

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Long Island Water Corporation d/b/a Long Island American Water for Water Service.

Case 11-W-0200

**STATEMENT OF LONG ISLAND WATER CORPORATION
IN SUPPORT OF JOINT PROPOSAL**

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INTRODUCTION

Long Island Water Corporation, d/b/a Long Island American Water (“LIAW” or the “Company”), hereby submits this Statement in Support of the Joint Proposal (“JP”) entered into by the Company, Department of Public Service Staff (“Staff”) and the Utility Intervention Unit (“UIU”) of the New York State Department of State’s Division of Consumer Protection (collectively the “Parties”).¹ The JP resolves all issues in the above-referenced proceeding.

LIAW is the largest investor owned water system in Nassau County supplying various types of water service to approximately 75,000 customers. The Company prides itself on providing quality service to its customers at reasonable costs. Its success is due in large part to its place among the American Water system of companies. American Water provides its companies with the expertise, resources and capital needed to overcome the numerous challenges faced by water companies.

¹ The Village of Lynbrook, through its counsel, requested party status in this proceeding but did not participate in settlement discussions or sign the JP.

LIAW received its last rate increase in March 2008 when the Public Service Commission (“Commission”) approved the JP adopted by the parties to that proceeding.² The JP in LIAW’s last rate case covered the three years ending March 31, 2011. Although LIAW was entitled to file for a base rate increase in 2010 for rates to go into effect in April 1, 2011, the Company opted to delay filing an additional year. The Company’s aggressive policies on maintaining costs allowed it stay out the extra year but, despite the Company’s best efforts, maintenance of costs in the long-term was not sustainable and an increase in revenue was required.

LIAW initiated this proceeding by filing an application for a base rate increase on April 29, 2011 (“April 29 Filing”). As the Company’s testimony showed, an increase in revenue was required to meet increasing costs of providing safe, reliable and quality service. In addition to increased costs of operation, including property taxes, a major driver of LIAW’s April 29 Filing is capital expenditures associated with major plant additions. LIAW continues to invest in capital in its system to maintain its commitment to quality. The Company invested over \$40 million in its system between 2008 and 2010. LIAW plans to invest \$16 million by the end of calendar year 2011 and \$18 million in 2012.

A Notice of Impending Settlement Negotiations was filed with the Commission on September 15, 2011. On or about October 14, 2011, the Parties reached an agreement in principle and proceeded to negotiate the language of the JP. The JP was filed with the Commission on November 28, 2011.

As with the JP approved by the Commission in the Company’s last rate proceeding, the instant JP provides for a three-year rate plan extending through March 31, 2015. The JP provides for a base rate increase of 6.02%, 2.64% and 2.17% in Rate Years One, Two and Three,

² Case 07-W-0508: *Long Island Water Corporation*, Order Determining Revenue Requirement and Rate Design (Mar. 5 2008).

respectively. By excluding from annual revenues amounts received from Distribution System Improvement Charge (“DSIC”) and System Improvement Charge (“SIC”) surcharges, the actual increases in annual revenues under the JP are \$1,402,212 (2.77%), \$1,375,826 (2.64%), and \$1,160,602 (2.17%) for Rate Years One through Three, respectively.

LIAW will not file for another base rate increase before April 1, 2014. The JP also provides for (1) an earnings sharing mechanism, (2) continuation of the SIC, and (3) discontinuation of the DSIC. The JP also recognizes potential synergy savings associated with American Water’s proposed acquisition of Aqua America’s New York water companies.

Adoption of the JP is in the public interest and the Company respectfully requests that the Commission approve it in its entirety without modification. The JP reflects a consensus among parties with competing interests which would be undone by selective modification of any of its provisions. The JP strikes a fair balance between ratepayer and shareholder interests keeping rates low while allowing the Company to make necessary investment in critical infrastructure and earn a fair rate of return. Taken as a whole, adoption of the JP is in the public interest and satisfies the standards contained in the Commission’s Settlement Guidelines.³

I. STANDARD OF REVIEW

In assessing the reasonableness of a JP the Commission applies the principles contained in its Settlement Guidelines. According to the Commission, a desirable settlement should aspire to achieve a balance among protection of consumers, fairness to investors and the long-term viability of the utility; should be consistent with sound environmental, social and economic policies of the Commission and the State; and produce results that are within the range of

³ Cases 90-M-0255, et al.: *Procedures for Settlements and Stipulation Agreements*, Opinion, Order and Resolution Adopting Settlement Procedures and Guidelines (Mar. 24, 1992) (“Opinion 92-2”).

reasonable results that would have likely arisen from a Commission decision in a litigated proceeding.⁴ In reviewing a settlement, the Commission gives weight to the fact that a settlement reflects agreement among normally adversarial parties.⁵ For the reasons set forth herein, the JP satisfies these guidelines and should be approved.

II. TERM

The JP covers the three-year period commencing April 1, 2012, and ending March 31, 2015. The time periods covered by the rate plan are as follows:

Year One: Twelve months ending March 31, 2013

Year Two: Twelve months ending March 31, 2014

Year Three: Twelve months ending March 31, 2015

The three-year term of the rate plan is consistent with Commission policy as reflected in prior Company rate proceedings and of plans recently approved for other Commission regulated water companies. A multi-year plan allows for rate stability for both customers and the Company and provides a strong incentive for the Company to control costs.

III. BASE RATE INCREASES

In its April 29 Filing, LIAW proposed a base rate increase of approximately \$9.6 million or 19.49%.⁶ Staff's initial testimony proposed a base rate increase of \$493,747 or 1.0 %. Thereafter, Staff's initial case was adjusted to \$987,668, or 2.01 %, after discovering miscalculations in its initial testimony. Settlement negotiations resulted in a base rate increase of \$2,955,218 for Rate Year One or 6.02%. The plan also calls for base rate increases of

⁴ Opinion 92-2, Appendix B, Section F.

⁵ *Id.*.

⁶ After accounting for resetting of certain surcharges, the net impact of the rate filing was reduced to 13.23%.

\$1,375,826 or 2.64% in rate Year Two and \$1,160,601 or 2.17% in Rate Year Three. Excluding from annual revenue amounts received from DSIC and SIC surcharges, the actual increase in annual revenue under the JP for Rate Year One is \$1,402,212 or 2.77%. Similarly, Rate Years Two and Three are reduced to \$1,375,826 (2.64%), and \$1,160,602 (2.17%), respectively.

The Company last received a base rate increase in March 2008. While the Company was able to postpone seeking a revenue increase by carefully maintaining costs, continually escalating operations costs, including property taxes, and necessary large capital expenditures require an increase in base rates to ensure continued quality service.

The base rate increases contained in the JP represent a fair settlement of the Parties' positions and is well within the range of possible outcomes of a fully litigated case. There is a full and complete record, and a rational basis, upon which the Commission can assess the reasonableness of the JP.

Attached to the JP as Appendix A are Income Statements for each year of the rate plan. The Income Statements lay out the revenue requirement for each year and the underlying data supporting the proposed rates. The JP also contains supporting data for implementation of the adjustment and reconciliation mechanisms.

IV. ACQUISITION CONSIDERATIONS

As part of a larger transaction, American Water, LIAW's corporate parent, is currently in the process of acquiring the New York assets of Aqua America. In return, Aqua America will acquire the Ohio assets of American Water. Settlement discussions among the Parties addressed issues of possible synergy savings resulting from the acquisition mainly because the service

territory of New York Water Service (“NYWS”), serving approximately 45,000 customers, is also located in Nassau County.

Until such time as American takes over the operations of Aqua American’s New York assets, actual synergies savings, if any arise, cannot be quantified with any degree of accuracy. The JP, however, attempts to estimate such savings for the benefit of the ratepayers. The JP revenue requirement recognizes \$901,331 of ratepayer synergy savings throughout the three-year period of the rate plan (\$133,777 + 383,777 + 383,777 for rate year 1, rate year 2 and rate year 3, respectively). This amount represents the Company’s best estimate for the three-year rate plan.

Staff is continuing to examine synergy savings in the pending acquisition proceeding (Case 11-W-0472) and the savings identified above may be subject to adjustment based on the determination of the Commission. Any adjustment would be taken care of through the RPCRC Mechanism (discussed below).

If the acquisition does not occur, the Company will recover the \$901,331 in synergy savings through the RPCRC Mechanism.

V. SYSTEM IMPROVEMENT CHARGE (“SIC”) MECHANISM

Under this Joint Proposal, the Parties have agreed that LIAW will continue the existing SIC mechanism. The SIC mechanism applies to the following specific, reviewed and approved projects and the associated capital expenditures: iron removal facilities at Plant 15 (\$8,450,000), storage tank rehabilitation at Plant 13 (\$1,900,000), Plant 5 common suction well rehabilitation (\$525,000), and Business Transformation EAM/CIS (\$4,926,481). This mechanism will allow recovery of carrying costs (*i.e.*, return and depreciation expense) on these specific projects placed into service in Rate Years Two, Three and beyond.

The SIC mechanism was approved for use by the Commission within LIAW's last rate case proceeding, Case 07-W-0508. It protects the Company's customers from "slippage" in the in-service date of these very large projects while providing the Company recovery of the cost of the capital devoted to the projects over the course of the multi-year rate plan. The SIC strikes a fair balance concerning the protection of customers, fairness to investors, and long-term viability of the utility. The capital needs of the water utility industry in general, and LIAW in particular, are formidable. For these reasons, the implementation of the SIC by LIAW is a proper, creative approach to the challenge of this type of infrastructure renewal.

As required by the JP, the Company will provide Staff with detailed project information within 30 calendar days of the project's in-service date. Staff will have 60 days to analyze and verify the data, as well as the surcharge calculation. The SIC surcharge will remain in place until the Commission issues a decision in the Company's next general rate case, at which time all of the costs previously collected via the SIC surcharge will be accounted for and included in base rates.

VI. DISTRIBUTION SYSTEM IMPROVEMENT CHARGE ("DSIC") MECHANISM

The Parties also recommend that the DSIC surcharge, as described in the settlement agreement approved by the Commission in Case 04-W-0577 and extended with some modification by the Commission in Case 07-W-0508, end on the effective date new rates are implemented in this proceeding. As approved under these Commission orders, the DSIC mechanism applied to costs associated with distribution and transmission mains installed as replacements or reinforcements, cleaning and lining of mains; and related valves, services and hydrants. Under the order issued in Case 07-W-0508, the Company was required to make semi-

annual filings with the Commission regarding the amount of monies invested in distribution-system related capital expenditures, in order to determine the amount of the surcharge on customers' bills. A final reconciliation of this DSIC surcharge was conducted at the end of each rate year.

The final, annual reconciliation for this existing DSIC surcharge for the twelve-month period ending March 31, 2012 will be filed upon the expiration of this DSIC surcharge, which will occur upon adoption of this JP. This final DSIC reconciliation amount will be recovered or refunded via a one-time surcharge or credit forty-five (45) days from the date of the filing via operation of the Final DSIC Statement Reconciliation Statement No. 1 (annexed to the JP), also recommended by the Parties for adoption by the Commission.

In place of the DSIC mechanism, the Parties have agreed that LIAW will spend \$7.75 million per rate year on distribution system related work, including but not limited to mains, services, hydrants, and valves over the term of the rate plan. The carrying costs associated with the \$7.75 million capital investment in each of the rate years have been included in base rates for each of those years. The Company will make annual filings regarding the capital expenditures for these distribution system-related projects with the Commission at the end of each rate year. Should the Company spend less than the authorized, annual amounts of \$7.75 million, the Company will defer the revenue requirement impact of any shortfall below this target level for the benefit of its ratepayers.

Like the SIC, the DSIC mechanism was implemented as a fair means by which the immense capital needs of water utilities such as LIAW can be met by permitting LIAW to maintain consistent levels of investment in such critical infrastructure work, while at the same time effectively managing the bill impact on its customers resulting from such work. The

elimination of the DSIC mechanism and inclusion of \$7.75 million in capital spend in base rates that is specifically dedicated to distribution system-related work, as described above, will continue to allow LIAW to make necessary, consistent investments in its distribution system. LIAW will be able to, continue to enhance overall service quality, reduce leaks, and ensure adequate delivery capacity. The administrative process for doing so has simply been streamlined by the inclusion of the capital spend within base rates. The Company is still required to make an annual reconciliation with the Commission. Should the Company spend less than the required \$7.75 million, it will be required to refund this difference to its customers, with applicable interest.

Regulatory policies must encourage investment. This process for encouraging the regularized investment in LIAW's distribution system is similar to what the Commission approved in New York Water Service Corporation's last rate proceeding.⁷ Under the terms of the JP, customers will receive the benefits of an aggressive capital expenditure program that ensures the safety and reliability of the water system. Shareholders will receive a timely return of their investment in infrastructure improvements.

VII. REVENUE, PRODUCTION COSTS, AND PROPERTY TAX RECONCILIATION (RPCRC) MECHANISM AND PROPERTY TAXES

The existing RPCRC Mechanisms (previously called the RPT mechanism) are continued under this JP and updated for new target levels. These mechanisms allow LIAW to defer and recover (or refund) the differences in the level of actual revenues compared to the level of revenues in rates and changes in costs associated with production, such as the fuel, power and chemicals required to delivery water to the system.

⁷ Case 09-W-0237: *New York Water Service Corporation*, Order Establishing Three-Year Rate Plan (Jan. 29, 2010), Joint Proposal, Section VIII.

The property tax reconciliation mechanism approved in LIAW's previous rate case is also continued under the RPCRC Mechanism agreed to by the Parties within this JP. Under this RPCRC mechanism, LIAW defers and returns to its customers decreases in property taxes below the target level of property tax expense. This mechanism protects LIAW from the financial impact that property tax increases pose to a business where so much of its revenue requirement is used to pay taxes.

Over the past several years, the Company has aggressively challenged, and continues to aggressively challenge, its property tax assessments by Nassau County and the Villages within its service territory. To the benefit of its customers, over the four-year period 2007-2010 the Company has refunded a total of \$11,541,557 to ratepayers as a result of these property tax challenges.⁸ Moreover, property taxes constituted approximately 22.8% of the Company's test year revenues in the instant base rate proceeding, down from 36.2% in the 2003 test year shown in the Company's base rate proceeding in Case 04-W-0577.⁹

Under this JP, for each of the Rate Years, the variance between forecast and actual property taxes will be tracked. The Company will absorb or retain 10% of such variance, and the remaining variance (90%) shall be deferred and fully recovered or passed back to customers in the succeeding 12-month period as part of the RPCRC Mechanism. LIAW will be allowed to retain the 10% of such variance only if it can successfully demonstrate that the reduction in property tax expense was a direct result of the Company's intervention and actions. The Company will absorb 10% of all property tax increases above the reconciliation levels as set forth in the JP with the remainder paid by customers.

⁸ See Case 06-W-0069; Case 08-W-1251; Case 09-W-0581; Case 10-W-0449; currently pending before the Commission is the Company's most recent property tax refund petition, Case No. 11-W-0484.

⁹ See Casillo Initial Testimony pp 8, line 5, - 14, line 20.

In terms of property tax expenses, the RPCRC Mechanism allows the Company's customers to recapture all savings if tax expense is less than the projection. Further the Company is provided with an incentive to continue its aggressive property tax challenges and continue its successful efforts in that regard by being permitted to retain 10% of the savings if it can show that the reduction in actual property taxes was a direct result of its intervention and actions. While the Company proposed in its direct testimony that it be allowed full recovery of property tax increases, the JP, by including an adjustment to the sharing of the property tax expenses between the Company and its customers, acknowledges the Company's efforts to vigorously manage its tax burden as well as its aggressive efforts to challenge and reduce the level of its property tax expenses.

VIII. EQUITY RATIO AND EARNINGS SHARING MECHANISM

The Company and Staff agreed to an equity capitalization ratio of 42%¹⁰ and an equity return of 9.65% which includes a stay-out premium. The equity return is based on Commission methodologies for calculating fair returns (*i.e.* weighting two-thirds DCF and one-third CAPM) and is representative of current market conditions.

In its April 29 Filing, Company testimony proposed a pre-tax equity return of 11.67%. Staff's initial prepared testimony proposed an equity return of 8.9%. Through settlement negotiations and corrections to filed positions, the Parties arrived at an equity return of 9.65%.

LIAW will be permitted to retain 100% of earnings attributable to an achieved return up to and including 10.2%, a dead band of 55 basis points.¹¹ All earnings attributable to an achieved ROE above 10.2% and up to 10.7% will be shared 50%/50% between customers and

¹⁰ For purposes of settlement, the Company agreed to utilize Staff's hypothetical equity ratio of 42%.

¹¹ The 55 basis point dead-band is significantly less than the 100 basis point dead-band approved in LIAW's last rate proceeding (Case 07-W-0508) and allows for earnings sharing with ratepayers at much lower levels.

shareholders. All earnings attributable to an achieved ROE above 10.7% will be shared on the basis of 75% to the customers and 25% to the shareholders.

The benefits Earnings Sharing Mechanism will continue beyond the end of the Rate Plan until LIAW's rates are reset in the next rate proceeding.

IX. OUTREACH AND EDUCATION

The Company will continue to develop and implement customer outreach and education programs and materials to increase awareness and understanding of water issues, policies, and initiatives such as water quality, cost, system improvements, conservation techniques, customer rights and customer service matters. Within 30 days after the Commission issues an order adopting the terms of the Joint Proposal, the Company will file a plan with the Director of the Department of Public Service's Office of Consumer Policy ("OCP Director") for Staff review that details the outreach and education program's goals and objectives, target audiences, source of funding, core messages and implementation strategies, methods and schedule for the coming year. The annual plan may be reviewed and updated as appropriate and necessary based on significant changes in Company services or programs. The Company will review the plan each year of the rate term and send a letter to the Director within 30 days after the end of the Rate Year stating whether any change to the plan is warranted, and, if a change is warranted, describing the change.

X. PENSION AND OPEBS

In its rebuttal testimony, and as required under Section N of the Commission's Order adopting the Pension/OPEB Policy Statement ("Pension Policy"),¹² the Company formally requested that it be allowed to compute Pension/OPEB expense on a consolidated rather than on a stand-alone basis. LIAW established in this proceeding¹³ that Pension/OPEB expenses were lower when taken into account on a consolidated basis. The Parties recommend in the JP that for the three-year term covered by this agreement, the Company's Pension/OPEB expense will be computed on a consolidated basis for ratemaking purposes. The Company will also continue to compute the amount of Pension/OPEB expense on a stand-alone basis for the three-year term covered by this JP in order to compare the expenses (stand-alone versus consolidated).

Generally, the Commission's Pension/OPEB Policy Statement requires that these expenses be computed on a stand-alone basis. The Pension Policy provides, however, that a utility may request Commission authorization to compute pension and OPEB expenses if the utility can make a showing that computing pension and OPEB expenses on a stand-alone basis is onerous to itself and its ratepayers.¹⁴ The Company is seeking recovery of pension and OPEB cost on a consolidated basis computing these costs on a stand-alone basis would be onerous to both the ratepayers and the Company. In its rebuttal testimony, the Company established that continuing to compute pension and OPEB expenses on a stand-alone basis would be onerous to the ratepayers because LIAW would need to recover these increased costs through higher rates with no known corresponding benefit. Computing these costs on a stand-alone basis would also be onerous to LIAW because it would increase the balance in the internal reserve that the

¹² Case 91-M-0890: Statement of Policy and Order Concerning Accounting and Ratemaking Treatment for Pensions and Postretirement Benefits Other Than Pensions (Sep. 7, 1993) ("Pension Policy Statement").

¹³ See Casillo Rebuttal Testimony, pp. 10, line 1 – 11, line 13; See also King Rebuttal Testimony.

¹⁴ Case 91-M-0890: Order Adopting Statement of Policy and Order Concerning Accounting and Ratemaking Treatment for Pensions and Postretirement Benefits Other Than Pensions (Sep. 7, 1993), Section N.

Company is currently accruing interest on at the pre-tax rate of return. Moreover, the Company would incur significant additional costs to manage and administer a stand-alone plan for LIAW. Thus, accounting for pensions and OPEBs on a consolidated basis would result in lower expenses (in the form of pension and OPEB costs and administration expenses) and, therefore, lower rates.¹⁵

XI. OTHER

The JP includes all the customary provisions of a multi-year rate plan. For example, the Commission's ongoing authority to set just and reasonable rates is recognized. The Company is authorized to seek relief if circumstances jeopardize its ability to provide safe and adequate service. There are also comprehensive reporting requirements regarding a range of activities including the capital programs, the SIC, distribution system-related capital expenditures, RPCRC Mechanism, property tax expense, pension and OPEB expense, reporting and accounting, and earnings.

CONCLUSION

The JP represents a comprehensive, multi-year plan. It provides the Company with the means to continue its tradition of quality service and capital investment while mitigating the economic impact on its customers. The JP also provides incentives to achieve savings and efficiencies and protects the Company, to an extent, from certain uncontrollable expenses. It meets the public interest standards set forth in the Commission's settlement guidelines and represents a balance among the competing interests of adversarial parties. It also eliminates the

¹⁵ Staff is in the process of reviewing a recent update filed by the Company to determine whether the Company should be allowed to accrue interest on pension internal reserves. Staff will issue a draft report with preliminary recommendations for resolution of the filing for possible inclusion in this Joint Proposal.

expense of additional rate proceedings over the next three years. Accordingly, the JP should be approved in its entirety, without modification.

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