STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

Case 16-W-0259 –	Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York American Water Company, Inc. for Water Service.
Case 17-W-0300 -	Petition of New York American Water Company, Inc. for Approval to Offset the RAC/PTR Surcharge, P.S.C. No.5

STAFF INTERIM REPORT ON ITS INVESTIGATION INTO NEW YORK AMERICAN WATER'S PROPERTY TAX OVERCHARGES

HOLD HARMLESS CALCULATION

April 30, 2018

EXECUTIVE SUMMARY

After an investigation of New York American Water's property tax calculations affecting Sea Cliff customers, Department of Public Service staff found that the company's erroneous tax calculations have caused an overpayment over the past four years of $2.3 million. As discussed in this report, Staff recommends the overpayment be given to customers as a credit on future bills, which, after accounting for rate changes already implemented to protect customers, equals $65.37 per average customer that will be spread out over 12 months.
Based on the corrected property tax levels and targets, Staff estimates that customers will see a $2.4 million reduction in future forecasted rates related to property taxes, in addition to the $2.3 million retrospective error. Staff notes that the actual property taxes in future rate years will vary from the revised targets, and ultimately be trued-up through the rate process.

Meanwhile, Staff continues to pursue a second phase of the investigation into how the company initially made the mistake and why it allowed the errors to persist without being corrected. DPS will also continue to investigate why the company failed to notify Staff and the Commission about the errors. Staff anticipates that it will complete the final phase of the investigation by June 30.

INTRODUCTION

In December 2017, New York American Water Company, Inc. (NYAW or the Company) informed Department of Public Service (DPS) Staff that it filed incorrect plant-in-service information with the Office of Real Property Tax Services (ORPTS) initially in 2013, after the acquisition of Aqua New York, Inc. in 2012. The reporting of erroneous data was perpetuated in NYAW's 2014 and 2015 filings with ORPTS.[1] The erroneous data resulted in over-assessed property values in the Company's Sea Cliff Water District (Sea Cliff, or the Company). These over-assessments caused inflated tax expenses which the Company paid and would ordinarily collect from customers in Sea Cliff.

On December 26, 2017, DPS informed NYAW that Staff was investigating the issue and related ratemaking.[2] On December 28, 2017, NYAW filed a Petition[3] with the Commission seeking to reconcile its past and future property taxes in the Sea Cliff District with the tax expenses the Company would have incurred if there had not been a reporting error. Also, on December 28, 2017, Carmen Tierno, President of NYAW, sent a letter to Chairman Rhodes, stating that: "NYAW is unconditionally committed to fully safeguard its customers from financial harm as a result of this issue".

In order to minimize any customer overcharges related to this error, NYAW immediately reduced two of Sea Cliff's

[1] The majority of NYAW's properties' assessed value is determined by ORPTS, and is based on the utility's self-reported cost of plant-in-service. Municipalities and school districts rely on ORPTS assessments to determine and bill annual property taxes. ORPTS market value assessments are based on the original costs and vintage year of additions as reported by New York utilities. The vintage year original cost data is adjusted to determine the cost to reproduce the plant in the current year. The "reproduction value less accumulated depreciation" represents the assessed market value of the assets for taxation purposes.

[2] December 26, 2017 letter from Chair and Chief Executive Officer John B. Rhodes to Carmen Tierno, President, New York American Water ("December 26, 2017 DPS Letter").

[3] The petition was updated by NYAW on January 29, 2018.

property tax surcharges effective January 1, 2018 by amending tariff statements to:

1) reduce a surcharge of 49.47 cents per 100 gallons to 36.24 cents per 100 gallons – related to the rate plan in Case 16-W-0259;[4] and,

2) eliminate a surcharge of $26.95 per month, - related to a property tax reconciliation (PTR) from its previous rate plan in Case 11-W-0472.[5]

On January 18, 2018, the Commission directed Staff to continue to investigate and report on NYAW's disclosures.[6] In the Order, the Commission expressed its interest in "… understanding the reasons for the NYAW error and why that error was not reported and addressed by NYAW during the earlier phase of this proceeding." Staff is still pursuing that part of the investigation, and expects to issue a supplemental report on those issues once its investigation is complete. This Interim Staff Report provides Staff's calculation of the customer financial harm caused by NYAW's tax reporting errors.

BACKGROUND

Although some property tax expenses are recovered from Sea Cliff customers in base rates, they are mostly collected through two surcharges. The first surcharge relates to the

[4] The surcharge was designed to collect $2.29 million to cover allowed property taxes expenses for the Rate Year Ended March 31, 2018 ($1 million is included in base rates).

[5] The surcharge was originally designed to collect $1.4 million of property tax expense under-collections relating to the Rate Year ended March 31, 2017.

[6] Case 16-W-0259 – Order Initiating Investigation, Issued and Effective January 18, 2018, page 4.

reconciliation mechanism in Case[7] 11-W-0472, which is a lagged process since it is not until the year is over that the variance from the target can be determined. The final surcharge related to Case 11-W-0472, was approved to be collected from November 1, 2017 to October 31, 2018 and relates to the Rate Year ended March 31, 2017.

The second property tax surcharge was approved by the Commission in Case 16-W-0259,[8] and it relates to Sea Cliff's proposed merger with the Merrick District (Merrick). Sea Cliff's property taxes were high compared to Merrick, so the Commission approved a property tax surcharge for Sea Cliff customers to collect the incremental amount above the per customer property tax responsibility of Merrick customers. Since property tax expenses are treated uniquely in the rate setting process, in that they have a reconciliation mechanism and a significant portion is often collected via surcharge/sur-credit, the corrective solutions for these errors do not need to involve any adjustments to base rates.

In May 2013 NYAW filed incorrect plant inventory reports for the Sea Cliff system with ORPTS that had inaccurate plant-in-service dates. This shuffled vintage year data resulted in erroneous assessed values on various Company assets that were, in aggregate, overstated. ORPTS approved the Company's incorrect filing in December 2013. The inventory reports filed by NYAW in 2014 and 2015 only reported incremental plant additions and retirements, and did not correct the

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[7] Case 11-W-0472, Aqua Utilities, Inc. et al. – Acquisition, Order Approving Stock Acquisition (issued April 20, 2012.

[8] Case 16-W-0259, New York American Water, Inc. – Rates, Order Establishing Rates for Water Service (issued June 15, 2017) (2017 Rate Order).

underlying historic data from the 2013 filing, which led to three years of over-assessed property values and inflated tax bills. These inflated assessed values led to local taxing authorities (town, village and schools) charging the Company too much for property/school taxes, relative to tax burdens based on correct assessment valuations.

The local taxing authorities operate and bill property taxes based on different fiscal years, so the over-assessed property values hit the tax rolls of the taxing authorities in different months.

Impacted Periods – By Taxing Authority			
Taxing Authority	**ORPTS Filing Year**	**Asset Value Year**	**Fiscal Year Impacted (Years Sea Cliff Tax Bills Impacted)**
Village of Sea Cliff	2013 2014 2015	2012 2013 2014	June 2014- May 2015 June 2015- May 2016 June 2016- May 2017
Schools	2013 2014 2015	2012 2013 2014	July 2015 - June 2016 July 2016 - June 2017 July 2017 - June 2018
Town of Oyster Bay	2013 2014 2015	2012 2013 2014	Calendar Year 2016 Calendar Year 2017 Calendar Year 2018

CALCULATION TO HOLD SEA CLIFF CUSTOMERS HARMLESS

Staff’s audit identified three ways customer rates were impacted by the incorrect plant inventory reports that were filed with and relied on by ORPTS.

The first two impacts are retrospective in nature and are caused by property tax bills that were based on erroneous assessed values. These bills have been paid by the Company and it has no recourse with the taxing authorities. Actual tax bills are relevant here because property tax expenses are reconciled or trued-up pursuant to the Company’s approved rate plans.[9] Inflated tax bills have impacted, or will impact, property tax reconciliations for multiple rate years in Cases 11-W-0472 and 16-W-0259. In order to hold customers harmless, Staff recommends that the Commission require the Company to credit its customers for the impact of the inflated tax bills. Since the Company cannot recover its overpayments from the taxing authorities, its shareholders will ultimately assume the losses related to the reporting errors.

The third way the errors impact customers is in rates established in Case 16-W-0259 that include property tax expense allowances that are overstated. Since the property tax expense allowances were based on actual tax bills which included the impact of the Company's reporting errors, rate allowances for property tax expenses are artificially high due to the errors.

The Company worked with ORPTS to correct the reporting errors in its 2016 filing, which first impacted the Village tax year beginning in June 2017; the school districts beginning in July of 2018; and the Town beginning in January 2019. Accordingly, the Company's tax bills beginning on those dates will be based on the corrected valuations. The table below shows the taxing authorities and the effective date that tax bills will be free of the reporting error:

Taxing Authority	**Date Assessments No Longer Effected by Error**
Town of Oyster Bay	January 2019
Village of Sea Cliff	June 2017
North Shore School District	July 2018
Brookville School District	July 2018
Roslyn School District	July 2018

[9] Reconciliation in this context means that the difference or part thereof between forecast expenses and actual expenses is collected from or passed back to customers.

By operation of the 2017 Rate Order, customers would automatically be made whole for these prospective variances through the property tax reconciliation provisions. However, given the revised property tax information, Staff recommends that the Commission require further adjustments to the surcharges to avoid over-collections that would need to be passed back in subsequent periods.

NYAW acknowledged the rate case forecasting errors of property tax expenses, and effective January 1, 2018, reset its property tax surcharge authorized in Case 16-W-0259 from 49.47 cents to 36.24 cents, per 100 gallons, in order to provide a timelier rate adjustment for the impacts of the errors to customers. Rate Year One (RY1), ended March 31, 2018, and Rate Year Two (RY2), ending March 31, 2019, of the reconciliation calculation should include an offset for the gross amount of the reduced surcharge rate, or $99,629 and $608,781 respectively.

Rate Year Three (RY3), ending March 31, 2020, and Rate Year Four (RY4), ending March 31, 2021, of the current rate plan will be free of the retrospective error, and all the tax bills will be based on corrected assessments. For those Rate Years, the Commission should reset the property tax forecast/benchmark, and the related approved surcharge designed to collect the target amount. Updating the expense forecast and related surcharge, will lower the surcharge rate upfront and minimize the over-collection/pass-back through the reconciliation mechanism.

CUSTOMER HARM – RETROSPECTIVE - JUNE 2014 – DECEMBER 2018

On January 29, 2018, NYAW filed an updated Petition that included an estimate of the retrospective customer harm (without interest) of $1.8 million. To develop its estimate, NYAW made the following calculations:

- **Actual Tax Bills** – NYAW started with all of its actual tax bills, by taxing authority, from 2014 through 2018 (including the years with errors). These property tax bills reflect the property assessment values and applicable tax rates, the product of which were the actual taxes paid.

- **Estimated Error Factor** – the Company calculated the effect of the reporting errors by taking the recently corrected and approved assessed values for each taxing authority and comparing them to the assessed values for the most recent year before the error took place.

- **Applied Updated Assessed Values to the Years with Errors** – for each of the years with errors, the Company assumed that the assessed values would have grown ratably over the three-year period that covered the reporting errors.

- **Increased Actual Tax Rates by 5%** - The Company proposed that its Sea Cliff property is a relatively significant portion of the total assessed value in Class-3 (utility class). Given the reporting errors, assessed values for Class-3 were artificially high. With the correction of the Sea Cliff assessment, the total assessed values for the class would have been less. The Company assumed that the tax rates would have been higher to collect roughly the same amount of taxes from Class-3. Accordingly, the Company’s analysis included an adjustment that increased the actual tax rates by 5% to estimate what its tax bills would have been if correct assessments were in place. The Company’s adjustment increased the estimated bills, thereby reducing the estimated amount of the over-collections.

- **Company’s Share (15%)of Taxes over The Benchmark** – The Company’s rate plan in case 11-W-0472 provided for a partial reconciliation of the variance between forecast and actual property tax expenses. The rate plan requires the Company to absorb 15% of property tax under-recoveries and authorizes the Company to pass 85% of the variance on to customers. In the Company’s property tax reconciliation filings for the Rate Years ended March 31, 2014, 2015 and 2016, the Company passed 85% of the under-recoveries to customers, either through surcharges, or recording a regulatory asset (customer IOU) on its books. The Company’s variance calculation adjusts for the amount already passed back to customers.

Staff reviewed the Company's methodology and calculations of the retrospective harm stemming from the reporting errors. Staff verified the property tax paid to town, school, and village in the impacted periods (see table below) by reviewing actual property tax bills. Staff verified the revised assessment per letter from ORPTS, and evaluated the reasonableness of allocating the net plant additions evenly over the three-year impacted period.

Impacted Periods		
Taxing Authority	**First Year Impacted**	**Last Year Impacted**
Village	6/2014-5/2015	6/2016-5/2017
School	7/2015-6/2016	7/2017-6/2018
Town	1/2016-12/2016	1/2018-12/2018

Staff found the Company's assumptions, forecasts and calculations to be a reasonable estimate of total customer harm, with two exceptions:

1) Staff's estimate assumes zero growth in tax rate (vs. 5% growth as filed); and,

2) Staff does not apply the 85% customer share to the retrospective error related to the current rate plan.

Adjustment to the 5% Assumed Growth Rate

While we understand the general theory of why one might expect the tax rate to go up if total assessments for a tax class went down, the Company did not support why the 5% tax rate growth assumption was reasonable. There are so many independent and inter-dependent variables at play when a taxing authority determines tax rates, that it is impossible to say with any accuracy whether the 5% growth assumption is reasonable, particularly without any support. Moreover, Staff tested the Company's theory by looking at the actual change in tax rates when the erroneous assessments were first used, and it did not show a big decrease in the tax rates in the year the assessed values went up by a significant amount as a result of the errors. In fact, the average tax rate for Sea Cliff properties in the school districts, which represents 74% of the taxes Sea Cliff pays, actually went up by 3%, when the assessment increased by approximately 46% in 2015/2016 tax roll year, or the first impacted year for the school districts. For those reasons Staff rejected the Company's assumption that the actual tax rates would increase by 5%. Staff used the historic tax rates, which were the only verifiable values available, which resulted in a $393,000 adjustment to the Company's filing.

Adjustment Disallowing 85%/15% Sharing to Case 16-W-0259

In its calculation, the Company credited the 15% it already absorbed in the tax reconciliation calculations, as its share of the variance over the benchmark. Staff believes that it is proper to apply the customer share in the last rate plan because the reconciliations have already been completed to determine the customer share of the under-recoveries during that period. However, the Company also applied the 85% customer share to the reconciliations in Case 16—W-0259, which have not yet occurred. In addition, absent correction of the assessment errors, the Company would collect more for Sea Cliff property taxes than it should, based on the corrected assessments. The current rate plan does not provide sharing of property tax over-collections unless the Company can demonstrate the savings were a direct result of its intervention and action. In this instance, it is the correction of an error that the Company was responsible for creating to begin with. The effort would not have been necessary, but for the Company's error. Correcting its own error is not the type of efforts envisioned in the sharing provisions of property tax reconciliation mechanism. Staff eliminates this sharing for variance resulting from correction of assessment errors in the 2017 Rate Order, which results in a $83,000 adjustment.

These two adjustments increase the Company's $1.8 million calculation of the retrospective harm by $0.5 million, to a total retrospective harm of $2.3 million. The table below summarizes Staff's calculation of the impacts of the property tax errors broken down by rate plan period and taxing authority:

Rate Periods Impacted by the Incorrect ORPTS Filings		
	Previous Rate Plan (11-W-0472)	**Current Rate Plan (16-W-0259)**
Village **Dates:** **Months:** **Amount:**	 June 2014- March 2017 (34 months) $237,358	 April and May 2017 (2 months) $13,620
Schools **Dates:** **Months:** **Amount:**	 July 2015 – March 2017 (21 Months) $990,481	 April 2017- June 2018 (15 months) $680,636
Town **Dates:** **Months:** **Amount:**	 Jan. 2016 – March 2017 (15 months) $147,687	 April 2017–December 2018 (21 months) $253,506
Total	$1.376 million	$947,762
• The amounts are "as adjusted by Staff" amounts, which total $2.3 million, and do not include interest.		

PROSPECTIVE IMPACT - REVISED RATE FORECAST AND ADJUSTMENT OF SURCHARGE

In its updated Petition, the Company estimated the prospective property tax impact to be approximately $2.5 million over the term of the current rate plan, from April 2017 through March 2021. This calculation is based on an estimate of property tax bills reflecting the corrected assessed values and revised tax rates 5% higher than the actual tax rates. The prospective impact is the estimated savings related to corrected tax bills, that neither the Company, nor its customers will over-pay. It is basically a forecasting error, caused by the test year being too high due to the incorrect assessed values, which rate year forecasts were based upon.

For RY1 of the current rate plan, Staff revised the property tax target to reflect corrections to the actual bills already paid during this period. The Company’s collections should also be adjusted to reflect the corrections to the actual bills paid. Any over-collection should be returned to customers. For RY2, since a portion of the paid bills (2018 town and 2017/18 school taxes) fall in this period, a portion of property tax target reflects correction to the actual payments and the remaining portion reflects forecasts for 2019 town and 2018/19 school and village taxes. For the Company’s property tax reconciliation in RY2, the actual expense per book will be reduced by the portion representing the correction to actual payments recorded during the period. The remaining per book expense will be compared with the forecast portion of property target to determine the variance due to forecast error per the JP provisions.

Rate Year One Reconciliation		
Amount Collected in Rates – RY1	$3,298,216	
Surcharge Reduction 1/1/18-3/31/18	(99,629)	
Net Actually Collected		3,198,587
Original Target	$3,298,216	
Correction of Target	(789,204)	
Adjusted Target (normalized)		2,571,536
Over Collection (no sharing)		689,575
Error Amount -Passed-back (sur-credit Options above)**		726,680
Net Deferral – Customer owes Company		37,105
** This assumes the customers were credited for the error previously. If they were not credited previously, this line would be $0, and the customers would be owed $689,575.		

Similarly, the RY2 reconciliation would need to be adjusted for the reduced surcharge, the error and the corrected target amount. The table below is an illustrative example of the formula for RY2. We will not know a portion of the actual amounts until the Company receives the 2018/2019 school and village bills and the 2019 town bill.

RY3 and RY4 are relatively straightforward to correct because they have not started yet, and they are not contaminated with over-inflated bills that contain the retrospective error. The RY3 and RY4 reconciliation should be done the traditional way by comparing the amount allowed in rates (the benchmark) to the property tax expense actually incurred, to determine the surcharge/sur-credit to customers. Staff recommends that Commission adopt the new targets for RY3 and RY4 of $2,712,444 and $2,820,941 respectively. These forecasts are based on the corrected RY target, growing at 4% per year, which was the annual growth rate used in the Rate Order. Based on these new lowered targets, the property tax related surcharge for Sea Cliff should be set at 32.21 cents and 32.90 cents, per hundred gallons, for RY3 and RY4, respectively. If the Company stays out beyond RY4, per the Rate Order language, the surcharge and property tax benchmark will remain at the RY4 level.

Rate Year Two Reconciliation – Example**		
Amount Collected in Rates – RY2	$3,430,145	
Surcharge Reduction 4/1/18-3/31/19	(608,781)	
Net Expected to be Collected		2,821,364
Original Target	$3,430,145	
Adjustment to Target	(822,026)	
Adjusted Target		2,608,119
Over Collection (no sharing)		213,245
Error Amount -Passed-back (sur-credit Options above) **		221,082
Est. Deferral–Customer owes Company		7,837
** This assumes RY2 variance is used to offset previous deferrals and the actual property tax bill paid for 2019 town and 2018/19 for school and village are the same as target. If they are not credited previously this line would be $0, and the customers would be owed $213,245.		

The table below shows the original and revised property tax expense targets and related surcharges.

Revised Property Tax Expense Estimate and Associated Surcharge		
	RY 3	RY4
Original Estimate (Target)	$3,567,351	$3,710,045
Original Property Tax Surcharge (cents per 100 gallons)	49.19 cents	50.24 cents
Revised Estimate (Target)	$2,712,444	$2,820,941
Revised Property Tax Surcharge (cents per 100 gallons)	32.21 cents	32.90 cents

Based on the corrected targets, Staff estimates that customers will see a $2.4 million reduction in future forecasted rates related to property taxes, in addition to the $2.3 million retrospective error. The actual property taxes in RY2, RY3 and RY4 will vary from the revised targets, and ultimately be trued-up through the reconciliation mechanism.

EXISTING DEFERRAL BALANCE AND INTEREST CALCULATION

Since property tax under-recoveries have been so significant over the last three reconciliation years (Rate Years ended March 31st, 2015 -2017), the Commission authorized the Company to defer a total of $865,065 for later recovery because the bill impacts of the PTR surcharges were so high. The table below is a summary of the last three reconciliations.

Summary of Approved Property Tax Reconciliations			
Period Reconciled	**Approved Deferral**	**Amount Authorized**	**Period Collected**
Apr 2014- Mar 2015	$262,630	$710,058	Nov 2015 – Oct 2016
Apr 2015 – Mar 2016	300,000	1,313,568	Nov 2016 – Oct 2017
Apr 2016 – Mar 2017	302,437	1,586,700	Nov 2017 – Oct 2018 (shut off 1/1/18)
Total	**$865,067**		

The deferral balances accrue interest at the Other Customer Capital Rate to compensate the Company for the time value of money. The accrued interest is also deferred and recoverable from customers. If it were not for the error, the deferred balance would have been less and therefore the accrued interest would also have been less. In its Petition the Company committed to reconciling the interest impact, but did not quantify the amount.

Staff estimates that the amount of accrued interest related to the error is approximately $20,500 related to the previous case. This amount was calculated by taking the impact of the error, month by month, starting when the error first occurred (June 2014 for the Village of Sea Cliff, July 2015 for the schools, and January 2016 for the Town of Oyster Bay) through the end of the previous rate plan, because the interest component is included in the past deferrals, and the Company is not seeking interest accrual on these past deferrals starting from the end of last rate plan (*i.e.* March 31, 2017).

ACCOUNTING AND RATEMAKING

The table below summarizes the impact of the retrospective error, related to the previous case, RY1 and RY2 of the current case, the interest due to customers, the impacts of the decreased surcharges on January 1, 2018, the deferral balances, and three ratemaking options for making customers whole for the impacts of the error:

Ln	Summary of Deferral Balance and Sur-Credit Options – Related to the Retrospective Error		
	Error Prior Rate Plan (11-W-0472)	$1,375,525	
	Interest Due Customers (11-W-0472)	20,539	
	Elim. $26.95 Surcharge (11-W-0472) – 10 months (Jan – Oct 2018)	(1,160,233)	
A	Net Owed to Customers -Prior Rate Plan (11-W-0472)		$235,831
	Option 1– Leave prior deferrals on the books (line B) for recovery in next rate case– sur-credit balance. (line A /4,305 /12) Customers credited RY1 and RY2 error in the Reconciliation Calc. (lines E & F)	Avg $4.57 per cust, per month for 1 year	
	Approved Deferrals (11-W-0472)		
	April 2014- March 2015	$262,630	
	April 2015- March 2016	300,000	
	April 2016- March 2017	302,437	
B	Subtotal Prior Approved Deferrals Owed to Company		(865,067)
C	Net Amount Under Collected (11-W-0472) (line A + line B)		(629,236)
D	Error RY1 (16-W-0259)		726,680
E	Error RY2 (16-W-0259)		221,082
F	Amount Owed to Customers for Retrospective Error - Net of Deferral Balances and Surcharge Reduction		$318,526
	Option 2 – Net All Deferrals and Errors, and Sur-Credit the balance – (Line F / 4,305 Cust /12 months) (RY1 and RY2 Errors adjustment in the Reconciliation Calculation)	Avg $6.17 per cust, per month for 1 year	
	Option 3 – Leave All 11-W-0472 Deferral Balances on the books at this time, for future collection (no sur-credit or sur-charge at this time) RY1 and RY2 errors handled in the reconciliation process		
** Our RY1 reconciliation shows that $37,105 will be owed by customers to the Company. We would propose to use this to offset the $318,421, which equals $281,421, or $5.45 sur-credit on average.			

Option 1 – True-Up Error Related to 11-W-0472 through a sur-credit, Leave the Previous Deferral Balances for Later Disposition, Handle RY1 and RY2 Errors through the Reconciliation Process

This option would isolate the retrospective error related to the previous case and pass back an average monthly sur-credit of $4.57 to customers for one year. The $865,067 deferral owed to the Company would remain on the books, earning interest for future recovery determined by the Commission. RY1 and RY2 errors would be handled through the reconciliation filing, resulting in future sur-credits to customers for RY1 and part of RY2 due to collections at higher target levels, and could be used to offset the $865,067 at that time.

Option 2 – Handle all of the errors and deferrals all at once, and sur-credit the customers the remaining balance

This option deals comprehensively with all of the variances for the correction of the errors upfront, including the amounts in RY1 and RY2 of the current rate plan, nets them against the deferrals currently on the books and sur-credits the customers the remaining balance. With this option the variances are credited to customers upfront, and would not be available in future RY1 and RY2 reconciliations, resulting in a small amount of customer IOUs in each of the two rate years (calculations below). Since RY1 is complete, Staff would propose to net the $37,105 owed by customers via the RY1 reconciliation (detailed below) against the $318,526 for a net amount owed to customers of $281,526, which would produce an average monthly sur-credit of $5.44 per customer for one year.

Staff believes this is the best option. It takes care of all of the issues upfront, and avoids customers accruing interest and future rate pressures by eliminating the existing deferrals. It also minimizes bill complications by avoiding various sur-credits, and possibly surcharges, hitting the bills at various times in the future.

Option 3 – Approve the net deferral balances (credits to customers) and all deferrals on the books for future disposition

This option would approve the net deferred credit of $235,081 owed to customers related to the previous rate plan. Together with the existing deferred debits owed by the customers of $865,067, the net amount of $629,236 would remain on the books for future collection from customers. The retrospective errors related to RY1 and RY2 would be handled through the reconciliation process and result in a sur-credit once they are filed and approved.

CONCLUSION

Staff is still investigating how the error occurred; why the errors persisted for several years without correction; and why the Company failed to notify Staff and the Commission in a timely manner. We will file a report on that investigation by the end of June.

Staff believes the quantification of the $2.3 million retrospective error is a reasonable estimate of what would have occurred if the tax filings were made properly. There are many ways the Commission could choose to pass back the impacts of this error to customers and we have outlined three possible options. Staff recommends Option 2, which resolves all errors and deferrals at once, and sur-credits the customers the remaining balance which on average works out to be $5.44 per customer per month for a year, because it simplifies credits on customers' bills and avoids a build-up of previous deferrals through continued interest accruals.

In order to hold customers harmless, and give credit to the Company for lowering its surcharge rate, Staff recommends adopting the adjustments to the reconciliation mechanism for RY1 and RY2 of the current rate plan. Staff also recommends resetting the property tax expense forecast/benchmark for RY3 and RY4, and related surcharges, to eliminate projected over collections from customers.

Because the Commission had delayed recovery of property taxes for three years (the $865,000 deferral), and the Company was quick to reset its surcharge collection on January 1, 2018, the over-billing of customers due to the error was much less than it otherwise would have been. Taken in aggregate, from when the error first began until today, we estimate the customers were over-billed by approximately $282,000 or about $65.50 per customer, which will be returned to them by offsetting deferrals and sur-crediting the remainder as described above.

Staff recommendations to the Commission:

1) Adopt the retrospective error estimate (hold harmless) amount of $2.3 million.
2) Approve the adjusted reconciliation formula for RY1 and RY2. (as detailed on page 16)
3) Approve the calculation of the RY1 reconciliation of $37,105 owed by customers to the Company. (assuming Option 2 of the sur-credit calculation is approved)
4) Approve Option 2 of the of the sur-credit calculation. (detailed in the table on page 12)
5) Adjust Sea Cliff’s property tax benchmark to $2,712,444 and $2,820,941 in RY3 and RY4, respectively. And adjust the related surcharges to 32.21 cents and 32.90 cents, per 100 gallons, for RY3 and RY4.