

**STATE OF CONNECTICUT  
PUBLIC UTILITIES REGULATORY AUTHORITY**

APPLICATION OF AQUARION : Docket No. 13-02-20  
WATER COMPANY OF CONNECTICUT :  
TO AMEND ITS RATES : July 18, 2013

**BRIEF OF GEORGE JEPSEN, ATTORNEY GENERAL  
FOR THE STATE OF CONNECTICUT**

George Jepsen, Attorney General for the State of Connecticut (“Attorney General”), hereby submits his brief regarding the Aquarion Water Company of Connecticut’s (“Aquarion” or the “Company”) Application to Amend its Rates (“Application”) filed on March 28, 2013. In its Application, Aquarion seeks a three year rate plan in which it proposes to increase its rates by approximately \$27.2 million in year one of its rate plan (“Rate Year 1”), and by an additional three million per year for years two and three. Aquarion’s proposed rate increase would average more than 17 percent across its service territory in Rate Year 1, Application, 1, with a total increase of 23 percent over the three year period. For the reasons stated herein, the Attorney General respectfully submits that the Public Utilities Regulatory Authority (“PURA” or “Authority”) should reject Aquarion’s Application. The Company has failed to meet its burden of showing that such a large rate increase is necessary or appropriate. To the contrary, the evidence in this proceeding clearly shows that Aquarion’s proposed rate increase is excessive and unwarranted.

The Attorney General has identified a number of unnecessary expense items for which the Authority should disallow recovery from ratepayers. The adjustments proposed by the Attorney General would reduce Aquarion’s proposed revenue requirement by more than \$20 million per year, offsetting the vast bulk of Aquarion’s

proposed \$27 million increase for Rate Year 1. Other parties have also identified the excessive and unnecessary costs in this Application. The Attorney General believes these cuts represent a substantial first step towards reducing Aquarion's requested rate hike and that the Authority should adopt these recommendations in determining whether Aquarion merits any rate increase at all. The Authority should also reject Aquarion's proposal to increase its rates in each year of its three year rate plan and should instead approve only adjustments for Rate Year 1. The Authority should hold Aquarion's rates steady for the entire three year plan and should suspend the company's Water Infrastructure and Conservation Adjustment increases.

**I. AQUARION'S APPLICATION**

Aquarion is the largest water company in the State of Connecticut, serving more than 625,000 people in 47 towns and cities across the State. Transcript, 7; Morrissey PFT, 19. Aquarion has acquired fifty-seven smaller water systems since its last rate proceeding in 2010. In its Application, Aquarion proposes to increase its rates by more than \$27 million over the first year of a three year rate period, with additional increases of more than \$3 million per year for years 2 and 3. Firlotte Pre-Filed Testimony ("PFT"), 13. This represents a total increase of \$33 million, or more than twenty-three percent. Moreover, this Application comes less than three years after the Authority awarded Aquarion rate increases of more than \$15 million, or more than 11 percent average increase across its service territory. Final Decision, Docket No. 10-02-13 *Application of Aquarion Water Company of Connecticut for Amended Water Service Rate Schedules*, 73 ("Docket No. 10-02-13") (September 8, 2010), 1. The Company further proposes that the Authority authorize Aquarion to earn a return on equity ("ROE") of 10.6%. Morrissey

PFT, 11. Aquarion claims that this new 23% rate increase is necessary because the Company has: (1) invested more than \$143 million in plant and infrastructure investments since its last rate case; (2) incurred substantial increases to its pension, water treatment and delivery expense; and (3) seen declining water consumption reduce its revenues. Tr., 10-11; Firlotte PFT, 5-6.

The rates proposed by Aquarion far exceed levels that could be considered just and reasonable for the following reasons. First, Aquarion's proposed ROE is far too high and its proposed capital structure uneconomic and burdensome. The Company's proposed ROE is based upon a flawed analysis and is out of touch with current market conditions and recent Authority decisions. Second, the record in this proceeding shows that Aquarion has overstated a number of its expense items. These expense items include executive retirement expenses, directors and officers liability insurance and incentive compensation. Similarly, the Company's revenue projections, particularly its sales forecasts, are flawed.

As the Authority is well aware, the past five years have been exceptionally difficult for Connecticut citizens. The United States is slowly emerging from the most prolonged and profound economic contraction since the Great Depression eighty years ago. Connecticut has not been spared from the lingering effects of the Great Recession, with a United States Bureau of Economic Analysis report finding that the combined value of goods and services actually shrank from 2011 to 2012.<sup>1</sup> Connecticut consumers – especially those on fixed or limited incomes – are simply unable to absorb any further increases in their cost of living. These customers need the Authority and all of the

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<sup>1</sup> [http://www.bea.gov/newsreleases/regional/gdp\\_state/2013/pdf/gsp0613.pdf](http://www.bea.gov/newsreleases/regional/gdp_state/2013/pdf/gsp0613.pdf)

participants in this proceeding to work to ensure that the water utility rates approved will be no more than absolutely necessary.

## **II DISCUSSION**

### **A. The Authority Should Reject Aquarion's Proposed ROE and Capital Structure**

In its Application, Aquarion proposed that the Authority approve a ROE for the Company's shareholders of 10.6%. Ahern PFT, 4. This ROE, if approved, would be the highest authorized return for any of the State's principal regulated public service companies. The Connecticut Light and Power ("CL&P") is currently authorized an ROE of 9.4%. Final Decision, Docket No. 09-12-05, *Application of the Connecticut Light and Power Company to Amend its Rate Schedules*, 2. The United Illuminating Company is authorized a return of 8.75%. Final Decision, 08-07-04, *Application of the United Illuminating Company to Increase its Rates and Charges*, 1. The Connecticut Natural Gas Corporation ("CNG") and the Southern Connecticut Gas Company ("SCG") are authorized to earn a 9.31% ROE and 9.26% ROE respectively. Final Decisions, Docket No. 08-12-06, *Application of Connecticut Natural Gas Corporation for a Rate Increase*, 139; Docket No. 08-12-07, *Application of the Southern Connecticut Gas Company for a Rate Increase*, 168. The Connecticut Water Company has an authorized ROE of 9.75%. Final Decision, Docket No. 09-12-11, *Application of the Connecticut Water Company to Amend Rate Schedules*, 1.

The Company offers no credible explanation why a relatively low risk operation such as a water utility should be awarded the highest authorized ROE of any of the State's regulated public service companies. All of the electric and gas distribution

companies listed above present higher risk profiles for investors than water companies.

As noted by the Office of Consumer Counsel's cost of capital expert:

the water utility is the lowest risk industry as ranked by Beta in Value Line. As such, water companies have the lowest cost of equity capital of any industry in the U.S. according to CAPM. Second, as shown in exhibit JRW-3, capital costs for utilities, as indicated by long term bond yields, have declined to historically low levels.

Woolridge PFT, 51.

Aquarion's unreasonable ROE request is based upon a flawed and unreliable cost of capital analysis. First, Aquarion proposed a capital structure that includes an uneconomically high level of equity. In addition, Aquarion's testimony in support of its proposed ROE of 10.60% contains serious errors that have distorted the Company's discounted cash flow ("DCF"), risk premium ("RP") and capital asset pricing model ("CAPM") analyses and unreasonably inflated its proposed ROE. As a result, the Company's proposed ROE is substantially higher than other similarly situated water utility companies and substantially higher than the levels recently approved for Connecticut's other public service companies.

The Attorney General generally supports the OCC's cost of capital testimony with its recommended ROE of 8.53%, Woolridge PFT, 2. Adjusting Aquarion's proposed ROE from 10.6% to the more reasonable 8.53% would result in a rate reduction of approximately \$11.3 million per year.<sup>2</sup> The Attorney General believes, however, that the Authority should impose an additional 50 basis point reduction to Aquarion's authorized ROE to reflect the reduced business and operations risk from the revenue and sales

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<sup>2</sup> This \$11,321,639 represents 207 basis points difference in ROE times Aquarion's pre-tax revenue requirement of \$5,469,391 for each 100 basis points. LF-1, Revised Schedule A-1.0 A.

decoupling mechanism implements in response to the newly enacted Public Act 13-78, *An Act Concerning Water Infrastructure and Conservation* (“P.A. 13-78” or the “Act”). This will result in a further reduction to the Company’s revenue requirements of \$2.7 million. LF-1, Revised Schedule A-1.0 A.

**1. The Authority Should Reject Aquarion’s Proposed Capital Structure**

In its Application, Aquarion proposed a capital structure of 51.5% common equity and 48.5% debt. Morrissey PFT, 7. The Authority should reject the Company’s proposed capital structure because it is economically inefficient and does not effectively balance the interests of the Company and its ratepayers. The cost of equity is much higher than the cost of debt. The Company projects its cost of equity as 10.6%, its cost of long term debt as 5.24% and its cost of short term debt as 3.03%. Woolridge PFT, Exhibit JWR-5. Moreover, because of the income tax responsibility associated with the use of common equity in the capital structure, that form of capital is nearly three times more costly than debt capital. Increasing the Company’s equity component relative to less expensive debt raises the overall cost of capital and, therefore, is unnecessarily expensive for ratepayers.

In its last rate proceeding, the Company proposed its capital structure to include 54.94% common equity, 40.6% long term debt, and 4.46% short term debt. Final Decision, Docket No. 10-02-13, *Application of Aquarion Water Company of Connecticut for Amended Water Service Rate Schedules*, 73 (“Docket No. 10-02-13”). The Authority rejected Aquarion’s proposed capital structure as too costly.

There is a long history of Aquarion requesting a ratemaking capital structure higher than the average mix used by the water utility industry. In the 2004 and 2007 Aquarion Rate Case Decisions, the Department

imposed a ratemaking capital structure on the Company using the highest end of the range of common equity percentage that other firms in the water utility industry use. This was a conservative approach to guide the Company's understanding and to make it possible for Aquarion to have an easier transition to a lower Common Equity portion. It should be no mystery to the Company what the Department is trying to accomplish. The time has come to make the Company's ratemaking capitalization mix more closely mimic the practices of the water utility industry. Therefore, the Department imposes a 50% Common Equity to 50% Total Debt capital structure for ratemaking purposes.

Final Decision, Docket No. 10-02-13, 85.

In the present case, the Company claims to have improved its debt to equity ratio from its 2010 rate case. *Morrissey PFT*, 7. The Attorney General agrees that a 51.5% equity ratio is an improvement over 55% equity ratio, but sees no reason for the Authority to deviate from its prior decision to impute a 50 / 50 debt to equity ratio. The failure to maintain a 50/50 debt to equity ratio would only serve to encourage the Company to return in the next rate case with an even more expensive capital structure. Reducing the Company's proposed capital structure from 51.5 percent equity to 50 percent equity will reduce Aquarion's revenue requirement by approximately \$675,000.<sup>3</sup>

**2. The Authority Should Reject Aquarion's Discounted Cash Flow Analysis and Risk Premium / Capital Asset Pricing Model Analysis of the Cost of Equity**

The Authority should reject the Company's ROE testimony because it is less compelling than that presented by the OCC. First, both the OCC and the Company began with the same proxy group of nine water companies. *Woolridge PFT*, 56. The financial

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<sup>3</sup> The \$675,000 represents an eight basis points reduction in the Company's weighted cost of capital from 8.0 percent to 7.92 percent. Based upon the Company's Rate Year 1 rate base of \$622 million, an eight basis point reduction reduces utility operating income by just under \$500,000. Using a revenue conversion factor of 1.7 to estimate the revenue requirement for the 50 percent equity component yields an additional \$175,000 for a total revenue requirement reduction of \$675,000.

data necessary to support a robust discounted cash flow analysis (“DCF”) is, however, largely absent from the water company proxy group. This is likely a result of the relatively small sample size of regulated water companies. As described by the OCC’s consultant:

As previously indicated, the financial data needed to perform a DCF analysis for the Water Proxy Group is limited. Analysts’ coverage of the water companies is sparse. For example, four of the nine companies have no long-term EPS [earnings per share] growth rate projection listed at Reuters and Zacks. In addition, three of the other water companies are covered by only one analyst, according to [www.reuters.com](http://www.reuters.com).

Woodridge PFT, 56. Woodridge later testified that:

1 The coverage of  
2 the water companies is limited in terms of  
3 analyst coverage, and so I think it's  
4 important to get another measure when you  
5 look at water companies, especially when you  
6 look at the DCF model. I provide a little  
7 more detail in that discussion on page 56  
8 from lines 1 through 14, where, you know, I  
9 highlight the fact that, you know, four of  
10 the nine water companies do not have  
11 long-term EPS growth rate projections from  
12 Reuters and Zacks. In addition, three of the  
13 other water companies are covered by only one  
14 analyst, according to Reuters. And so I  
15 believe that it is helpful to use the gas  
16 companies as another measure for equity cost  
17 rates.

Tr., 989.

Consultants for both the Company and the OCC responded to the paucity or reliable data by including in their proxy group analysis entities that were not water companies. The OCC’s expert explained:

[b]ecause of these data limitations, I have included an analysis of the results for the Gas Proxy Group in my testimony. In addition, the return

requirements of investors on gas companies should be similar to that of water companies. Both industries are capital intensive and heavily regulated and provide for the distribution and delivery of an essential commodity whose service rates and rates of return are set by state regulatory commissions.

*Id. See also*, tr., 989. Aquarion's consultant, however, included a proxy group of non-regulated companies whose business model and financial profile are quite different from regulated water companies. Aquarion's proposed proxy

group includes such companies as Baxter Intl., Kroger, McKesson, Sherwin Williams, Safeway, and Molson Coors. While many of these companies are large and successful, their lines of business are vastly different from the water utility business and they do not operate in a highly regulated environment. In addition, as discussed in Appendix B, the upward bias in the EPS growth rate forecasts of Wall Street analysts is particularly severe for non-regulated companies and therefore the DCF equity cost rate estimates for this group are particularly overstated. As such, the non-utility group is not an appropriate proxy for Aquarion, and therefore the equity cost rate results for this group should be ignored.

Woolridge PFT, 56-7.

In addition, the Company's discounted cash flow analysis used a growth rate exclusively based upon projected earnings per share forecasts by historically optimistic Wall Street analysts and without consideration of the dividend growth rate. Woolridge PFT, 58. Because Aquarion selectively used an unsustainably high expected growth rate, its DCF model overestimates the true cost of capital and, therefore, its recommended return on equity.

Similarly, in its RP analysis, the Company may have substantially overestimated the risk premium to be applied in this case. The RP, in short, represents the investors' expected value for the increased risk associated with a stock offering as compared to a more secure bond instrument such as United States Treasury bills. The problem in any RP analysis, however, concerns the inherent uncertainty of measuring that investor's

future expectation. Moreover, the most used measures of RP, which are based upon the long term historical returns for stock market investments, have so far exceeded yields from Treasury bonds that the results are not economically justified. Woolridge PFT, Attachment D. As a result, Ahern's calculations of ROE through the equity risk premium model for the water proxy group are grossly inflated, ranging from a minimum of 10.31% to an astonishing high of 30.25% for the American Water Works Company. Ahern PFT, Exhibit A-9, Schedule 8, page 2. Ahern's risk premium calculation of an average ROE for the water proxy group was 14.6%, clearly well in excess of all but the most avaricious investor expectations and simply not credible. *Id.* The PURA should disregard these projections as unrealistic.

The Company's true cost of capital is simply much lower than presented by the Company's witness. Capital costs are down generally, there has been an overall decline in interest rates and there is now a lower tax rate for investors which has made stock investment more attractive. As a result of the lingering effects of the Great Recession, "the capital costs for utilities, as measured by the yields on the 30-year utility bonds, have declined to historically low levels." Woolridge PFT, 8. For these reasons, as well as those more fully explained in the prefiled testimony of Woodridge on behalf of the OCC, the Attorney General supports the OCC's cost of capital testimony and its recommended ROE of 8.53%.

**3. The Authority Should Substantially Reduce Aquarion's ROE to Account for Risk Reducing Effects of the Water Revenue Decoupling Provisions Approved in Public Act 13-78**

The Authority should adjust downward Aquarion's ROE to account for the substantial impact Public Act 13-78. Section 3 of the Act provides that the Authority

shall implement full sales decoupling by means of a “revenue adjustment mechanism” that “reconciles in rates the difference between the actual revenues of a water company and allowed revenues.” This provision will have a profound impact on water utility companies’ cash flows, revenue stability and financial risk. This new law eliminates the risks that the Company now bears - the risks of variable weather and sales. As indicated by the OCC’s cost of capital expert:

a revenue conservation adjustment clause that removes the risk of not achieving allowed revenues should lower the business risk of AWC. All else equal, lower business risk associated with such an adjustment clause should result in a lower allowed return on equity.

Interrogatory Response FI-207.

The passage of P.A. 13-78 occurred after the prepared testimony was filed in this proceeding, and Wooldridge’s testimony does not reflect any downward revision to his proposed authorized return of 8.53 percent. Woolridge declined to quantify an appropriate ROE adjustment. Tr., 1030-33; FIN-208. Nonetheless, the Authority has acknowledged that in considering an appropriate return, such factors as decoupling mechanism contribute to reducing a company’s risk of operations. *See* Final Decision, Docket 08-07-04, *Application of the United Illuminating Company to Increase its Rates and Charges*, 103. The Authority should therefore reduce Aquarion’s authorized ROE by at least 50 basis points. Such a reduction would amount to an additional reduction to the company’s revenue requirements of \$2,734,696. LF-1, Revised Schedule A-1.0A.

**4. The Authority Should Reject any Return on Equity Premium for Acquiring Small Water Companies**

As noted above, subsequent to Aquarion’s filing of its Application, Connecticut passed Public Act 13-78. In that Act, the legislature provided that the Authority may

allow a premium rate of return to a water company that has acquired other non-viable water systems since its last rate case. Specifically, the Act states:

(b) In the case of a proposed acquisition of a water company that is not economically viable, as determined by the Public Utilities Regulatory Authority in accordance with the criteria provided in subsection (b) of section 16-262n, by a water company that is economically viable, as determined by the authority in accordance with said criteria, the authority may, as part of the acquiring water company's next general rate case, award a premium rate of return to such acquiring water company when it is demonstrated that such proposed acquisition will provide benefits to customers by (1) enhancing system viability, or (2) avoiding capital costs or saving in operating costs, or as otherwise determined by the authority.

Since its last rate case, Aquarion has acquired 57 new water systems, many of them non-viable. Firlotte PFT, 10; Tr., 1440. While Aquarion made no such request for an enhancement to its ROE in its Application, the Company in a late filed exhibit nonetheless asserted such an enhanced ROE was appropriate. *See* LF-4. Specifically:

[t]he Company has not proposed a specific rate of return premium in its rate application, but believes that a 25-50 basis point is deserved in recognition of Aquarion's response to the state's recognized need to consolidate its many small under-funded water systems.

LF-4.

The Act makes clear that the Authority's determination whether or not to award a premium ROE is discretionary. For the following reasons, the Authority should exercise its discretion and decline to award any premium. First, all of the Company's acquisitions were made prior to the passage of P.A. 13-78, and thus none of the acquisitions were motivated by or responsive to a potential reward. Second, and more importantly, the award of an enhanced ROE to Aquarion in this case simply places additional unfair burdens on Aquarion's existing ratepayers who are already paying higher rates to support the acquisition of those 57 new water systems. The Company's witnesses admitted that

the nonviable systems would require substantial infrastructure investment at the expense of existing ratepayers (“Yes, I think typically yes, they would require significant capital investment.” Tr., 1437-38). Moreover, Aquarion was also allowed to pay substantially above book value for the water companies and to have ratepayers pay for that “acquisition premium.”

- Q. (Wright) Okay. So the total amount  
10 of acquisition premium was 6.3 million about?  
11 A. (Morrissey) Yes.  
12 Q. (Wright) And that -- that premium  
13 value gets put into rate base as well.  
14 Correct?  
15 A. (Morrissey) That is correct.

Tr., 1442.

The Attorney General does not dispute the public policy that encourages financially stable water companies to purchase failing water systems. In the present case, however, Aquarion’s ratepayers are already shouldering the additional costs of restoring those systems to viability as well as the acquisition premium to purchase the systems. That is more than enough. Aquarion’s ratepayers have already done their share to promote the public good; they should not have to fund premium ROEs in addition. The Authority should decline to impose any further burden on Aquarion’s ratepayers.

**C. The Authority Should Reject Aquarion’s Proposed Revenue Requirements**

In its Application, Aquarion overstated a number of revenue and expense items. Taken together with the Attorney General’s recommended changes to the Company’s proposed ROE, the revenue and expense adjustments eliminate the need for all, or at least the great bulk of, the Company’s requested rate increase. The following discussion addresses a few of the adjustments to larger ratebase, revenue and expense items that the

Authority should impose. In addition to addressing the merits of these particular proposals, these adjustments are intended to provide examples of the many revenue requirement adjustments that are warranted in this case and are not intended to represent an exhaustive list.

1. **The Authority Should Reject Aquarion's Base Load Water Consumption Calculations**

In its Application, the Company proposed a reduction to its *pro forma* revenues based upon a weather normalization adjustment. Dixon PFT, 15. The Company proposed to determine base load usage by using only first quarter data for 2008 through 2012. Dixon PFT, 13. The practical effect of that adjustment was to overemphasize first quarter consumption and substantially reduce *pro forma* residential and commercial consumption levels below the test year numbers. The Company's actual sales spanning from 2008 through 2012, have remained fairly stable in all of its service divisions. Rubin PFT, Schedule SJR-3. Using the Company's actual data from the test year, as opposed to its "normalized" data, shows that the Company substantially underestimated Aquarion's sales and revenues. This represents a \$3,881,391 reduction in consumption revenues. LF40, Supplement.

The Attorney General supports the OCC's use of test year sales for estimating future sales. The Attorney General recognizes that the Authority has previously used multiyear averages of annual consumption to set future sales levels but, as noted above, Aquarion's sales since 2008 have remained stable and the multiyear average would not appreciably change estimated consumption levels. Moreover, because of the passage of Public Act 13-78, discussed above, the Company will implement a revenue adjustment mechanism to reconcile the difference between authorized sales levels and actual sales

levels. As a result, the Company will be guaranteed full recovery of revenues in the event its actual sales differ from those sales projected through the test year. The Attorney General therefore supports the OCC's proposal to adjust the pro forma revenues upwards by \$3,881,391.

**2. The Authority Should Reject Ratepayer Funding of Directors and Officers Liability Insurance**

In its Application, Aquarion included \$25,037 for Directors and Officers Liability Insurance ("D&O") in the test year. Aquarion claims that D&O insurance is recoverable from ratepayers as a prudent and necessary expense and that it will not be able to attract qualified individuals to serve on the board without it.

The Authority should reject Aquarion's request to have ratepayers fund 100% of D&O insurance and, consistent with Aquarion's past two rate decisions, allow no more than 30% of this cost be allocated to ratepayers. *See* Docket No. 10-02-13, *Application of Aquarion Water Company of Connecticut for Amended Water Service Rate Schedules*, 70 and Docket No. 07-05-19, *Application of Aquarion Water Company of Connecticut for Amended Water Service Rate Schedules*. D&O insurance is intended to "protect shareholders only from the actions of the management they selected." Final Decision, Docket No. 05-06-04, *Application of the United Illuminating Company to Increase its Rates and Charges*, 47. Moreover, these lawsuits are principally brought by those very same shareholders. The Authority should therefore disallow at least \$17,526 from Aquarion's revenue requirements.

**3. The Authority Should Reject Aquarion's Proposed Employee Bonus Programs Funding**

In its Application, Aquarion proposes that its customers fund incentive plans that would pay the Company's employees \$1,643,530 in incentive bonuses, with an additional \$53,000 in rate years 2 and 3. WPC-3.2A, B and C. The Company proposes that 100% of these costs should be funded by its ratepayers. *Id.*

The Attorney General opposes this ratepayer funded incentive plan, particularly for executives and officers. These proposed bonus plans are designed to achieve certain profit levels that serve to benefit the Company's shareholders and not its ratepayers. Ratepayers should not be forced to fund incentive plans that benefit the Company's shareholders, especially when so many Connecticut ratepayers are in dire economic circumstances. In Aquarion's last rate proceeding, the Authority eliminated ratepayer funding for Aquarion's incentive plans.

As with the annual wage increase, the Department is concerned about the increasing overall payroll in the current economic climate and the Company's unwillingness to adjust. Accordingly, the Department has eliminated all employee bonuses and has reduced this expense by \$809,264.

Final Decision, Docket No. 10-02-13, at 59. Moreover, the Company's incentive program does not appear to be structured to provide any "incentive," but rather appears to be a base compensation measure under another name. As indicated in OCC-77, since 2008 only four of 1437 eligible employees did *not* receive an incentive payment – a .0027 probability of *not* receiving a bonus. The DPUC should therefore eliminate the entire \$1,643,530 from the Company's revenue requirements and from rates.

**4. The Authority Should Reject Aquarion’s Supplemental Executive Retirement Plan**

Aquarion seeks to recover \$12,855 in Supplemental Executive Retirement Plan (“SERP”) benefits for executives. SERP payments are allegedly designed to provide post-retirement payments for executives that are similar to the pensions received by non-executives relative to their pay.

The DPUC should remove 100 percent of SERP from the Company’s rates, which would result in a reduction in the Company’s revenue requirements of \$12,855. This is consistent with the Authority’s treatment of SERP costs in the two recent rate cases for Southern Connecticut Gas and Connecticut Natural Gas, Docket Numbers 08-02-07 and 08-02-06 respectively. In those cases, the DPUC properly noted that ratepayers should not fund excessive benefits in these difficult economic times.

**5. Other Adjustments Proposed by OCC**

The Attorney General supports the many adjustments proposed by the OCC in this matter. These include adjustment to plant in service, tank painting costs, dues and memberships, bad debt expense and depreciation. Cumulatively, these adjustments, together with those proposed by the Attorney General, should allow the Authority to reject the great bulk of Aquarion’s proposed rate increase.

**D. The Authority Should Reject Aquarion’s Proposed Three Year Rate Plan and Suspend and Water Infrastructure and Conservation Adjustment Increases Pending Clarification of the Impact of Certain Internal Revenue Service Rule Changes**

In its Application, Aquarion proposed to increase its rates in each of the three years in its rate plan. The Company testified that this was to “minimize ‘rate shock’ for

customers as well as provide more timely rate relief and financial stability for Aquarion.”  
Firlotte PFT, 11.

The Authority should reject Aquarion’s proposal for annual rate increases, both for its proposed three year rate plan and for any 2014 Water Infrastructure and Conservation Adjustment<sup>4</sup> (“WICA”) increases for 2014. First, Aquarion’s rates have increased relentlessly since 2007, rising from \$115 million to more than \$190 million if the Authority were to grant this rate increase request in full. Aquarion’s customers deserve a period of rate stability and relief from these rising costs.

Second, in March 2012, the Internal Revenue Service (“IRS”) issued Revenue Procedures 2012-2019 and 2012-2020. These new regulations allow businesses, including Connecticut’s water companies, to adopt an alternative method of determining how capital expenditures can be treated for federal tax purposes. The IRS now allows certain qualified capital spending associated with the repair and maintenance of utility plant to be deducted as an expense rather than capitalized for tax purposes. Aquarion has substantial annual infrastructure repair and maintenance costs that are likely to qualify as a deduction to their federal tax liabilities. The new federal tax guidelines may therefore substantially lower Aquarion’s tax liabilities on a going forward basis. Aquarion’s ratepayers, of course, fund 100% of these tax payments in rates. These taxes are embedded in the formula rates that Aquarion proposes to have its ratepayers pay both for

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<sup>4</sup> Public Act 07-139, An Act Concerning Water Company Infrastructure Projects, provides that water companies may apply for a water infrastructure and conservation adjustment in their rates. The practical effect of this WICA adjustment is to allow water companies to immediately include the costs of new incremental plant investment into their rates, reducing the regulatory lag associated with such investment and reducing risk to the Company’s shareholders. The purpose of this law is to encourage water companies to make continuous investment to improve their infrastructure rather than to wait until just before a rate proceeding.

the investment increases it proposes in Rate Year 2 and 3 as well as any future WICA increases it otherwise may seek before its next rate case.

Unfortunately, Aquarion claims that it cannot quantify the impact this tax rule change will have on its future liabilities. Tr., 1380-85. Aquarion states it will not have a clear understanding of the tax impacts until June 2014, at which time it will report back to the Authority on how best to flow these benefits back to ratepayers. Tr., 1588.

Until such time as the Company can estimate the future tax responsibilities, ratepayers should not be required to pay those costs. It is the Company's obligation to demonstrate that the rates it proposes to charge its customers are no more than just and reasonable. The Authority should not allow the Company to charge its customers for taxes embedded in Rate Year 2 and 3 investments or WICA investments until those tax liabilities are known and measurable. The Authority should therefore reject Aquarion's proposal to increase its rates in the second and third years of its rate plan and should further suspend any WICA increases until the Aquarion has fully clarified and reported the impact of the IRS rule changes. This ruling should also serve to ensure that the Company resolves this matter promptly and without delay. The Authority should include in its final decision appropriate orders memorializing the Company's commitments to protect ratepayers with respect to this issue and report back to the Authority no later than June 1, 2014. Tr. 1588.

**E. The Authority Should Proceed with Rate Equalization Deliberately and Slowly to Minimize Rate Shock**

The Authority has repeatedly ordered Aquarion to take affirmative steps to move toward rate equalization over its various service territories. See Final Decision, Docket No. 10-02-13, 52-54. The Company's current plan fails to achieve this goal. Rubin PFT,

6; Dixon PFT, 4-7. The Attorney General supports rate equalization. Over the long term, overall costs to serve customers should converge as new infrastructure investment replaces older depreciated plant. Certain costs, such as the “meter charge,” are designed to recover system wide costs that are already actually already the same for customers regardless of their service territory. These costs include meter reading, billing, customer service and general overhead. Rubin PFT, 6. These costs should be immediately standardized across all Aquarion’s water systems to prevent cross-subsidization among the different systems. The consumption costs for water, however, may vary throughout the service territories reflecting the relative costs of providing water. Certain regions, such as the Northern and Western regions, may simply have lower costs to provide water service, and those regions rates should reflect that cost differential. Rubin PFT, 8. Unfortunately, Aquarion’s current service territories comprise various and diverse water systems with divergent rate structures, a situation complicated by the recent addition of fifty-seven new water systems in the past two years. The Attorney General therefore recommends that the Authority design a rate equalization program that gradually but surely moves Aquarion’s customers to more standard rates over the next three or four rate cases, or a period of twelve to fifteen years. The Authority should make certain that real and permanent differences in the costs to serve should remain embedded in regional rates. This should help protect customers from the rate shock that immediate rate equalization might engender, while avoiding long term cross-subsidization of rates among the various water system regions.

### **III. CONCLUSION**

The cumulative \$33 million per year rate increase requested by Aquarion is unwarranted at this time and would result in rates that are more than just and reasonable. The Attorney General has proposed certain reasonable adjustments to the Company's authorized ROE and capital structure that would save ratepayers nearly \$15 million per year and maintain rates at reasonable levels. In addition, the Attorney General has identified additional ratebase, expense and revenue adjustments that the Authority should approve, further reducing Aquarion's revenue requirement by more than \$5 million per year. The itemization of adjustments discussed herein is by no means meant to provide an exhaustive list. The Attorney General concurs with many of the other adjustments recommended by the OCC in this case. The Attorney General urges the Authority to adopt these specific rate reduction recommendations as a first step and then determine whether and to what extent any rate increase is appropriate for Aquarion. The Authority should strive to find ways to lower customer bills.

**WHEREFORE**, for the foregoing reasons, the Attorney General respectfully requests that the Authority reject Aquarion's rate Application. The Authority should instead approve rates as described herein.

Respectfully Submitted,

GEORGE JEPSEN  
ATTORNEY GENERAL  
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Service is certified to all parties and interveners on this agency's service list.

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