

E. Operating & Maintenance Expenses

1. Salary and Wage Expense, the 2013 Compensation Study and Incentive Compensation

(a) Salary and Wage Expense

176. The Company's direct testimony projected payroll expense to increase by \$899,703 through the end of the Test Period. Ex. 1 (Valcarengi) at 24. The projected increase was the annualized result of employees added or lost during the test year and test period, annualized salary and wage expenses incurred in the test year, and a projected wage increase in base salaries of 3%. *Id.* and Sch. DLV-3B-1. At the evidentiary hearing, the Company sought to admit evidence that it had committed to giving its employees an approximately 3% increase in wages and salaries prior to the end of the test period, and that the new rates took effect just after the end of the test period, in October 2014. Tr. at 310-11; Artesian OB at 26. The Hearing Examiner sustained the DPA's objection against admitting such evidence, so the Company proffered what the testimony would have stated had it been admitted. Tr. at 310-11.

177. The DPA objected to including the projected wage increase in the revenue requirement on two grounds: (1) it was an inflation adjustment; and (2) the Commission had rejected post-test period wage increases in Delmarva's most recent case. DPA AB at 47; Ex. 17A (Watkins) at 26. One of the reasons the Commission gave for rejecting such increases in *Delmarva* was that it distorted the matching principle: "We do not believe that the relationship between historical revenue, investment and expenses should be adjusted solely for estimates of future expenses." *Delmarva Power*, PSC Docket No. 13-115,

Order No. 8589 at ¶131. The DPA noted that Artesian had not adjusted its revenues to take into account post-test period revenue increases either. DPA AB at 48-49.

178. The DPA contended that Artesian's prefiled testimony belied its claim that it had "already committed" to this post-test period wage increase. The DPA pointed out that Artesian filed its rebuttal testimony on October 27, 2014 - only four days before the end of the month - and that that testimony did not say that Artesian had already committed to implementing this wage increase; rather, it said only that "[l]astly, AWC traditionally awards merit increases to employees each year in October." *Id.* at 49, quoting Ex. 21 (Valcarenghi-Rebuttal) at 41. The DPA argued that if Artesian had in fact already committed to implementing the wage increase by the time its rebuttal testimony was due, one would think it would have specifically said so in that testimony. *Id.*

179. The DPA noted that it was not challenging either Artesian's decision to award merit increases or the fact that the amount of the projected wage increase could be precisely calculated based on the number of Artesian employees and their current salaries. *Id.* at 48. The DPA emphasized that it was challenging the Company's decision to reach beyond the end of the partially-projected test period that it selected to bring this projected increase into the test period revenue requirement. *Id.* The DPA argued that the cases in which the Delaware Supreme Court had addressed the "waste/bad faith/abuse of discretion" standard were clear that the standard applies to expenses that had already been incurred. See *Delmarva Power & Light Company v. Public*

Service Commission, 508 A.2d 849 (Del. 1986) (Commission required to allow rate recovery of fuel costs already incurred by utility in absence of waste, bad faith, or abuse of discretion); *Application of Wilmington Suburban Water Corp.*, 211 A.2d 602, 608-09 (Del. 1965) (Commission required to allow rate recovery of normal operating expenses incurred in test year in absence of waste, bad faith or abuse of discretion). DPA AB at 48.

180. The DPA further argued that both of the cases Artesian cited to support its adjustment involved *contractual* wage increases for union employees. *Id.* at 49. See *Delmarva Power*, PSC Docket No. 09-414, Order No. 8011 at ¶106; *Chesapeake Util. Corp.*, PSC Docket No. 95-73, Order No. 4104 at ¶99. Here, however, there was no record evidence that the wage increase for which Artesian sought recovery was contractually mandated. DPA AB at 49.

181. The DPA contended it did not logically follow that because a company awards merit wage increases around the same time every year that the increase is *not* an inflation adjustment. It noted that the Company presented no record evidence for how it settled on a 3% raise in this case versus the percentage raises approved in previous years. *Id.* at 49-50.

182. Finally, the DPA contended that all companies are subject to wage pressure, but not all companies give their employees raises annually. *Id.* at 50. The DPA explained that if the cost of an unregulated product or service becomes too high, consumers can purchase the product or service from some other company, substitute a similar product, or forgo the product or service altogether. *Id.* In

the case of regulated water utilities, however, customers have no option to switch to another supplier: there is no product that can be adequately substituted for potable water, nor can a household simply turn off the tap. *Id.* These are captive customers of whatever utility has the certificate of convenience and necessity to serve their location. *Id.*

183. Hearing Examiner's Recommendations. The Hearing Examiner found that the Company did not include in its rebuttal testimony a definitive commitment to the increase in wages and salaries in its rebuttal testimony, noting that Artesian could have easily done so. HER at 57. He also stated that Artesian appeared to be "hedging its bets" regarding this wage increase. *Id.*

184. The Hearing Examiner observed that in the most recent Delmarva electric rate case, contrary to his recommendation, the Commission prohibited Delmarva from correcting errors on two schedules it had discovered on the first day of evidentiary hearings because to allow the record to be supplemented at that time would have violated the timing requirements of the Minimum Filing Requirements ("MFRs"). HER at 57-8, citing PSC Order No. 8537 (Apr. 15, 2014) at ¶ 2.

185. Because the proposed increase was not definitively committed to in Artesian's pre-filed testimony, the Hearing Examiner recommend that the Commission not recognize the proposed increase in rates. HER at 58.

186. Exceptions. Artesian contended that as a matter of law and policy the Commission should reject the Hearing Examiner's

recommendations with respect to the change in salary and wages expense. Artesian EB at 24-32.

187. Artesian cited Delaware Supreme Court precedent regarding the need to recognize known and measurable operating expenses in rates. *Id.* at 25. That court has pronounced that under "Delaware law, a utility is entitled to recover all operating expenses it legitimately incurs unless those operating expenses are the result of waste, inefficiency, or bad faith." *Delmarva Power & Light Co. v. Pub. Serv. Comm'n*, 508 A.2d 849, 859-60 (Del. 1986).¹⁹ The Court cautioned that the "Legislature's grant to the Commission of broad discretionary authority in the ultimate fixing of just and reasonable rates ... should not be confused with the Commission's limited authority to disallow a public utility's incurred operating expenses." *Id.* at 860.

188. Artesian further argued that this proceeding is analogous to the case of *In re Application of Delmarva Power & Light Co.*, 337 A.2d 517 (Del. Super. 1975), where a utility sought to admit updated, accurate information at the evidentiary hearing. Artesian EB at 26; *In re Delmarva*, 337 A.2d at 517. This Commission initially refused to consider the updated information. *In re Delmarva*, 337 A.2d at 517. Relying upon the principle that rate making is prospective, and

¹⁹The DPA contended that the business judgment rule does not apply to the Artesian Board of Directors' commitment to increase its employees' salaries and wages, because the business judgment rule only applies to expenses that have already been incurred. DPA AB at 48. Artesian contended that the business judgment rule applies to its Board of Directors' compensation decisions, and neither the DPA nor Staff submitted evidence that this change in salary and wage expense was the product of waste, inefficiency, abuse of discretion or bad faith. Artesian EB at 25-26. As we resolve the salary and wage expense question through reference to previous Commission and court precedents, we need not address this dispute.

therefore rates should be just and reasonable in the foreseeable future as well as the present, the court held that it was legal error to refuse to consider the information that Delmarva brought to the evidentiary hearing. *Id.* at 518-519; see *In re Delmarva Power & Light Co.*, PSC Docket No. 09-414, Order No. 8011, at ¶ 51 (Aug. 9, 2011).

189. Artesian distinguished the most recent Delmarva proceeding, where this Commission refused to allow the utility to correct certain errors in its pre-filed testimony. Firstly, the Delmarva errors did not relate to salary and wages expense, which is what Artesian sought to admit during the evidentiary hearing. Artesian EB at 28-29. Secondly, the other parties in Delmarva had no forewarning that new evidence was contemplated, whereas Artesian disclosed the projected salary increase from the commencement of the present proceeding. *Id.* at 29. Thirdly, unlike Artesian, which commences rate proceedings every 2-3 years, Delmarva had expressly stated an intention to commence rate proceedings every year (and had in fact done so for several years). In that circumstance, this Commission expressly ruled that it was more appropriate to defer recognizing future changes in labor expense until the next proceeding. *In re Delmarva Power & Light Co.*, PSC Docket No. 13-115, Order No. 8589, at ¶ 131 (Aug. 5, 2014).

190. Artesian further notes that there have been several cases where increases in salary and wage expense that had been approved during the test period were recovered in rates, even though the increases took effect after the end of the test period. Artesian EB at 27-28; see *In re Application of Diamond State Tel. Co.*, 103 A.2d 304, 322 (Del. Super. 1954); *In re Delmarva Power & Light Co.*, PSC

Docket No. 09-414, Order No. 8011, at ¶ 49 (Aug. 9, 2011). The relevant inquiry is not whether the exact amount of the increase is known, but rather whether the increase is sufficiently ascertainable, reasonably certain to occur, and would better reflect the period during which rates are in effect. Artesian EB at 30; *Chesapeake Utils. Corp. v. Pub. Serv. Comm'n*, 705 A.2d 1059, 1064 (Del. Super. 1997).

191. Finally, Artesian contended that sound policy suggests that increases in operating expenses such as salaries and wages that take effect after the test period should be recognized in rates, because the utility is otherwise incentivized to commence another rate proceeding quickly to recoup the increased expense. Artesian EB at 29-30.

192. Discussion and Decision. We will reject the Hearing Examiner's recommendation and approve the proposed wage increase of 3% on the basis that the Company committed to giving the merit increases during the test period, not after it, even though the implementation occurred shortly afterwards. We believe this fact distinguishes earlier Commission decisions, in particular the Commission's recent *Delmarva* decision, where we did not allow wage increases during the rate effective period that were merely estimates. Here, the Company testified that the increase was approved before the close of the test period, September 30, 2014, and was known and measurable prior to the time Artesian filed rebuttal testimony. (Unanimous).

(b) 2013 Compensation Study

193. In connection with its Application, Artesian commissioned a compensation study to assess the competitiveness of the salaries and wages of both the Company's executive and operational employees. Ex. 1 (Valcarenghi) at 26-27. The process was overseen by Artesian's Board of Directors (the "Board"). *Id.* at 26. The Board retained a firm that was certified as independent from any business or personal relationship with any member of the Company's Board or management. *Id.* The consultant concluded, after approximately nine months of effort, that Artesian's current levels of pay and wages are appropriate. *Id.* A schedule in the Company's direct testimony stated that the cost of the compensation study was \$75,000. Ex. 1 (Valcarenghi) at Sch. DLV-3H.

194. Through data requests, Staff and the DPA sought information about the compensation study. Artesian produced more than 600 pages of materials relating to it. Ex. 21 (Valcarenghi) at 37, 38, 41-42; Artesian's Mot. To Supplement the Record, at 1 (Jan. 8, 2015). In its rebuttal testimony, Artesian updated the cost of the compensation study to \$97,000. Ex. 21 (Valcarenghi) at 49

195. After the evidentiary hearing Artesian determined that in response to a data request it had misidentified the compensation study for which it sought recovery (the discovery response referred to a compensation study that the Company commissioned in 2008 rather than the 2013 Compensation Study). Artesian's Mot. to Supplement the Record at 2 (Jan. 8, 2015). Staff and the DPA argued that in reliance upon the erroneous data request response, they did not elicit or

introduce any testimony about the 2013 Compensation Study during the evidentiary hearing.

196. Upon discovering the error in January 2015, after the evidentiary hearings had concluded but while the record remained open for Artesian to provide unredacted copies of legal bills related to the Chester Water Authority litigation and information regarding its attorneys' fees in this case, Artesian filed a motion to supplement the record seeking to admit the 2013 Compensation Study into evidence. Through the motion Artesian explained why the individuals who prepared its data request responses identified the wrong report (they are not allowed access to the compensation studies, and therefore did not realize that they referred the parties to the 2008 report). *Id.* at 1. Artesian emphasized that testimony about the cost of the 2013 Compensation Study had been admitted into evidence. It contended that millions of dollars in expenses are routinely recognized in rate proceedings based upon testimony alone, without requiring admission into the record of receipts and similar documentation for all of the expense. *Id.* at 1-2. Finally, Artesian contended that it would be inconsistent to refuse to admit the 2013 Compensation Study into the record where the record had been kept open so that certain "in-hearing" data requests propounded by the DPA could be answered by the Company. *Id.* at 2-3.

197. The DPA and Staff opposed the motion, contending that Artesian had not established that it could not have discovered its mistake by the exercise of reasonable diligence and citing court rules governing motions to reopen the record to admit additional evidence.

Joint Opposition of the Delaware Division of the Public Advocate and the Staff of the Delaware Public Service Commission to Artesian Water Company, Inc.'s Motion to Supplement the Record at 10-14.

198. Hearing Examiner's Recommendation. In PSC Order No. 8704, dated February 2, 2015, the Hearing Examiner denied Artesian's Motion and did not admit the 2013 Compensation Study into evidence, although it was marked as Hearing Exhibit No. 93. The Hearing Examiner also agreed with Staff and the DPA that the costs associated with the study should not be included in rates. HER at 60.

199. Exceptions. The Company argued that disallowing recovery of the costs of the 2013 Compensation Study would reward gamesmanship, undermine Delaware's rate proceeding process by compelling utilities to admit every discovery item and exchange between the parties into evidence, and deny recovery of a known and measurable expense that is mandatorily recoverable in rates. Artesian EB at 39. In addition, the Company argued that the correct cost of, and other accurate information about, the study was already in the record through sworn testimony, and extensive documentation of that expense had been provided to Staff and the DPA prior to the evidentiary hearing. *Id.*

200. Discussion and Decision. The Company acknowledges that it made a mistake in its discovery responses, which led to confusion at the evidentiary hearing. During discovery, the Company provided Staff and the DPA with documentation relating to the 2013 Compensation Study, but Staff and the DPA relied on the erroneous responses that Artesian provided to them, as well as the testimony of Artesian's witness who stated that the Company was seeking recovery of costs

associated with the 2008 Compensation Study. It was not until after the evidentiary hearings concluded that Artesian realized it had made a mistake. We reject the Hearing Examiner's recommendation and determine that the 2013 Compensation Study is admitted into evidence and Artesian can recover its expense, amortized over five years, without rate base treatment. (Unanimous).

(c) Incentive Compensation & Stock Plan

201. Artesian included costs associated with its incentive compensation and stock option plans in its revenue requirement. The DPA objected to the inclusion of these costs in Artesian's revenue requirement. First, the DPA claimed that not all the materials relating to the executive and employee incentive compensation plans and bonus programs had been produced. DPA AB at 50.

202. Second, the DPA contended that bonuses paid as a result of achieving Company financial performance should be borne, and paid for, by stockholders, as they are the beneficiaries of such performance standards. DPA AB at 52; Ex. 17 (Watkins) at 25-26. The DPA further observed that the Commission had excluded non-executive incentive compensation from the revenue requirement in Delmarva's most recent case, in part, because payment under the plan was based on a financial trigger: employees would not receive incentive compensation payments, regardless of how well they performed, unless Delmarva achieved a specific earnings level. *Id.* The DPA noted that Company witness Spacht had agreed that Artesian's incentive compensation plan was predominantly based on meeting financial goals or business goals that

had a financial component. DPA AB 51; Tr. at 474-75; see also Ex. 78 at 9.

203. Lastly, the DPA contended that the cost of its incentive compensation plans was not a necessary cost of providing utility service: DPA AB 52. Artesian can provide water service in the absence of incentive compensation and stock option plans, and the DPA did not doubt that Artesian's employees would provide the same level of service that they do now. *Id.* Furthermore, the DPA noted that the plan could be terminated or amended at any time. *Id.*; Ex. 78 at 12. The DPA contended that the waste/bad faith/abuse of discretion standard for including expenses in the revenue requirement does not apply to expenses that are not necessary for the provision of water service. DPA AB at 52.

204. In response, Artesian stated that the Commission should reject the DPA's request to deny bonus and incentive compensation, as well as stock option expenses. The Company argued that the Commission's focus should not be on the form that compensation takes, but rather on the overall compensation Artesian pays and whether it constitutes waste or has been given in bad faith or an abuse of discretion. Artesian RB at 24. Artesian asserted that the business judgment rule applies to the compensation decisions of its Board of Directors, including decisions relating to incentive compensation. Since the DPA did not contend that Artesian's incentive compensation was the product of waste, inefficiency, or bad faith, the Company argued that the Commission should recognize incentive compensation in rates. Artesian EB at 32, citing *Delmarva Power & Light Co.*, 508 A.2d

at 859-60 (holding that under "Delaware law, a utility is entitled to recover all operating expenses it legitimately incurs unless those operating expenses are the result of waste, inefficiency, or bad faith.").

205. Hearing Examiner's Recommendations. The Hearing Examiner recommended that the Commission not approve the Company's claim for any type of incentive compensation, including, but not limited to, executive and non-executive incentive compensation plans, stock options or bonuses (except an \$800 holiday bonus). HER at 59. He noted that on cross examination, Company witness Spacht agreed that Artesian's incentive compensation plan was predominantly based on meeting financial goals or business goals that had a financial element. *Id.*

206. Exceptions. The Company took exception to the Hearing Examiner's incentive compensation recommendation. According to the Company, the Commission should allow recovery of incentive compensation and stock option expenses because the form that compensation takes is not what is relevant. Artesian EB at 32. What is relevant, according to the Company, is the overall compensation Artesian pays and whether it constitutes waste or has been given in bad faith. *Id.* Because neither the DPA nor the Hearing Examiner contended that Artesian's incentive compensation or stock option expense was wasteful or that Artesian awarded them in bad faith, the Commission should recognize them in the just and reasonable rates that the Commission sets in this proceeding. Artesian EB at 32-33.

207. Artesian distinguished the present case, where executive incentive compensation is at issue, from the most recent Delmarva rate proceeding, where we refused to compensate employee incentive plans. *Id.*

208. Artesian further argued that the Hearing Examiner erroneously concluded that stockholders are the sole beneficiaries of incentive compensation that is tied to financial performance. *Id.* at 33. The Company contended that ratepayers also ultimately benefit in the form of lower rates from any cost cutting goals that the Company achieves. *Id.*

209. Finally, Artesian argued that if incentive compensation cannot be recovered in rates like other forms of compensation, Delaware utilities may be incentivized to encompass that quantum of expense in salary and other forms of compensation that are recoverable in rates. *Id.* An advantage of incentive compensation is that it may not be incurred unless the Company and its ratepayers receive some particular benefit. If that compensation is instead bundled into salary, the result could be higher overall salary expense for less benefit. *Id.*

210. Discussion and Decision. Regarding the incentive and compensation plans, we accept the Hearing Examiner's recommendation to reject the Company's claim for any type of incentive compensation, including, but not limited to, executive and non-executive incentive compensation plans, stock options or bonuses, except for the \$800 holiday bonus, which the Hearing Examiner recommended. We believe our earlier decision in the *Delmarva* case is controlling for reasons

similar to those argued here by both Staff and the DPA -- these plans have financial triggers that primarily benefit shareholders, not ratepayers, and therefore should not be included in rates. Unless those financial triggers are met, employees receive no compensation under the terms of the plan. In addition, as in the most recent *Delmarva* case, we find that these plans are not necessary for the provision of safe and adequate utility service. (Unanimous).

2. Chester Water Litigation Expenses

211. Artesian requested recovery of approximately \$1.647 million in connection with its litigation against Chester Water Authority ("CWA"). These costs arose because Artesian had filed suit against CWA and alleged that the water costs charged by CWA were excessive. The lawsuit began in 2010, and Artesian argued that it had informed Staff and the DPA of the litigation in 2011. Artesian proposed to amortize the \$1.647 million over the seven remaining years of its CWA contract. Ex. 1 (Valcarengi) at 28. However, the Company neither requested nor received Commission authorization to defer these litigation costs.

212. About one-half of the \$1.647 million was recorded prior to the test year; approximately \$813,304 was incurred during the test year; and approximately \$100,000 was incurred during the test period. Ex. 1 at 30; Ex. 66.

213. Both Staff and the DPA objected to the recovery of any costs that were incurred prior to the test year, and the DPA also opposed recovery of any of the remaining costs that were incurred during the test year and the test period. The DPA and Staff argued

that costs incurred prior to the test year were not recoverable because to do so would constitute retroactive ratemaking. See *Pub. Serv. Comm'n v. Diamond State Tel. Co.*, 468 A.2d 1285, 1298-99 (Del. 1985) ("A pervasive and fundamental rule underlying the utility rate-making process is that rates are exclusively prospective in application and that future rates may not be designed to recoup past losses in the absence of express legislative authority.") (citations omitted).

214. Staff and the DPA argued that the Company had neither sought nor obtained an order from the Commission permitting it to defer these costs. Staff AB at 12; DPA AB at 43. As Staff pointed out, the Company had an opportunity to defer a portion of its legal expenses in the prior rate case, but failed to do so and now sought to correct that error by requesting inclusion of these expenses in this case. Staff AB at 14.

215. The DPA further observed that the Commission had provided guidance regarding utilities' requests for recovery of previously-incurred costs in two cases involving United Water Delaware, Inc.: (1) the ratemaking process does not seek to adjust for past losses to either the utility or to consumers; and (2) the Commission will exercise its authority to defer costs "sparingly and only in situations where it is necessary." DPA AB at 40-41, quoting *In the Matter of the Petition of United Water Delaware, Inc. for Approval of Accounting Treatment to Defer an Extraordinary Industrial Revenue Loss*, PSC Docket No. 10-171, Order. No. 7838 at 10-11 (Sept. 7, 2010); see also *In the Matter of the Application of United Water Delaware,*

Inc. for an Increase in Water Rates and Other Tariff Changes, PSC Docket No. 96-164, Order No. 4383 at 4-5 (Jan. 7, 1997). Next, the DPA contended that Artesian's financial integrity would not be jeopardized if these costs were not recovered in rates. *Id.* at 42. Finally, the DPA observed that shareholders also had a vested interest in the CWA litigation because lower purchased water costs would have increased Artesian's profits, and lower expenses benefit shareholders between rate cases. *Id.* at 31.

216. The DPA argued that even the litigation expenses that Artesian incurred in the test year should be excluded because they are non-recurring. DPA AB at 40. He argued that the Commission has declined to include non-recurring costs in rates in previous cases, citing *In the Matter of the Application of the Delaware Division of Chesapeake Utilities Corporation for a General Increase in Natural Gas Rates and Approval of Other Tariff Changes*, PSC Docket No. 95-73, Order No. 4104, at ¶ 105 (Dec. 19, 1995) (adopting Hearing Examiner's recommendation at ¶ 60 that "[i]t is, therefore, essential that the expenses sought to be included in utility rates are recurring and can be determined with reasonable certainty and without speculation" (emphasis added)), *aff'd*, *Chesapeake Utils. Corp. v. Pub. Serv. Comm'n*, 705 A.2d 1059 (Del. Super. 1997). The DPA contended that Artesian had admitted that it had never sued a water provider before and did not expect to incur significant costs related to the litigation going forward. Tr. at 369, 381-82. In addition, the DPA argued that the costs were excessive based on a review of the unredacted bills (which were not received until after the evidentiary

hearing) that showed numerous attorneys billing Artesian for participating in the same activity. DPA AB at 45-46.

217. Artesian emphasized that it had commenced the suit against CWA to protect its customers from what Artesian believed were improper increases in purchased water expense. Artesian AB at 28. CWA is a quasi-governmental agency that had raised its water rates for six consecutive years, including by 27% over a three year period, prior to Artesian's commencement of the lawsuit. *Id.* at 29.

218. Artesian noted that it had informed Staff and the DPA about the lawsuit during its 2011 rate proceeding, although the settlement of that rate case did not expressly address the expense that Artesian was incurring in connection with the CWA litigation. *Id.* at 28.

219. Artesian disputed the DPA's contention that permitting recovery of the litigation expense that was incurred prior to the test year would constitute retroactive ratemaking, arguing that proper application of the matching principle showed that customers would receive the benefit of the suit during the rate effective period. *Id.* at 29. In that regard, Artesian noted that although it did not prevail in its suit against CWA, it had caused CWA to stop raising rates. *Id.* After CWA's six year history of annual rate increases, it had not raised its rates again since the lawsuit commenced. *Id.*

220. With respect to DPA's contention that Artesian should not recover the litigation expense that it incurred during the test year and test period because it is an extraordinary expense that will not recur, Artesian noted that the Commission has the discretion to fashion appropriate relief. Artesian RB at 32, citing *Chesapeake*

Utils. Corp. v. Pub. Serv. Comm'n, 705 A.2d 1059, 1064 (Del. Super. 1997) (regarding a rider that the Commission granted to allow a utility to recover extraordinary environmental cleanup expenses over an appropriate period of time).

221. Hearing Examiner's Recommendation. The Hearing Examiner found the Commission's prior decision regarding Integrated Resource Planning costs in the recent *Delmarva* case to be on point. HER at 61. There, the Commission agreed with Staff and the DPA that allowing a utility to defer a cost for collection in future rates should be the exception, not the rule, and should occur only when there exists a specific Commission order allowing such a deferral. *Id.*

222. As in the *Delmarva* case, the Hearing Examiner found no order permitting or directing deferral of any CWA litigation expenses. *Id.* To allow Artesian to collect in future rates the costs it incurred before the test year, in the absence of such an order -- as argued by both Staff and the DPA -- would constitute retroactive ratemaking. *Id.*, citing DPA AB at 43-44; Staff AB at 12-13. Artesian's arguments to the contrary were not persuasive, according to the Hearing Examiner. HER at 62.

223. Regarding the DPA's argument that the test year expenses for CWA litigation are non-recurring, the Hearing Examiner found them recurring, albeit at a much lesser amount. *Id.* at 63. As Artesian witness Spacht testified, the litigation was "not quite concluded," and bills were being received "but nothing of major significance." *Id.*; Tr. at 368. The Hearing Examiner concluded that this statement must be taken in its context of a suit in which \$1.647 million in

legal expenses had already been incurred. *Id.* Moreover, Mr. Spacht testified that the Defendant CWA was filing for approximately \$300,000 of pre-judgment interest, which will include more attorney time to resolve. *Id.*; Tr. at 389. The Hearing Examiner found this testimony to be persuasive on this issue. HER at 63.

224. Exceptions. Artesian did not except to the Hearing Examiner's recommendation to allow recovery of CWA litigation expenses incurred during the test year and test period, but did except to his recommendation that no recovery be allowed for expenses incurred before the Test Year. According to Artesian, all expenses associated with Artesian's suit against CWA should be recovered through rates because the Company instigated the suit to protect its customers. Artesian EB at 41. According to Artesian, CWA had raised its rates for six consecutive years, including by 27% during the three years before Artesian commenced its suit. *Id.* Artesian observed that CWA had not raised its rates since the suit began in 2010 and thus customers were getting the benefit of that rate stability. *Id.* Accordingly, Artesian contended that proper application of the matching principle would allow recovery of the pre-test year litigation expense, because customers would enjoy the benefits of the lower purchased water rates during the rate effective period. *Id.*

225. Artesian also attempted to distinguish the *Delmarva* case upon which the Hearing Examiner relied in rejecting the recovery of pre-test year litigation expenses. Artesian argued that the Commission had previously ordered *Delmarva* to seek recovery of a particular expense in each rate proceeding, but *Delmarva* failed to do

so. Artesian EB at 41-42. When Delmarva later sought to recoup amounts from previous rate cycles, the Commission denied recovery. *Id.* Artesian explained that its case was not analogous to Delmarva's circumstances and, accordingly, Artesian should be allowed to recover its pre-test year CWA suit expenses. *Id.*

226. In its exceptions, the DPA did not except to the Hearing Examiner's exclusion of pre-test year costs, but did except to the inclusion of test year and test period costs. First, the DPA argued that the expenses were non-recurring, so it was immaterial that any costs were incurred during the test year or test period. DPA EB at 37-38. Non-recurring costs should not, according to the DPA, be recovered in a utility's revenue requirement because rates are forward-looking and reflect only those costs that are expected to recur (such as rate case expense and other regulatory legal expenses). *Id.* In addition, Artesian's witness testified that Artesian had never sued a water provider before and it did not expect to incur significant litigation costs going forward. *Id.* at 38. Second, even if the expense item was recurring, the amount that the Company could expect to spend during the rate effective year was speculative and incapable of determination with reasonable specificity. *Id.* at 38-39. Third, even if the amount of costs could be determined with reasonable specificity, the appropriate ratemaking treatment was normalization, not amortization. *Id.* at 39. Finally, the DPA reiterated that the Company's financial health would not be jeopardized absent recovery of these costs because Artesian had long since written the costs off. *Id.* at 39, citing Ex. 17 (Watkins) at 30.

227. Discussion and Decision. The recovery of these litigation expenses breaks down into two parts: (a) those costs that were incurred before the test year; and (b) those incurred during it. As to the first part, the evidence is unrebutted that the Company never asked this Commission to defer these costs pending a future rate case. Discussions with Staff or the DPA are not a substitute for a Commission Order allowing a deferral. This was our holding in the recent *Delmarva* case where that utility sought to include in current rates certain planning costs that it had previously incurred, but for which it had not sought a deferral order. As we stated there, allowing a utility to defer a cost for collection in future rates should be the exception, not the rule, and should occur only when there exists a specific Commission order allowing such a deferral. We find our decision in that case is applicable here regarding the pre-test year CWA litigation expenses.

228. Regarding the \$813,304 of expenses incurred during the test year and test period, the issue raised by the DPA is whether they are non-recurring and, therefore, should not be normalized or collected in future rates. We recognize an argument can be made that the level of expenses incurred during the test year or test period is unlikely to occur in the future. However, the evidence is clear that the litigation was not completely over as of the end of the test period and that some level of expense continued into the rate effective period. Further, there is a perceived benefit in stabilizing the CWA rate increases. Accordingly, we believe amortizing the expense over seven years properly balances the sharing of the expense between shareholders and

ratepayers since no return will be earned on the remaining balance during the amortization period. We accept the Hearing Examiner's recommendation. (4-1, Chair Winslow voting no).

3. Purchased Water

229. In its direct testimony, the Company projected a 10% increase in purchased water expense because CWA had not raised its rates since 2010, whereas it had raised its rates annually prior to that time. Ex. 1 (Valcarengi) at 30-31. In its rebuttal testimony, Artesian stated that as CWA had not raised its rates, Artesian was not seeking recovery of the originally projected 10% increase. Ex. 21 (Valcarengi-R) at 46. In that rebuttal testimony, however, Artesian also disclosed an increase of \$20,723 for purchased water expense related to a surcharge levied by the Susquehanna River Basin Commission ("SRBC") that was included in CWA's rates. *Id.* The SRBC had recently raised the price of the mitigation component by \$0.01 per thousand gallons (to \$0.32 per thousand gallons). This increased fee raised the costs of purchased water by \$20,723 during the rate effective period. Ex. 21 (Valcarengi) at 46. During the evidentiary hearing, Staff asked the Company's witness about this increased expense, and Artesian confirmed that it sought recovery of the increased purchased water expense relating to the SRBC surcharge. Tr. at 396-97.

230. Staff opposed this increase in purchased water charges primarily on two points: (1) Artesian purportedly informed members of Staff that there would be no purchased water increases included in the final rates of this case; and (2) the proposed increase was raised as

a new issue in Artesian's rebuttal testimony, which denied Staff the opportunity to address this issue in its testimony. Staff AB at 14-15.

231. Artesian maintained that it had disclosed in its rebuttal testimony its intention to recover this expense. Artesian RB at 33-34; Tr. at 1078. Artesian noted that Staff had an opportunity to elicit testimony about the surcharge during the evidentiary hearing, including any purported communications that had occurred relating to it, but did not do so. *Id.* Artesian further stated that it did not know what purported communications Staff was referring to, and Staff had provided no details as to who purportedly said what, to whom, or when. *Id.*

232. Hearing Examiner's Recommendation. According to the Hearing Examiner, this claim did not involve the 10% increase in purchased water costs by CWA. HER at 64. He stated that claim was never implemented. *Id.* Moreover, he found that this claim was adequately disclosed by the Company to the parties in its rebuttal testimony and by Mr. Spacht's testimony at the evidentiary hearing. Even if Staff had presented testimony at the evidentiary hearing, the Hearing Examiner believed that the Company was clearly entitled to receive this amount. *Id.*

233. Exceptions. Staff excepted to the Hearing Examiner's recommendation that Artesian recover the amount of the SRBC surcharge. The bases for the exception were that Artesian had purportedly raised the SRBC surcharge as a new issue in rebuttal testimony and therefore it should not be addressed in this proceeding. Staff also claimed

that Artesian had informed it that it would not seek any increase in purchased water expense. Staff EB at 11-12

234. Discussion and Decision. We understand Staff's concern that this issue was apparently discussed with its members outside the record, which created certain expectations about cost increases for purchased water. But this minor increase is a known and measurable change in expense and Artesian raised the issue of potential purchased water increases prior to the rebuttal phase of the proceeding. Accordingly, we will accept the Hearing Examiner's recommendation and allow in rates the increase in purchased water costs caused by the increase in the SRBC surcharge. (Unanimous).

4. Charitable Donations

235. The Company argued that its \$45,825 of charitable donations should be recoverable, noting that prior to 2004 the Commission allowed utilities to recover charitable donations in rates. Artesian OB at 32. However, the Commission changed its policy in 2004, concluding that charitable donations should not be included in operating revenues. *Id.* The Company has accounted for charitable donations in conformity with that decision since that time, although the Company continues to believe that charitable donations should be recoverable through rate proceedings in order to develop and foster a strong community. *Id.* Therefore, Artesian respectfully requested that the Commission revert to its previous policy. *Id.*

236. Staff and the DPA opposed any change in the Commission policy, believing that charitable donations reflect management's

thinking, not ratepayers', and should not be recoverable. Staff AB at 16-17; DPA AB at 54.

237. Hearing Examiner's Recommendation. The Hearing Examiner agreed with the positions of Staff and the DPA that charitable donations not be recovered in rates. HER at 65.

238. Exceptions. No exceptions were taken on this issue.

239. Discussion and Decision. The Commission adopts the recommendation of the Hearing Examiner. (Unanimous).

5. Social and Professional Dues

240. In its Application, Artesian sought recovery of \$122,816 in expenses related to social and service club dues incurred during the test year. Ex. 1 (Valcarenghi) at Sch. DLV-3G. Staff reviewed these expenses and opined that some of the dues did not relate to the provision of utility service and were associated with lobbying and public relations. As such, Staff recommended that since a portion of these expenses failed to directly relate to providing safe, reliable, and adequate utility services, they should not be charged to ratepayers consistent with prior Commission decisions. Staff AB at 17.

241. Artesian noted that Staff presented no evidence as to which of Artesian's fees and dues related to lobbying or public relations. Artesian RB at 38. The Company's sworn testimony was that it agreed that lobbying costs must be accounted for below the line and that it had not included any lobbying expense in its request. *Id.*

242. Staff noted that in the most recently-litigated electric rate case, the Commission upheld a 20% reduction in membership fees

and dues as an appropriate disallowance for lobbying activities where no specific evidence existed to support which membership fees and dues were attributable to lobbying. Staff AB at 17-18.²⁰ Accordingly, it supported a 20% reduction in social and service club dues.²¹ *Id.* at 18.

243. Hearing Examiner's Recommendation. Although Staff sought a 20% reduction of the claimed expenses relying, in part, on the *Delmarva* rate case ruling, the Hearing Examiner examined these expenses one-by-one and, based on his experience and Commission precedent, found that of the \$25,314 recommended disallowance, \$12,553 of these expenses were recoverable in rates and \$12,662 were not because they directly related to lobbying, public relations and marketing efforts. HER at 67.

244. Exceptions. No party excepted to the Hearing Examiner's recommendation with respect to the amount that should be excluded from social and professional dues. Staff excepted to the Hearing Examiner's reliance upon matters outside the evidentiary record in reaching his recommendation. Staff AB at 17-18.

245. Discussion and Decision. Since no party excepted to the Hearing Examiner's conclusion that a portion of the social and professional dues related to lobbying, public relations and/or marketing efforts should not be recovered in rates (i.e., \$12,662), we

²⁰ There, the Commission commented that organizations such as the Chamber of Commerce and the Committee of 100, etc., engaged in lobbying activities. PSC Order No. 8589 at 101 (Aug. 5, 2014).

²¹ The DPA recommended a reduction of \$7,733 by allocating the costs across all ARC Companies. Ex. 17 (Watkins) at 39 & Sch. GAW-15. In its exceptions, the DPA also noted some inconsistencies in the Hearing Examiner's determination of the appropriate disallowance.

will not disturb that conclusion. The Company is allowed to recover \$110,154 in social and professional dues in rates. (Unanimous).

6. Rate Case Expense

246. Artesian originally sought \$1.1 million of rate case expense, including \$155,000 for Staff charges and an unknown amount for DPA charges: Artesian OB at 54; Ex. 1 (Valcarenghi) at 34. Nevertheless, Artesian and the DPA eventually agreed that Artesian should be permitted to recover only \$564,816 in rate case expense. Artesian RB, at 33.

247. The remaining unresolved question in the record is whether this amount should be recovered (normalized) over two years, as sought by the Company, or three years as sought by the DPA and Staff.²²

248. Hearing Examiner's Recommendation. The Hearing Examiner agreed with the Company that its rate case filing history since 1999 supported a two-year normalization, as opposed to following the history of the last two settled rate cases as Staff and the DPA have done in arguing for three-year normalization. HER at 68. Also, the last litigated rate case was commenced in February 2004, and the rate case following it was commenced in May 2006, twenty seven months later, thereby further supporting the Company's argument. Finally, the Hearing Examiner supported his recommendation by noting that the Company had significantly compromised its actual rate case expense in this case. *Id.*

²² Staff derived a comparable figure of \$548,087 from averaging the attorney's fees in the Company's three prior settled rate cases. Ex. 15 (Woodward), Sch. 1. The Hearing Examiner rejected Staff's recommendation in favor of the Company's and DPA's agreed upon amount. HER at 68.

249. Exceptions. Staff excepted to the Hearing Examiner's recommendation of a two-year normalization period rather than three. Staff argued that the Hearing Examiner erroneously based his decision in part on the size of the rate case expense and the fact that the Company had agreed to compromise. Staff EB at 13. Staff argued that neither factor was germane to the issue of how often the Company actually filed requests for rate relief. *Id.*

250. On exception, the DPA abandoned its contention that this expense should be normalized over three years, but asked the Commission to clarify that rate case expenses are normalized, rather than amortized. DPA EB at 40. As noted by the DPA, normalization and amortization differ for revenue requirement purposes. *Id.* If an expense is amortized, the Company would receive dollar-for-dollar reimbursement of the allowed amount of \$564,816 over two years. If the expenses were normalized, then \$282,408 (half of the allowed amount) would be included in operating expenses as a recurring expense. *Id.*

251. Discussion and Decision. After hearing the positions of the various parties on the appropriate length of time to allow the Company to recover these expenses, and noting that the prior history of Artesian's rate case filings is inconclusive as to which time period is better supported, we are of the opinion that 30 months is the appropriate period for normalizing these expenses. The Hearing Examiner commented that the last litigated case was filed in 2006 and the next case was filed 27 months later. More recently, as Staff points out, the time periods have been closer to three years between

rate filings. Having reviewed all the evidence on this issue, we conclude that 30 months is the appropriate period for normalization of the \$564,816 in rate case expenses based on the evidence in this proceeding. (Unanimous).

7. Llangollen Well Operating Expenses

252. As the Company explained in its pre-filed testimony, the Llangollen Wells have elevated levels of 1,4 dioxane, and the Company installed oxidation equipment to remove it. Ex. 1 (Valcarenghi) at 32. The treatment process involves the addition of hydrogen peroxide and exposure to ultra-violet ("UV") sterilization/irradiation. *Id.* The Company incurs variable expenses associated with the hydrogen peroxide, ongoing repair and maintenance of UV bulbs, and additional purchased power expense for the energy required to power the UV equipment. *Id.* The Company estimated the additional annual variable cost of the Llangollen Well treatment to be \$120,657. Ex. 21 (Valcarenghi-R) at 45.

253. According to the DPA, Artesian's evidence was inconsistent regarding the capacity factor of the wells which operated during 2011-2012. DPA AB at 53. Furthermore, Artesian's witness admitted he did not know when the wells went offline because he did not become employed by Artesian until September 2013. *Id.* Artesian's proposal assumed that the wells would be operating at a 100% capacity factor, which according to the DPA would be unreasonable. *Id.*

254. In light of the DPA's position, Artesian in its rebuttal testimony agreed to reduce the expense level based on an 85% load factor rather than 100% as originally filed. Ex. 21 (Valcarenghi) at

46. This reduced the expense level from \$120,657 to \$108,591 (a \$12,066 reduction). *Id.* Staff took no position on this issue.

255. Hearing Examiner's Recommendation. As the parties reached agreement on agreement on this issue, the Hearing Examiner did not specifically address it in his report.

256. Exceptions. As the parties reached agreement on this issue, no party filed exceptions on it.

257. Discussion and Decision. This issue comes before us as an uncontested issue. The Commission adopts the resolution proposed by the parties to allow \$108,591 in expenses. (Unanimous).

F. Tariff Issues

1. Ready To Serve Charges

258. As the Company pointed out, prior to Artesian's 2011 rate proceeding, the Commission and Delaware courts had held that owners who temporarily disconnected from Artesian's water system were nevertheless obligated to pay Ready to Serve Charges. Artesian at 47, citing *Catinella v. Artesian Water Co.*, PSC Docket No. 369-10, Order No. 7938, at ¶¶ 42-44 (May 10, 2011); *Cat Hill Water Co. v. Pub. Serv. Comm'n*, 1991 WL 302547, at *2 (Del. Super. Dec. 23, 1991); *Town of Ocean View v. Brown*, 2010 WL 3159808, at *3 (Del. Ch. Aug. 4, 2010). Ready to serve charges are comprised of the monthly customer charge and charges for fire protection as those terms are defined in the tariff. Artesian RB at 45-46. Accordingly, they correspond to expenses that Artesian incurs regardless of whether there is any water consumption. *Id.* To allocate these expenses fairly, Artesian's Cost

of Service Study ("COSS") divides these expenses by the number of customers Artesian serves, so each customer pays its share. *Id.*

259. According to Artesian, the "Billings and Changes In Ownership" and "Seasonal Reconnection Charge" provisions in the Company's tariff must be read in conjunction with the definition of "customer" to properly determine when a landlord/property owner must pay ready to serve charges if the landlord/owner temporarily disconnects water service. Artesian OB at 37. Under the definition of "customer," once a tenant vacates a property, the landlord/owner automatically becomes Artesian's "customer." *Id.* That landlord/owner can request to have water service discontinued. *Id.* Ready to serve charges will accrue, but will not be billed unless and until service is reconnected. *Id.* Under Artesian's understanding of its tariff, if the service is reconnected in less than 12 months, then the landlord/owner must pay the accrued ready to serve charges, but if more than 12 months lapse before service is reconnected, then under the seasonal reconnection charge provision, the landlord/owner need never pay the accrued charges. *Id.*

260. The DPA contended that the settlement in PSC Docket No. 11-207 was the Commission's most recent pronouncement on the definition of a customer for purposes of disconnection/reconnection within 12 months. DPA AB at 56. According to the DPA, Staff and the DPA specifically negotiated for language to preclude Artesian from assessing customer and fire protection charges to a resident whose home/unit was vacant but was still connected to Artesian's system. *Id.* at 56-57. The same logic, stated the DPA, should apply in the

landlord situation. Artesian's proposed tariff revision was therefore an attempt to circumvent the language the parties specifically negotiated in the Company's prior rate case. *Id.* at 57.

261. Hearing Examiner's Recommendation. The Hearing Examiner did not rule on this issue. He stated that he was not the Hearing Examiner in PSC Docket No. 11-207, and had no knowledge of the circumstances surrounding the resolution of that matter or the parties' intent regarding the now-disputed tariff provision contained in the parties' settlement agreement in that case. HER at 74. Thus, he stated it was impossible for him to make any recommendation as to how the Commission should decide this issue. *Id.* at 74-75. Instead, he attached some exhibits to his report that he thought were relevant to the resolution of this issue. *Id.* at 74.

262. Exceptions. DPA restated its position regarding this issue. DPA EB at 45-49. Staff noted, as did the Hearing Examiner and the other parties, that PSC Docket No. 11-207 was the Commission's most recent pronouncement on the definition of a customer for the purposes of reconnection. Staff EB at 12. The settlement agreement of PSC Docket No. 11-207 precludes a user from being defined as a customer for the purposes of incurring monthly customer and fire protection charges when such user disconnects and does not reconnect at the same address for over a year. *Id.* at 13. Staff and DPA contended, however, that change in the tariff was to address seasonal customers who routinely connect and disconnect from the system. Staff EB at 13; DPA EB at 47-48. The DPA argued that the proposed revision was neither a seasonal disconnection/reconnection issue nor a ready-

to-serve issue. DPA EB at 47. Rather, the DPA framed the issue as involving who is a customer under two different scenarios. *Id.* at 47-48. In the first: (1) a tenant account holder discontinues service; (2) the landlord/owner does not reconnect; and (3) within 12 months a new tenant account holder requests connection at that same address. In the second: (1) a tenant account holder discontinues service; (2) the landlord/owner reconnects service in its own name for cleaning or other purposes; (3) the landlord/owner then discontinues the service in its name; and (4) a new tenant account holder requests service in that tenant's name at the same address. *Id.* In these situations, the DPA contended that the Company's proposed revision tried to either create a customer relationship with the landlord/owner (in Situation 1) or to continue a customer relationship with the landlord/owner after the landlord/owner has discontinued that relationship (in Situation 2) based solely on the address. *Id.* at 48. Either way, the DPA argued that that was not what the settlement in Docket No. 11-207 intended, and Artesian should not be permitted to create a customer relationship where one is not requested. In the DPA's view, service should go with the customer, not the address. *Id.* at 48.

263. On exception, Artesian presented again the precedents that held, prior to Artesian's 2011 rate case, that customers are obligated to pay "Ready to Serve Charges" even if they were temporarily disconnected from Artesian's system. Artesian EB at 47. Artesian noted that its tariff presently defined "customer" as "any person ... being supplied with water by the Company. The 'customer' shall be either the record title owner of the property receiving service or the

occupant, as the case shall be." *Id.* (citing Tariff Fifth Revised Sheet No. 8 (emphasis added)).

264. Artesian argued the DPA's contention that Artesian has no customer at an address after a tenant leaves the property was disproven by the plain language of Artesian's tariff, which provided that "When the customer is a tenant and water service has been discontinued for non-payment or at the request of the tenant, the customer account will be transferred to the owner of the property...." Artesian EB at 48-49 (citing Sixth Revised Sheet No. 9).

265. Artesian further argued even if the Commission concluded that its current tariff prohibited it from assessing Ready to Serve Charges where a landlord discontinues service and water service is later restored in a tenant's name, Artesian should nevertheless be permitted in this rate proceeding to revise its tariff to provide that the landlord must pay any Ready to Serve Charges that accrue after the discontinuation of service unless service is resumed more than 12 months after disconnection. Artesian EB at 50. Artesian noted that to hold otherwise would shift what is the landlord's obligation to the Company (in the form of lost revenues) and ultimately to other ratepayers (by forcing them to bear a disproportionate amount of fixed charges). *Id.*

266. Discussion and Decision. We agree with the DPA that there are situations not specifically addressed in the settlement of the prior case and that the illustration of a landlord renting a property to a third party less than 12 months after its request to disconnect service might be one of them. However, the fixed costs of operating

the system continue. To deny the Company the ability to recover its costs in that situation seems unfair to the majority of other customers and to the Company. Accordingly, we accept Artesian's proposed amendment to the tariff and allow the change to apply to landlords who re-let the premises to a third party within 12 months of disconnecting the property from the system. (4-0; Commissioner Karia did not participate in the remainder of the deliberations).

2. Security Deposits

267. In its Application, the Company proposed to increase security deposits from \$100 to \$200 for residential tenants who are responsible for paying water bills. Ex. 1 (Valcarenghi) at 44. This would not apply to homeowners and other types of residential customers. *Id.*

268. The Company incurred more than \$53,000 in losses due to unpaid tenant bills in just 22 months, and sought to limit such losses in the future by increasing the deposit for all tenant accounts to \$200. *Id.*; Ex. 12 at AWC Response to Initial Data Request DPA-TRR-10a and DPA-TRR-10a-0001 through 0013.²³

269. Staff opposed Artesian's proposal to increase the amount of the required security deposit for residential tenant customers because the Company failed to provide any record evidence as to why residential tenant customers should be charged a different amount for security deposits than other types of residential customers. Staff AB at 21. According to Staff, this change would discriminate unjustly

²³ The Company does not request a change in its tariff to recoup the \$53,000 that had been lost, but rather to prevent similar losses in the future. Artesian RB at 44.

against residential tenants as compared to non-tenant residential customers. Staff AB at 21-22; Ex. 12 (Marshall) at 3-4.

270. Artesian responded that as all of the losses are the result of tenant accounts, it made no sense to require a deposit from homeowners just to treat all customers in the same manner. Artesian RB at 44. Artesian noted that is particularly so as homeowner deposits could not be used to offset tenant losses. *Id.* at 44-45. Artesian contended that refusing to change the deposit amount would cause it to continue to bear preventable losses. *Id.* at 45.

271. Hearing Examiner's Recommendation. The Hearing Examiner recommended that the Commission not approve this tariff change. HER at 71. He agreed with Staff's arguments and found that the Company's evidence did not justify the proposed increase and that such proposed increase was unfair. *Id.* He expressed concern about Artesian's tenant defaults, which had increased from 2012 to 2013, and noted that the tenants with the largest deposits caused most of the losses. *Id.* He also noted that credit card companies use "credit scoring models" to determine credit risk and presumed that Artesian had access to the same credit information to better determine how much of a security deposit to require from different residential tenants. *Id.* Finally, he believed the increase in the amount of the security deposit would unfairly burden residential tenants with good credit history, which he posited included many tenants with limited funds, such as students, workers and the elderly. *Id.* Hence, he concluded that the Commission should not approve this proposed tariff modification. *Id.*

272. Exceptions. Artesian argued that because the losses reflected in Exhibit 12 arose from tenant accounts -- not from homeowner accounts -- a rational and principled basis for requiring tenants to provide security deposits existed. Artesian EB at 44. If a homeowner failed to pay its utility bill, Artesian could obtain a judgment against the homeowner that would constitute a lien on the property, reducing the need for a security deposit. *Id.* Artesian contended that security deposits are simply a practical method of preventing losses that are otherwise difficult to collect from tenant customers who fail to pay for their water services. *Id.*

273. Artesian further noted that losses from tenant non-payments are eventually borne by paying customers. *Id.* Artesian contended it would be fairer and more reasonable to ensure, through higher deposits, that tenants pay their own water charges rather than allowing tenant losses to be borne by the Company and paying customers. *Id.* In addition, Artesian argued that common sense dictated that the amount of security deposits should be determined by the typical losses that the utility experienced, particularly since tenants who pay their water bills receive their deposits back. *Id.* at 44-45.

274. Artesian contended that developing, implementing and operating a system to tailor the size of each deposit to each customer's specific credit rating would be costly and cumbersome, and would require changes to Artesian's tariff. *Id.* at 45-46. Finally, nothing in the record demonstrated that deposits based on individual credit ratings would result in lower losses from non-payment. *Id.* at

46. Artesian contended that the simple, efficient and most fair solution was to raise the deposit amount required from the type of customers who were causing the losses, which in this case was the residential tenants. *Id.* Hence, Artesian concluded that the Commission should not adopt the Hearing Examiner's recommendation on this issue. *Id.*

275. Discussion and Decision. We agree with the Company that the security deposit should better reflect the losses that the Company experiences from non-payment of bills by tenants. As pointed out in the record, a homeowner who fails to pay a utility bill could have a lien placed on their house; no such remedy exists for the utility to collect against a tenant. Unpaid tenant bills are ultimately borne by other customers who pay their bills on a timely basis. We believe that basing security deposits on customers' credit scores would not be efficient and such an approach could increase rather than decrease costs for the Company. Accordingly, we adopt Artesian's position to increase its security deposit for residential tenant customers from \$100.00 to \$200.00 and reject the Hearing Examiner's recommendation. (3-1, Commissioner Gray voting no).

3. Allocation of Purchased Water and Purchased Power Expense

276. Artesian argued that its allocation of purchased water expense and pumping power costs to the base or average function²⁴ was correct. Artesian OB at 38-39. The objectives of Artesian's COSS were to establish the cost of serving each class of customer and to

²⁴ "Base costs are those that tend to vary according to *average use*." Ex. 2 (Guastella) at 5 (emphasis in the original).

design a rate structure that reasonably recovered those costs, while also promoting water conservation. *Id.* at 38. As in past Artesian rate cases, its present COSS is based upon the Base-Extra Capacity ("BEC") method, which identifies and classifies the various cost components that comprise the revenue requirement and then categorizes the costs based upon what drivers the costs incurred under the general design criteria and operation of a water utility. *Id.* Stated differently, the apportionment of the revenue requirement or "functionalization" allocates the costs incurred to serve customers. *Id.* The BEC method assigns costs to base, extra capacity maximum day, and/or extra capacity peak hour conditions, and by number of customers (split between "Meters/Services" and "Billing and Accounting") and hydrant costs. *Id.* at 38-39.

277. According to the Company, CCHS witness Brian C. Collins adopted most of Artesian's rate design methodology, but allocated purchased water and purchased power costs to the base component, extra capacity maximum day and peak hour functions. Artesian OB at 41. Conversely, the Company's rate design assigns only those costs to the base (average use) function. *Id.* The Company opposed CCHS' proposal because it shifted purchased water and purchased power costs to public fire service charges -- which in effect meant shifting additional costs to the Residential class.²⁵ *Id.* Staff and the DPA did not take a position on this issue.

²⁵ The Company proposed to increase CCHS's rates by 18.29%, as compared to the general proposed rate increase of 15.98%. Ex. 19 (Collins) at 2.

278. Artesian disagreed with CCHS' purchased water allocation because Artesian's system is integrated, meaning all customers' water demands are met with both purchased water and water from the Company's own sources. *Id.* Customers' use of purchased water occurs regardless of whether it is an average, maximum day, or peak hour demand. *Id.* Accordingly, Artesian's rate design recovers purchased water costs from customers according to the quantity of water they use. *Id.* The Company's method assigns costs based upon causation. *Id.* Customers who use more water on the maximum day would pay more of the costs associated with purchased water. *Id.* Artesian concluded that CCHS' method of allocated purchased water expenses would unfairly reallocate costs to residential customers. *Id.* at 42.

279. Artesian also disagreed with CCHS that purchased power costs should be allocated among the base, extra capacity maximum day and peak hour functions. *Id.* CCHS cited the AWWA Manual M-1, Sixth Edition, page 65 as support for allocating KWhr consumption and KW demand charges among the three functions. *Id.* at 42; Ex. 22 (Guastella) at 6-7. The AWWA Manual, however, actually suggests that the KWhr consumption portion (90% of the total charges) be allocated entirely to the base function, which Artesian's rate design does but CCHS' rate design does not. Artesian OB at 42; Ex. 22 (Guastella) at 7; Tr. at 241. Although the AWWA Manual suggests that it may be appropriate to allocate KW demand power costs (10% of the total charges) to the extra-capacity cost component, the manual acknowledges that the power allocation would depend on variations in the electric demand for pumping, and the manual offers no guidance as to how to

analyze the variations in KW demand charges or how to allocate them. Ex. 22 (Guastella) at 7. Artesian contends that in practice, there is no way of knowing when during the billing period a meter's 15-minute KW demand interval occurred. *Id.* Similarly, Artesian contends that it cannot know if the 15-minute KW demand interval coincided with customers using water at an average, maximum day or peak hour rate of consumption. *Id.* at 7-8. Artesian further notes that the 15-minute KW demand interval of each meter likely occurred at a different time than the interval measured on other meters tracking the Company's power usage. *Id.* Accordingly, Artesian concluded that it was simply too speculative and arbitrary to allocate the KW demand charge among the customer classes on any other basis than to the base, or average, function. Artesian OB at 42.

280. CCHS contended that Artesian's rate design did not properly allocate purchased water and purchased power costs based upon what was driving them. CCHS AB at 1. CCHS considered Artesian's allocation of those costs solely to the base function to be arbitrary. *Id.*

281. With respect to purchased water, CCHS contended that Artesian's own documents established that, because Artesian's system is integrated, purchased water is used to meet not just average use, but maximum day and peak hour use as well. *Id.* at 2. CCHS denied that causation justified Artesian's allocation of purchased water cost because, although its system is integrated, Artesian uses different allocation factors based upon whether the water was purchased or from Artesian's own sources. *Id.* CCHS further noted that Artesian's own records demonstrated that purchased water volumes vary on a monthly

basis, contrary to testimony from Artesian's witness John F. Guastella at the evidentiary hearing that Artesian's purchases are done on a steady basis. *Id.* As the record indicated that purchased water is purchased for maximum day and peak hour demands in addition to average use, which is where Artesian allocated all purchased water cost, CCHS concluded that reallocation among all three functions was appropriate. *Id.*

282. With respect to Purchased Power Expenses, CCHS noted that Artesian classified pumping power investment, accumulated pumping plant depreciation, and non-electrical pumping plant operating and maintenance expenses into Allocation Factor 4, but placed pumping plant power costs in Allocation Factor 1. *Id.* at 3. CCHS considered that disparate treatment inappropriate. *Id.*

283. CCHS contended that pumping power costs should be classified as Allocation Factor 4 because Artesian's COSS reflects that its pumping facilities are designed and operated to meet average day, maximum day and peak hour requirements. *Id.* Accordingly, CCHS concludes, the pumps must use power at all three classifications as well. *Id.*

284. CCHS rejected Artesian's contention that, although allocation of power costs beyond the base component may be proper, it had no way of knowing when the peak demand occurred. *Id.* CCHS contended that while Artesian may not know when the peak demand for power occurs, it is plainly wrong to allocate no power cost to the peak hour function. *Id.* at 3-4.

285. In response, the Company contended that CCHS had ignored evidence regarding its purchased water contract, which includes take or pay provisions, and therefore there is no change in the purchased water rate regardless of whether water is purchased on an average or maximum demand day. Artesian RB at 50. Artesian also cited to evidence that the quantity of purchased water it purchases is virtually constant throughout the year. *Id.* The Company noted that if a customer used more purchased water on a maximum demand day, the customer would pay more according to their usage. *Id.*

286. Artesian contended that CCHS' criticisms of Artesian's classification of water from its own sources to the base and maximum day functions, but classification of purchased water solely to the base function, were flawed. *Id.* Artesian stated that is so because the cost of the excess capacity of its own wells must be allocated among the customer classes according to their respective maximum to average demands. *Id.* Artesian contended there was no such design criteria or operational inefficiency with respect to purchased water, so purchased water does not involve excess capacity or cost that must be assigned. *Id.* at 50-51. As the Company's purchased water costs the same amount whether it is purchased on average or maximum demand days or during peak hours, Artesian concluded that CCHS' contention should be rejected. *Id.* at 51.

287. Artesian contended that CCHS' argument with respect to pumping facilities was flawed for the same reason. *Id.* Pumping facilities, which are designed to meet peak hour demands, must be allocated among the functions, but there is no similar excess capacity

with purchased power. *Id.* Artesian further noted that CCHS' allocation of purchased power expense was inconsistent with the AWWA Manual upon which CCHS relied. *Id.* at 52. Artesian reiterated that it had no reasonable way to identify when the 15-minute peak occurred or which customer class had contributed more towards the consumption. *Id.* at 51. Accordingly, Artesian concluded that the Commission should reject CCHS' attempt to shift costs to the residential class. *Id.* at 52.

288. Hearing Examiner's Recommendation. The Hearing Examiner agreed with the Company regarding the allocation of purchased water and pumping power costs. HER at 78. He disagreed with CCHS's criticism of Artesian's cost of service model regarding the allocation of purchased water to the base or average function. *Id.* He disagreed with the suggestion that Source of Supply Wells are allocated to both base and maximum day functions and, therefore, purchased water should be allocated the same as wells. *Id.* He agreed with Artesian's argument that wells are designed to meet maximum demand, and therefore they are not used at 100% efficiency throughout the year. *Id.* He agreed that the cost of the excess capacity of wells is allocated among the customer classes according to their respective maximum to average demands. *Id.* Thus, because there is no design criteria or operational inefficiency with respect to purchased water, purchased water does not involve excess capacity or costs that should be assigned to the customer classes. *Id.* The Company's purchased water did not cost any more whether purchased on average days, maximum days

or during peak hours. *Id.* Hence, he recommended that the Commission approve the Company's rate design as to purchased water. *Id.*

289. The Hearing Examiner also agreed with Artesian's arguments regarding its allocation of purchased power expense to the base average function and found that this allocation was correct. HER at 79. Like the wells, he found that pumping facilities have been designed based on maximum demands, and therefore they are not used at 100% efficiency throughout the year. *Id.* He agreed that the cost of excess capacity of pumping facilities was allocated among customer classes according to their respective maximum to average demands. *Id.* Accordingly, under Artesian's appropriate rate design, he believed that all customers paid more for purchased power costs on maximum days because they buy more water on those days. *Id.* The Hearing Examiner rejected CCHS's argument that allocating power costs beyond the base component would be proper. *Id.* He concluded that only if a power study had been performed, and in this case none had been, would allocating the costs beyond the base component be appropriate. *Id.* Hence, he recommended that the Commission approve the Company's rate design as to purchased power expenses. *Id.*

290. Exceptions. On exception, CCHS reiterated the arguments that it had initially made to the Hearing Examiner. CCHS EB at 2-3.

291. Discussion and Decision. We accept the Hearing Examiner's recommendation on this issue. As pointed out by Artesian, the impact of CCHS's allocation of these expenses across maximum day and peak hour functions would result in an increase in fire protection service rates from \$60,000 under Artesian's proposal to \$524,000 under CCHS'

proposal. The consequence of that reallocation of cost would be that it is borne by the residential class rather than CCHS. Because this record does not contain any other allocation methodology that tracks the cost incurrence for these types of expenses more precisely, we are disinclined to move away from Artesian's proposed rate design based on the arguments made by CCHS. We also note that neither Staff nor the DPA joined with CCHS in its observations regarding the proper allocation of these costs. Hence, we will affirm the Hearing Examiner's recommendation on these two issues. (4-0).

4. Monthly Customer Charge

292. Artesian's current customer charge is \$13.22 per month, which Artesian sought to increase by 9.76% to \$14.51 per month. Ex. 17 (Watkins) at 41. The Company described its fixed monthly customer charge as encompassing those costs that are not driven by water consumption, such as insurance, office space, office equipment, computers, storage for materials and supplies related to services and meters, administrative supervision or management, labor overhead costs or insurance for the employees that perform meter reading, accounting and collecting. Ex. 22 (Guastella-R) at 3. The Company also argued that as a result of its rate proceedings since 1999, it had been allowed 100% of its customer costs through fixed monthly charges. Artesian RB at 48-49.

293. Artesian proffered four arguments as to why the Commission should approve its COSS (which included an increased customer charge): (1) for many years regulated Delaware utilities have been allowed to recover through fixed charges the costs associated with metering and

billing, and with fire protection, that do not fluctuate according to water demands or usage; (2) the DPA's policy concern regarding water conservation is already addressed through Artesian's use of inclining blocks rates, where customers who use more water pay more; (3) recovering the costs of providing service through volumetric charges causes higher volume consumers to subsidize lower volume customers; and (4) if the Commission determines that customer charges will not recover all costs that are not driven by consumption, the Company will face a higher risk of not earning the rate of return authorized by the Commission. Artesian RB at 48.²⁶

294. The DPA opposed the Company's proposed increase in the monthly customer charge. DPA AB at 58-59. It noted that the Company's proposed customer charge includes a large amount of corporate overhead costs, including general plant and administrative and general expenses. *Id.* at 58. The DPA contended that including such costs in the customer charge is inappropriate and that such costs should be recovered in the volumetric charge. *Id.*; Ex. 17 (Watkins) at 45. The DPA noted that every Artesian case since 2004 had been settled, so the Commission has not specifically addressed the issue of what costs should be included in the customer charge for over a decade. DPA AB at 59. The DPA contended that the charge should remain at \$13.22 per month. *Id.* at 58.

295. Because water is an essential service, the DPA believed that the fixed customer charge should be kept as low as reasonably possible. *Id.* at 61. The DPA contended that the volumetric charge --

²⁶ Staff accepted the Company's COSS, including raising the customer charge to \$14.51.

not the customer charge -- impacts water usage. *Id.* In addition, the more costs that are included in the customer charge, the lower the volumetric charges will be. *Id.* Accordingly, the DPA concluded that this distorts the price signal given to customers based on usage, and results in customers who use less water (because they have smaller households or practice conservation) subsidizing those who use more water (because they have larger households or for whom price is not a concern). *Id.* The DPA contended that if the Commission allows the Company to recover all of what it calls customer costs in the monthly customer charge, its risk is reduced, and the Commission should consider some reduction in the Company's ROE to reflect this reduced risk. *Id.*

296. In response, the Company noted that although its rate proceedings had been resolved through settlements since 2004, that fact did not mean there is uncertainty as to the Commission's policy of allowing the recovery of fixed costs through monthly customer charges. Artesian RB at 48. Every Artesian rate case application since 1999 had requested recovery of all customer costs through fixed charges. In addition, although the Commission's orders have not specifically discussed this issue, the Company's Commission-approved tariff has allowed that recovery. *Id.* at 48-49.

297. The Company also stated that the DPA's concern about small households subsidizing large households was illogical. *Id.* at 49. The costs that are encompassed by fixed monthly charges are not driven by consumption, but rather by the number of customers. Hence,

Artesian asserted that the only fair method of allocating such costs was ratably to all customers. *Id.*

298. Finally, Artesian contended that the DPA's ROE argument was also incorrect. *Id.* at 49-50. Since 1999 the Commission-awarded ROE have reflected that fixed costs would be recovered through monthly charges. *Id.* Continuing that policy would mean no change in the risk faced by the Company, and therefore no need to reconsider Artesian's ROE. *Id.* The converse, however, is not true. If the Commission adopted the DPA's proposal of not allowing the recovery of all fixed charges through monthly charges, the Company would face increased risk that it might not recover all of its costs through volumetric charges, and would similarly face an increased risk that it could not earn its authorized return. *Id.* Therefore, if the Commission were inclined to change its policy on this issue, it should award Artesian a higher ROE to compensate it for its increased risk. *Id.*

299. Hearing Examiner's Recommendation. The Hearing Examiner recommended accepting the Company's proposed increase in the monthly customer charge because increasing the charge provides Artesian with fiscal stability, which is important when water usage is declining. HER at 77. Further, he believed that customer charges should include all costs that do not vary with consumption. *Id.*

300. The Hearing Examiner noted this Commission' policy has recognized that the fixed monthly customer charge provides the Company with fiscal security and that recovering more costs through the volumetric charge requires higher usage customers to subsidize lower usage customers. HER at 76. For these reasons he recommended that the

Company's COSS and Rate Design be adopted by the Commission. *Id.* at 77.

301. Exceptions. The DPA excepted to the Hearing Examiner's recommendation and maintained that the monthly customer charge should remain at \$13.22. DPA EB at 42. The DPA reiterated its arguments that it is inappropriate to include the large amount of corporate overhead costs in the customer charge, and that such costs should be recovered in the volumetric charge. *Id.* at 42-43. It contended that recovering more revenue in the customer charge, as opposed to the volumetric charge, results in customers who use less water subsidizing customers who use more water. *Id.* at 43. Because recovering more costs in the customer charge provides greater revenue stability and reduces risk, ~~if~~ the Commission adopts the Hearing Examiner's recommendation, it should reflect the reduced risk in Artesian's ROE. *Id.* The DPA further noted that following the logic of the Commission's decision on the ready to serve charge, this was an issue where the many would be subsidizing the few. Tr. at 1188.

302. Discussion and Decision. Here we are asked to consider approving a \$1.29 increase (9.76%) in the monthly customer charge. The last rate case filed by this utility was resolved in 2012, approximately four years ago. The evidence does not suggest that the Company has changed its methodology with respect to which costs are included in monthly charges, but rather it has attempted to recover the increased expense of those same fixed costs (such as insurance, office space, equipment, copiers, meter costs, etc.). We find, as the Hearing Examiner did, there is sufficient evidence to support the

proposed increase in the customer charge. (3-1, Commissioner Gray voting no).

G. Staff and DPA's Objection to Artesian's Substitution of Testifying Witness

303. On December 4, 2014, the DPA and Staff filed a joint Motion objecting to Artesian's request to substitute Mr. Spacht as the witness sponsoring all three of the pre-filed testimonies prepared by Mr. Valcarengi and submitted under his name. According to the Company, Mr. Spacht should have been allowed to testify during the evidentiary hearing, provided he adopted Mr. Valcarengi's testimony. Artesian reasoned that Mr. Spacht had overseen the drafting of Mr. Valcarengi's testimony and was, according to the Company, the person most knowledgeable about some of the matters in dispute, such as the normalization program.

304. Staff and the DPA contended that if Artesian wanted to introduce Mr. Valcarengi's testimony into the record, it should produce him as a witness. They argued Artesian's only provided reason for substituting Mr. Spacht was Mr. Valcarengi's inexperience as a witness. Staff and the DPA contended that they sought to probe Mr. Valcarengi's knowledge as the author of the testimonies, not Mr. Spacht's, and if the Company had wanted Mr. Spacht to be the witness, it should have submitted the testimonies in his name. Motion at 5.

305. Staff and the DPA also argued that prefiled testimony is akin to a pretrial deposition, and that under Delaware state court rules, a pretrial deposition can only be used at trial if the court finds:

(i) the witness is dead; (ii) the witness is out of the State of Delaware, (unless it appears the absence of the witness was procured by the party offering the deposition); (iii) the witness is unable to testify because of age, illness, infirmity or imprisonment; (iv) the party offering the deposition has been unable to procure the attendance of the witness by subpoena; or (v) upon application to the court and notice to the opposing party, exceptional circumstances exist making it desirable, in the interest of justice and with due regard to the importance of presenting the testimony of witnesses orally in open court, to allow the deposition to be used.

Id. at 6 (citing Ch. Ct. R. 32(a)(2); Super. Ct. Civ. R. 32(a)(2); Comm. Pls. Ct. Civ. R. 32(a)(2); Fam. Ct. Civ. R. 32(a)(2)). Staff and the DPA contended that none of these factors were present. They observed that Mr. Valcarengi was not outside the state of Delaware; he was not unable to testify because of age, illness, infirmity or imprisonment; and Artesian had not proffered any "exceptional circumstances ... making it desirable, in the interest of justice and with due regard to the importance of presenting the testimony of witnesses orally in open court" to allow the prefiled testimony to be introduced into evidence. *Id.*

306. Although no rule forbade witness substitution, Staff and the DPA pointed out no rule permitted witness substitution either. In their counsels' long experience appearing before the Commission, this was the first time that a party had sought to present a different witness to support and defend the person under whose name the prefiled testimony was submitted. *Id.* at 7. They suggested the reason no Commission rule existed on point was because the Commission believed that the witness presenting the testimony would be the one to defend it at an evidentiary hearing. In addition, the Commission could not be

expected to have a rule for every situation that an imaginative lawyer could present. *Id.*

307. Staff and the DPA also argued it was not their burden to demonstrate prejudice against them would occur if the witness substitution were permitted, but rather, it was Artesian's burden to provide a justifiable explanation for why Mr. Valcarenghi was not available to testify. *Id.* They contended Mr. Valcarenghi's alleged lack of experience was an insufficient reason. *Id.* at 6.

308. Staff and the DPA pointed out that prefiled testimony does not become evidence until its author has been sworn in and has authenticated such testimony under oath. *Id.* at 7. They noted Artesian would have had the right to decide not to present Mr. Valcarenghi, and that none of the other parties could have forced Artesian to present him as a witness without first identifying him pre-hearing or subpoenaing him. *Id.* If, however, Artesian did not want to proffer Mr. Valcarenghi to defend his testimony, then it should not be permitted to introduce that testimony into the record. *Id.* at 7.

309. Staff and the DPA acknowledged that there had been many times where a witness adopted the testimony of another witness without complaint from Staff or the DPA. However, none of those instances involved a witness in a contested matter. Rather, those witness substitutions took place in the context of settlements in which the settling parties agreed that one witness would adopt the testimony of another. *Id.* at 8. They also contended that allowing witness substitution would encourage parties in future matters to submit testimony in one witness' name fully expecting to change the

testifying witness prior to the evidentiary hearings as long as they notified the opposing parties that they were going to call a different witness to testify at the evidentiary hearing. Staff and the DPA argued that this was gamesmanship and was fundamentally unfair. *Id.*

310. In response, Artesian noted that it had informed the other parties on November 26, 2014 of its intention to substitute Mr. Spacht for Mr. Valcarengi. *Opp. to Joint Mot. at 1 (Dec. 5, 2014).* The Hearing Examiner conducted a pre-hearing conference on December 2, 2014, during which Staff disclaimed any intention of filing pretrial motions and the DPA indicated that it did not anticipate filing any "at this time." *Id.* Accordingly, Artesian argued that Staff and the DPA's subsequent motion to prevent the substitution of witness, filed even closer to the evidentiary hearing, was a tactical ploy to gain advantage at the hearing. *Id. at 2.* Artesian viewed the DPA's motion to prohibit Mr. Spacht from substituting for Mr. Valcarengi as an attempt, just days before the evidentiary hearing, to disrupt Artesian's preparations. *Id. at 1.* Artesian further noted no rule or law prohibits the substitution of witnesses in Commission proceedings, so there was no basis for Staff and the DPA's assertion that Artesian bore a burden of providing a justifiable explanation as to why a different witness would appear. *Id. at 2.*

311. Artesian argued that the Commission's overarching policy in rate proceedings is to fundamental fairness and the presentation of the most accurate and reliable information from the parties. *Id.* From Artesian's perspective, with those principles in mind, Mr. Spacht should have been allowed to substitute for Mr. Valcarengi. *Id.*

Artesian further noted that administrative proceedings, such as rate cases, are supposed to be flexible in nature and that the rules of evidence do not apply in them. *Id.* at 2-3.

312. Artesian also noted that neither Staff nor the DPA claimed that they would suffer any prejudice if the substitution were to occur. *Id.* at 2. Instead, they merely claimed it was not their burden to show the substitution was prohibited. *Id.* Since the motion appeared to be driven solely to obtain a tactical advantage by keeping the most knowledgeable person off the stand, Artesian contended that the motion should be denied. *Id.*

313. Artesian contended that Staff should not be heard to complain about the substitution of witnesses where, in Artesian's 2004 rate proceeding, it had one of its witnesses leave the evidentiary hearing during a break and not return to avoid having his testimony admitted into the record. *Id.* at 3. Here, once Mr. Spacht adopted Mr. Valcarengi's testimony, there would be a witness subject to cross examination with respect to all of its contents. *Id.*

314. Artesian disputed Staff and the DPA's analogy of pre-filed testimony to pretrial depositions. *Id.* at 3-4. Artesian contended that its intention to substitute witnesses is different from admitting a pretrial deposition at trial in that, in the latter circumstance, no one is present at trial for cross examination. *Id.* Here, Mr. Spacht would be entirely adopting the testimony and be present during the evidentiary hearing for cross examination. *Id.* at 4. Moreover, pre-filed rate case testimony is prepared by the parties themselves (rather than responses to questions posed by opposing counsel), and

many persons at the utility are necessarily involved to provide testimony that encompasses the utility's entire operations. *Id.* at 4. A utility's pre-filed testimony, which is not under oath, is merely submitted under one individual's name. *Id.* Accordingly, Artesian contended that this circumstance is more analogous to a Rule 30(b)(6) deposition in which the company should present for sworn testimony during the evidentiary hearing the person who is most knowledgeable about the issues in dispute. *Id.* at 4-5.

315. Hearing Examiner's Recommendation. The Hearing Examiner denied Staff and DPA's Motion to exclude the testimony of Mr. Valcarenghi and allowed Mr. Spacht to testify in his place. PSC Order No. 8686 (Dec. 5, 2014). The Order further provided that Mr. Valcarenghi must be present during the evidentiary hearing without the need for a subpoena; that Mr. Valcarenghi could not be in the hearing room while Mr. Spacht testified; and "upon request of the Public Advocate and/or Staff," Mr. Valcarenghi could be subject to cross examination if: (a) Mr. Spacht was not able to sufficiently testify as to a substantial issue in the pre-filed testimony; or (b) Mr. Spacht's testimony conflicted with a substantial issue in the pre-filed testimony; or (c) Mr. Spacht testified as to any new, substantial issue or argument not presented in the pre-filed testimony. *Id.* at 3.

316. Exceptions. Both the DPA and Staff excepted to the Hearing Examiner's resolution of their joint motion. According to Staff, the Hearing Examiner's ruling disregarded Delaware law regarding hearing procedures. Staff EB at 3. If a witness provides pre-filed testimony, such witness should be subject to cross-examination; if a person did

not provide pre-filed testimony, such person could not supplant the testifying witness for purposes of cross-examination on that testimony. *Id.* at 3. As a fundamental right, all parties to any proceeding have the right to confront by the witnesses who give testimony against them, the right to cross-examine such witnesses, and to adduce evidence to refute what they say. *Id.* In administrative hearings, the parties are entitled to due process, and this right includes the right to cross-examine a party on any information that may be considered by a state agency in reaching an administrative decision. *Id.* at 3-4. Finally, cross-examination does not simply mean the right to examine the witness - it generally means the right to examine the witness after the witness has been examined through direct examination. *Id.* at 4.

317. The DPA pointed out that no Commission rule allowed witness substitution. DPA EB at 13. Rather, the substitution of witnesses occurs only in the context of uncontested settlement hearings. *Id.* In addition, a witness's lack of experience and/or knowledge is not a valid reason for substituting another witness. In any event, the DPA observed that Artesian proffered another witness (Mr. deLorimier) with even less regulatory experience and knowledge than Mr. Valcarengi, but did not propose a substitute for that witness. *Id.* Moreover, Staff also submitted pre-filed testimony from relatively inexperienced witnesses. *Id.* at 13-14 and n.5.

318. The DPA analogized pre-filed testimony as being similar to a pretrial deposition in the trial context; its purpose is to inform the opposing party of what the witness will say. *Id.* at 14. Artesian's

comparison of pre-filed testimony to a Rule 30(b)(6) deposition in the trial context was misplaced because that is a discovery rule, not a trial rule, and says nothing about the use of that deposition at trial. *Id.* at 15-16. Finally, the DPA suggested that it was irrelevant whether the substitution of witnesses prejudiced Staff and the DPA; Artesian had the burden of justifying why the witness who submitted three different testimonies was unable to appear and testify at the hearings. *Id.* at 16. At oral argument, the DPA took issue with Artesian's claim that the Motion was simply an attempt to distract it from preparing for the evidentiary hearings, noting that the DPA was also preparing for those same hearings. Tr. at 1203.

319. Artesian reiterated its arguments as to why substitution was reasonable, including Staff and the DPA's failure to suggest any prejudice. Artesian further noted that after Mr. Spacht's cross examination, neither Staff nor the DPA sought to cross examine Mr. Valcarenghi, even though the Hearing Examiner's Order authorized them to do so in appropriate circumstances.

320. Discussion and Decision. This is a case of first impression before the Commission. We note at the outset that no parties requested a remand for further proceedings with Mr. Valcarenghi as Artesian's testifying witness rather than Mr. Spacht.

321. As noted by the parties, the norm for this Commission for some time has been to allow the substitution of witnesses in uncontested cases in order to make a record and to avoid the costs of bringing out-of-town witnesses to a hearing to approve a settlement. Here, we have a different situation -- a contested case in which the

utility sought to substitute one witness (who sponsored three sets of pre-filed testimony) for a more knowledgeable witness on the same subject over the objections of both Staff and the DPA.

322. We find that the concerns raised by Staff and the DPA were legitimate ones given that this case involved witness substitution shortly before an evidentiary hearing.

323. Artesian and the DPA favored the development of a rule that would guide parties on this issue in the future. Staff requested instead a general statement of policy. We are concerned about establishing a definitive rule or precedent on this issue in the context of one utility's rate proceeding without providing other interested utilities and parties an opportunity to comment. Similarly, we are concerned about stating a definitive rule in the context of this proceeding without having given careful thought to all of the circumstances and issues that might be implicated. Because this is the first time, as far as we know, when a witness has been substituted for another witness over the objection of another party, we feel it is unnecessary to make an immediate pronouncement. Rather, we think it is sufficient to admonish the parties to avoid a similar circumstance in the future, that substitution of witnesses should be the exception, and such substitution should not occur where it would be unfair to do so. We direct Staff to investigate and report back to us as to whether other states (such as Maryland, New Jersey and Pennsylvania) have guidelines or process rules that address substitution of witnesses. (4-0).

324. Finally, as part of our overall findings, we note that certain sections of the Hearing Examiner's Report failed to properly show the analytical basis upon which specific legal conclusions and recommendations were made. An administrative agency's record is considered to be insufficient if it fails to adequately support its findings with material facts in the record or if it fails to provide sufficient reasons for its decision based upon the record. Hence, we stress that in future findings and recommendations (e.g., in "hearing examiner's reports"), our hearing examiners must provide a full legal and factual analysis as to why and on what basis in the record they reached their conclusions and recommendations.

325. We also note that in reaching certain conclusions in his findings and recommendations, the Hearing Examiner here relied on non-record evidence, including his personal experience, his knowledge, and research he conducted on his own. Reliance on evidence outside the record is contrary to established Delaware law, and we must reject such reliance. A state administrative agency may not base its decision on its own information or on information outside the evidentiary record. Here, we believe that we have relied only on record evidence in reaching our conclusions on each of the issues brought before us.

326. Finally, we stress that all future findings and recommendations of our hearing examiners must follow the requirements of 29 Del. C. §10126(a) and should include a legal analysis of why the record evidence supports the conclusions and recommended decisions. Furthermore, we instruct our hearing examiners to prepare draft

proposed orders for this Commission's consideration as required by 29 Del. C. §10126(a).

IV. ORDER

AND NOW, this 19th day of January, 2016, **IT IS HEREBY ORDERED**:

327. That the Commission finds that the appropriate rate of return on common equity for Artesian is 9.75%;

328. That the Company's allowed rate base shall be \$216,771,690.

329. That deferred taxes shall not be included in the Cash Working Capital calculation;

330. That the Company's revenue normalization methodology is approved in this proceeding with the understanding that Artesian's old normalization program will not be used in any future rate proceedings. Artesian, Staff and the DPA shall report to this Commission within nine months of the date of this Order regarding Artesian's revised approach to normalization;

331. That the Company's revenue requirement shall include the amounts associated with the 3% wage increase that took effect in October 2014;

332. That no costs associated with incentive compensation and stock option plans shall be included in the revenue requirement, with the exception of the \$800 holiday bonus;

333. That the costs of the Company's 2013 Compensation Study shall be amortized over five years;

334. That the Company's revenue requirement shall include \$564,816 for rate case expense, normalized over thirty months;

335. That the purchased water increase associated with the SRBC is approved;

336. That the charitable donations identified in this case shall not be included in the Company's revenue requirement;

337. That the Company's revenue requirement shall include \$108,591 for Llangollen operating expenses;

338. That \$110,154 in social and professional dues shall be included in the Company's revenue requirement;

339. That the test year and test period expenses associated with the CWA litigation shall be amortized over seven years with no return being earned on the unamortized balance;

340. That the Company's proposed amendment to Tariff Sheet No. 9, regarding ~~ready to serve~~ charges, is approved;

341. That the Company's proposed amendment to Sheet No. 8, regarding security deposits, is approved;

342. That the allocation of purchased water and purchased power expenses shall be allocated to the base (average) component of the COSS as proposed by Artesian;

343. That the Company's proposed monthly customer charge of \$14.51 is approved;

344. That we approve the Hearing Examiner's resolution of all issues discussed in his report that have not otherwise been considered by the Commission in this decision; and

345. That the Commission reserves the jurisdiction and authority to enter such further Orders in this Docket as may be deemed necessary or appropriate.

BY ORDER OF THE COMMISSION:

Chair

Commissioner

Commissioner

Commissioner

Commissioner

ATTEST:

Secretary

Exhibit "A"

Approved Revenue Requirement Increase

PSC Order No. 8783 (September 8, 2015)

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF DELAWARE

IN THE MATTER OF THE APPLICATION)
OF ARTESIAN WATER COMPANY, INC.) PSC DOCKET NO. 14-132
FOR A REVISION OF RATES)
(FILED APRIL 11, 2014))

ORDER NO. 8783

AND NOW, this 8th day of September, 2015:

WHEREAS, on April 11, 2014, Artesian Water Company, Inc. ("Artesian" or the "Company") filed an application (the "Application") with the Delaware Public Service Commission (the "Commission") that requested approval of a rate increase of \$9,983,823, and such Application was docketed as PSC Docket No. 14-132; and

WHEREAS, by Order No. 8558 (dated May 13, 2014) the Commission opened this docket to consider Artesian's Application; designated Senior Hearing Examiner Mark Lawrence to conduct any necessary evidentiary hearings and to submit his proposed findings and recommendations to the Commission; and authorized Artesian, pursuant to 26 Del. C. §306(c), to implement interim rates intended to produce an annual increase of \$2,460,674 million in intrastate operating revenues, effective June 10, 2014, with the proviso that such increased rates would be implemented on a prorated basis and would be subject to refund to the extent that the Commission did not grant the relief requested in Artesian's Application; and

WHEREAS, the Commission Staff, the Division of the Public Advocate ("DPA"), Christiana Care Health Services, Inc. ("Christiana"), and Independence Homeowners Association ("HOA") (collectively, the "Parties") intervened or otherwise participated in the proceedings; and

WHEREAS, on June 30, 2015, Artesian filed supplemental testimony that reduced its requested revenue increase from \$9,983,823 to \$9,859,005; and

WHEREAS, on November 13, 2014, Artesian placed into effect an additional interim rate increase of \$4,500,000 pursuant to 26 Del. C. §306(b);¹ and

WHEREAS, evidentiary hearings were held before Senior Hearing Examiner Lawrence on December 8 and 9, 2014; and

WHEREAS, on June 2, 2015, Senior Hearing Examiner Lawrence issued his proposed Findings and Recommendations (the "Hearing Examiner's Report") regarding the Application; and

WHEREAS, Artesian, Staff, the DPA, and Christiana filed exceptions to certain matters addressed in the Hearing Examiner's Report; and

WHEREAS, the Commission met in public session on August 18, 2015, to hear oral argument and conduct deliberations on the issues addressed in the Hearing Examiner's Report and consider the exceptions taken to the Hearing Examiner's Report; and

WHEREAS, the Commission has resolved the issues in this matter as set forth below;

¹ See Order No. 8664 (November 13, 2014).

NOW, THEREFORE, IT IS HEREBY ORDERED BY THE AFFIRMATIVE
VOTE OF NOT FEWER THAN THREE COMMISSIONERS:

1. As a result of our deliberations referenced above, we hereby approve an overall increase in Artesian's water rates of \$6,030,000, the components of which are set forth below:

<u>Description</u>	<u>Amount</u>
Rate Base	\$216,771,690
Overall Rate of Return	7.82%
Return on Equity	9.75%
Cost of Long-Term Debt	5.84%
Net Operating Income based on Commission's Decision	<u>\$16,951,546</u>
Total Revenue Requirement Increase	<u><u>\$6,030,000</u></u>

The parties agree to the amounts reflected above. A full Findings, Opinion and Order setting forth the reasoning for our decisions on the various contested issues will follow at a later date.

2. We order that Artesian develop and file new compliance tariff leaves to be effective on September 8, 2015, which shall include the new water service rates and tariff charges and which shall become effective with services rendered on and after September 8, 2015.

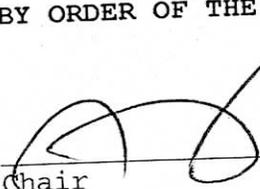
3. Because the new rates placed into effect September 8, 2015 are less than the interim water service rates placed into effect on November 13, 2014, pursuant to 26 Del. C. §306(a)(1), customers will be entitled to a refund of overpayments. Artesian

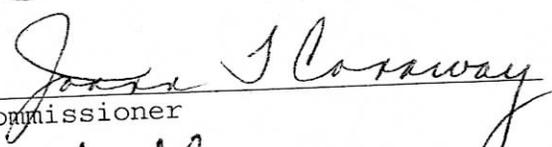
shall issue its customers a refund with interest as provided in P.S.C. Regulation Docket No. 11.

4. The method and manner of such refund shall be approved by the Commission in a further Order.

5. The Commission reserves the jurisdiction and authority to issue such further Orders as it deems necessary or proper.

BY ORDER OF THE COMMISSION:


Chair

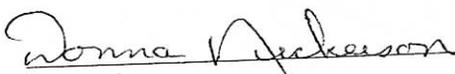

Commissioner


Commissioner

Commissioner

Commissioner

ATTEST:


Secretary

