


City of Alexandria, Virginia

MEMORANDUM

DATE: JUNE 21, 2012

TO: THE HONORABLE MAYOR AND MEMBERS OF CITY COUNCIL

FROM: RASHAD M. YOUNG, CITY MANAGER 

SUBJECT: CONSIDERATION OF PROPOSED VIRGINIA AMERICAN WATER COMPANY RATE INCREASE

ISSUE: Consideration of staff comments on the Virginia-American Water Company's (Water Company) proposed rate increase.

RECOMMENDATION: That City Council oppose the proposed general rate case application that seeks a 15.93 percent overall increase, with a 12.2 percent increase in the Virginia-American Water Company's Alexandria District rates, and authorize City staff to provide formal comments and concerns as outlined in this report to the State Corporation Commission.

DISCUSSION: On February 6, the Water Company, a privately-owned for-profit entity, filed with the State Corporation Commission (SCC) an application seeking a 15.93 percent overall rate increase (Case No. PUE-2011-00127). Since the SCC regulates each service district separately, the Water Company is seeking a 12.2 percent increase for the Alexandria District. Under SCC rules, this rate increase can become effective on July 12, 2012, subject to refund with interest if the SCC later determines that a lower amount of increase is appropriate. As proposed, the Water Company states that rates for Alexandria's residential customers will increase from \$47.73 to \$53.53 per quarter for the typical customer using 14,400 gallons per quarter. Virginia American Water last filed for a rate increase in March 2010.

The proposed overall 15.93 percent increase is driven largely by proposed new capital investments and construction work in progress (CWIP) in the Water Company's Hopewell and Prince William County service areas, the deployment of new meters, and the implementation of an Enterprise Resource Planning (ERP) software platform to facilitate Water Company's business operations upgrade.

According to William Walsh, President of Virginia American Water Company, the Alexandria rate filing reflects additional investment of \$3.3 million the company will have made in Alexandria between September 2011 and June 2013. Some of the water system improvements include water main replacement/reinforcement projects in Trinity, Ft. Williams, Washington, and

South Streets, as well as the start of an Automatic Meter Reading program involving the installation of radio read meters, which over the next three years, will allow the company to move to monthly billing. Mr. Walsh also notes that the rate increase request also covers increasing operational costs to ensure reliable water service for customers.

City staff has reviewed the rate case documents and recommends that the City of Alexandria submit formal comments to the SCC opposing the proposed size of the general increase of 15.93 percent in water rates. Staff has found that the rate case documentation contains sufficient information to support a rate increase, but not as large as requested. The following are items that staff noted in the rate case documentation:

- The Water Company's rate of return on average equity for the test year ending September 30, 2011 was 7.87 percent. The Water Company is requesting a revenue increase that will allow the company to increase its rate of return on common equity to 11.3 percent. In the prior approved rate increase (PUE-2010-00001), the SCC permitted a 10.2 percent allowable rate of return on common equity.
- The Water Company's last submitted rate increase was for the test year ending September 30, 2009. Based on documents provided by the Water Company, approximately \$1.6 million and \$3.6 million has been invested in the Alexandria District in 2010 and 2011, respectively, to improve the facilities and business operations that support Alexandria customers.
- Staff compared the annual revenues and expenses from the prior rate case (test year ended September 2007) to this rate case (test year ended September 2009). Staff noted in that two-year period total operating revenues on an annual basis increased 9.68 percent, operations and maintenance expense increased by 0.68 percent, depreciation and amortization expense increased 19.34 percent, and interest expense decreased by 0.68 percent. However, for the test period, Operating Revenues also increased 9.68 percent and Operating Income increased by 19.2 percent. This resulted in a 66.59 percent increase in Income Available for Common Equity as calculated by the Water Company.

Staff is not convinced of the merits of all the arguments and facts associated with the rate increase request for the following specific reasons:

- Increase in Rate of Return on Common Equity: As stated above, the Water Company is requesting an 11.3 percent rate-of-return on common equity. This proposed rate-of-return is based on the work of an independent consultant hired by the Water Company. The consultant developed a rate of return calculation for the Water Company as a whole and not solely for the Alexandria District. The consultant determined that the Water Company should receive a higher rate of return because the water utility industry has a higher business risk due to three factors: high operating leverage, demand uncertainty, and supply uncertainty. Staff questions whether these factors are applicable to Alexandria. The Water Company purchases the water sold in the Alexandria District from the Fairfax County Water Authority. This should mitigate the water quality and

supply concerns. With respect to demand uncertainty, Alexandria residents should not have to pay more because of uncertain demand from industrial customers in Hopewell. While baseline water use may be slightly decreasing, the overall water rate base and water demand is increasing in the Alexandria District due to substantial new residential and commercial development in the City. Staff believes Alexandria customers' solid and consistent revenue stream, coupled with little risk of supply water availability, reduces revenue generation and cost risks substantially. Consequently, the proposed rate-of-return can be lower than the requested 11.3 percent.

- **Large Rate Increase:** The 15.93 percent rate increase requested by the Water Company would generate \$1.7 million a year in additional income for common equity. The Water Company's invested an additional \$2 million in Total Rate Base that supports Alexandria customers, and is entitled to receive a return on its investment. If expenses could be controlled the Water Company would recoup its investment in less than two years, thus allowing a lower rate of return (10.20 percent as determined in the 2010 rate case).

In prior years, the SCC staff has concurred with many of the issues identified by the City. In addition, the SCC has raised additional issues, which have resulted in the SCC approving rate increases substantially lower than requested by the Water Company. As noted earlier, in 2010, the Water Company requested revenue increases of 22.4 percent, but the SCC approved 14.1 percent instead. In 2008, the Water Company requested a rate increase of 24.9 percent and the SCC approved a rate of 9.5 percent. It is recognized that the Water Company has invested in its infrastructure and business operations servicing Alexandria customers and thus should be granted a rate increase, but not a 15.93 percent increase.

FISCAL IMPACT: If the 15.93 percent rate increase is approved, Alexandria customers will experience a 12.2 percent overall water rate increase. As noted earlier, the average increase for a typical residential customer would be \$5.80 per quarter. If City water bills increase 12.2 percent, the City's water bill would increase \$71,000.

It should be noted that the Water Company, which is in the process of upgrading its billing systems as part of a larger business transformation initiative and implementing an Enterprise Resource Planning (ERP) software platform, is eliminating the third-party billing services to the Alexandria Sanitation Authority (ASA) and the City, presumably to reduce the cost of implementing this new computer system. While the Water Company asserts this reduction in service will allow for more strategic focus on their core mission, these costs are being shifted from the Water Company's Alexandria District operations and place an additional financial burden on ASA and the City.

STAFF:

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