



STATE OF CONNECTICUT

PUBLIC UTILITIES REGULATORY AUTHORITY

2023 AQUARION RATE CASE SUMMARY

I. RATE CASE FUNDAMENTALS

The Public Utilities Regulatory Authority (PURA or the Authority) regulates the distribution rates of all investor-owned electric, natural gas, and water utilities (IOUs or companies) in Connecticut.¹ In order to change their distribution rates, a company must file a detailed application to amend their rates (rate application) with the Authority. PURA is statutorily charged with conducting an adjudicated proceeding to investigate any rate application. This investigation is called a “rate case” and is one of the core functions of the Authority.

PURA is guided by Conn. Gen. Stat. §§ 16-19 and 16-19e, among other statutes, when conducting a rate case and reviewing a rate application. Conn. Gen. Stat. § 16-19e provides particularly relevant guidance regarding PURA’s review of a rate application:

[PURA] shall examine ... the expansion of the plant and equipment of existing public service companies, the operations and internal workings of public service companies and the establishment of the level and structure of rates in accordance with the following principles: ... (4) that the level and structure of rates be sufficient, but no more than sufficient, to allow public service companies to cover their operating costs ... and yet provide appropriate protection to the relevant public interests, both existing and foreseeable....(5) that the level and structure of rates charged customers shall reflect prudent and efficient management of the franchise operation.

Further, by law, the company has the burden to prove that its proposed rates are just and reasonable. Conn. Gen. Stat. § 16-22. Notably, this burden requires the utility to provide more than mere assertions or documentation of expenses. Rather, the company must provide credible and sufficient evidence and clear explanations that demonstrate that the proposed rate change is just and reasonable and that the costs arise from prudent and efficient management of the utility. The Authority is obligated to deny any portion of the company’s request that is not proven to be just and reasonable. Indeed, it is only in demonstrating that a requested rate is just and reasonable that the Authority can ensure that the public interest is protected as required by Conn. Gen. Stat. § 16-19e.

¹ Conn. Gen. Stat. § 16-19 statutorily charges PURA with regulating the rates of Connecticut’s public service companies; otherwise known as investor-owned utilities.

Importantly, the company is, at all times, obligated by law to provide safe, adequate, and reliable service to all customers regardless of the outcome of a given rate case.² The requirement to serve the public need for safe and reliable utility service, and being subject to PURA's review of any rate applications, are requirements of the monopoly franchise granted by the State to the utility to provide utility service in its exclusive service territory.

II. AQUARION RATE CASE DOCKET AND DECISION

A. Overview

On August 26, 2022, the Aquarion Water Company of Connecticut (Aquarion or Company) filed a rate application with PURA in accordance with Conn. Gen. Stat. § 16-19 in Docket No. 22-07-01, Application of Aquarion Water Company of Connecticut to Amend its Rate Schedule (Aquarion Application).³ Aquarion currently provides water service, including fire protection service, to approximately 207,000 customers in 56 Connecticut municipalities. Aquarion Application, p. 5. Aquarion initially requested a return on equity (ROE) of 10.35%⁴ and an annual revenue requirement of \$226 million, but later increased its request to \$236 million. If approved, the requested revenue requirement would have increased residential customer annual bills by about 9% on average over *current* rates, or approximately \$61 per year.⁵

The Authority conducted an extensive investigatory process involving four public comment hearings, several days of field audits and inspections, seven in-person days of evidentiary hearings, two days of late filed exhibit hearings, oral arguments, and the issuance of several hundred discovery requests (i.e., requests for further information). At the conclusion of that process, on March 15, 2023, the Authority issued a Decision approving a return on equity (ROE) of 8.70% and an annual revenue requirement of \$196 million for the rate year commencing on March 15, 2023. The authorized revenue requirement is an approximately \$40 million reduction from Aquarion's request, as the Company failed to meet its burden of demonstrating that the requested revenue requirement and return on equity were just and reasonable. The Authority's determination will decrease customers' bills beginning on March 15, 2023, by about 11% on average compared to *current* rates, or by approximately \$67 per year, inclusive of the reduction of the Water Infrastructure Conservation Adjustment (WICA) to \$0.

This outcome protects the public interest by preventing customers from having to pay for costs that Aquarion did not sufficiently justify. Key components of the Decision in Docket No. 22-07-01 are further summarized below.

² Conn. Gen. Stat. §§ 16-244i and 16-10a.

³ Aquarion's last rate application was submitted on March 28, 2013 in Docket No. 13-02-20, Application of Aquarion Water Company of Connecticut to Amend Its Rates.

⁴ The September 24, 2013 Decision in Docket No. 13-02-20 previously set Aquarion's ROE at 9.63%.

⁵ This calculation compares the current Aquarion distribution and Water Infrastructure Conservation Adjustment (WICA) charges with the proposed distribution charges, as the proposed distribution charges incorporated all prior WICA-related (i.e., the WICA surcharge is reset to \$0).

B. Aquarion Failed to Meet its Evidentiary Burden

As stated above, by law, it is Aquarion's burden to demonstrate that its proposed rates are just and reasonable. Similarly, proposed rates must reflect prudent operating expenses and infrastructure investments necessary to efficiently operate and provide safe, adequate, and reliable service. Investments and expenses found by the Authority to be prudent based on the evidence presented during the rate case are added together and spread across the rates charged to all customer classes to be recovered over time.⁶

The Authority declined to include in the approved revenue requirement several categories of expenses that Aquarion failed to adequately demonstrate are prudent, reasonable, and in the best interest of ratepayers. These buckets include, but are not limited to, operation and maintenance (O&M) costs, including continued annual costs based on prior periods and adjustments to O&M expenses, and capital expenditures.

In its rate application, Aquarion requested annual O&M expenses totaling over \$80 million. Based on its findings, PURA reduced the allowable annual O&M expenses for recovery through rates by over \$10.7 million. Specifically, the Authority did not allow the following to be incorporated into rates: Aquarion's share of costs linked to its 2017 merger with Eversource (\$4.9 million); outside legal costs related to this rate case (\$390,000); industry and non-industry membership dues (\$300,712); charitable donations (\$81,491); and entertainment expenses (\$37,812), among others. Regarding its 2017 merger with Eversource, the Authority found that Aquarion failed to provide evidence demonstrating ratepayer savings as a result of the merger. Regarding membership dues, the Authority found at least one instance of membership dues associated with lobbying activities, coupled with no quantifiable or ascertainable benefit to ratepayers. Additionally, the Company did not justify how entertainment expenses such as reserved seats at various venues, or donations to entities such as a zoo, were necessary for the provision of water service.

Importantly, the Decision does not bar the Company from participating in industry advocacy efforts, nor does it penalize or preclude Aquarion from investing in the local communities it serves; rather, the Decision finds that such expenses that do not contribute to the safe, reliable, and efficient provision of water service or otherwise provide discernable value to a utility's customers should *not be* the burden of ratepayers, particularly when Aquarion is receiving public goodwill for such endeavors made in its name. Denying these expenses from recovery through rates does not prohibit the Company from engaging in such activities. Aquarion may instead fund such activities with shareholder funds. Indeed, the Authority hopes that Aquarion follows through on its promises to be a responsible community and corporate partner by committing shareholder funding to these efforts rather than ratepayer money.

The Authority also did not allow a going forward adjustment for chemical expenses that would have more than doubled the cost of these chemicals to ratepayers. PURA

⁶ Expenses associated with capital investments, including the associated return on investments, are recovered over the asset's "useful life". Fixed annual expenses are incorporated into the revenue requirement on a one-to-one basis.

found that this request was based on projections that Aquarion's own suppliers advised were not reliable and that, ultimately, the public interest is not served by allowing Aquarion to receive increased revenues to cover speculative costs.

Lastly, the Authority declined Aquarion's request to include over \$50 million of capital expenditures made during the end of 2022 or to be made in the first quarter of 2023. Under traditional utility ratemaking principals, capital expenditures must be prudent and "used and useful" before being incorporated into customer rates. This simple standard means that investments must be both in-service *and* provide reasonable value to ratepayers and the drinking water distribution system. However, the Company did not provide sufficient evidence to show that these expenditures were prudent or in-service.

C. The Approved ROE Maintains Aquarion's Financial Condition

As an investor-owned utility, Aquarion is permitted the *opportunity* to earn a reasonable return on equity to (ROE) to compensate its shareholders, as afforded by Supreme Court precedent.⁷ As part of the ratemaking process, the Authority examined several factors in determining a just and reasonable ROE, including current economic and market conditions, analytical models and cost of equity capital methodologies, such as the Discounted Cash Flow (DCF) Model and the Capital Asset Pricing Model (CAPM), ROEs of similar companies in other jurisdictions, and the Company's financial risk and credit rating.

In its analysis, the Authority found the DCF Model to be more reflective of current market conditions and therefore weighted its results, including a DCF output mean of 8.71%, more heavily than other methodologies. The Authority ultimately selected an ROE of 8.70%, as (1) this level of return will support a capital structure that would not adversely affect the Company's credit rating or financial condition and (2) it more accurately reflects the risk associated with operating a drinking water utility with a decoupling mechanism that annually trues up revenue and a mechanism, WICA, that allows for incremental capital expenditures between rate cases.

D. WICA Provides for Necessary Future Investments

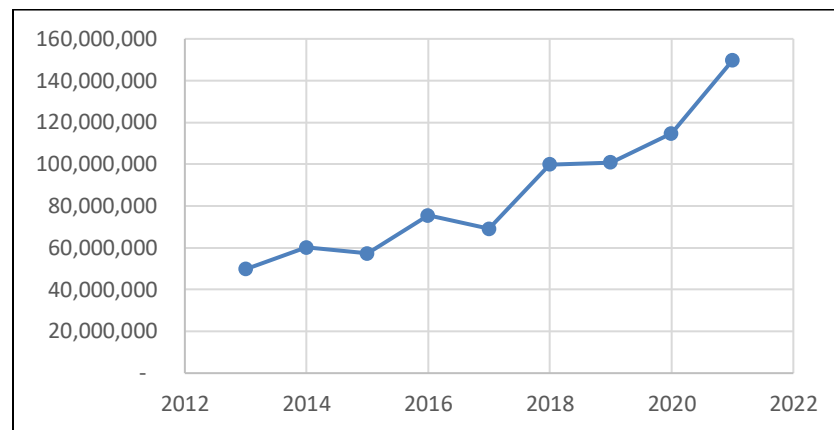
Despite failing to meet the burden of proving the proposed rate is just and reasonable, Aquarion continues to carry a statutory obligation to provide safe, adequate, and reliable service, as noted above. Aquarion is also obligated to operate efficiently and to prudently plan and invest in drinking water infrastructure. To meet these obligations, Aquarion can avail itself of a unique interim rate adjustment mechanism, WICA, in addition to the annual revenue requirement authorized in the Decision in Docket No. 22-07-01.

⁷ Fed. Power Comm'n v. Hope Nat. Gas Co., 320 U.S. 591, 603 (1944) (Hope); Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W. Va., 262 U.S. 679, 690 (1923) (Bluefield); see also Duquesne Light Co. v. Barasch, 488 U.S. 299, 310 (1989).

WICA allows all regulated water companies, including Aquarion, to increase its water quality and conservation-related investments between rate cases,⁸ enabling the acceleration of the rate of replacement and/or rehabilitation of existing water system infrastructure to mitigate the effect of decay of aging water systems and to promote conservation measures. By law, WICA allows water companies to make capital investments and to recover those investments through rate increases of up to 10% between rate cases, and up to 5% in a given year. Each rate case resets this cap, meaning Aquarion may seek recovery for additional eligible water infrastructure investments of up to \$19.6 million (10% multiplied by the authorized revenue requirement of \$196 million = \$19.6 million) through its next rate proceeding.

Indeed, since the Company's last rate case in 2013, WICA has enabled, at least in part, a significant increase in capital expenditures by Aquarion, which saw an even greater increase after its acquisition by Eversource in 2017. The figure below illustrates the significant and increasing levels of annual plant addition since 2013.

Figure 1: Annual Capital Additions (\$) by Year



Notably, this level of investment substantially exceeds the amount projected by Aquarion in its 2013 rate case. At that time, the Authority expressed concern about Aquarion spending \$287 million as part of its five-year capital plan covering 2013-2017. In fact, as noted in the Authority's 2013 decision, annual capital improvement spending from 2011-2013 had already increased by almost 50% from the \$40 million in annual investment for 2008-2010.

E. New Rate Structures Support Conservation and Affordability

The Authority authorized a new three-tier pricing structure for Aquarion residential single-family customers designed to encourage conservation by sending appropriate pricing signals to higher-volume users. The initial consumption rate tier, which applies to the first 9 hundred cubic feet (CCF) of usage per month, will capture 76% of customer bills based on historic usage analysis. The higher consumption rate tiers will apply to 17% and 7% of customer bills, respectively. The approved rate design appropriately considers

⁸ Conn Gen. Stat. § 16-262w.

water conservation as required by Conn. Gen. Stat. §§ 16-19e(a)(2) and 16-19/ by discouraging excessive water consumption particularly for discretionary uses such as lawn irrigation.

The Authority also approved a Low-Income Rate Assistance Program (LIRAP) that will provide a 15% credit to qualifying residential customers on their total monthly bill. The Authority required Aquarion to begin implementation of LIRAP no later than 60 days from the date of the Decision, or May 14, 2023. The Authority will monitor the compliance data the Company is required to track and report to ensure effective implementation of the LIRAP.

F. Executive Compensation Tied to Affordable Service

Aquarion requested recovery of \$410,676 in Eversource and \$2,045,996 in Aquarion executive compensation. The average impact per household of this aggregated compensation would have been approximately \$3.50 per year. Instead of authorizing the compensation as requested, PURA tied recovery of Eversource and Aquarion officer compensation to the achievement of certain affordability metrics. As such, \$294,046 of Aquarion officer compensation is subject to certain performance metrics. If these metrics are not achieved on an annual basis, Aquarion customers would pay \$0 toward Eversource executive compensation and would see the compensation paid toward Aquarion officers reduced by 10% per year.