STATE OF NEW JERSEY
OFFICE OF ADMINISTRATIVE LAW
BEFORE THE HONORABLE IRENE JONES

I/M/O THE PETITION OF SUEZ WATER ARLINGTON HILLS, INC. FOR APPROVAL OF AN INCREASE IN RATES FOR WASTEWATER SERVICE AND OTHER TARIFF CHANGES	))))))	**BPU DOCKET No. WR16060510** **OAL DOCKET No. PUC-09261-2016**

REPLY BRIEF ON BEHALF OF THE DIVISION OF RATE COUNSEL

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INTRODUCTION

The contested issues in this case are fairly straightforward. The parties were unable to reach agreement on (1) the appropriate return on equity (ROE), (2) the appropriate allocation of rate case expenses, (3) whether the Company's costs for certain incentive compensation programs are recoverable from ratepayers, (4) the appropriate sharing of consolidated income tax savings, (5) whether the Company's request for carrying charges during its rate phase-in should be granted, (6) whether the late request for an accelerated phase-in is appropriate and (7) whether the Company's proposed Apartment Rate should be allowed. There is, however, no actual disagreement on the appropriate test year, on the Company's ability to recover its requested $13.1 million in post test-year projects, or the wisdom of the Board's long-standing Elizabethtown Water Company decision.[1]

There is also no legitimate issue to be decided in this case regarding whether the Company is entitled to a settled resolution. The Company takes great pains in its brief to argue that because it made some perceived concessions when filing the case, that Rate Counsel has done something inappropriate by litigating the above issues rather than settling them. The Company seems to suggest that it has been "wronged" by the process, even though, despite its "concessions," the rate increase sought more than doubles the rates charged to its customers. Moreover, the Company argues, on the one hand, that Rate Counsel inappropriately relies on the ROE approved by the Board in recent settlements, while at the same time arguing that older settlements at a 9.75% ROE should be viewed as precedent here.

Despite the Company's 15 page discourse on why it believes the Board's decision in Elizabethtown should be overturned, and despite its thinly veiled argument that Rate Counsel's

[1] In re Elizabethtown Water Co., Docket No. 8504330, Order, (5/23/85).

arguments should be rejected as apparent punishment for litigating the remaining issues, neither of those actions should be taken by this tribunal. Petitioner has no right to a settled case or an ROE of its choosing. Nor is it appropriate to reject Rate Counsel's arguments simply because it is doing its job.[2]

The fact is, as argued more fully below and in Rate Counsel's initial brief, current market conditions support an ROE of no more than 9.6%, as evidenced by the cases that have been resolved and upheld by the Board in the last six months. Sound policy and long standing Board precedent support a 50/50 sharing of rate case expenses and a denial of the Company's request for rate treatment of its incentive compensation programs which are clearly tied to financial performance. The consolidated income tax adjustment proposed by Rate Counsel reflects a fair sharing and the unprecedented request for carrying charges on the four year phase-in of this substantial increase in the Company's rates should be denied. The Company's late request for an accelerated phase-in should be rejected, as it would exceed the rate increase noticed to the public. Finally, the Company's proposed Apartment rate is inconsistent with the cost of service and should be denied.

These are the issues in this case. That the Company chose to litigate over a difference in ROE worth approximately $19,000 (26T:L9-L13 (3/13/17)), and increase its rate case expenses by over $250,000 to do so, should not be the determining factor in deciding any of the issues here. Nor, should the Company's resentment of the sound holding of Elizabethtown impact any issue since neither the test year nor the inclusion of the post test year additions sought by the

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[2] In fact, by litigating this case, Rate Counsel was able to eliminate more than $200,000 of post-test year projects that were originally sought by the Company. Despite prior sworn testimony by the Company's witness that these projects were in service and used and useful, the Company's witness conceded on cross-examination that these projects were in fact never built. 45T:L12-L19; 56T:L22-57T:L4 (3/13/17). As a result, the Company has now – as it must - agreed that these projects cannot be recovered in this case.

Company are contested. For the reasons set forth below, Rate Counsel urges that its arguments be accepted and a rate base of $13,022,966 and an ROE no greater than 9.6% be established.

ARGUMENT

I. Notwithstanding the Company's Objections, There Are No Disputed Issues as to the Appropriate Test Year or Level of Post-Test Year Additions.

The Company's initial brief [3] claims that the matching principle involves "matching customer rates with the costs, risks and investments made to provide utility service during the time that service is provided…as well as matching during the same time the various components of ratemaking, including rate base, revenues, rate of return and expenses." SWAHIB at 12. Only the second part of this statement is true. The matching principle states that all components that make up a utility's revenue requirement should be matched to one specific moment in time, usually the end of the test year. See, e.g., Increasing Use of Surcharges on Consumer Utility Bills, AARP, May 2012, Larkin & Associates, Author ("The matching principle involves matching revenues with related expenses and investments in the time period they occur.") Indeed, Company witness Mr. Prettyman concurs, testifying that "rate-setting attempts to match the date or period of using each of those components of a revenue requirement with each other." PRT-1 at 12. The matching principle does not, as argued in the Company's initial brief, provide for extending the test year in a rate case.

The Elizabethtown Water decision, supra, allows certain adjustments beyond the test year that are exceptions to the matching principle. These exceptions, however, were designed to benefit utilities such as Suez. The exceptions set forth in Elizabethtown Water benefit utilities by allowing certain capitalization, expense and particularly post-test year capital additions to be included in rates even though they occur beyond the test year. Indeed, the Company is greatly benefiting from the Elizabethtown Water order in this case. Because of that order, Suez will be

[3] The initial briefs of the parties will be abbreviated as SWAHIB (Suez), SIB (Board Staff), and RCIB (Rate Counsel).

able to include $13.1 million in post-test year additions in its rate base. Without that order, these projects would be excluded from rates because they went into service after the end of the test year. In arguing for Your Honor to reject the Elizabethtown Water decision, the Company risks being denied rate recovery of this $13.1 million in post-test year additions.

Despite the major benefit the Company is receiving from the Elizabethtown Water order, its initial brief objects to "Rate Counsel's rigid application of that order requiring as a pre-requisite that any post-test year item be major in nature and consequence in addition to being known and measurable."[4] SWAHIB at 13. In other words, the Company assumes that without the Elizabethtown Water decision, it would be entitled to an extended test year. It is unclear why the Company makes this assumption. It is clear that absent the Elizabethtown Water case, rate recovery would end at the close of the test year.[5]

Indeed, the only test year that is supported by the record in this case is the test year ended April 30, 2016 which was proposed by the Company. Rate Counsel and Board Staff have both accepted the Company's proposed test year. Notwithstanding the Company's complaints, all of the evidence in the record supports a test year ended April 30, 2016. The Company's Petition, direct testimony, rebuttal testimony, and schedules all utilize the April 30, 2016 test year.

Regarding post-test year additions, the issue is moot. The Company will be receiving rate recognition for 100% of its in-service post-test year additions totaling $13,124,145. There are no routine, in-service post-test year projects sought in this case.

Thus, there are no justiciable issues involving either the test year or post-test year additions in this case. The Company instead appears to be asking Your Honor for something

[4] It appears the Company is actually arguing here that projects should be allowed in rate base that are not even known and measurable.

[5] In fact, it is only Rate Counsel's "rigid" application of the Elizabethtown Order that supports inclusion of the $13.1 million in post-test year additions.

akin to an advisory opinion on the wisdom of the Elizabethtown decision. This is wholly inappropriate. The role of the courts is to decide actual controversies, not issue advisory opinions. As our State Supreme Court has said, courts should "refrain from rendering advisory opinions, from deciding moot cases, or generally from functioning in the abstract…." N.J. Turnpike Auth. v. Parsons, 3 N.J. 235, 240 (1949); see also Johnson v. Johnson, 204 N.J. 529, 554 (2010) ("[j]udicial restraint counsels that the Court not decide an issue when there is no concrete case or controversy before it.") An issue is moot "when the decision sought in a matter, when rendered, can have no practical effect on the existing controversy." N.Y. Susquehanna & W. Ry. Corp. v. State, 6 N.J. Tax 575, 582 (Tax Ct. 1984). Consistent with New Jersey case law, Your Honor decline to opine on these moot or abstract issues.

II. The Company's Argument for a 9.75% Return on Equity is Not Supported By the Record or Current Policy.

The Company makes its request for a 9.75% ROE based on "the Board's consistent actions in authorizing a return on equity of 9.75% for most water and sewer companies in the last five years in New Jersey." SWAHIB at 22.[6] Although there has not been a litigated water or sewer rate case in New Jersey during the last five years, the Company relies on older settlements as precedent while discounting more recent settlements. Id. The Company complains about "Rate Counsel's apparent new practice, evidenced in this proceeding of treating returns on equity achieved through settlements in other cases as "precedent," (SWAHIB at 4), while relying on settlements at 9.75% as precedent.

[6] The Company ignores the most recent wastewater base rate case to come before the Board, where the Board adopted a return on equity of 9.6%. I/M/O Atlantic City Sewerage Co. for Authorization to Increase Tariff Rates & Charges for Sewerage Service, BPU Docket No. WR16100957, Board Order dated 3/24/17.

If the Company wants to use settled cases as the basis for setting the ROE in this case, then it must be done consistently. If Your Honor adopts this position, the Company cannot be allowed to ignore the last six months of settled cases, including a case involving a small wastewater company, that have been settling for ROEs of 9.60%. In addition, as set forth below, the analyses offered by the expert witnesses in this case support a lower ROE than the 9.75% requested by the Company. A case-by-case analysis is always appropriate and may be applied to reflect the particular circumstances here.[7]

A. The Company's own Expert Witness Cannot Justify a Return on Equity Above the 9.6% Currently Being Authorized By the Board.

The Discounted Cash Flow ("DCF") and Capital Asset Pricing Model ("CAPM") analyses are the most widely accepted methods for estimating the appropriate return on equity for a public utility. Company witness Ms. Ahern's DCF analysis produced a recommended 8.47% ROE. Ms. Ahern's CAPM model, despite using inputs most favorable to her client, resulted in a recommended 9.52% ROE. As Rate Counsel has previously noted, Ms. Ahern's DCF and CAPM analyses both result in recommended ROEs below the 9.60% currently being authorized by the Board.

Ms. Ahern is only able to inflate her recommendation by using a risk premium model and a comparable earnings model based on competitive, unregulated companies (the "Non-Regulated Proxy Group") that are hardly comparable to a public utility with a monopoly in its service

[7] As President Mroz recently stated at the December 2016 BPU agenda meeting, "it's still incumbent upon us to make a determination on the ROE for any particular matter in front of us." PRT-2, Exhibit PMA-2, p.7. If you Honor applies an analysis based on the unique circumstances of this case, including the size of the Company, the four year phase-in and the imputed customer growth, the Initial Decision should make that clear to resolve any confusion in future cases about the applicability of precedent.

territory, and by using two adders – a business risk adder and a credit risk adder.[8] Ms. Ahern bases her business risk adder of 75 basis points on her assertion that the small size of SWAH compared to the companies in the comparison group puts it at greater risk. PRT-2 at 22. Her credit risk adder of nine basis points is based on the A- credit rating of Suez Water Resources (SWR) compared to the A rating of the comparison group. Id. at 21.

In his written surrebuttal testimony, Rate Counsel witness Dr. Marlon Griffing refuted both of these adders. As Dr. Griffing noted, the difference between an A- and an A credit rating is small and does not warrant a credit risk adjustment. Dr. Griffing also rejects the business risk adjustment, noting that SWAH is not a small, stand-alone company. RC-6 at 31. Dr. Griffing notes that "SWAH has access to cost efficiencies not associated with a firm its size because many of its business functions are part of the larger SWR's central operations. SWAH also receives all of its financing from SWR." Id. Indeed, Suez's ultimate parent company is an international corporation with a multi-billion dollar market capitalization. Neither of Ms. Ahern's adders can be supported by the record, particularly not the business risk adder. Because the Company's own expert cannot support an ROE above 9.60%, the Company's request for a 9.75% ROE must be rejected.

B. Board Staff Errs When It Characterizes the Company's Proposed ROE as a Return on Book Value Equity and Dr. Griffing's Proposed ROE as a Return on Market Price.

Board Staff stated the Company's 9.75% proposed ROE should be interpreted as a return on book value equity, while Dr. Griffing's proposed ROE of 8.65% should be interpreted as a return on market price. SIB at 8. Dr. Griffing's proposed ROE is based primarily on the DCF

[8] While Ms. Ahern refers to these as "adjustments," Rate Counsel is not aware of any testimony where Ms. Ahern has actually *decreased* a Company's recommended ROE to reflect a lower credit risk or a lower business risk.

model, which does use current market prices of common equity shares of water/wastewater utilities as an input to the model. RC-5 at 13, at 26-27. However, as Dr. Griffing explains, his ROE is appropriately applied to the book value of a regulated utility for the purposes of ratemaking. Investors are well aware that an ROE authorized by the Board is applied to the book value of a regulated utility. 73T:L4 – L11 (3/16/17). The investors incorporate this knowledge into what they are willing to pay for common-equity shares. Id. Thus, the DCF result and Dr. Griffing's proposed ROE do reflect book value. RC-6 at 18-21. No conversion of Dr. Griffing's ROE is needed, contrary to the assertion of Board Staff.

Further, to say that Ms. Ahern's recommended ROE should be interpreted as a return on the book value of equity is incorrect. Her ROE would have to be developed using only book values in the analytical models to justify that statement. Instead, her analyses incorporate market-value information. For example, Ms. Ahern applies the DCF model in the same manner as Dr. Griffing, meaning market-value share prices are one of the inputs. PRT-2, pages 25-26; PRT-2, PMA-13, page 1 of 9. Her Predictive Risk Premium Model (PRPM) uses forecasts of market-value bond yields for the risk-free interest rate. PRT-2, page 28; PRT-2, PMA-14, page 2 of 11; PRT-2, PMA-15, page 2 of 2. These are just two of many examples where Ms. Ahern incorporates market-value information into her analyses. In fact, all of Ms. Ahern's ROE analyses include market-value information. Her ROE result cannot be interpreted as a return on book-value equity.

C. Board Staff Errs When It States That Dr. Griffing Provided No Explanation Regarding His Use of One-Half the Estimated Growth Rate of Dividends for the Companies in His Comparison Group to Calculate the Expected Dividend Yield.

Board Staff stated that "Dr. Griffing provided no explanation with respect to the expected dividend yield and with respect to why one-half of the estimated growth rate was used rather

than the full growth rate as is generally required in the annual DCF model." SIB at 13. This assertion is completely incorrect.

Dr. Griffing explained his estimation of the expected dividend yield in the constant-growth DCF model he uses in his Direct Testimony. RC-5 at 24. His explanation begins with how the dividend yield is calculated. Id. at 24-25. He proceeds to adjust the resulting dividends for each of the eight companies in his Comparison Group by multiplying them by one-half the projected growth dividend growth rate for the respective company. Id. at 25. He explains that this adjustment method is appropriate because increases to the initial dividends used in the calculating the dividend yields can come after one quarter, two quarters, and so forth during the year. Id. He states that to accommodate these differences in the timing of increases he assumes that the dividend increases are evenly distributed over time. Id. Hence, the average dividend will increase by one-half a year's projected growth rate.

Ms. Ahern uses the same method to obtain her equivalent of the expected dividend yield. PRT-2, page 26. The rationale for the computation is the same as Dr. Griffing's. PRT-2, Appendix B, Section II. Thus, Staff's rejection of Dr. Griffing and acceptance of Ms. Ahern is inconsistent and should be disregarded.

D. Board Staff Misrepresents Dr. Griffing's Position Regarding Interest Rates.

Board Staff stated that Dr. Griffing acknowledged that interest rates were increasing. SIB at 14. A plain reading of the evidentiary hearing transcript relied on by Board Staff in reaching this conclusion shows that Dr. Griffing did not agree that interest rates are increasing.

At the hearing, Dr. Griffing stated that in response to two events, a March 3, 2017, speech by Janet Yellen, the Chair of the Federal Reserve System, about the chances of an increase in the federal funds rate, and the announced 25-basis point increase in the federal funds

rate on March 15, 2017, the interest rate (yield) on the U.S. Treasury 30-year bond had increased slightly, then fallen back slightly. The net change from the Yellen speech to the increase announcement was an increase of 3 basis points. 51T:L23 to 52T:L19 (3/16/17). Dr. Griffing then stated that the change in the federal funds target rate by the Federal Reserve did not necessarily mean that interest rate increases would follow, or if they did, that they would increase as much as changes in the federal funds rate. He stated that factors other than the federal funds rate affect the interest rates for instruments such as the 30-year treasury bond. 53T:L5 to L23 (3/16/17). Dr. Griffing noted at the evidentiary hearing that there had been a 3-point increase in the yield of that bond (to 3.11 percent) in response to a 25-point increase in the federal funds rate. 53T:L5 to L23 (3/16/17). Since the evidentiary hearing, the 30-Year Treasury Yield has fallen 14 basis points, closing at 2.97 percent on May 2, 2017.[9] This is further evidence that increases in the federal funds rate do not necessarily lead to a higher interest rate environment.

Board Staff bases its opinion that markets expect a high interest rate environment on its misrepresentation of Dr. Griffing's hearing testimony and Ms. Ahern's statement that at least two increases in the federal funds rate are expected. SIB at 11. Dr. Griffing showed in his hearing testimony that if the asserted federal funds rate increases materialize, it is not certain that yields and interest rates on other financial instruments will follow.

E. Board Staff's Criticism of Dr. Griffing's Recommendation of an 8.65% ROE is Misplaced.

Board Staff criticized Dr. Griffing for offering no proof that his choice of 8.65%, the mean of his DCF analysis, is the best estimate of ROE. Board Staff stated that the range from

[9] Rate Counsel asks Your Honor to take Judicial Notice of this recent decrease in interest rates. See https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yieldYear&year=2017

Dr. Griffing's DCF analysis of the Comparison Group results in a low ROE outcome of 7.14% and a high ROE outcome of 10.17% results in hypothetical ROR differences that are huge. SIB at 12-13.

Board Staff erred in claiming that Dr. Griffing offered no explanation of this range. In fact, Dr. Griffing stated that the range from the low ROE to the high ROE reflects differences of opinion among the various independent expert analysts contributing to the Zacks, Yahoo! Finance, and Value Line estimates of the dividend growth-rate component of the DCF model. RC-5 at 30-31. The mean of the analysis represents a point of consensus among the analysts. Dr. Griffing then checked whether 8.65% is a reasonable ROE recommendation. The base CAPM result of 7.16% is barely within the low end of the DCF ROE range, while other analyses Dr. Griffing performed to accommodate checking the effect of Chair Yellen's speech and the increase in the federal funds rate produced ROEs of 7.176% and 7.185. 52T:L20 to 53T:L4 (3/16/17); RC-6, MFG-19, Schedule 2a and Schedule 5a. These outcomes do not support moving away from the resulting consensus mean. Thus, Dr. Griffing did show that 8.65% is a better estimate than other points within the range. RC-6 at 10-12.

Board Staff has not applied the same rigor to its review of Ms. Ahern's ROE analysis as it has to Dr. Griffing's ROE analysis. Ms. Ahern performed four analyses that produced ROE results ranging from 8.47% to 11.34%. She stated that her recommended ROE of 10.00 percent is the "indicated" common equity cost rate. She offers no support for why this value from this range of results is the indicated ROE. PRT-2 at iii, 24, 25, 38. Yet Board Staff does not criticize Ms. Ahern for offering no proof as to why this choice of 10.00% is the best estimate of ROE. Further, the range of her ROE outcomes is 2.87%, not materially different from the range of Dr. Griffing's low and high ROE averages of 3.03%. Using her high and low ROEs in hypothetical ROR

analyses also results in large differences. Again, Board Staff does not offer this same criticism of Ms. Ahern's analyses as it did of Dr. Griffing's. For all of these reasons, Board Staff's analysis of Dr. Griffing's recommendation is flawed.

III. The Record in this Case Demonstrates the Wisdom of the Board's Policy To Share Rate Case Expenses Between Ratepayers and Shareholders.

Board Staff and Rate Counsel both agree that Your Honor should adopt the Board's long-standing policy to split rate case expenses equally between ratepayers and shareholders. As shown below, the record evidence in this case illustrates the wisdom of the Board's policy.

In its initial brief, Suez repeatedly states that this case did not settle because of the parties' differences on return on equity. SWAHIB at 4, 20. Rate Counsel agrees with the Company that this issue precluded settlement.[10] The revenue requirement difference between the 9.60% that the Board is currently adopting in settled cases and the 9.75% ROE requested by the Company is approximately $19,000. 26T:L9-L13 (3/13/2017). The Company has so far incurred an additional $200,000 in rate case expenses compared to its filed position.[11] RC-TR-1, Attachment A. This $200,000 does not even include evidentiary hearings, post-hearing briefs, or the filing of exceptions.[12] In total, the Company is requesting an additional $255,000 in rate case expenses due to this litigation, or a total of $340,000.[13]

The Board's 50/50 rate case sharing policy is rooted in fundamental fairness, as both shareholders and ratepayers benefit from a rate case proceeding. <u>I/M/O Middlesex Water Co. for Approval of an Increase in Its Rates For Water Service,</u> BPU Docket No. WR00060362,

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[10] Rate Counsel disagrees with the blame the Company repeatedly places on Rate Counsel for this case failing to settle, neglecting its own rigid position on this issue.

[11] In its Initial Brief, Rate Counsel inadvertently omitted the additional rate cases expenses of $36,571 for Ms. Ahern.

[12] The Company submitted an update of its rate case expenses on May 3, 2017, raising the total amount of rate case expenses incurred to $365,462. Because it was submitted the afternoon before reply briefs were due, Rate Counsel did not had the opportunity to review or determine the accuracy of this information.

[13] The vast majority of these additional expenses are solely associated with additional legal fees.

Order, (6/6/01). While the Company's initial brief contests the Board's rationale, the Company's actions support it. SWAHIB at 34, 35. This case litigated primarily over the return on equity issue, which is an issue that benefits shareholders exclusively. Ratepayers receive nothing from a higher ROE except higher bills. Furthermore, the Company is now incurring additional legal fees to fight issues that are either moot or uncontested. For example, the Company is arguing for a longer test year, despite there being no evidence in the record to support anything other than the April 30, 2016 test year. The Company also continues to argue the issue of post-test year additions, despite it being moot since the Company is receiving rate recognition for 100% of its in-service post-test year additions. These additional legal fees are unnecessary, and are being incurred by the Company in an effort to add shareholder value. Requiring shareholders to bear some of the costs of litigation helps prevent waste and places appropriate incentives to consider costs. Thus, this case plainly demonstrates the wisdom of the Board's policy to split rate cases expenses between ratepayers and shareholders.

Rate Counsel accepts the Board's policy to pay half of these additional rate case fees. Indeed, despite the fact that most of these legal fees have been expended for the exclusive benefit of shareholders, Rate Counsel has agreed to update the Company's rate case expenses through the close of the evidentiary record in this matter.[14] However, to require ratepayers to pay all of additional fees would be patently unfair. The facts here fail to offer any basis to overturn the Board's long-standing policy of splitting rate case expenses. Your Honor should order the splitting of rate case expenses consistent with this long-standing policy.

[14] The Company also seeks to recover 100% of legal fees incurred after the close of the evidentiary record in this matter. These fees are not in the record, have not and cannot be reviewed for prudency and are therefore properly excluded from recovery at any level. Indeed, if granted, fundamental fairness would require an additional proceeding to review these bills.

IV. The Company's Incentive Compensation Plan is Designed to Incent a Select Group of Employees to Achieve Financial Targets and Thus Should Not Be Charged to Ratepayers.

Board Staff and Rate Counsel agree that Your Honor should adopt the Board's long-standing policy to exclude incentive compensation expenses from rates. Although the Company seeks to recover certain incentive compensation expenses, its argument is flawed. As shown below, the Company's argument omits critical facts that illustrate why recovery of these expenses must be denied.

The Company's seeks to recover the "personal goals" portion of its incentive compensation expense, claiming that this amount is paid out regardless of the Company's financial performance. SWAHIB at 53. The Company also argues that its incentive compensation expense is not directed at a select group of employees. Neither of these statements is accurate. Since the Board's long-standing policy is not to allow ratepayers to be charged for incentive compensation programs aimed a select employees and based on financial goals, the recovery sought here should be denied.

Employees are only able to participate in the Company's incentive compensation plan if they are in exempt, eligible positions. RC-1 at RCR-A-40, Attachment 1, p. 2. The plan's objectives include "[a]warding outstanding achievement among employees who can directly impact United Water's results." Id. (emphasis added). The plan is clearly directed at a select group of employees.

Furthermore, the "personal performance" portion of the incentive compensation expense is not "paid out regardless of the Company's financial performance," as the Company claims. SWAHIB at 53. The written terms of the plan permit employees' individual goals to be based solely on the Company's financial performance. RC-2 at RCR-A-40, attachment, p. 4. If

employees elect this option, and the Company does not meet its financial targets, this portion of "personal performance" incentive compensation will not get paid out.

The other reason this incentive compensation expense cannot be recovered is that it is not known and measurable. The "personal performance" portion of the incentive compensation plan requires management to evaluate employee performance. RC-1 at RCR-A-40, attachment, p. 3. If employees are rated below a certain threshold, no incentive compensation is paid out. Id. at 2. The Company offered no evidence about how many employees actually achieve their individual goals.

The Company also disputes $12,461 in incentive compensation paid to M&S employees that Rate Counsel witness Mr. Mugrace removed. SWAHIB at 53. The Company's Petition requested M&S Fees totaling $42,244. RC-2, Schedule DM-13. During the pendency of this rate case, the Company received Board approval of a new methodology for allocating M&S fees. This new methodology would have increased the allocation to SWAH from $42,244 to $115,969. PRT-1 at 41. The Company decided not to make an amended request for the higher amount. However, when Mr. Mugrace asked the Company to provide the amount of incentive compensation imbedded in M&S fees, the Company provided the amount that is embedded using the new methodology, or $12,461.

The Company now argues in its initial brief that Mr. Mugrace should have taken a ratio of $12,461 to the $115,969 (10.7%) to arrive at an adjustment of $1,333. SWIB at 53-54. There is absolutely no accounting basis for doing this. The Company had the responsibility to provide Mr. Mugrace with the amount imbedded in the original $42,244 but never did so. The Company has the burden of proof here.[15] Mr. Mugrace used the incentive compensation number provided

[15] The calculation that the Company supports does not make sense to Rate Counsel. Not only does it not provide a basis for an adjustment, but it may be mathematically incorrect.

by the Company and the Company never updated its information at any point in the proceeding. Mr. Mugrace's adjustment of $12,461 should stand.

For all of these reasons, the Company's proposed incentive compensation expense should be excluded from rates, consistent with Board policy.

V. Board Staff & Rate Counsel Agree That the Proposed Carrying Charges Must Be Rejected.

Board Staff and Rate Counsel are in agreement that the Company's proposed carrying charges should be denied. Carrying charges on a rate phase-in would be unprecedented. As Board Staff noted in its initial brief, "Staff is unaware of any proceeding in which the Board allowed carrying charges for the duration [of] a rate phase in." SIB at 42. While there is no Board precedent to grant such charges, there is Board precedent to deny them. In a Seaview Water rate case, the Board adopted a phase-in of rates, against the Company's wishes and without carrying charges, in an effort to mitigate rate shock. I/M/O the Petition of Seaview Water Co. For an Increase in Rates For Water Service, BPU Docket No. WR98040193, Board Order dated (10/1/99). Noting the magnitude of the increase, Seaview's small customer base, and the lack of specificity in the ALJ's suggestion, the Board determined a deferral mechanism to be neither "supported nor feasible." Id. at 19. The eventual rate increase for SWAH will exceed Seaview's 80% rate increase. Indeed, the rate increase here will likely exceed 100%. The same reasons given by the Board for approving a phase-in without carrying charges in Seaview are equally applicable here.

The Company admits that it never requested these carrying charges in its petition. SWIB 45. The Company's reason for this was its assumption when it filed the petition that the case would settle. SWAHIB at 45. This is simply not a sufficient reason to allow this unprecedented request.

Because of SWAH's late request for carrying charges, both Board Staff and Rate Counsel were deprived of adequate time to analyze and rebut the issue. Accordingly, there are still many unanswered questions. How would these charges be recovered? Would they be deferred on the company's books? Would the Company write them off if they exceed the noticed rate increase? No one knows, because there was no opportunity to ask any of these questions. This is the reason a petition must include all the Company seeks from the BPU. Adding to the request at the last minute prejudices the other parties.[16]

The published public notice also never included these carrying charges. Given the lack of public notice, the Company's ratepayers have no idea that they may be subject to carrying charges on top of this already very large rate increase. The facts are that the Company did not include carrying charges in its filing, did not notice them to the public, and cannot point to any Board precedent of such charges ever being allowed. For all of these reasons, the Company's request for carrying charges should be denied.

VI. The Company's Proposal to Accelerate the Amount of the Increase Received in the First Year of the Phase-In Must Be Rejected.

The Company's proposal to accelerate the amount of the increase received in the first year of the Phase-In should also be rejected. In its petition, the Company's proposal called for an overall Year 1 revenue increase of $300,000, out of a total requested increase of $1.404 million. P-4, Sch. 1B. In rebuttal testimony, the Company changed its position. The Company is

[16] Indeed, the Company continues to change its request up to and including the filing of its initial brief. In his rebuttal, Mr. Prettyman testified that if the Company received approximately 50% of its awarded increase in Year 1 of the phase-in, with the remainder of the increase divided equally over Years 2-4 (*i.e.*, an accelerated phase-in), then carrying charges would not be needed. PRT-1 at 46. When it filed its initial brief, however, the Company backed off from this position and now requests both an accelerated phase-in and carrying charges on the deferred revenues associated with that phase-in.

now asking for a Year 1 revenue increase of $700,000, or 59.0%.[17] PRT-1, Exhibit GSP-7, page 2 of 5. This increase would greatly exceed the Year 1 increase included in the public notice of 25.3%, which was based on the proposed $300,000 increase. Moreover, this accelerated revenue recovery would more than compensate the Company for the delay in revenue recovery it is experiencing from its decision to litigate this case. The Company should not be permitted to amend its phase-in proposal at the last minute in order to avoid the consequences of its decision to litigate. If utilities were permitted to avoid the consequences of litigation, there would be little incentive for any utility to enter into settlement. For this reason, Your Honor should reject the Company's proposed accelerated phase-in, and limit the Year 1 increase to 25.28%, the Year 2 increase to 23.54%, the Year 3 increase to 23.1%, and assigned any required residual increase to Year 4 of the phase-in, consistent with the public notice and Rate Counsel's position.

VII. Rate Counsel's Proposed Rate Base Deduction for CTA Should be Adopted.

Rate Counsel proposes a CTA adjustment that uses a rate base deduction based on a twenty year lookback period. RCIB at 19. This results in a rate base deduction of $107,440. Id. The Company and Board Staff both propose a CTA adjustment using a rate base deduction and a five year lookback, and then split this deduction 75% to shareholders and only 25% to ratepayers. SIB at 22; SWAHIB at 38. This would result in a proposed rate base deduction of $79,381. Id.

In 2014, the Board issued an Order on the subject of consolidated tax adjustments. I/M/O The Board's Review of the Applicability & Calculation of a Consolidated Tax Adjustment, BPU Docket No. EO12121072, Board Order dated 12/17/14 ("2014 CTA Order"). The 2014 CTA

[17] This is yet another change that the Company improperly made via rebuttal testimony, without filing an amended petition or updated direct testimony, and without allowing proper time for the parties to conduct thorough and complete discovery.

Order set forth a methodology to serve as a minimum filing requirement for utilities in base rate cases, and made clear that parties could also argue other CTA positions. Id. The Company and Board Staff claim that their proposed methodology follows the methodology mentioned in the 2014 CTA Order. SIB at 22; SWAHIB at 38. However, the Company's and Board Staff's methodology uses a rate base deduction, while the 2014 Board Order calls for a revenue requirement deduction.

This minimum filing requirement in the 2014 CTA Order first requires utilities to calculate a CTA using a five year lookback period. 2014 CTA Order at p. 11. After calculating the CTA based on a five year lookback period, the 2014 CTA Order then requires that the CTA "shall be allocated so that the revenue requirement of the company is reduced by 25% of the adjustment." 2014 CTA Order at p. 11. It may be that the Board intended a rate base deduction rather than a revenue requirement deduction, but the Board has never clarified this language. Indeed, the Board issued two supplemental orders in the months following the 2014 Board Order to clarify errors, but left this language untouched. If Your Honor were to adopt a CTA that is consistent with the 2014 CTA Order, then this would result in a revenue requirement deduction of $79,381. This is a larger adjustment than what Rate Counsel has proposed.

If Your Honor chooses to use a rate base deduction, then Rate Counsel's proposed CTA most appropriately reflects the intent of the 2014 CTA Order to "reduce rates as a result of a CTA applied during base rate cases to reflect certain tax savings realized by the holding company." 2014 CTA Order at p. 11. The twenty year period that Rate Counsel recommends minimizes the effect of outlier years. RC-2 at 14. Also, there is no need for any additional "sharing" of CTA benefits as proposed by the Company and Board Staff, since the rate base

deduction used by Rate Counsel already includes a sharing of benefits. As Your Honor knows, a rate base deduction is akin to a carrying charge.

For all of these reasons, the CTA recommended by Rate Counsel reflects a fair sharing of the benefits of the Company's consolidated tax filing with ratepayers as intended by the Board's 2014 CTA Order and should be adopted.

VIII. The Proposed Apartment Rate Has No Cost-of-Service Basis, and If Adopted By Your Honor, Must Be Revenue-Neutral.

The Company argues that its proposed Apartment Rate is appropriate because absent such a rate, the apartment buildings would otherwise be billed the higher commercial rate. SWAHIB at 42-43. This is a red herring. There is no reason why the apartment buildings would have to be billed as commercial customers. The Company's existing tariff does not define apartment buildings, nor does its current commercial tariff apply to apartment buildings. 10T:L25 – 11T:L4 (3/16/17). As Rate Counsel witness Brian Kalcic testified, the Company could easily amend its residential tariff to add the meter sizes used for the apartment buildings. 41T:L25 – 42T:L3 (3/16/17).[18] If the Company's motivation was to ensure that the apartment buildings do not pay the higher commercial rate, the Company should have simply proposed a revenue-neutral apartment rate. Yet this is not what the Company did. Instead, the Company's proposed apartment rate would provide an additional $83,400 in fixed charges at the start of the first year of the phase-in, compared to its filed rate design position. 13T:L24 – 14T:L3 (3/16/17). This, it appears, is the Company's primary motivation for proposing this Apartment Rate.

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[18] The Company's initial brief wrongly states that "Rate Counsel agrees that it would be inappropriate to charge these master-meters under the Company's current residential tariff." SWAHIB at 44. Mr. Kalcic's testimony specifically stated the opposite. 10T:L21 – 11T:L7 (3/16/17). The Company's "evidence" for its claim is a question asked of a different witness, against Rate Counsel's objection (135T:L22 – 136T:L4 (3/13/17)), who was retained by Rate Counsel as an expert in a different subject area, and did not offer testimony on this subject.

This amended rate design should not be allowed. It would be poor policy for Your Honor to allow the Company to amend its rate design proposal at the rebuttal phase of the proceeding. However, if Your Honor were to adopt an Apartment Rate, the new rate should be revenue-neutral, *i.e.*, it should provide the same amount of annual fixed charge revenues (*i.e.*, $116,604 per Exhibit GSP-8, page 1 of 1) as was anticipated under the Company's filed rate design, and not an additional $83,400 as requested by the Company.

The Company's proposed Apartment Rate should also be rejected because it has no cost-of-service basis, and would not provide any net benefits to ratepayers. Without cost-of-service evidence, the Company's original proposal for an across-the-board increase to all ratepayers, including apartment dwellers, is the most reasonable revenue allocation. Accordingly, for all of these reasons, Your Honor should adopt Rate Counsel's rate design, which is consistent with the across-the-board increase originally recommended by the Company.

CONCLUSION

For all of the reasons discussed above, we recommend that Your Honor issue an Initial Decision finding that:

1. The appropriate return on equity for the Company is 8.65%; in the alternative, if Your Honor bases your recommended ROE on prior cases, Your Honor should adopt an ROE of 9.60% reflective of the Board's most recent actions;
2. The appropriate consolidated tax adjustment is $107,440, reflecting a rate base deduction that uses a twenty year look back period with no additional sharing;
3. Consistent with Board policy, rate case expenses should be updated for the actuals provided by the Company through the end of February, amortized over four years, and split 50/50 between shareholders and ratepayers;
4. There should be no carrying charges on the Company's proposed phase-in;
5. Consistent with Board policy, incentive compensation should be excluded from rates;
6. Rates should be increased across-the-board to all rate classes and phased in consistent with the public notice and without a new apartment rate.
7. The Company's request for an accelerated phase-in should be denied.

Respectfully submitted,

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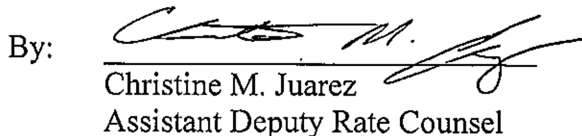
By: 
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