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City of Alexandria, Virginia

MEMORANDUM

DATE: MARCH 29, 2022

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

THROUGH: JAMES F. PARAION, CITY MANAGER /s/

FROM: LAURA B. TRIGGS, DEPUTY CITY MANAGER
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DOCKET TITLE:
Virginia American Water Rate Case (PUE-2021-00255).

ISSUE: Consideration of Virginia-American Water Company's (VAWC) proposed rate increase.

RECOMMENDATION: That City Council receive this report outlining staff efforts to (1) minimize the unreasonable magnitude of water rate increase for Alexandria residents and businesses, including opposing VAWC's proposed 28% overall increase in revenue requirement and resulting rate increase, and a proposed 10.9 percent Rate of Return on Common Equity; (2) oppose any additional unreasonable requests in VAWC's

rate increase application.

BACKGROUND: On November 15, 2021, the Virginia-American Water Company (VAWC) filed an application with the State Corporation Commission (SCC) requesting an increase in allowable revenues and to increase customer rates, along with other policy and programmatic changes. In their rate increase application, VAWC proposes the following to their Alexandria residential and business customers:

- An increase in annual water service rates of approximately \$11.6 million, or approximately 28 percent, across all their service districts (including Alexandria, Prince William, Hopewell, Eastern Shore);
- A 10.9 percent proposed Rate of Return on Common Equity (“ROE”);
- Continued consolidation of revenues and rates across all their service districts, resulting in an additional increase of 8 and 11 percent increase to Alexandria’s residential and commercial customers, respectively;
- Significant capital projects not benefiting Alexandria;
- Reconciliation of COVID-19 lost revenues from unpaid, delinquent accounts;
- Acquisition of the Town of Waverly’s water system;
- An auto-adjusting mechanism to collect uncollected revenues;
- A revenue stabilization mechanism;

There may be justification for VAWC to request some increase in rates, but an extraordinary request of \$11.6 million or 28 percent increase far exceeds the level of capital investment Alexandria residents have or can expect to receive from this increase.

On average, an Alexandria residential customer’s annual water bill will increase by about \$94 or 36 percent.

VAWC has requested that the proposed rates take effect on May 1, 2022, even if the SCC has not issued its final determination on the rate increase. The proposed rates would take effect on an interim basis, and any differences between the proposed and approved rates would be subject to credit or charge as appropriate.

VAWC’s last rate increase request was filed in November 2018 and approved by the SCC in November 2020.

DISCUSSION: VAWC, a subsidiary of American Water Works Company, Inc. (NYSE: AWK), provides water treatment and distribution service to Alexandria in addition to districts within Prince William County, the town of Hopewell, and in Virginia’s Northern Neck (i.e., Eastern District). VAWC also operates wastewater treatment services in the Dale City area of Prince William County.

VAWC’s recent application to the SCC requests an increase in allowable revenues and an increase in customer rates based on their capital investment in their infrastructure. In the application, VAWC notes slight reductions in their operations and maintenance costs, and implications of the federal Tax Cuts and Jobs Act of 2017 to marginally lessen the requested increase. In addition, VAWC requests to take the next step in consolidating their revenue requirement and implementing a single tariff across all their Virginia districts for each customer class. VAWC also proposes a Revenue Stabilization Mechanism and reconciliation of lost revenues resulting from the impacts of the COVID-19 pandemic.

In reviewing the application, the City has two primary objectives: 1) minimize the magnitude of the water rate increase, and 2) as appropriate, oppose any additional unreasonable requests in VAWC’s rate increase application. Each objective is discussed below, including substantive issues of consequence. In addition, impacts to customer rates are also discussed.

Minimize the Magnitude of Water Rate Increase

As a primary objective, City staff recommend minimizing the magnitude of the water rate increase which is driven by several compounding factors. Each factor is briefly discussed below.

Increase in Revenue Collected from Customers

VAWC seeks an overall \$11.6 million, or approximately 28 percent, increase in allowable revenues for its water service based on a 10.9 percent Rate of Return on Common Equity (“ROE”). For comparison, VAWC requested a \$6.6 million increase in the 2018 rate case and was ultimately awarded a \$1.2 million increase. This increase is spread across all its customers, but about \$4.9 million, or 43 percent, of the total requested increase is apportioned to Alexandria customers.

Requested Rate of Return on Common Equity

As previously noted, VAWC’s revenue requirement is based on a Rate of Return on Common Equity (“ROE”) of 10.9 percent. A higher ROE increases the water revenue requirement, and therefore increases water rates. In VAWC’s most recent rate case, approved in November 2020, the SCC authorized a 9.3 percent ROE. To put into perspective VAWC’s proposed ROE, Table 1 provides recently authorized ROE’s for VAWC’s American Water peers across the country. Authorized ROE values range from 9.1 percent to 9.9 percent.

Table 1: Comparison of Rate base, Authorized ROE, Authorized Equity Ratio, and Rate Case Effective Date for American Water’s Largest subsidiary water utilities.

American Water Subsidiary	Authorized Rate Base (\$000s)	Authorized ROE (%)	Authorized Equity (%)	Effective Date
Illinois	\$883,386	9.79%	49.80%	1/1/2017
New York	\$275,463	9.10%	46.00%	6/1/2017
West Virginia	\$652,900	9.75%	48.40%	2/25/2019
Kentucky	\$443,654	9.70%	48.90%	6/28/2019
Indiana	\$1,182,170	9.80%	53.41%	5/1/2020
New Jersey	\$3,573,450	9.60%	54.56%	11/1/2020
Virginia	\$194,165	9.30%	40.75%	11/6/2020
California	\$667,632	9.20%	55.39%	1/1/2021
Missouri	\$1,703,170	9.55%	50.00%	5/28/2021
Pennsylvania	\$4,107,143	9.90%	55.24%	1/1/2022

Capital market interest rates have remained low to date, and there doesn’t appear to be a reasonable justification for the increase.

Capital Projects

VAWC proposes several costly capital projects which may not offer direct or immediate benefit to Alexandria residents or businesses. Moreover, the application includes inconsistent statements of need in that VAWC suggests requiring to invest in expanding capacity for growth opportunities, while at the same time generally experiencing a system-wide decrease in water usage.

Continuing Rate Consolidation

As allowed by Virginia Code, and initiated in VAWC’s last rate case, VAWC’s application proposes the next step towards a consolidated or uniform set of rates across all their Virginia districts. In general, this process of rate consolidation results in an increase to Alexandria residential and commercial customer’s rates. Conversely,

Prince William, Hopewell, and Eastern District customers will, in general, experience a decrease in their rates.
Reconciliation of COVID-19 lost revenues

The impacts of the COVID-19 pandemic and public health emergency have resulted in VAWC experiencing uncollected expenses and avoided revenues, such as from unpaid, delinquent accounts. As such, VAWC proposes recovering lost revenues, and making VAWC whole from lost revenues or uncollectables resulting from COVID-19. Thorough review of the uncollected revenues will determine what costs are reasonable and necessary, and how these costs are allocated to Alexandria customers.

Acquisition of Town of Waverly Water System

In 2021, VAWC filed an application with the SCC requesting permission to acquire the Town of Waverly's water system. In so doing, VAWC includes some of these costs in this rate case. Because of the consolidation of revenues and rates, costs will be borne by existing customers. As such, Alexandria customers will be responsible for some of the costs associated with the Waverly water system once it is in VAWC's portfolio. Thorough review of the acquisition costs will determine what costs are reasonable and necessary, and how these costs are allocated to Alexandria customers.

Oppose Unreasonable Requests

As a secondary objective, City staff will evaluate and, if necessary, oppose any of VAWC's additional proposed requests in the rate case application. These additional requests include:

- Creation of a Revenue Stabilization Mechanism ("RSM")
- Creation of an auto-adjusting Uncollectable Automatic Rate Adjustment Clause
- Reasonable and appropriate cost allocations among customer classes

A full evaluation of these requests is necessary to determine if reasonable, necessary, or potentially subject to abuse. Should any of these issues not be in the best interest of Alexandria residents or businesses, City staff will move to oppose.

Impact on Rates

The requested revenue increase and rate consolidation results in changes to VAWC's rate tariffs used to charge customers. VAWC uses as a two-part rate tariff consisting of 1) a minimum charge and 2) charges according to the amount of water usage. VAWC doesn't propose any changes to the minimum charge. However, VAWC proposed an increase to the usage charges applied to Alexandria's residential and commercial customers water usage by 112 percent and 57 percent, respectively.

Table 2: Current and Proposed Usage Charges (\$ per 100 gallons)

	Current (\$/100 gallons)	Proposed (\$/100 gallons)	% Change
Residential	0.34833	0.73972	112%
Commercial	0.22163	0.34797	57%

Cost Increases to Alexandria Residential and Business Customers

An average Alexandria residential customer uses around 4,000 gallons per month. Accordingly, an average

Alexandria residential customer's monthly bill will increase by about \$7.83 or 36 percent. An Alexandria residential customer who uses more or less than 4,000 gallons per month will experience slightly different cost impacts.

Alexandria's commercial customers have much more diverse usage patterns. Commercial customers include traditional commercial buildings, but also large multi-unit dwellings, which have drastically different water uses making average values less meaningful. However, if an Alexandria commercial customer uses 50,000 gallons per month, their costs would increase roughly by about \$61 dollars per month. For most Alexandria commercial customers, this is between a 27% and 50% monthly cost increase. An average Alexandria commercial customer who uses more or less than 50,000 gallons per month will experience slightly different cost impacts.

The proposed rates are scheduled to take effect on May 1, 2022. Should the SCC later determine a lower or no rate increase is appropriate, customers will be refunded accordingly, with interest as appropriate.

City of Alexandria Government Rates

There are no proposed changes to rates for water use by the City of Alexandria's government operations including for City facilities, parks, pools, etc. Government organizations, like the City of Alexandria, are charged under different rate tariffs than conventional commercial customers.

Other Issues

Water and Wastewater Investment Service Charge ("WWISC")

VAWC's application does not include any changes to the Water and Wastewater Infrastructure Service Charge (WWISC) except for adjustments made to reconcile booked revenues that were collected, but not authorized, as part of base rates. Reconciliation of WWISC-related costs and earnings are addressed by the SCC in Annual Information Filing cases PUR-2019-00176 and PUR-2020-00249. In both cases, SCC staff analysis shows WWISC overearnings and recommend refunds to Alexandria customers. The cases are still open, and no final orders have been issued. At such time the SCC makes a final determination on refunds due to Alexandria customers, City staff will notify City Council.

NEXT STEPS: The SCC has issued a Notice of Order and Hearing on December 21, 2021. Hearings are scheduled for September 23 and 27, 2022.

Due to the specialized nature of the issues presented in this water rate case, City staff have retained outside legal counsel and outside consultants. City staff, through outside counsel, filed the City's Notice of Participation as a Respondent on February 14, 2022. As a Respondent, the City seeks to represent Alexandria community's best interests by reviewing discovery, filing expert testimony, cross-examining VAWC and other participating witnesses, responding to briefs, orders, rulings, etc., as appropriate.

Should other jurisdictions participate - ex. City of Hopewell, Prince William County, and Prince George County - where there is alignment in priorities, City staff will seek opportunities for partnership.

In addition to the City's participation as a Respondent, members of the Alexandria are encouraged to submit comments to the SCC reflecting their desired outcome of the water rate case at the following URL:

<http://www.scc.virginia.gov/case/PublicComments.aspx>. The Alexandria community may submit comments until September 20, 2022.

FISCAL IMPACT: Fiscal impacts to the City of Alexandria are as follows:

- 1) No anticipated changes to rates for water use by the City of Alexandria's government operations; and

- 2) The City's intervention in the rate case requires outside legal counsel and consultant support expertise. Based on previous experiences intervening in VAWC rate cases, we estimate these direct costs to be about \$50,000 to \$75,000.

Fiscal impacts to members of the Alexandria community will result from the rate case's outcome. If the SCC approves VAWC's proposed 28 percent revenue increase according to a 10.9 percent proposed Rate of Return on Common Equity (ROE) and other factors, the estimated increase in an average residential will be about \$94 per year.

ATTACHMENTS: Presentation

STAFF:

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