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October 20, 2014

Honorable Kathleen H. Burgess
Secretary
New York Public Service Commission
Three Empire State Plaza
Albany, New York 12223-1350

Re: Cases 13-W-0295 (Rates), 13-W-0246 (Surcharge) and 13-W-0303 (Need and Prudence) – Utility Intervention Unit’s Letter in Support of Motions

Dear Secretary Burgess:

The Utility Intervention Unit (“UIU”) of the New York Department of State’s Division of Consumer Protection submits this letter in support of three related United Water New York (“UWNY” or the “Company”) filings, all dated October 10, 2014, pertaining to the above-captioned proceedings. These are: (1) Supplement to Petition for Rehearing and/or Clarification on Behalf of the Municipal Consortium (“MC Rate Case Motion Supplement”); (2) Supplement to Motion to Dismiss the Verified Petition of UWNY for a Long-Term Water Supply Surcharge or in the Alternative, for a Prudence Investigation on Behalf of the Town of Ramapo (“Ramapo Surcharge Motion Supplement”), and, (3) Supplement to Motion for a Prudence Investigation on Behalf of the Town of Ramapo (“Ramapo Prudence Motion Supplement”).

The MC and Ramapo state that their filings were prompted by news of the recent dismissal of former UWNY Vice President Mr. Michael Pointing and two United Water employees from the accounting department in connection with an internal Company investigation into alleged misappropriation of funds and misstatement of revenue. The MC and Ramapo question whether the alleged conduct may have had significant impacts on the quality and accuracy of the information on which the Public Service Commission (“PSC” or “Commission”) and the parties reasonably relied in the three United Water cases. The MC and Ramapo expressed in their filings their concern that the accounting information and other relevant data that the Company provided in the rate and surcharge cases “may have been tainted by whatever impropriety [that] led to the dismissal of Mr.

Pointing and two accounting colleagues.”¹ Further, Ramapo’s Prudence Motion Supplement states that “the allegations of misappropriation of funds and misstatement of revenues might be part of a pattern of behavior that affected aspects of the Company’s administration of the development of [the] desalination facility, and the alleged conduct may be part of a corporate culture that extends beyond the three employees mentioned in the article.”²

All three filings seek the institution of a prudence investigation as well as a Commission order setting 20% of the overall rate award to UWNY temporary, subject to refund, pending the outcome of a thorough prudence investigation and audit of all aspects of the Company’s operations.³ Ramapo’s Prudence Motion Supplement further states, in addition to an audit of accounting information, that: “[i]t would also be appropriate for Staff to investigate whether the conduct of any [UWNY] employees resulted in actions or inactions that made the demand for a long-term water supply more urgent than real facts now reveal.”⁴

The UIU supports these requests. There is a documented history of mismanagement and imprudence on the part of UWNY in connection to its operations in Rockland County. In the 2014 Rate Order, the PSC directed the Company to conduct a management study and an audit of charges.⁵ This directive was based upon the Commission’s findings of UWNY mismanagement, which included six years of rate increases that collectively outpaced inflation by a substantial margin,⁶ failure to apply for economic obsolescence awards, unsupported and inflated charges and evidence that management has lost sight of its responsibilities to ratepayers. Similarly, the record in the Surcharge Proceeding demonstrated unequivocally that UWNY failed to exercise cost controls on its vendors or to properly document the costs incurred. These incidents of mismanagement are not surprising given the pervasive failures of management identified by the PSC in the 2014 Rate Order. The UIU’s previous concern is now even more pronounced in light of the recent allegations of misappropriation of funds and misstatement of revenue against the senior UWNY manager.

The Commission’s broad rate-making powers are “sufficient to allow it generally to assess the prudence of a utility’s actions as those actions impact upon ratepayers.”⁷ A prudence investigation is warranted when the facts establish a *prima facie* case of poor decision-making or, as the recent news indicates, financial mismanagement. The records in the Rate Proceeding and in the Surcharge Proceeding demonstrated that a *prima facie* case of imprudence exists. The new allegations are consistent with the records in those cases. The record in these proceedings presents instances of imprudent decision-making

¹ MC Rate Motion Supplement, at 3, and Ramapo Surcharge Motion Supplement, at 3.

² Ramapo Prudence Motion Supplement, at 7.

³ MC Rate Motion Supplement, at 4; Ramapo Surcharge Motion Supplement, at 4; Ramapo Prudence Motion Supplement, at 6.

⁴ Ramapo Prudence Motion Supplement, at 7.

⁵ Case 13-W-0295, United Water New York-Rates (issued June 26, 2014) (“2014 Rate Order”).

⁶ Note that UWNY capitalized on these rate hikes by increasing its dividend to its parent in 2013 by 50% while spending tens of millions of dollars on the Haverstraw Desalination Facility.

⁷ Crescent Estates Water Co., Inc. v. Public Service Com'n, 77 N.Y.2d 611, 617 (1991).

and conduct on the part of UWNY and its affiliates in general, and specifically, in regard to expenditures relating to the Haverstraw Desalination Facility.

A recurrent theme throughout the hearings in the Rate and Surcharge Proceedings pertained to failures of UWNY's management to act in the best interests of its ratepayers. In the 2014 Rate Order, the PSC stated: "Yet the record in this case gives rise to inferences that the Company has lost sight of its mission and no longer is focusing its full attention on the operational requirements implicit in the statutory standard of safe and adequate service at just and reasonable rates."⁸ The Commission also found that some of UWNY's expense recording practices were deficient, and expenses were not adequately justified.⁹ In addition to its deficient recordkeeping, UWNY failed to control costs and also tried to bill ratepayers for excessive and unexplained Management and Service Company ("M&S") costs. The PSC recognized these problems and disallowed these costs and also required UWNY to take further steps to examine its management decisions, which included an audit of M&S Company charges.

Whether the filings of the MC and Ramapo are considered "supplements" to motions or new motions, they are appropriate reactions to the reported escorted removal of the senior UWNY official for alleged wrongdoing. In light of the allegations against Mr. pointing and two accounting employees, the UIU recommends that the Commission expand the previously ordered audit of the M&S Company charges to a full-scale audit of UWNY's books and also direct the Company to show cause as to why the Commission should not institute a prudence proceeding. A thorough investigation by the Commission would ensure the reasonableness of the UWNY's routine operations and maintenance charges and of the Haverstraw Desalination Facility invoices.

To better protect ratepayers, the UIU also supports the MC and Ramapo's proposal to set 20% of the Company's current revenues temporary and subject to refund, pending the outcome of a thorough audit of the Company's operations. In making this and the above recommendation, the UIU is guided by previous Commission orders regarding cases involving similar allegations of company misconduct. The reference in the MC and Ramapo's filings to Case 09-M-0114, a proceeding instituted to examine the prudence of Con Edison's capital and operation and maintenance expenditures, is apt. In that proceeding, the Commission expressed concern that the alleged misconduct on the part of several employees may have been part of a wider company pattern and stated its belief that the prudence investigation would lead to development of recommendations for improving Con Edison's practices and procedures.

The adoption of a similar course of action by the Commission is merited in this case. In order to appropriately protect ratepayers, 20% of the rate should be made temporary subject to refund, pending the outcome of an audit into the Company's operations. This recommended approach will promote greater transparency into the Company's operations and ensure that ratepayers are protected while not unduly injuring

⁸ 2014 Rate Order, at 11.

⁹ *Id.*, at 36.

the Company in the event that the Company's actions are found to be appropriate and proper.

Respectfully submitted,

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Dated: October 20, 2014
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