

**Before  
The Ohio Senate  
Public Utilities Committee**

**Testimony on House Bill 422**

**By  
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**On Behalf of  
Office of the Ohio Consumers' Counsel**

**June 7, 2018**

Vice-Chair McColley, Ranking Minority Member Williams, and members of the Committee. My name is Jeff Jacobson. I am testifying on behalf of the Office of the Ohio Consumers' Counsel. OCC is the state's representative of residential utility consumers. Utility consumer bills could be increased by House Bill 422 (the Bill). Thank you for this opportunity to testify.

The Bill would diminish longstanding protections for water consumers in Ohio's ratemaking law (when a water utility acquires other water systems). That could increase rates for Ohio water consumers. I recommend that the Bill not be enacted. At a minimum, the bill should be modified to add consumer protections.

Specifically, our concern includes that the Bill would undermine the consumer protection in O.R.C. Title 49 that Ohio utility consumers should not pay rates based on more than the “original cost” of acquired utility plant (assets). (See lines 173 through 212)

The use of original cost as a fair ratemaking method for consumers is described in a classic ratemaking treatise. That treatise, “Principles of Public Utility Rates,” describes the original cost as a ratemaking method as follows: “Original cost, in public utility accounting has now become a term of art. It means the cost of an asset when first devoted to the public service **rather than the cost to a transferee company.**” [James Bonbright, p. 174 (1969) (emphasis added).]

The use of original cost for ratemaking, in O.R.C. 4909.05, is fair to utilities and to consumers. But the Bill would redefine original cost in a way that can lead to higher valuations of acquired utility plant and thus higher rates for Ohio consumers to pay. And the protective mechanism of original cost will then exist in name only, where original cost is no longer the original cost of utility plant assets.

The Bill, by modifying the definition of original cost (lines 107-108), would undermine traditional consumer protections. Specifically, the revised definition in the Bill will allow the water utility to charge the market value for monopoly plant as opposed to its actual original cost. In this regard, the market value can inflate the true cost to consumers. More specifically, the Bill would allow the regulated water utility to charge consumers

higher rates than the utility would be able to charge otherwise, where the acquisition cost of plant is inflated above true original cost.

I will reference A 2004 Regulated Utilities Manual, by Deloitte, that discusses utility ratemaking methodologies and alternative methods of addressing ratemaking that deviate from the original cost ratemaking principle: <http://ipu.msu.edu/wp-content/uploads/2017/09/Deloitte-Regulated-Utilities-Manual-2012-2.pdf>.

At page 9 of the *Manual*, Deloitte states as follows on this subject:

Balancing the interests of the customer and the utility is the basic objective in selecting a costing method. The two historic measures have been fair value and original cost. The “end-result doctrine” holds that the propriety of the choice in any given case lies in which of the two produces results that are both fair to the consumer and reasonable for the investor. As a practical matter, the fair-value concept has been abandoned, and original-cost concepts dictate the results of the ratemaking process.

At page 10 of the *Manual*, Deloitte states that (as of 2004) the use of original cost is predominant in the United States for utility ratemaking purposes. And Deloitte states that, where original cost was not used, consumers typically were given protection from higher rates by a requirement to lower the utility’s rate of return that consumers pay:

Original-cost ratemaking is the formal posture for rate-base determination by all federal jurisdictions and most states, probably in large part because the amounts involved are readily accessible, and their use minimizes the expense and controversy entailed by plant measurement under fair value. The remaining states, even though labeling their process as representing fair value or some other standard, in fact typically produce original-cost results by adjusting the rate of return.

At a minimum, the General Assembly should amend the Bill to require the PUCO to reduce the utility's rate of return if valuations for acquired assets are allowed at above original cost. As stated in the Deloitte Manual, reducing the utility's rate of return would simulate for consumers the protections of original cost.

In Pennsylvania, legislators enacted a statute in 2012 that provides extra protection for consumers when utilities deviate from original cost in acquiring property. (66 Pa.C.S. §1327) The statute is attached. Consumer protections in the Pennsylvania law require utilities - that want to charge consumers for acquired property above the value of original cost - to show that the seller of the property was not "furnishing and maintaining adequate, efficient, safe and reasonable service and facilities, ..." (66 Pa.C.S. §1327(a)(3))

At a minimum, the General Assembly should amend the Bill to require the PUCO to add this consumer protection and other consumer protections in the Pennsylvania law, when acquired assets are to be allowed at above original cost in the rates the utility charges to consumers.

In this regard, the Bill actually prevents consumer protection where it provides that the "original source of funding for any part of the tangible assets shall not be relevant to the determination of the value of those assets." (Lines 206-208) The Bill should be amended to delete this provision.

Please also be aware that the Ohio water utility industry has been successful at chipping away (toward dismantling) some of the long-standing ratemaking principles in Ohio law that have protected Ohio consumers for decades. In 2004, Senate Bill 44 provided water utilities with the ability to collect additional charges from consumers outside of a rate case process, up to three percent for infrastructure improvements related to distribution systems. In 2012, House Bill 379 amended the law to increase these charges to customers up to four and a quarter percent for water companies and expanded the list of the type of plant that qualifies, to include production plant. House Bill 379 also provided water utilities the ability to propose rate increases by expanding the test year concept of ratemaking to include the costs incurred for an additional 12-month period after the test year. And, House Bill 379 permitted a water utility to select a date certain that is farther in the future than what is currently allowed for other utilities, so that more assets can be included in rate base on a projected basis (without actual cost figures). The date certain is the date for determining whether plant is used or useful in providing service, and if so, for ascertaining the value of the plant for which customers will pay. House Bill 422 is yet another attempt by the water industry to deviate from long-standing consumer protection principles with the result of allowing higher charges to consumers with less process.

Accordingly, we recommend that House Bill 422 not be enacted. The Bill's change to the meaning of "original cost" in the ratemaking statutes would result in higher water bills for Ohio utility consumers. And please note that our position would not prohibit a

water utility from acquiring plant for more than original cost; our recommendation is focused on limiting to original cost what the utility can charge its customers for acquired assets.

Again, I thank the Committee for this opportunity to make recommendations for protection of Ohio utility consumers. We look forward to making further recommendations during any process for this legislation.

## 66 Pa.C.S. § 1327

Pa.C.S. documents are current through 2018 Regular Session Acts 1-21; P.S. documents are current through 2018 Regular Session Acts 1-16

*Pennsylvania Statutes, Annotated by LexisNexis® > Pennsylvania Consolidated Statutes > Title 66. Public Utilities (Pts. I — II) > Part I. Public Utility Code (Subpts. A — E) > Subpart C. Regulation of Public Utilities Generally (Chs. 11 — 21) > Chapter 13. Rates and Distribution Systems (Subchs. A — B) > Subchapter A. Rates (§§ 1301 — 1329)*

### **§ 1327. Acquisition of water and sewer utilities.**

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**(a) Acquisition cost greater than depreciated original cost.** —If a public utility acquires property from another public utility, a municipal corporation or a person at a cost which is in excess of the original cost of the property when first devoted to the public service less the applicable accrued depreciation, it shall be a rebuttable presumption that the excess is reasonable and that excess shall be included in the rate base of the acquiring public utility, provided that the acquiring public utility proves that:

- (1) the property is used and useful in providing water or sewer service;
- (2) the public utility acquired the property from another public utility, a municipal corporation or a person which had 3,300 or fewer customer connections or which was nonviable in the absence of the acquisition;
- (3) the public utility, municipal corporation or person from which the property was acquired was not, at the time of acquisition, furnishing and maintaining adequate, efficient, safe and reasonable service and facilities, evidence of which shall include, but not be limited to, any one or more of the following:
  - (i) violation of statutory or regulatory requirements of the Department of Environmental Resources or the commission concerning the safety, adequacy, efficiency or reasonableness of service and facilities;
  - (ii) a finding by the commission of inadequate financial, managerial or technical ability of the small water or sewer utility;
  - (iii) a finding by the commission that there is a present deficiency concerning the availability of water, the palatability of water or the provision of water at adequate volume and pressure;
  - (iv) a finding by the commission that the small water or sewer utility, because of necessary improvements to its plant or distribution system, cannot reasonably be expected to furnish and maintain adequate service to its customers in the future at rates equal to or less than those of the acquiring public utility; or
  - (v) any other facts, as the commission may determine, that evidence the inability of the small water or sewer utility to furnish or maintain adequate, efficient, safe and reasonable service and facilities;
- (4) reasonable and prudent investments will be made to assure that the customers served by the property will receive adequate, efficient, safe and reasonable service;
- (5) the public utility, municipal corporation or person whose property is being acquired is in agreement with the acquisition and the negotiations which led to the acquisition were conducted at arm's length;
- (6) the actual purchase price is reasonable;
- (7) neither the acquiring nor the selling public utility, municipal corporation or person is an affiliated interest of the other;
- (8) the rates charged by the acquiring public utility to its preacquisition customers will not increase unreasonably because of the acquisition; and

## 66 Pa.C.S. § 1327

(9) the excess of the acquisition cost over the depreciated original cost will be added to the rate base to be amortized as an addition to expense over a reasonable period of time with corresponding reductions in the rate base.

(b) **Procedure.** —The commission, upon application by a public utility, person or corporation which has agreed to acquire property from another public utility, municipal corporation or person, may approve an inclusion in rate base in accordance with subsection (a) prior to the acquisition and prior to a proceeding under this subchapter to determine just and reasonable rates if:

(1) the applicant has provided notice of the proposed acquisition and any proposed increase in rates to the customers served by the property to be acquired, in such form and manner as the commission, by regulation, shall require;

(2) the applicant has provided notice to its customers, in such form and manner as the commission, by regulation, shall require, if the proposed acquisition would increase rates to the acquiring public utility's customers by an amount in excess of 1% of the acquiring public utility's base annual revenue;

(3) the applicant has provided notice of the application to the Director of Trial Staff and the Consumer Advocate; and

(4) in addition to any other information required by the commission, the application includes a full description of the proposed acquisition and a plan for reasonable and prudent investments to assure that the customers served by the property to be acquired will receive adequate, efficient, safe and reasonable service.

(c) **Hearings.** —The commission may hold such hearings on the application as it deems necessary.

(d) **Forfeiture.** —Notwithstanding section 1309 (relating to rates fixed on complaint; investigation of costs of production), the commission, by regulation, shall provide for the removal of the excess costs of acquisition from its rates, or any portion thereof, found by the commission to be unreasonable and to refund any excess revenues collected as a result of this section, plus interest, which shall be the average rate of interest specified for residential mortgage lending by the Secretary of Banking in accordance with the act of January 30, 1974 (P.L.13, No.6), referred to as the Loan Interest and Protection Law, during the period or periods for which the commission orders refunds, if the commission, after notice and hearings, determines that the reasonable and prudent investments to be made in accordance with this section have not been completed within a reasonable time.

(e) **Acquisition cost lower than depreciated original cost.** —If a public utility acquires property from another public utility, a municipal corporation or a person at a cost which is lower than the original cost of the property when first devoted to the public service less the applicable accrued depreciation and the property is used and useful in providing water or sewer service, that difference shall, absent matters of a substantial public interest, be amortized as an addition to income over a reasonable period of time or be passed through to the ratepayers by such other methodology as the commission may direct. Notice of the proposed treatment of an acquisition cost lower than depreciated original cost shall be given to the Director of Trial Staff and the Consumer Advocate.

(f) **Reports.** —The commission shall annually transmit to the Governor and to the General Assembly and shall make available to the public a report on the acquisition activity under this title. Such report shall include, but not be limited to, the number of small water or sewer public utilities, municipal corporations or persons acquired by public utilities, and the amounts of any rate increases or decreases sought and granted due to the acquisition.

## History

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Act 1990-24 (H.B. 24), P.L. 107, § 1, approved Apr. 4, 1990, eff. in 60 days; Act 1995-7 (H.B. 882), P.L. 49, § 1, approved June 1, 1995, eff. in 60 days; Act 2012-11 (H.B. 1294), P.L. 72, § 5, approved Feb. 14, 2012, eff. in 60 days.

Annotations



## Notes

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### EDITOR'S NOTES.

Act 1995-18 abolished the Department of Environmental Resources, referred to in subsection (a)(3)(i), and transferred its functions to the Department of Conservation and Natural Resources and the Department of Environmental Protection.

### AMENDMENT NOTES.

The 2012 amendment substituted "subchapter" for "chapter" in the introductory paragraph of (b).

## Research References & Practice Aids

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### LexisNexis ® Notes

#### PENNSYLVANIA ADMINISTRATIVE CODE REFERENCES.

52 Pa. Code § 69.711 (2013), PART PUBLIC UTILITY COMMISSION.

52 Pa. Code § 69.721 (2013), PART PUBLIC UTILITY COMMISSION.

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