

STATE OF NEW YORK  
PUBLIC SERVICE COMMISSION

Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of United Water New York Inc. for Water Services.

Case 13-W-0295

**RESPONSE OF THE  
UTILITY INTERVENTION UNIT TO THE  
MUNICIPAL CONSORTIUM'S PETITION FOR  
REHEARING AND/OR CLARIFICATION**

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**INTRODUCTION**

The New York State Department of State's Utility Intervention Unit ("UIU") submits this response pursuant to 16 NYCRR §3.7 in support of the "Petition for Rehearing and/or Clarification On Behalf Of The Municipal Consortium" ("MC Petition"), filed on July 28, 2014. The MC Petition points out errors of law and fact in the 2014 Rate Order<sup>1</sup> of the Public Service Commission ("PSC" or the "Commission") that should be rectified and, as necessary, clarified to avoid an unjust and unreasonable rate and policy outcomes, and to accelerate improvements in the relationship between the utility and the community.

The MC Petition urges the correction of the errors in the PSC's 2014 Rate Order by (1) making temporary, subject to refund, 50% of the management and services charges pending the outcome of the comprehensive audit of United Water New York ("UWNY" or the "Company"), (2) rescinding the Lake DeForest cost allocation

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<sup>1</sup> Case 13-W-0295, supra, Order Establishing Rates (issued June 26, 2014) ("2014 Rate Order").

amendment as it was granted without record support and without reasonable opportunity for public comment, and (3) involving intervenors in the development of future studies and proposals. The UIU supports the MC Petition because granting the requests contained therein would protect ratepayers from paying unjust and unreasonable rates. It would also have the important benefit of accelerating realization of the Commission's objectives of improving the performance of UWNY's management and the relationship between UWNY and its ratepayers.

UWNY has enjoyed substantial annual rate increases since 2008, allowing it to enhance the dividend paid to its parent (United Water New Jersey) by 50%, at the same time it allowed its management to engage in conduct that has estranged it from the community it is obligated to serve.<sup>2</sup> The Commission observed in its 2014 Rate Order:

The efforts of the Department of Public Service Staff and other parties have enabled us to significantly moderate the Company's request, but **the increase we are authorizing is still substantial**, and this increase follows six increases that collectively have substantially outpaced inflation, averaging nearly 10% each. While the costs driving the rate increase authorized by this order are principally property taxes and enhancements to infrastructure, and are thus difficult to control, **the upward pressure on rates nevertheless is an issue of great concern.**<sup>3</sup>

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Much of this order confirms the reasoning presented in the RD [Recommended Decision] regarding the best disposition of numerous discrete issues affecting an appropriate revenue allowance and rate design. In broader terms, however, our perspective on this rate application is guided by what we perceive to be a compelling need that UWNY better define its strategy for fulfilling its responsibilities as a franchised monopoly. Water, perhaps more than any other type of utility service, is not merely a commodity delivered to a service territory but an essential condition of life in UWNY's community. **Yet the record in this case gives rise to inferences that the Company has lost sight of its**

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<sup>2</sup> Id. at 46.

<sup>3</sup> Id. at 2; emphasis added.

**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.<sup>4</sup>**

Despite these important acknowledgements, the 2014 Rate Order awarded the Company a revenue increase of \$7.4 million or 10.0% for year one and an additional \$7.4 million or 9.1% for year two and, counterintuitively, *put off until the Company's next rate case* any requirement that the Company improve its management practices: "We are also taking this opportunity to strongly remind UWNY of the need to carefully examine strategies to reduce upward rate pressure and call on the Company to demonstrate that it is pursuing all reasonable management and cost control strategies and address such effort in its next major rate filing."<sup>5</sup>

The UIU encourages the Commission to rehear and reconsider several aspects of the 2014 Rate Order and to grant the MC Petition. Doing so would significantly improve management's conduct and protect ratepayers *now* rather than waiting for another two years.

## **ARGUMENT**

### **I. THE COMMISSION ERRED BY NOT MAKING TEMPORARY AND SUBJECT TO REFUND A PORTION OF THE M7S CHARGES PENDING THE OUTCOME OF THE AUDIT.<sup>6</sup>**

The 2014 Rate Order required a comprehensive audit of the United Water Management and Services Company charges ("M&S Charges") based upon the improprieties discovered by Department of Public Service ("DPS") Staff in its sampling of those charges.<sup>7</sup> However, the Commission erred legally by not setting a portion of the rates attributable to the M&S Charges as temporary rates, subject to refund. This approach departed from the Commission's own past practice of setting rates as

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<sup>4</sup> Id. at 10-11; emphasis added.

<sup>5</sup> Id. at 2-3.

<sup>6</sup> Id. at 12-17.

<sup>7</sup> Id. at 12-17. The 2014 Rate Order directed UWNY to conduct a "comprehensive audit" of the M&S Charges whereas the UIU and the MC had asked that DPS Staff oversee such an audit.

temporary while an audit of expenditures is pending. A recent example of this practice is the Commission's treatment of certain Niagara Mohawk expenditures that were the subject of an audit.<sup>8</sup> The Commission asserted that such a measure is unnecessary in this case because the M&S Charges allowance was set "by escalating the final year of the last rate plan rather than using UWNY's test year expense level, which effectively disallows \$1.3 million or 30% of the Company's claimed expense [and, in turn,] provides ratepayers with adequate protection pending the outcome of the comprehensive audit."<sup>9</sup>

The UIU submits that this reasoning is a factual error because it assumes *a priori* that the historic levels of M&S Charges were appropriate. Yet, we can readily assume from DPS Staff's findings of improper charges and lax audit controls discovered in the current rate case that it is highly likely that the historic levels were improperly high.

Because of the prohibition against retroactive ratemaking, in the event that the audit reveals widespread irregularities or unreasonable costs incurred by UWNY management, ratepayers will not have any recourse unless some portion of the revenue requirement is set as temporary. However, the 2014 Rate Order ensures that no meaningful remedy will be available to compensate the ratepayers if any irregularities or unreasonableness are found.

As the Commission observed, an expenditure is not reasonable simply because it was made: "The fact that UWNY may be incurring a specific expense level does not necessarily make that expense level reasonable, particularly where the expenses originate in non-arms-length transaction with an affiliate."<sup>10</sup> The UIU agrees with the MC that making the rates temporary and subject to refund is administratively easy and will afford ratepayers complete—not just "adequate"—protection from paying unjust and unreasonable rates.

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<sup>8</sup> Case 10-E-0050, Niagara Mohawk Power Corporation-Electric Rates, Order Establishing Rates for Electric Service (January 24, 2011) at. 4-5.

<sup>9</sup> Id. at 17.

<sup>10</sup> 2014 Rate Order at 16. Another "non-arms-length transaction with an affiliate" is discussed infra.

**II. THE COMMISSION ERRED IN ACCEPTING THE LAKE DEFOREST COST ALLOCATION AMENDMENT WITHOUT RECORD SUPPORT AND WITHOUT REASONABLE OPPORTUNITY FOR PUBLIC COMMENT.<sup>11</sup>**

The Commission erred in “accepting” in this rate case, without a record basis and without notification to the parties in this case or the other two related UWNJ proceedings,<sup>12</sup> an amendment to the Lake DeForest Reservoir Cost Allocation Agreement (“Cost Allocation Amendment”) that UWNJ negotiated with its parent company (United Water New Jersey). The amount of water routinely flowing from Lake DeForest to United Water New Jersey and the amount of compensation United Water New Jersey pays UWNJ for the water have been the subject of debate and controversy in PSC proceedings since at least 2009. The Commission “approved” the previous intercompany cost allocation agreement, which was executed by Spring Valley Water Company (predecessor of UWNJ), and its parent, Hackensack Water Company (predecessor of United Water New Jersey), by an order issued September 16, 1993 in Case 92-W-0638.<sup>13</sup> This agreement between a subordinate entity and its corporate parent not surprisingly continues the same passing flow and cost allocation metrics that have been a prominent subject of controversy for years in Rockland County; commenters have repeatedly expressed their belief that the current arrangement benefits United Water New Jersey ratepayers to the detriment of UWNJ ratepayers. UWNJ did not advise the parties that it filed the Cost Allocation Amendment on February 11, 2014;<sup>14</sup> the filing was given a different case number (14-00290) and notice of the filing was not published in the State Register.

The UIU agrees with the Municipal Consortium that the 2014 Rate Order violated the due process rights of the intervenors and Rockland County citizens in accepting the Lake DeForest Cost Allocation Amendment that UWNJ negotiated with its parent, United Water New Jersey. In contrast to the process followed in the Commission’s

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<sup>11</sup> 2014 Rate Order at 43-46.

<sup>12</sup> In addition to this rate proceeding, Lake DeForest issues pertain to the Surcharge Proceeding (Case 13-W-0246) and the Need and Prudence Proceeding (Case 13-W-0303).

<sup>13</sup> The Commission approved the previous cost allocation agreement pursuant to SAPA No. 92-W-0638SA1.

<sup>14</sup> Apparently, Rockland County learned about the February 11, 2014 filing through an informal conversation at a social event. The County submitted a letter on the filing on April 14, 2014; this letter was not distributed by the PSC Secretary’s office to the parties in the rate case.

review and eventual approval of the previous cost allocation agreement, this time, no notice of the 2013 filing was provided to stakeholders. Further, the record in this rate proceeding does not support any decision on the merits.

The subject of the Lake DeForest negotiations was discussed during the procedural conference held in this case on August 27, 2013. One of UWNYS attorneys stated that it was his opinion that Commission review of any renegotiated agreement would be decided in another case: “Lastly, with regard to what was raised about the New Jersey/New York issue, we do not see that as part of this proceeding either.”<sup>15</sup> UWNYS attorney elaborated on his view of the process later in the discussion, emphasizing that the Company would keep the parties informed of the status of the negotiations and that Commission review of the results of the negotiation would be a public process:

We don’t believe that, your Honor, it would happen in this case. I’m not aware of there being a pending...docket.

But I – I do understand that it requires Public Service Commission approval. And I think Mr. Duthie’s concerns about being aware of things and being advised, that’s the proceeding where that would occur. To the extent that – and we could talk to the Company – to the extent there’s public information about that that the Company can provide, you know, there will be negotiations that will be occurring, we will be perhaps involved in some. But there will be negotiations between the D.E.C. and the – the New Jersey D.E.P. that, you know, we will not be involved in. **But we can share information that we’re able to share.**

**But, also, we believe when the Public Service Commission has to make its determination that that will be a public – in fact it will be a public process.**<sup>16</sup>

Despite these assurances, the Company did not advise the parties during the evidentiary hearings in this case, held on February 13 and 14, or at any time thereafter, that it had filed the Cost Allocation Amendment on February 11, 2014.

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<sup>15</sup> Tr. 62.

<sup>16</sup> 2014 Rate Order at 70-71; emphasis added.



A review of filings on the Commission's web site indicates that issues pertaining to Lake DeForest's allocation of costs and passing flow have been a prominent subject of controversy for years in Rockland County. The County of Rockland and Scenic Hudson raised these issues in their respective filings opposing the Joint Proposal in the Company's 2009 rate case (Case 09-W-0731), and the Commission suggested in its order in that proceeding that parties would have an opportunity to comment on any amendment prior to the Commission's decision on whether or not to *approve* (as opposed to *accept*) the Agreement:

In addition to the performance incentive we have rejected, Rockland County has asked us to consider the intercompany cost allocations for Lake DeForest in this proceeding. From the record, we are aware of the reservoir's established safe yield and the additional water flow to New Jersey above and beyond the water that New Jersey receives to satisfy its riparian rights. The intercompany cost allocation agreement was previously **approved** by the Commission and it controls the amount of costs each affiliated company incurs and it does not end until mid-2013. The matters Rockland has raised may warrant consideration when a new contract comes before the Commission for **approval**; however, they do not provide a basis for any changes to be made now. When the new agreement is submitted to the Commission for action, Rockland County and Department Staff should, at that time, examine the contract terms and submit their respective recommendations to the Commission for its decision.<sup>17</sup>

In Case 13-W-0303, the Need and Prudence Proceeding, DPS Staff's Report On Need, which was issued on May 22, 2014, devoted fully ten pages to Lake DeForest issues (without mentioning that the Cost Allocation Amendment had been filed three months earlier). Many of the parties that submitted initial and reply comments in Case 13-W-0303 (Robert Kesckes, Robert Dillon, Albert Appleton, Charles McLane, Scenic Hudson and the Rockland County Water Coalition, to name just a few) addressed Lake DeForest issues.

Intervenors and the public have a rational and reasonable expectation that the Commission will provide an opportunity for comment on issues important to ratepayers

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<sup>17</sup> Case 09-W-0731, UWNY-Rates, Order Adopting Joint Proposal as Modified and Establishing A Three-Year Rate Plan (issued July 30, 2010) at 26-27.

and communities. UWNY made its filing pursuant to Section 110 (3) and (4) of the Public Service Law. These provisions set out the structure for PSC review of arrangements between affiliates. The UIU acknowledges that the statutes explicitly require an investigation and public hearing only if the PSC intends to “disapprove” the arrangement as “not in the public interest.” However, as discussed above, the Cost Allocation Amendment contains provisions that have widespread impacts on the ratepayers of Rockland County and the PSC’s ultimate decision regarding the need for a new major long-term water supply in Case 13-W-0303. As the Supreme Court stated in Mullane v. Central Hanover Trust, 339 US 306 (1950):

An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections. Milliken v. Meyer, 311 U.S. 457; Grannis v. Ordean, 234 U.S. 385; Priest v. Las Vegas, 232 U.S. 604; Roller v. Holly, 176 U.S. 398. The notice must be of such nature as reasonably to convey the required information, Grannis v. Ordean, *supra*, and it must afford a reasonable time for those interested to make their appearance, Roller v. Holly, *supra*, and cf. Goodrich v. Ferris, 214 U.S. 71.

Citing Mathews v. Eldridge, 424 US 319, 334 (1976), the PSC noted in 2001 that “[t]he Supreme Court has held that ‘[d]ue process, unlike some legal rules, is not a technical conception with a fixed content unrelated to time, place and circumstances. Due process is flexible and calls for such procedural protections as the particular situation demands.’”<sup>18</sup> The UIU asserts that this is such a situation that calls for procedural protections.

The Commission’s “acceptance” should be withdrawn and parties and the public should be given a reasonable opportunity to file comments and testimony on the Cost Allocation Amendment. After a hearing, a PSC decision on whether the Cost Allocation Amendment is in the public interest can be incorporated into its decision in the Need and Prudence Proceeding, which is expected to address related supply-side issues.

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<sup>18</sup> Case 96-E-0898, RG&E-Rates/Restructuring, Order Denying Petition for Rehearing (issued November 8, 2001).

**III. THE COMMISSION ERRED IN NOT DIRECTING UWNY TO WORK WITH THE INTERVENORS AND OTHER INTERESTED PARTIES IN DEVELOPING THE SCOPE AND ASSUMPTIONS OF THE VARIOUS STUDIES AND PLANS ORDERED BY THE PSC.**

The UIU joins with the Municipal Consortium in recommending that aspects of the 2014 Rate Order require clarification. The Commission discussed several times the importance of the Company taking steps to improve its management and operation decision-making and to regain trust and work cooperatively with the ratepayers and local governments of Rockland County.<sup>19</sup> The PSC ordered the Company to develop and conduct studies, analyses, plans and proposals related to: (1) improving management practices (Ordering Clause 6);<sup>20</sup> (2) decreasing non-revenue water (“NRW”) (Ordering Clause 7);<sup>21</sup> (3) developing rate structures that promote conservation (Ordering Clause 8); and, (4) improving the Company’s relationship with its customers (Ordering Clause 10). Yet, the 2014 Rate Order directed UWNY to discuss, with DPS Staff *only*, the scope and nature of items 1, 2 and 4 before embarking upon them.

Of particular concern—and opportunity—is the 2014 Rate Order’s discussion of a management review:

More broadly, we are concerned that UWNY must demonstrate that it is exercising diligent management oversight over the UWNY operations and pursuing all reasonable cost control strategies to minimize rates. Thus, in addition to the M&S audit, the Company is directed to conduct a review of its management strategies, long-term construction planning, and programs, with an objective of optimizing operational efficiencies, with an appropriate focus on the UWNY service territory resources and needs. This audit should evaluate UWNY’s managerial approach to overseeing and controlling its capital and operational costs and its tax burdens. **The Company shall consult with staff on the scope and basic approach, including use of external consultants, of these two interrelated reviews**

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<sup>19</sup> See, for example, 2104 Rate Order at 11-12, 15-16, and 69-71.

<sup>20</sup> “We are directing the Company to coordinate the scope of the audit with our staff to ensure a thorough review of the M&S issues identified in the Recommended Decision: improper charges and misallocation of expenses; equitability of continued application of the three factor methodology to regulated affiliates; and a cost/benefit analysis that compares M&S services to alternative outside services.” *Id.* at 71.

<sup>21</sup> “The Company is directed to submit for our staff’s review and approval, within 90 days of this order, the specific measurement criteria that it proposes for application in the analysis.” *Id.* at 43.

**within two months of the date of this order and shall continue to work with staff throughout.<sup>22</sup>**

Reinforcing the distance between the Company and its ratepayers will not advance the objective of improving the relationship between the Company and its ratepayers, as discussed in the 2014 Rate Order. Moreover, since it is unclear how the management review ordered by the Commission is different from a management audit, which the Commission did not order (although the Commission did order a “comprehensive audit” of the M&S Charges), it is important for the parties that recommended the latter to have an opportunity to comment on “the scope and basic approach” of the management review.

Regarding the relationship between the Company and its service territory, the Commission stated:

The plan should identify, at a minimum, key stakeholders; information to be provided to stakeholders including cost drivers, actions UWN Y is taking to control its costs, and the impact of factors not in UWN Y's control on its revenue requirement; a description of methods to be used to provide this information to stakeholders on a recurring basis; and the timeline under which this information would be delivered. Staff will review this plan and may recommend changes to enhance its effectiveness.<sup>23</sup>

It is especially appropriate for the Company to implement the PSC's directive that it develop a “plan to improve its public communications and relationships with stakeholders” in conjunction with the representatives of those stakeholders.

Granting the requests for clarification would acknowledge not only that the UIU and the MC had a large role in the Commission's determination to order these initiatives but also that the landscape has changed dramatically since the time the 2014 was prepared: On June 19, 2014, Rockland County adopted Resolution 294, which established a Task Force of Water Resources Management. The 19-member Task Force, which is expected to include the General Manager of UWN Y, large water users,

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<sup>22</sup> Id. at 72.

<sup>23</sup> Id.

scientists, government officials and community members, has been charged with developing a long-term County water plan that:

incorporates sustainability, demand-side principles, and conservation . . . while developing this Plan, the Task Force's first objective will be to ensure that demand for water will not come close to available supply while the Plan is being fully developed. Conservation measures shall be instituted . . . to reduce demand to create the necessary buffer while developing the comprehensive plan that meets the water supply of the next generation[.]<sup>24</sup>

The County's swift passage of such a resolution demonstrates the County's commitment to increased conservation efforts. New rate structures are a critical element in determining the County's future water needs. The intervenors should have an opportunity to shape the initiatives ordered by the PSC, especially given that these initiatives are intertwined with the demand and supply issues that are the focus of Case 13-W-0303.

An effective model for intervenor involvement in post-Order initiatives can be found in the recent Consolidated Edison gas, electric and steam rate cases in which the PSC established several collaboratives to work on diverse issues. In these collaboratives, the utility typically prepares drafts of scoping documents and reports, the other parties have opportunities to comment, and the utility prepares revised documents for filing with the PSC based on that input. Similarly, the UIU urges the PSC to develop in this case a streamlined structure for effective participation by intervenors in these important initiatives.

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<sup>24</sup> Rockland County Legislature, Resolution No. 294 of 2014 (adopted June 19, 2014).

**CONCLUSION**

For the reasons discussed above, the Commission should grant the petition for rehearing and requests for clarification as described in the MC Petition. Granting the MC Petition will protect UWN Y ratepayers from paying unjust and unreasonable rates and will contribute significantly to restoring a sound relationship between UWN Y and its ratepayers.

Respectfully submitted,

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