block, as proposed by Staff and the intervenor parties. The discount tail block rate structure is inherently inconsistent with the goal of providing incentives to customers to conserve their water usage. Perhaps in the short run UWNY is correct that the SC-7 customers have no ability to constrain their water use, but over a longer time horizon some of them may be able to react to price signals to invest in more efficient technologies or processes requiring less water usage. In an era of concern about the effects of climate change due to emissions of greenhouse gases, all efforts

to promote conservation of resources, including constraining the use of water that requires electricity for its delivery, should be pursued. It is true that this case does not address the issues of UWNY's potential need to develop a new long-term water supply. Nevertheless, the pendency of that issue lends further urgency to the elimination of a discount tail block rate for any customer group.

D. Tariff Changes

UWNY proposed several changes to its tariffs which, in general, are minor housekeeping changes that are not opposed by any party. These changes, set forth in Exhibits 13 and 14, should be adopted, except as noted below. First, the Company's initial proposal regarding tariff leaf numbers 22 and 24, addressing the installation of meter pits on customer property, should be modified to reflect the stipulation reached between Staff and the Company, to which the other parties do not object. The stipulation with respect to meter pits is set forth as Exhibit 96, which is hereby attached and made an Appendix to this Recommended Decision.

Second, Staff does object to the Company's proposal to change tariff leaf 39.1, regarding termination of service. This issue is discussed below ("Termination of Service"). As noted there, we agree with Staff that the Company's proposal should not be adopted.

X. CUSTOMER SERVICE ISSUES

A. Monthly Billing

UWNY proposes to institute monthly billing for all customers, most of whom are now billed quarterly. The proposal itself is uncontroversial, as it is supported by Staff and MC and not opposed by any party. We recommend its adoption for the reasons cited by its supporters: that it would conform UWNY's

practice to those of New York's other large utilities and would tend to facilitate budget billing plans, accelerate investigations and resolution of billing errors and complaints, reduce customers' arrears and the Company's working capital requirements, identify abandoned properties more promptly, encourage effective and timely communication between UWNY and its customers, and provide customers more effective price signals to guide their discretionary water consumption (See, e.g., Tr. 186-90, 227, 843-44).

We also recommend the transitional steps advocated by Staff and, likewise, unopposed. That is, UWNY should provide customers at least 90 days' advance notice of the change, by means of a bill insert in their last quarterly bill preceding the commencement of monthly billing; a press release 30 days before implementation of monthly billing; and prominent disclosure of explanatory information on UWNY's website and through social media outlets starting at least 90 days in advance.

Although there is no controversy over the monthly billing proposal itself or the associated transitional measures, we mention them here for informational purposes. First, the Commission of course should be aware that the unopposed tariff provisions in UWNY's filing include this significant change. Second, monthly billing is part of the context in which controversies have arisen regarding indirectly related issues discussed elsewhere in our recommended decision, notably UWNY's staffing needs, the cost of its outreach programs, and the expected complaint levels that might affect earnings under Staff's proposed Customer Service Performance Incentive mechanism.

B. Outreach & Education

UWNY proposes to increase its $271,250 base year outreach and education budget by $43,600 (16%), to $314,850 for the rate year. Staff would allow only a $28,750 (11%) increase, to $300,000. The other parties take no position. We recommend that the Commission approve Staff's proposed allowance.

Staff generally endorses UWNY's outreach activities, but would deny part of the proposed budget increase on the ground that in the past the Company consistently has underspent its outreach budgets and used the excess revenue allowance for unrelated purposes. Staff therefore has derived a proposed $300,000 budget by combining a forecast based on past years' actual expenditures plus an increment specifically for informational outreach regarding the transition to monthly billing. The resulting allowance would exceed actual base year expenditures by $61,129 (23%).

MC finds the issue "difficult ... because UWNY's public relations campaign for the desal[ination] plant has antagonized the community" (MC IB p. 27). UWNY, for its part, cites the ambitious scope of its outreach and education efforts in the past, and explains that the proposed budget increase reflects the Company's intention to expand its educational activities regarding water (quality, conservation, etc.), school partnerships, and other community involvement. Based on those justifications, UWNY concludes that its budget presentation is "superior" to Staff's insofar as Staff allegedly has offered no opposing rationale (UWNY IB p. 63).

We disagree with UWNY's characterization of the record. Doubtless the Company is correct that it could spend the additional amounts it seeks, by expanding its programs in the directions it has described. However, Staff has sustained its own burden of persuasion by showing that UWNY's outreach

budgets systematically overstate the Company's actual needs. UWNY has neither addressed that criticism, nor shown why a 23% increase over the base period will not suffice to support UWNY's proposed new outreach activities. We are somewhat concerned that our recommendation might cultivate a "spend it or lose it" attitude on UWNY's part when the Company is presented with Commission allowed budgets in the future; but that result would be more amenable to monitoring, and ratemaking remedies if necessary, than continued excesses of allowances over actual expenditures as in the past.

C. Customer Service Performance Incentive

Staff proposes a Customer Service Performance Incentive (CSPI) mechanism which would disallow a portion of UWNY's allowed return on common equity should the Company fail to satisfy various performance targets. MC and UIU support the Staff proposals and UWNY opposes them. We recommend that the Commission adopt Staff's plan, but only after a one-year delay to better ensure that the results will not be systematically biased against the Company. Thus, under our recommendation, any equity return adjustment indicated by Staff's proposed CSPI calculations would initially be implemented in 2016 on the basis of calendar 2015 data.

1. Necessity and Legality

Aside from UWNY's objections (discussed below) regarding specific features of the CSPI mechanism, the Company's main argument in opposition is that the plan is unnecessary and unlawful. We find both these contentions unpersuasive.

On the question of necessity, UWNY's position seems misconceived in two respects. First, the Company seeks to defend its current levels of service quality and customer satisfaction with empirical evidence. This includes results of

its most recent Customer Satisfaction Survey, conducted annually through 2012, showing that 83% of respondents were satisfied with overall customer service and field performance and 84% would recommend UWNY service if it were offered as a choice. The Company reports what it deems a favorable complaint rate of 0.056 per 1000 customers per month for January 2009 to August 2011. It claims that it has maintained a creditable degree of reliability even during extraordinary weather conditions. The Company cites its new Customer Information System as a source of "enhancements in all aspects of Customer Relationship Management," and notes that it already is launching new service initiatives and reviewing indicia of service quality. UWNY enumerates these measures as follows: "1) implementation of a new customer contact and billing system that will help the Company identify billing errors sooner in the process; 2) call center statistics are tracked daily and in 2013, on average, customers have waited to speak to a representative for less than 60 seconds; 3) self service functions have been added to the website and telephone system which customers can access 24 hours a day, 7 days a week to check their balance, pay bills, enter meter reads, and schedule meter change appointments; 4) Western Union fees are waived for customers in good standing; and 5) customers in need may receive assistance from the Company's United Water Cares program" (UWNY IB p. 65, citing Tr. 230).

One difficulty in UWNY's presentation is that we cannot tell whether the new initiatives cited are having any impact on relevant measures of performance or customer satisfaction, possibly because they fall within the range of routine performance levels for a utility company or because customers perceive them as such. UWNY does not attempt to show a causal connection between its service quality efforts and the objective results mentioned such as complaint rates and survey

responses, nor does the Company even explain the timing of its efforts in relation to the results.

In addition, the results themselves lack the reliability needed for evidence-based decision making by the Commission. For example, UWNY does not show why the complaint rate of "only" 0.056 should be considered favorable, or why the period in which it occurred (32 months ending August 2011) is more relevant than other possible periods or trends within a time period. Regarding the Customer Satisfaction Survey with the 83%/84% favorable response rates, UIU claims that UWNY could not explain why the formerly annual survey did not occur in 2012, and MC would have us draw an inference that UWNY discontinued it because the Company's customer relations have become so abysmal that the Company would have been embarrassed by more recent survey results.

UIU’s and MC’s speculation on that point is unhelpful because UWNY has in fact offered an explanation for the absence of a 2012 survey, in response to an information request during cross-examination. UWNY says it postponed the 2012 survey to 2013 to avoid distortions that might have resulted from adoption of a new customer service system in late 2011.[74] Moreover, by MC's own admission, UWNY's public relations problems may result in large part from the desalination project, which is not a relevant measure of the quality of individual customer transactions. However, we do agree with UIU that the survey results are at least suspect because they are not current and

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[74] UWNY RB p. 7, citing UWNY RB App. 1, which is a copy of the Company’s response to an interrogatory during prehearing discovery. UWNY asks that the appendix be entered as an exhibit. Because UWNY could not reasonably have offered the exhibit before reply briefs, parties may address its status and contents on exceptions, and its disposition if necessary should be deferred until the Commission’s order concluding this proceeding. The same is true of UWNY App. 4.

because the respondents are a self-selected group comprising only those customers motivated by bill inserts inviting them to respond.

Meanwhile, Staff offers competing empirical data in support of its proposals, tending to rebut UWNY's portrayal of customer relations by illustrating a persistent deterioration in service quality as measured by customer complaints. According to Staff's undisputed data, the 12 month rolling average of UWNY's monthly Escalated PSC Complaint Rate through a base period ending August 2013 was 4.6, as compared with 3.1, 2.5, and 1.9 for 2012, 2011, and 2010 respectively (Tr. 848). Staff cites this continuing decline as one of the reasons for its decision to introduce the CSPI mechanism now, and to that extent Staff has refuted UWNY's assertions that the mechanism is superfluous.

An additional concern prompted by the arguments about the need for a service quality incentive is that they raise but ignore an unstated question how, if UWNY already is performing adequately, the introduction of a CSPI mechanism would prejudice the Company's legitimate interests. If the mechanism is properly designed, which of course is a question to be considered in this case and revisited as necessary in the future, the only incremental business risk resulting from its adoption is that the Company may fail to maintain adequate service quality as defined by the CSPI metrics. However, that risk remains within the Company's control, and shareholders therefore have no right to be insulated against it or to be compensated for it through an equity return allowance.

Finally, one must remember that Staff's proposals challenge UWNY to show that it needs no CSPI mechanism notwithstanding that the Commission has found similar measures necessary for all New York's major gas and electric utilities,

the former New York Water Service Company, Corning Natural Gas Corp., and St. Lawrence Gas Company. We are not suggesting that the Commission policy's near universality, without more, establishes irrebuttably that the same policy would be valid as applied to UWNY. However, it does obligate UWNY to show that the other utilities' performance or circumstances differ materially from UWNY's own. Yet the Company has made no effort to draw such comparisons. Moreover, we agree with UIU that the prevalence of performance mechanisms among New York's other utilities represents a generic determination by the Commission that the weakness of a monopoly's intrinsic economic incentives to provide good service is a market failure, requiring remediation through regulatory intervention.

Turning from the question of need to that of the CSPI mechanism's legality, UWNY argues that the mechanism would exceed the Commission's authority because it would operate as a penalty by potentially disallowing a portion of the authorized equity return if the Company missed the prescribed targets. In UWNY's view, the proponents' characterization of the mechanism as an "incentive" is deliberate misdirection, i.e., a studied refusal to call a "penalty" by its real name or to recognize that the CSPI mechanism offers no upside earnings potential as a reward for good service. UWNY suggests that the Commission's entire statewide practice of applying such mechanisms is imperiled by the possibility that UWNY or any utility might direct the courts' attention to the program's allegedly ultra vires character, especially in this case where its adoption would not be pursuant to a company's consent as part of a negotiated joint proposal.

UWNY’s assessment of litigation risk is not an element of our analysis, whether or not MC is correct that the Company is engaging in empty threats. However, UWNY's claims that an

incentive is a misnomer for a penalty, and that the imposition of penalties exceeds the Commission's jurisdiction, fails to address the jurisdictional implications of the penalty authority recently conferred on the Commission by PSL §25-a.[75] Furthermore, UWNY's argument reflects a misconception of the ratemaking process under the PSL. As Staff correctly observes, the allowed equity return is a component of a revenue allowance calculated to establish just and reasonable rates, i.e., to provide UWNY a reasonable opportunity of earning a return that will recover its cost of capital. In exchange for a rate allowance thus determined, UWNY is expected to provide safe and adequate service. Since safe and adequate service is not an either/or proposition but a matter of degree, it is just and reasonable that substandard service will justify only a lower return allowance than good service. Regardless of whether one chooses to describe the return differential as a penalty, the reality is that a downward adjustment pursuant to the CSPI mechanism will not in fact penalize shareholders: they still will be allowed the entirety of whatever return may be just and reasonable in the event of a measured degradation in service quality.

2. PSC Complaint Rate Target

The CSPI mechanism as designed by Staff would apply two metrics: a PSC complaint rate target, and (as discussed in the section following this one) a customer satisfaction survey target. Each component would operate by adopting an adjusted historic baseline as a starting point, and then reducing the allowed common equity return in a series of steps calibrated to the extent of any shortfall in actual annual results relative to the baseline. In the case of the PSC complaint rate component,

[75] On exceptions, the record might benefit from a discussion of this statute, which none of the parties has cited.

the adjusted historic baseline would be a rate of 5.3 complaints per 100,000 customers. This target is derived from an actual historic rate of 3.025,[76] augmented by 2.32 as a safety margin for the Company, for a total of 5.34 which would be rounded to 5.3.

A matter of some significance in the arguments about the CSPI is that the proposed 2.32 deadband represents two standard deviations (SDs), of 1.16 each, from the initial 3.025 baseline. An SD is a measure of variability in a statistical population such that the two-SD buffer as applied here would ensure, at a 95% confidence level, that the proposed metric would capture only the effects of systemic causes related to the complaint process and not be influenced by statistically random variations.

Starting from the adjusted baseline rate of 5.3, UWNY would be subject to an incremental disallowance of five basis points (bp) of equity return for each of three possible increases in the PSC complaint rate, up to a total of 15 bp. Specifically, the disallowance would be a total of five bp if the rate reached the adjusted historic 5.3; 10 bp if the rate exceeded 6.5; and 15 bp if the rate exceeded 7.7. The customer satisfaction survey metric likewise would create the possibility of a 15 bp disallowance, for a total of 30 bp at risk under the CSPI mechanism's two components. Assuming the 9.0% equity return allowance and the other revenue requirement components recommended herein, the potential maximum disallowance of 30 bp equates to $629,903 in revenues.

One of UWNY's main objections to this formula, in cross-examination and on brief, is that the mechanism would take into account "escalated complaints." These are customer

[76] The average of four 12-month rolling averages as of August 2010, 2011, 2012, and 2013 (Exh. 82).

complaints to the PSC that survive a discretionary triage in which customer communications are allowed to advance through the PSC review process only if Staff of the Commission's Office of Consumer Services (OCS) determines that they are true "complaints" about UWNY actions regarding a customer or account, as opposed to mere "opinions" such as a customer's general dissatisfaction with UWNY's rates and practices authorized in Commission approved tariffs. According to UWNY, such exercises of OCS staff's discretion create a problem of potential overinclusiveness, whereby the Company might incur an equity disallowance because of customers' dissatisfaction with tariff provisions. This criticism has further devolved into several subsidiary issues regarding the complaint handling process.

For one thing, Staff offered an observation, initially during cross-examination rather than in prefiled testimony, that 80% of escalated complaints result from contacts between UWNY and customers in which the Company's communications are poor, untimely, or both. This led to a request on the record in which UWNY sought substantiating data, a request Staff proved unable to fulfill completely because the Department's "TRAC" system for logging complaints retains only the most recent 24 months' data. UWNY therefore turned to its own records, through which the Company attempts to show that only a minor fraction of escalated complaints can be attributed to any customer relations problem other than UWNY's legitimate adherence to its tariffs. A second related issue is that Staff on cross-examination could not point to any provision in the Department's guidance documents that expressly grants OCS staff discretion to select true complaints for further processing after culling out mere opinions, even though the witness insisted that this is an established, unwritten policy. Third, UWNY sees a due process issue in the fact that all escalated complaints would be counted for purposes

of the CSPI, even though not all of them will ultimately be resolved in the customer's favor after full review in which the Company has an opportunity to be heard.

Regarding the strictly evidentiary problems, we are somewhat concerned by the limitations of the TRAC system. As this case illustrates, a systematically truncated record keeping system seems ill-suited to a regulatory regime in which the Commission supervises the utilities' service quality by reference to long-term trends. On the other hand, the Judges have not been asked, or given the evidentiary wherewithal, to investigate this issue; and the present case also demonstrates that a company's own records may suffice as an alternative to the Commission's. As for the scope of OCS staff's discretion at the triage stage, we can safely assume that the Staff witness's interpretation is accurate, because he demonstrated expertise in such matters and because the extent of OCS staff's authority in any event is within the Commission's constructive knowledge should the Commission find it relevant.

More important, in our estimation these factual disputes do not rise to the level of relevance that UWNY would ascribe to them. As Staff attempted to explain during cross-examination, the customer complaints embedded in the historic baseline data should reasonably be expected to resemble in all pertinent respects the complaints that may occur prospectively after implementation of the CSPI mechanism. In other words, in the future just as in the historic base period, customers will continue to present both true complaints, and mere opinions prompted by dissatisfaction with the tariffs; the quality and timeliness of UWNY's communications will affect the complaint rate (and, in all probability, the prevalence of negative opinions other than complaints); OCS staff will continue to identify opinions as such, in order to remove them from the

complaints to be escalated and thereby reflected in the CSPI data; and escalated complaints will continue to be validated or invalidated after final review, in substantially the same proportions as in the historic base period.

If these similarities between the historic baseline and future customer contacts remain consistent, any future deterioration in the PSC complaint rate relative to the baseline (other than random variations absorbed by the two-SD buffer) is likely to be a legitimate indication of declining service quality regardless of UWNY's stated concerns about the validity of past or future complaint data. Moreover, if the PSC complaint rate deteriorates for reasons other than service quality problems within UWNY's control, the annual reporting format proposed by Staff expressly provides the Company an opportunity to present that interpretation as part of the report and use it as the basis of a waiver petition if necessary.

Notwithstanding our conclusions that the CSPI and particularly the PSC complaint rate metric deserve to be implemented, we recommend that the Commission delay full implementation for a year beyond the schedule advocated by Staff. Staff testified that the CSPI mechanism should be put into effect "for calendar year 2014" (Tr. 842). We interpret this to mean that the eventual calculation of the first annual CSPI results, which Staff would require as part of a report and analysis to be filed 60 days after the end of each calendar year, would be filed in March 2015 and would include data for all of 2014. We agree that all 2014 data should be the subject of a March 2015 report in order to observe the operation of the CSPI metrics and identify and correct possible problems, but we do not recommend that a CSPI-based equity return adjustment actually be applied except on the basis of subsequent annual reports in March 2016 and thereafter.

Despite UWNY's opportunity to submit a qualitative analysis as part of the proposed reporting format results, and despite the likelihood that, as we have discussed, the nature and reliability of complaint data normally will not vary materially from the historic base to the period covered by the CSPI, we are not confident that conditions prevailing in calendar 2014 can be considered normal for this purpose. Most notably, 2014 is expected to mark the transition from quarterly to monthly billing, an event whose effect on the complaint rate seems uncertain after considering the Company and Staff testimony; public concern about the desalination project and UWNY's proposed desalination surcharge are likely to increase the prevalence of negative "opinions," increasing the difficulty of segregating them from true "complaints"; and similar results should be expected from the substantial rate increase likely to be authorized in this case, possibly compounded shortly thereafter by a desalination project surcharge.

In response to such concerns, Staff points to the "headroom" or leeway afforded by the two-SD deadband around the historic baseline PSC complaint rate. In theory, Staff is correct that the deadband could fully exceed, and thus protect UWNY against, complaint rate increases attributable to the above cited abnormal circumstances in 2014 which are largely known and beyond the Company's control. However, conditions so pervasively affecting UWNY's business environment are not, in our understanding, random statistical anomalies of the type intended to be captured in an SD. On the contrary, if the rate year is not normal, the two-SD buffer remains necessary but does not suffice to ensure a valid CSPI measurement, because the noncomparability of the rate year demands a reassessment of whether the base period remains relevant.

As an alternative to a one-year delay, which MC cites as a possible solution to these problems, MC notes that Staff's proposal for immediate implementation leaves open the possibility that UWNY could obtain a waiver once the 2014 data have been compiled. However, we find that proposal little more satisfactory than Staff's. Given our conclusion that immediate implementation would expose UWNY to an unreasonable risk that the CSPI results will reflect extraneous circumstances unique to 2014, we do not believe the risk can adequately be mitigated through a petition process in which UWNY would have to prove the invalidity of a performance metric that already appears invalid for 2014 for the reasons we have cited.

3. Customer Satisfaction Survey Target

In addition to the PSC complaint rate target, the CSPI mechanism's other proposed metric is a customer satisfaction survey target which would operate in a similar manner. Historically, UWNY has retained a consultant (Global Strategy Group) to survey overall customer satisfaction levels and customers' opinions about UWNY's response to specific issues (Tr. 850). The average "overall customer satisfaction" score for 2010, 2011, and 2013 was 80.33%. (The survey was not conducted in 2012.) Therefore the historic baseline target would become 80.33, reduced by 4.62 (two SDs of 2.31 each) for an adjusted baseline of 75.7.

Thereafter, UWNY would be subject to an incremental disallowance of five basis points (bp) of equity return for each of three possible decreases in the satisfaction survey score, up to a total of 15 bp (in addition to the 15 bp disallowance under the PSC complaint rate metric). Specifically, the disallowance would be a total of five bp if the future score fell to the

adjusted historic score of 75.7;[77] 10 bp if it fell to 73.4; and 15 bp if it fell to 71.1.

Aside from the issues of need and legality, UWNY's objection to the design of the survey metric is fundamentally the same as in the case of the PSC complaint rate metric: just as "opinions" submitted for complaint resolution may reflect customer dissatisfaction with practices obligatory upon the Company, a survey might measure public dissatisfaction with rate requests, rate increases, and the prolonged course of the desalination plant proceedings. Additionally, UWNY says that New York Water Service--the only New York water company with a voluntarily accepted CSPI plan--is not subject to a satisfaction survey metric, thus demonstrating in UWNY's view that the survey metric is unnecessary and irrational.

With regard to the satisfaction survey component, an additional reason for delay (besides those noted above in connection with the PSC complaint rate metric) is Staff's proviso that "to ensure consistency in results, the Company should utilize the existing contractor, survey instrument and methodology and should provide prior notice to the Department of any proposed changes to the survey methodology" (Staff IB p. 81, citing Tr. 852). For calendar 2014, at least, this would put UWNY in the untenable position of continuing a survey arrangement that was not designed for CSPI incentive purposes, unless the Company seeks and obtains Staff approval of a redesign which cannot be implemented until long after the supposed calendar 2014 survey period has started. The unfairness of this result is compounded by Staff's reliance on the contractor's skill and expertise as the sole assurance that

[77] A future score of 75.7 would signify deterioration as compared with the 75.7 adjusted historic baseline because the historic baseline, prior to the two-SD adjustment, is 80.33.

survey error will not distort the CSPI results to UWNY's disadvantage. Staff's proposed schedule would deny the contractor a meaningful opportunity to apply its expertise in redesigning the survey instrument in time to affect the March 2015 data report.

As we explained in connection with the PSC complaint rate, if customer opinions in the rate year continue to be negatively influenced by circumstances beyond UWNY's control to the same extent as in the historic baseline results, that in itself normally would not preclude the Commission from using the proposed mechanism to detect and remedy possible future deterioration in customer relations relative to the baseline. Again, however, just as in the case of the PSC complaint rate, extraneous conditions affecting the survey results in 2014 are likely to differ so abnormally from the base period that the two-SD buffer will not suffice to provide reasonable assurance that the metric leads to valid results. For that reason as well as the possible need to modify the survey methodology for purposes of a performance metric, we favor a one-year postponement in implementation of the entire CSPI mechanism, including both the Customer Satisfaction Survey metric and the PSC Complaint Rate metric.

D. Missed Appointments

Staff proposes, and we recommend, an "Appointments Kept mechanism" whereby UWNY would issue the customer a $25 bill credit if the Company misses a service appointment with that customer. Staff's stated rationale is that customers would appreciate the credit as a signal that UWNY acknowledges the value of the customer's time and inconvenience to the customer should an appointment be missed (Tr. 853). Additionally, in our view, regardless of that symbolic value, the mechanism deserves approval as an incentive for UWNY to keep appointments.

No party opposes Staff's proposal. However, UWNY argues that it should be adopted only in tandem with a "reciprocal" provision that the customer will be billed $25 for missing an appointment, and $25 for a UWNY field visit that proves unjustified because the problem is found to originate with the customer's own plumbing or from some other cause unrelated to UWNY and its facilities. Staff and MC oppose the proposed fee payable by customers. We recommend that the Commission not adopt it.

In support of a $25 fee payable to UWNY, the Company testified that such a fee is “standard practice” among other utility companies (Tr. 231). Also, by labeling the customer fee "reciprocal," UWNY seems to imply that the $25 should be payable by customers or Company alike as a matter of equity. Staff responds that UWNY's "cavalier" disregard for a monopoly's advantages over its customers in itself justifies regulatory intervention "to ensure UWNY treats ratepayers with an acceptable level of respect and provides adequate customer service" (Staff IB p. 85), while MC criticizes "cavalier" as too kind an adjective for what MC calls "another manifestation of UWNY's disdain for its customers" (MC IB p. 25). UWNY responds that its proposal demonstrates the Company's solicitude for customers collectively, by allocating some cost responsibility to the individual that causes the cost instead of socializing it among all customers.

We find much of the argument on this point simplistic or lacking in factual support. For example, the parties have not amplified or challenged the Company's characterization of "standard practice" to establish what utilities it refers to, whether they operate in this Commission's jurisdiction, and whether the magnitude of UWNY's $25 fee for customers and the extent to which the fee would recover relevant costs is similar

for other companies. Concededly, Staff's proposal likewise escaped this type of scrutiny on the record, but only because UWNY chose not to contest it. As for the notion that UWNY and its customers both should be equally subject to a potential $25 charge, the semblance of leveling their playing field diverts attention from relevant factors the Commission normally weighs when assessing the reasonableness of a rate or charge.

For example, the record offers no analysis of how highly the customers or the Company value their own flexibility versus their counterparts' reliability, to what extent (if any) a particular dollar amount will effectively incentivize reliability on either side, or whether $25 reasonably reflects the undoubtedly disparate costs of a missed appointment from the respective standpoints of the customers or Company. An even hazier policy question is whether a customer's mistaken interpretation of a service problem, attributing it to the Company rather than the customer's own facilities, ought to be deemed the errant customer's economic responsibility or part of the cost of business borne by all customers. In our view, this issue is at least as significant as the parties' debate whether UWNY's monopoly position unjustly empowers the Company to disrespect customers. In sum, UWNY has not produced sufficient evidence that a $25 charge on customers would be consistent with industry practice, efficient, or equitable.

E. Termination of Service

UWNY proposes tariff revisions to create two new grounds for termination of service in situations involving the Company's inability to gain access to a meter: that "the customer has more than three consecutive estimates and has not responded to the [Company's] no-access notifications," or that "the customer has not provided the Company with access to its equipment for [radio frequency meter] change outs due to testing

regulations, faulty equipment or expected tampering after receiving adequate notification from the Company in the form of a letter or series of letters" (Tr. 182-83). On rebuttal, noting Staff's opposition to these proposals, the Company suggests a compromise whereby the grounds for termination would remain as is, but the present $25 fee for a customer's denial of access to UWNY personnel (a) would increase to a level "such that the customer understands the implications" of denying access and (b) would no longer be waivable by Office of Consumer Services (OCS) staff in the course of a billing dispute (Tr. 232). We recommend that the Commission deny UWNY's proposals and leave the present tariff provisions unchanged.

In support of its proposals, UWNY notes that about 30% of its customers have three or more consecutive estimated reads because they have continued to deny the Company access to the meter despite bill insert messages and the $25 no-access charge (Tr. 183). UWNY says such situations need to be actively addressed because they may signal either theft of service, or meter malfunctions which eventually can lead to high "catch up" bills and consequently an increase in complaints to UWNY and the Commission (Tr. 183). In opposition, Staff testified that termination of such an essential service as water should remain an extreme remedy to be invoked only under the emergency conditions specified in 16 NYCRR 14.17, which do not include denial of meter access; and conversely that service termination cannot be found among the remedies for non-access expressly enumerated elsewhere in 16 NYCRR Part 14.

In our view, the regulations cited by Staff evince a considered determination by the Commission that only a carefully circumscribed category of customer conduct has consequences serious enough to justify termination. As far as 16 NYCRR Part 14 is concerned, denial of meter access does not rise to that

level. Moreover, the regulations' underlying logic commends itself to us because, while we agree with UWNY's undisputed recital of the possible negative consequences associated with non-access, the end result at worst is not an emergency or even an impairment of shareholders' economic interests, but only an inefficient allocation of revenue responsibility between customers that receive and pay accurate bills and those that do not.

As for the compromise solution offered in UWNY's rebuttal, we recommend against it because the present record is completely devoid of any basis for determining how much the $25 no-access fee should be increased to provide a fair yet effective price signal; and as a general matter we do not believe the Commission's complaint resolution process can be improved by removing OCS staff's discretion to choose specified remedies such as, in this instance, waivers of the no-access fee. We further recommend that if the parties are interested in continuing to pursue such possible solutions, they either develop a consensus proposal to be submitted to the Commission in the exceptions briefs in this case, or initiate a collaborative to develop such a proposal for submittal in a future rate case.

In UWNY's reply brief, answering the argument in Staff's initial brief (Staff IB pp. 71-72) that the proposed tariff revisions are inconsistent with 16 NYCRR Part 14, the Company says its proposals effectively constitute a request that the Commission waive those regulations pursuant to the authority granted in 16 NYCRR 3.3 (UWNY RB p. 60). In a motion filed after the reply briefs, Staff seeks to exclude the Company's

waiver theory from consideration on the ground of untimeliness.[78] The Company responds, and we agree, that there is no valid reason to exclude the Rule 3.3 waiver request, because it always has been implicit in UWNY's position that the tariffs should be revised despite the regulations relied on by Staff. In explicitly citing Rule 3.3 for the first time in response to a legal argument in Staff's initial brief, UWNY at worst may be charged with failure to anticipate every possible opposing argument at the time of its initial brief; but, as UWNY says, the merits of the Company's proposals have been fully joined in briefing and Staff therefore has not been prejudiced by any delay in development of the Rule 3.3 rationale.[79] Accordingly, we hereby deny Staff's motion with respect to the tariff revision issues.[80]

Regardless of the motion and the response, however, the arguments therein will be moot should the Commission adopt our recommendation that the tariff revisions be rejected on the merits for the substantive reasons presented above. Parties seeking to dispute either our recommendation on the merits or our disposition of the motion have the opportunity to do so on exceptions, for further determination by the Commission if

[78] Staff's Motion to Exclude, undated, filed March 18, 2014. As discussed elsewhere herein, Staff's motion also seeks to exclude evidence related to M&S Company charges.

[79] UWNY's Response, March 20, 2014.

[80] To the extent that UWNY's reply brief may constitute a petition for a waiver of Commission regulations, the Commission's deliberations must be preceded by notice pursuant to the State Administrative Procedure Act (SAPA). We have arranged for publication of such notice in the State Register. Our intention is that the parties, having a full opportunity to comment in briefs at the exceptions stage, need not comment separately in response to the SAPA notice. Conversely, for the Commission to reach a timely decision, the parties must adhere in all respects to the deadlines for exceptions briefs rather than the SAPA comment deadline.

necessary in its order setting rates at the close of this proceeding.

XI. NON-REVENUE WATER

Non-revenue water (or "NRW") refers to water losses from several sources. The Company breaks the losses down into two groups, physical losses and actual losses. Physical losses include unavoidable actual real losses (UARL);[81] fire fighting and fire drill consumption; and, water consumed by the Company for chemical makeup, instrumentation, meter changes, flushing hydrants and cleaning tanks (Tr. 315; UWNY IB p. 75). Actual losses consist of meter inaccuracies, unbilled revenues and theft of service (Tr. 318). Staff, in contrast to UWNY, breaks out real losses -- leaks in mains, services and connections -- into a third category (Tr. 1303).

Staff and MC note that UWNY's non-revenue water level has been over 18% for each of the years 2008 through 2012, averaging approximately 21% over those years (Tr. 1303-1304; Staff IB, p. 86; MC IB, p. 29). On a gallon of water basis, UWNY's average annual NRW level over those years averaged more than 2,200 million gallons (Exh. 8).

The Commission's regulations require water companies to notify the Department of Public Service (DPS) when annual non-revenue water levels exceed 18% and include descriptions of any significant events that impacted the level and steps taken to reduce it.[82] Although the Company has included the NRW percentage in annual reports it has filed with the Commission,

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[81] UARL is a theoretical calculation based on American Water Works Association (AWWA) methodology (UWWNY IB, p. 77). UWNY also testified that the acronym means "unaccounted for actual real losses" (Tr. 316).

[82] 16 NYCRR 503.8(b).

Staff complains that UWNY has not complied with the requirement that it report to DPS and requests that UWNY be directed to comply. The Company acknowledges that it has not provided separate reports to DPS, but commits to doing so going forward.

Staff agrees with the Company that switching to monthly billing should help to reduce the NRW level (Staff IB p. 86). And, it recommends that UWNY implement the findings from a non-revenue water study conducted of UWNY's sister companies, United Water New Rochelle Inc. (New Rochelle) and United Water Westchester Inc. (Westchester), by Halcrow Consulting Engineers (Halcrow study) (Staff IB p. 86).[83] UWNY says that it has been applying the HalCrow study findings to UWNY and plans to continue (UWNY IB p. 78).

According to MC, Staff's recommendations do not go far enough. It points out that the Company provided no analysis of how much it would cost to reduce NRW to 18% (MC RB p. 25). It proposes that the lost revenue impact of NRW levels above 18% be calculated, and the excess amount (above 18%) be used to offset the Company's revenue requirement (MC RB p. 25). It further recommends a 1% reduction in the NRW threshold target for each successive year, until UWNY's annual non-revenue water level reaches 15%, again reducing the revenue requirement by the revenue difference between the adjusted and actual levels (MC IB, p. 30). MC calculates the lost revenues based on the annual non-revenue water percentages from 2008 through 2012 above the reporting threshold to be worth about $4 million more than Staff's recommended rate increase which, it suggests, supports a rate freeze (MC RB p. 30).

UWNY argues that an incentive mechanism is not justified. According to the Company, part of the non-revenue

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[83] Staff did not, however, identify the specific findings it was referring to.

water problem is attributable to municipalities, and there are numerous examples of municipalities engaging in unauthorized use and unbilled consumption of water (UWNY IB p. 76). MC says that UWNY's claim is specious because there was no evidence introduced into the record of any MC members engaging in theft of service (MC RB p. 26).[84] Further, there are hydrant locking mechanisms available that MC says would prevent unauthorized use (MC IB p. 32). The Company insists such locking devices are not advisable from a public safety standpoint because they would make it more difficult for fire departments to access the hydrants to fight fires (UWNY RB p. 62). Although it admits that locking devices are in place in the New Square area, UWNY claims that they were installed because hydrants in that area were being tampered with causing fire-fighting equipment problems.

UWNY contends that its NRW level is well within industry standards (UWNY RB p. 61). Moreover, it states that MC's charge of unacceptably high non-revenue water ignores the results of the American Water Works Association (AWWA) audit of the New Rochelle and Westchester companies, and UWNY's plans and efforts to reduce the non-revenue water level (UWNY IB p. 76).[85]

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[84] UWNY estimates theft of service to account for 4% – 8% of its non-revenue water (UWNY IB p. 77).

[85] UWNY's Exh. 8 denotes that, in addition to proposing monthly billing and hiring a non-revenue water manager to oversee initiatives, UWNY has installed district meters and plans to install more in other areas; installed a billing system that places tighter control on estimated bills and zero read meters; placed warning notices on hydrants to deter unauthorized use; met with police to gain support for NRW reduction efforts; purchased additional leak detection equipment; commenced data gathering on water mains and soil conditions for leak evaluation; and, started plotting main breaks on a geographic information system. UWNY states that it will also be installing Advanced Metering Infrastructure that will assist in reducing NRW.

Citing to the Infrastructure Leak Index (ILI) calculated using an AWWA methodology, UWNY emphasizes that physical losses, such as leaks on mains and customer services, constitute only a small portion of the non-revenue water that can be reduced (UWNY IB p. 77). And, the Halcrow study indicates that physical losses represent about 60% of NRW, the Company says. Overlaying the Halcrow study results on UWNY's non-revenue water level, UWNY estimates that 12% of the losses are physical losses and 9.3% of the 12% is UARL, which the Company says is irreducible, leaving only 2.3% as the real system leakage that can be economically corrected (UWNY IB p. 78).[86]

Discussion and Conclusion

We find the Company's non-revenue water level to be unacceptably high. However, we are not recommending an incentive mechanism or revenue adjustment at this time. The only certainty UWNY has is how much water it produces and bills. Determining the cause of system losses and how much is lost to each cause involves a great deal of speculation. And, more information is needed to assess whether the Company failed to take reasonable and economically viable corrective action, and the likelihood of success of the Company's multi-faceted approach to non-revenue water mitigation. Some of the benefits of those program efforts should result in a reduced NRW level during its next rate case. If they do not, the Commission can revisit the concept of an incentive mechanism, as well as whether it should continue funding the mitigation programs.

There are additional features that UWNY should factor into its non-revenue water program planning and execution. In order for the Commission to evaluate the effectiveness of the various NRW mitigation program options, there should be a

[86] The Company contends that under the AWWA audit methodology it would have an "excellent" leak rating of less than 2.

cost/benefit analysis provided for each NRW program element that compares the NRW reduction to the ratepayer costs to achieve the reduction, and the projected revenue requirement savings going forward. The Company's extrapolation of its sister companies' results, which were then compared to UWNY, while informative, lacks UWNY specific analysis and findings.

We recognize the difficulty that UWNY has in discovering theft of service and other unauthorized use, and preventing or minimizing the possibility of future occurrence. The Company attributes a substantial amount of its non-revenue water losses to these causes. MC identified hydrant locking devices as an option, which UWNY acknowledges is in use in the New Square area. But, there is no information in the record regarding the economic viability of installing the devices on a wider system basis. UWNY's claim that such locking devices are not generally advisable because they can make fire fighting more difficult begs the question how the fire department serving the New Square area currently manages to access a locked hydrant. The Company did not identify any specific problems experienced in accessing the locked hydrants in the New Square area. Presumably, the same firefighting and public safety concerns exist in New Square. If the firefighting problems UWNY raises result from fire department access to unlocking devices, the Company should be able craft protocols and procedures which would allow access for appropriate fire department personnel or other authorized uses, while minimizing the possibility of unauthorized use and UWNY not receiving notice. The Fire Chiefs' Association might be a resource that could assist in constructing effective procedures and informing fire departments of locking device use restrictions.

Finally, the Company should consider providing additional public notice of the unauthorized use problem, the

rate impact it has on customers and any plans to prosecute unauthorized use. Ratepayers who are informed of the potential bill impact resulting from unbilled, unauthorized use may become voluntary enlistees in exposing the practice.

XII. RECONCILIATIONS

A. Property Taxes

The Company proposes that the Commission adopt a reconciliation mechanism that would permit UWNY to recover 100% of the property tax expenses incurred over the target.[87] Typical of large utilities, property taxes are a large portion of the Company's overall expenses. According to UWNY, the property taxes have also been increasing significantly and it has limited ability to affect valuation changes, which are set by statute (UWNY IB, p. 79).

Staff is opposed to creating a property tax reconciliation mechanism for this one-year rate plan. Aside from noting that there is less financial risk in one-year rate plans than in multi-year plans, Staff says that the 100% reconciliation would reduce the Company's incentive to aggressively work to lower its property tax expense (Staff IB p. 87). And, it asserts that the reconciliation would harm ratepayers as a result of tax adjustments made in light of UWNY's inadequate and late EO award (Staff IB p. 87).

UWNY argues that Staff's claim of a Company need for an incentive to fight property tax bills ignores the past aggressive efforts of UWNY to decrease taxes (UWNY IB p. 79). It contends that a one-year rate plan is not sufficient justification to eliminate a reconciliation mechanism (UWNY IB p. 79). Further, allowing the Company to recover the total cost

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[87] Under the current three year rate plan UWNY recovers 85% of the property tax increases above the target.

of its property taxes is said to be consistent with the principle that utility rates should be set to allow recovery of expenses (UWNY IB p. 79-80).

MC opines that property tax reconciliations serve to reduce UWNY's business and financial risk, but do not reduce the risk to ratepayers associated with UWNY's failure to file for EO awards or other mismanagement incompetence (MC RB, p. 26).

We are not recommending that the Commission adopt a property tax reconciliation mechanism in this case. Such mechanisms are not characteristic of one year rate plans, in part because they have less financial risk than multi-year plans. The Company has provided no evidence that justifies different treatment from other utilities operating under one year plans.

B. Revenue Reconciliation Mechanism (RRM)

The Company currently has a revenue reconciliation mechanism that provides for the reconciliation of revenues, property taxes, production costs (sludge removal, power, purchased water and chemical production costs) against actual expenses. The Company and Staff are in agreement to continue the revenue reconciliation mechanism, except for the above-described property tax reconciliation provision, with the addition of language dealing with disagreements over the proper net surcharge or surcredit and deciding disputes through a Dispute Resolution Process (UWNY IB p. 80; Staff IB pp. 87-88). The language states:

> [i]n the event of any disagreement over the proper net surcharge or surcredit amounts between the Company and Staff, Staff's calculated surcharge or surcredit will be temporarily placed in effect. The differences will be resolved through the Dispute Resolution Process. If the Dispute Resolution Process results in an amount ultimately resolved in the Company's favor, then the Company will be allowed to recover carrying charges on the determined net of tax amount.

> Carrying charges will be applied at the then current Other Customer Capital rate (Tr. 1302-03).

According to Staff, this provision will allow it and UWNY the time needed to determine the appropriate RRM surcharge or surcredit and ensure that ratepayers and the Company are held harmless.

The added text to the revenue reconciliation mechanism is designed to ensure that the surcharge or surcredit is accurate and that the Company and its ratepayers are not harmed by any delay in determining the final amount. We find the UWNY and Staff agreement to continue the revenue reconciliation mechanism with added language on the dispute resolution process to be reasonable and, therefore, recommend its adoption.

XIII. FIRE SERVICE ISSUES

MC outlined long-standing complaints regarding the water flow provided by the Company for fire fighting. The most critical issue concerns past situations where the fire department either ran out of water or experienced a low pressure from the Company's hydrants during fires (MC IB pp. 32-33). According to MC, there is a low fire flow condition in the northerly portion of the Village of Sloatsburg (Village) and in the Hamlet of Ramapo (Hamlet) (MC RB p. 27). It underscores that in one particular loss of water incident -- a fire which occurred in the Hamlet in October of 2010 -- in addition to the Company being immediately notified of the problem, it was discussed repeatedly at subsequent bi-monthly meetings between UWNY and the Fire Chiefs' Association (Tr. 1118; MC IB p. 33). MC states, furthermore, that the lower than anticipated water pressure in the Hamlet and Village was discussed with UWNY several months prior to the October 2010 fire, as indicated in

the July 2010 bi-monthly meeting minutes (Tr. 1119).[88] According to MC, the bi-monthly meetings minutes subsequent to the October fire illustrates a constant refrain given by the Company, "We're looking into it" (MC IB, p. 34). Highlighting its extreme frustration with UWNY's performance, MC claims that the fire service issue in the Hamlet has not yet been resolved despite more than three and a half years passing since the fire (MC IB, p. 34). Months go by before UWNY takes corrective action on other problems reported to the Company, says MC (MC RB p. 27). It points out that the delays in taking remedial action are straining the relationship between the Fire Chiefs Association and the Company (MC RB P. 28).

To resolve the fire pressure problems in the Company's service territory, MC recommends that the Commission order UWNY to correct the fire service pressure problems and direct that UWNY prepare a plan with completion of design, construction and in-service dates, with UWNY to incur significant penalties for failure to meet the in-service date (MC IB p. 34). It further proposes that any increase in the Company's rates should be postponed until the Hamlet and Village problems are corrected (MC IB p. 35).

[88] The minutes from the 2010 through January 2014 meetings were admitted into the record (Exh. 46-49, 49A).

UWNY addresses the Hamlet and Village issues separately.[89] Taking the October 2010 fire in the Hamlet first, UWNY explains that, in addition to there being some initial confusion over whether the water outage occurred on October 10th or 12th, the cause was ultimately determined to be the result of a power failure at UWNY's Ramapo Valley Well Field, which normally supplies the Hamlet (UWNY IB, p. 82). As a result, the water for firefighting would have been supplied by gravity feed through 11,000 feet of pipe from the Company's Post Road Tank and, it speculates, any low pressure condition that may have occurred was likely due to friction losses which are beyond the Company's control (UWNY IB pp. 82-83). UWNY further notes that in October of 2013 it conducted a flow test in the Hamlet and found the available water flow to be consistent with that area's land use and that the service pressures in the Hamlet exceed the minimum 20-psi in the Commission's regulations.[90] MC responds to UWNY's adequate pressure claim, stating that the issue is not water pressure, rather water volume because the fire trucks have internal capability to generate adequate pressure if the volume is present (MC RB, p. 29). Moreover, it argues that even if the water pressure is above the minimum standard, the water flow was inadequate for firefighting (MC RB, p. 28).

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[89] MC witnesses also testified to concerns over fading paint on fire hydrants and hydrants out of service for prolonged periods, suggesting for the latter an incentive mechanism geared toward hydrants continuing out of service more than three days and Fire Chiefs' Association access to UWNY's hydrant information (Tr. 1118). The Company explained in testimony and brief that although it changed in 2012 to a different paint and primer for hydrant painting, the fading paint that is still on the hydrants does not affect the protection qualities (UWNY IB, p. 85). These issues were not considered by us further, as MC did not preserve them in brief.

[90] 16 NYCRR 503.2.

System pressure in the Village of Sloatsburg area is also in accordance with the regulatory requirements and often exceeds those requirements, the Company states (UWNY IB p. 83). Nevertheless, UWNY says that it is committed to working with the Fire Chiefs' Association to improve the system pressure. It points out that the Company has conducted a field survey of hydrant elevations in UWNY’s Sloatsburg Low System which revealed that the system pressure gradient satisfies applicable regulations, replaced over 2.7 miles of mains in the Village since 2006, engaged in leak detection and removed and replaced a number of fire hydrants (UWNY IB, p. 84). The Company concludes that it adequately responded to the Fire Chiefs’ Association’s concerns and that its claim of continuing issues are unfounded.

Discussion and Conclusion

Adequate fire service protection is critical in protecting the public health and safety. The Company and Fire Chiefs’ Association clearly have a difference of opinion regarding the adequacy of the water available (flows versus pressure) for fire protection in the Hamlet and Village areas, as well as whether UWNY’s responses to concerns raised are satisfactory and timely. We are convinced from the testimony rendered that there was a water fire flow problem in the Hamlet and that the Company’s response was deficient. There was undoubtedly a protracted delay in the Company’s efforts to determine the root cause of the outage. It is alarming that, more than three and one-half years after the incident, the Fire Chiefs’ Association complains that there is a continuing problem. Regardless of whether the problem is a failure to fix the water flow issue, a failure to effectively communicate between UWNY and the Fire Chiefs’ Association or a combination of both, it needs to be corrected. We are not ignoring the possibility that further remedial action or system improvements

could be warranted, notwithstanding compliance with Commission regulations.

We are troubled by the indication that part of the delay may be attributable to a wrong outage date initially being communicated to UWNY. There appears to be a need for a better process in place to ensure accurate reporting and follow-up on problems affecting fire protection. Therefore, we recommend that in addition to any oral communication given to the Company, the process include a Fire Chiefs' Association e-mail notification to a designated Company representative (or representatives) containing all of the pertinent facts and issues. The e-mail service list should also include at least one other fire official to ensure verification of the information provided to UWNY.

We cannot determine from the record in this case whether there continues to be a water flow problem in the Hamlet and Village areas. The Fire Chiefs' Association obviously believes there is. No information was provided regarding the extent to which Department of Public Service Office of Electricity, Gas & Water (OEGW) staff may have independently evaluated the low fire flow issue. Staff did not testify on the issue or comment in its briefs. It was disclosed during the hearings, however, that, as of late, OEGW staff have been invited to the bi-monthly meetings. We believe that OEGW staff should be actively involved in this process going forward, as they offer the benefits of being independent evaluators of the issues raised; are familiar with Commission regulations; can provide constructive input to the Company and the Fire Chiefs' Association and monitor timely correction of problems; and, can serve as potential mediators to alleviate any strained relations. To the extent that Commission action is warranted to address uncorrected or delayed pressure and water flow problems,

the OEGW staff can make a referral to the Commission. We, therefore, are not recommending that the Commission postpone rates or issue an order requiring UWNY to prepare a design plan with construction and in-service date milestones and providing for penalties.

XIV. MANAGEMENT AUDIT

UIU and MI, opposed by UWNY, advocate that the Commission initiate a comprehensive outside audit of the Company's operations and management. As reasons for an audit, UIU and MC cite what they deem poor planning for new water supply, inadequate analysis of other capital investment needs, an unfavorable customer complaint rate, payment of excessive dividends and expenses to affiliates, deficient fire service, and other alleged manifestations of poor management. They assert that this case is similar to a recent National Grid case, in which allegations of National Grid mismanagement of its dealings with affiliated service companies, raised by DPS Staff in its rate case testimony, led the Commission to institute a separate proceeding to investigate National Grid's affiliate relationships using the management audit mechanism of PSL §66(19).[91] The parties have argued as if the issue were whether the record here provides a prima facie justification, establishing that the audit should be initiated unless UWNY prevails on rebuttal within this proceeding. UWNY responds by attacking these criticisms seriatim.

[91] Case 10-M-0451, Proceeding on Motion of the Commission to Investigate National Grid Affiliate Cost Allocations, Policies, and Procedures, Letter (November 18, 2010) and Order Directing Submission of Implementation Plan and Establishing Proceeding, (January 18, 2013); Case 10-E-0050, supra, Order Establishing Rates for Electric Service (January 24, 2011), pp. 4-12.

For reasons discussed elsewhere herein, either we have found the allegations of mismanagement unconvincing or (as in the case of M&S Co. expenses) we have recommended other remedies which we deem sufficient. Consequently, if the launch of a management audit is contingent on a prima facie showing that a company's management is failing or deficient, we do not recommend the institution of an audit on those grounds at this time.

We note, however, that the Commission has discretion generally to conduct an audit of UWNY under PSL §89-c(15), which no party has cited or discussed. That section provides, in pertinent part, that the Commission "shall provide for management and operations audits of water-works corporations" and "shall have discretion to have such audits performed by its staff, or by independent auditors." Where an independent auditor is selected, the statute gives the Commission authority to select the auditors, to require the Company to pay them, and to provide that the auditors shall work for and under the direction of the Commission. Moreover, the Commission "shall have authority to direct the corporation to implement any recommendations resulting from such audits that it finds to be necessary and reasonable," and shall review the company's compliance as part of the next major rate case. The statute thus generally parallels the like provision of PSL §66(19), governing management audits of electric or gas companies, with the notable difference that PSL §89-c(15) does not provide any time period within which audits must occur, whereas PSL §66(19) requires such audits to be conducted at least every five years.

The Commission could, therefore, invoke PSL §89-c(15) to institute a management audit of UWNY without any allegation or inference to be drawn of mismanagement on UWNY's part. Indeed, UIU seems to argue for such a neutral basis on which to

audit the Company through its assertion that the Commission's management audits typically generate worthwhile results.[92] Given the lack of any prescribed timing for audits under §89-c(15), we conclude that whether to require an audit at any particular time is purely a matter of administrative discretion vested in the Commission or the Chair. Consequently, we do not consider a recommendation to be within the scope of our duties or authority in this case, and we decline to make any recommendation here.

April 8, 2014
RAE, DVO /kaa

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[92] UIU IB p. 9 (in audits over the past six years, "[w]ithout exception, DPS Staff and the consultants produced reports that identified critical deficiencies and meaningful ways to remedy those deficiencies").

United Water New York Inc.
Case 13-W-0295
Statement of Operating Income
For the Rate Year Ending May 31, 2015

	As Adjusted Per Staff Supp. Testimony	Adj. No.	Adjustments Per Recommended Decision	As Adjusted Per Recommended Decision	Revenue Requirement Adjustment	Recommended Decision Revenue Requirement
Operating Revenue						
Sales Revenues	$ 70,474,893			$ 70,474,893	$ 10,988,606	$ 81,463,499
Interdepartmental (Lake DeForest)	1,701,809			1,701,809		1,701,809
Miscellaneous Revenues	1,091,516			1,091,516	113,239	1,204,755
Revenue Taxes	254,067			254,067		254,067
Non-Revenue Water Adjustment	330,245			330,245		330,245
Total Operating Revenue	73,852,530		-	73,852,530	11,101,845	84,954,375
Operating & Maintenance Expense	27,137,651	(1)	447,420	27,585,071	62,637	27,647,708
Depreciation Expense	9,207,114			9,207,114	-	9,207,114
Taxes Other Than Income Taxes	21,752,553	(2)	755,853	22,508,406	39,967	22,548,373
Total Operating Expenses	58,097,318		1,203,274	59,300,591	102,604	59,403,195
Operating Income Before Income Taxes	15,755,212		(1,203,274)	14,551,939	10,999,241	25,551,179
State Income Taxes	712,963	(3)	(97,980)	614,983	949,235	1,564,218
Federal Income Taxes	2,206,405	(4)	(352,703)	1,853,702	3,417,002	5,270,704
Net Income Available for Return	12,835,844		(752,591)	12,083,253	6,633,004	18,716,257
Rate Base	$ 271,498,729	(5)	$ 1,216,888	272,715,616	$ -	$ 272,715,616
Rate of Return	4.73%			4.43%		6.86%

United Water New York Inc.
Case 13-W-0295
Schedule of Operating and Maintenance Expenses
For the Rate Year Ending May 31, 2015

	As Adjusted Per Staff Supp. Testimony	Adj. No. 1	Adjustments Per Recommended Decision	As Adjusted Per Recommended Decision	Revenue Requirement Adjustment	Recommended Decision Revenue Requirement
Labor	$ 7,269,887	a.	$ 11,589	7,281,476		$ 7,281,476
Purchased Water	190,217	b.	5,938	196,155		196,155
Power Purchased for Pumping	3,381,323			3,381,323		3,381,323
Chemicals	822,248			822,248		822,248
Transportation	1,102,099			1,102,099		1,102,099
Uncollectible Accounts	254,791			254,791	36,636	291,427
Customer Information/Billing Costs	1,293,085			1,293,085		1,293,085
Outside Services Employed	805,281	c.	153,475	958,756		958,756
Property and General Corporate Insurance	531,300			531,300		531,300
Worker's Compensation	193,165			193,165		193,165
Medical & Employee Benefits	2,052,060	d.	76,491	2,128,551		2,128,551
Pensions	1,707,323			1,707,323		1,707,323
OPEB	465,864			465,864		465,864
Amortization Pension/OPEB	54,961			54,961		54,961
M&S Fees	2,805,357	e.	221,643	3,027,000		3,027,000
Amortization of Tank Painting	121,480			121,480		121,480
Public Service Commission Expense	172,919			172,919	26,001	198,920
Amortization of Rate Case Expenses	314,295			314,295		314,295
Waste Disposal	691,039			691,039		691,039
Fringe Benefit Expense Transferred	(1,547,117)	f.	(21,716)	(1,568,833)		(1,568,833)
Amortization AFUDC Equity Gross Up	15,003			15,003		15,003
Arc Flash Project	40,000			40,000		40,000
Other	4,519,907			4,519,907		4,519,907
Productivity Adjustment	(118,836)			(118,836)		(118,836)
Amortization of MTBE Settlement Proceeds	-			-		-
Total Operating & Maintenance Expenses	$ 27,137,651		$ 447,420	$ 27,585,071	$ 62,637	$ 27,647,708

United Water New York Inc.
Case 13-W-0295
Taxes Other than Income Taxes
For the Rate Year Ending May 31, 2015

	As Adjusted Per Staff Supp. Testimony	Adj. No. 2	Adjustments Per Recommended Decision	As Adjusted Per Recommended Decision	Revenue Requirement Adjustment	Recommended Decision Revenue Requirement
Real Estate Taxes	20,894,489	a.	755,853	21,650,342		21,650,342
Payroll Taxes	578,986			578,986		578,986
Other Municipal Taxes	265,805			265,805	39,967	305,772
Payroll Tax - Monthly Billing Adjustment	13,273			13,273		13,273
Total Taxes Other Than Income Taxes	21,752,553		755,853	22,508,406	39,967	22,548,373

United Water New York Inc.
Case 13-W-0295
Calculation of State Income Taxes
For the Rate Year Ending May 31, 2015

	As Adjusted Per Staff Supp. Testimony	Adj. No. 4	Adjustments Per Recommended Decision	As Adjusted Per Recommended Decision	Revenue Requirement Adjustment	Recommended Decision Revenue Requirement
Operating Income Before State Income Taxes	15,755,212	a.1.	$ (1,203,274)	14,551,939	$ 10,999,241	$ 25,551,179
Adjustments for Taxable Income						
Interest Expense	(7,493,763)	a.2.	67,932	(7,425,831)		(7,425,831)
Tax vs. Book Depreciation Differences	(4,084,439)			(4,084,439)		(4,084,439)
Cost of Removal	-			-		-
Total Adjustment for Taxable Income	(11,578,202)		67,932	(11,510,270)	-	(11,510,270)
Taxable Income For SIT	4,177,010		(1,135,342)	3,041,669	10,999,241	14,040,909
State Income Tax @ 8.63%	360,476		(97,980)	262,496	949,234	1,211,730
Deferred State Income Tax						
Tax vs. Book Depreciation Differences	352,487			352,487	-	352,487
Cost of Removal (net)	-		-	-	-	-
Total Provision for Deferred SIT	352,487		-	352,487	-	352,487
Net State Income Taxes	$ 712,963		$ (97,980)	$ 614,983	$ 949,234	$ 1,564,218

United Water New York Inc.
Case 13-W-0295
Calculation of Federal Income Tax
For the Rate Year Ending May 31, 2015

	As Adjusted per Supplemental Testimony	Adj. No. 5	Adjustments Per Recommended Decision	As Adjusted Per Recommended Decision	Revenue Requirement Adjustment	Recommended Decision Revenue Requirement
Net Operating Income Before Income Taxes	$ 15,755,212	a.1.	$ (1,203,274)	$ 14,551,939	$ 10,999,241	$ 25,551,179
Adjustments for Taxable Income						
State Income Tax	(360,476)	a.2.	97,980	(262,496)	(949,235)	(1,211,731)
Interest Expense	(7,493,763)	a.3.	67,932	(7,425,831)		(7,425,831)
Tax vs. Book Depreciation Differences	(2,944,815)			(2,944,815)		(2,944,815)
Cost of Removal	-			-		-
Domestic Production Deduction	(982,716)			(982,716)		(982,716)
Total Adjustments For Taxable Income	(11,781,770)		165,912	(11,615,858)	(949,235)	(12,565,093)
Taxable Income	3,973,442		(1,037,362)	2,936,081	10,050,006	12,986,086
Federal Income Tax - Stand Alone @ 35%/34%	1,350,970		(352,703)	998,267	3,417,002	4,415,269
Deferred FIT- Current Year						
Tax vs. Book Depreciation Differences	1,001,237			1,001,237		1,001,237
Deferred State Income Taxes	(119,846)			(119,846)		(119,846)
Total Deferred FIT - Current Year	881,391		-	881,391	-	881,391
Deferred FIT-Prior Years						
Cost of Removal	-			-		-
Excess Deferred FIT	-			-		-
Total Deferred FIT - Prior Years	0		0	0	-	-
Amortization of Investment Tax Credits	(25,956)			(25,956)		(25,956)
Net Federal Income Taxes	$ 2,206,405		$ (352,703)	$ 1,853,702	$ 3,417,002	$ 5,270,704

United Water New York Inc.
Case 13-W-0295
Rate Base Summary
For the Rate Year Ending May 31, 2015

	As Adjusted per Supplemental Testimony	Adj. No. 6	Adjustments Per Recommended Decision	As Adjusted Per Recommended Decision	Revenue Requirement Adjustment	Recommended Decision Revenue Requirement
Net Utility Plant						
Water Plant in Service	$ 398,147,031			$ 398,147,031		$ 398,147,031
Non-interest bearing CWIP	2,724,759			2,724,759		2,724,759
Plant Held For Future Use	8,794,537			8,794,537		8,794,537
Less Accumulated Depreciation	(105,523,440)			(105,523,440)		(105,523,440)
Total Net Utility Plant	304,142,887		-	304,142,887	-	304,142,887
Customer Advances for Construction	(2,457,595)			(2,457,595)		(2,457,595)
Working Capital:						
Cash Allowance	2,977,284		67,219	3,044,502		3,044,502
Materials and Supplies	1,039,118			1,039,118		1,039,118
Prepayments	7,697,405			7,697,405		7,697,405
Total Working Capital	11,713,807		67,219	11,781,025	-	11,781,025
Deferred Tank Painting Expense (net of tax)	1,030,578			1,030,578		1,030,578
Deferred Rate Case Expense (net of tax)	434,948			434,948		434,948
Deferred AFUDC (gross up method)	5,492,900			5,492,900		5,492,900
Accumulated Deferred Income Taxes	(48,858,796)		1,149,669	(47,709,127)		(47,709,127)
Accumulated Investment Tax Credits	-			-		-
Earnings Base Capitalization Adjustment	-			-		-
Rate Base	$ 271,498,729		$ 1,216,888	$ 272,715,616	$ -	$ 272,715,616

United Water New York Inc.
Case 13-W-0295
Capital Structure per Company
For the Rate Year Ending May 31, 2015
United Water New York Inc.
Capital Structure per Staff Supplemental
For the Rate Year Ending May 31, 2015

	Amount	Percent	Cost Rate	Weighted Cost	Pre-Tax Return 9.21%
Long-Term Debt	148,559,181	55.91%	5.05%	2.82%	2.82%
Short-Term Debt	0	0.00%	0.00%	0.00%	0.00%
Customer Deposits	239,140	0.09%	0.35%	0.00%	0.00%
Cost of Debt		56.00%		2.82%	2.82%
Common Equity	116,912,967	44.00%	8.75%	3.85%	6.38%
Cost of Equity				3.85%	6.38%
Totals	$ 265,711,289	100.00%		6.67%	9.21%

United Water New York Inc.
Capital Structure per Recommended Decision
For the Rate Year Ending May 31, 2015

	Amount	Percent	Cost Rate	Weighted Cost	Pre-Tax Return 9.59%
Long-Term Debt	147,029,755	53.91%	5.05%	2.72%	2.72%
Short-Term Debt	0	0.00%	0.00%	0.00%	0.00%
Customer Deposits	236,678	0.09%	0.35%	0.00%	0.00%
Cost of Debt		54.00%		2.72%	2.72%
Common Equity	125,449,183	46.00%	9.00%	4.14%	6.87%
Cost of Equity				4.14%	6.87%
Totals	$ 272,715,616	100.00%		6.86%	9.59%

United Water New York Inc.
Case 13-W-0295
Summary of Recommended Decision Adjustments
For the Rate Year Ending May 31, 2015

Adj. 1	**Operating and Maintenance Expenses**		
a.	**Labor**		
(1)	Adjustment to reflect the Company's projection of non union salary increases	$ 16,285	
(2)	Adjustment to reflect flow through for labor transferred out.	(4,696)	$ 11,589
b.	**Purchased Water** Adjustment to reflect increase in purchased water unit cost based on the Recommended Decision revenue requirement increase.		5,938
c.	**Outside Services Employed** Adjustment to reflect the Company's requested rate year R&I Alliance expense of $291, 994.		153,475
d.	**Medical and Employee Benefits** Adjustment to remove one-half of Staff adjustment to the Company's requested rate year Medical and Employee Benefits expense.		76,491
e.	**M&S Fees** Adjustment to reflect a rate year M&S fee expense of $3,027,000.		221,643
f.	**Fringe Benefit Expense Transferred** Flow through related to adjustment to Medical and Employee Benefits		(21,716)
	Total Operating and Maintenance Expense Adjustments		429,893
Adj. 2	**Taxes Other Than Revenue & Income Taxes**		
a.	**Real Estate Taxes** Adjustment to reflect an Economic Obsolescence award of 10%.		755,853
	Total Taxes Other than Income Taxes Adjustments		755,853
Adj. 3	**State Income Taxes**		
a.	**Current Income Taxes**		
(1.)	To reflect the Recommended Decision adjustments to net operating income before taxes	$ (1,203,274)	
(2.)	To reflect Recommend Decision calculation of rate year interest expense.	67,932	
			(1,135,342)
Adj. 4	**Federal Income Taxes**		
a.	**Current Income Taxes**		
(1)	To reflect the Recommended Decision adjustments to net operating income before taxes	(1,203,274)	
(2)	Tracking Staff's state income tax calculation	97,980	
(2.)	To reflect Recommend Decision calculation of rate year interest expense.	67,932	
			(1,037,362)
Adj. 5	**Rate Base**		
a.	**Cash Working Capital** To track Recommended Decision adjustments to O&M expenses.		67,219
b.	**Accumulated Deferred Income Taxes** Adjust ment to reflect Accumulated Deferred Federal Income Taxes based on a 34% tax rate.		1,149,669
	Total Rate Base Adjustments		1,216,888