Regulatory Policy Reform

The Santa Fe Conference
March 15, 2011

Paul G. Foran
Vice President and Counsel
Regulatory Programs
American Water – History and Operations

- Heritage dates back to 1886
- Largest U.S. water and wastewater services provider
- Serves more than 15 million people in more than 1,600 communities
- Operations in more than 30 states and parts of Canada
- More than 7,000 employees
Facts & Figures
(owned Assets)

• More than 370 individual water systems
• 49,000 miles of mains and collection pipes
• 80 surface water treatment plants
• 690 groundwater treatment plants
• 1,000 groundwater wells
• 60 wastewater treatment plants
Recap:

- American Society of Civil Engineers - State of Water and Wastewater Infrastructure: D-
- Most Capital Intensive of All Utilities
- USEPA Infrastructure Replacement Needs Estimates – Water and Wastewater: >$1 Trillion
  - 2009 Drinking Water Estimate: $335 Billion
  - 2002 Drinking Water Estimate: $154 Billion
  - >100% increase over about 7 years
- Water Quality: SDWA – A Moving Target
- Fragmentation
- Highly Energy Intensive and Will Become More so
- Decreasing Per Capita Consumption
- Only Utility Ingested Into The Body
Critical Sector Interdependencies: How Much Energy Does Water Use?

- 4% of domestic energy
- 7% of worldwide energy
- About 20%: California
- AW: 30% of all non labor O&M (85%-99% for pumping)
Critical Sector Interdependencies: Energy/Water
How Much Water Does the Power Industry Use?

- The average power plant withdraws from 100 to 250 million gallons of water per day

- Aggregate consumption of hydro and thermoelectric power uses 2 gallons per kWh of end use electricity

Nothing is more fundamental to the provision of sustainable, high-quality, basic customer service.

Nothing is more fundamental to the mission of a PUC.

Infrastructure Replacement

Water Quality Compliance

$1 Trillion/20 Years

Capital Attractions

Reasonable Cost
NARUC Water Committee

NARUC Resolution Supporting Consideration of Regulatory Policies Deemed as “Best Practices”

- Prospectively relevant test years
- DSIC
- Pass-through adjustments
- Staff-assisted rate cases
- Consolidation/economies of scale
- Fair returns to attract capital
- Streamlined rate case process
- Integrated water resource management
- Policies to address affordability
- Phase-ins
- Single tariff pricing
- Active and effective security programs
- Interagency coordination
- Data system modernization
- Etc.

Adopted by the NARUC Board of Directors, July 27, 2005.
Primary Regulatory Public Policy Need

- Adoption by PUC of an overarching, clear policy directive to enhance infrastructure replacement and capital attraction at reasonable cost
- The policy directive would be used to inform and provide a framework for all PUC decisions regarding other regulatory policy issues and decisions in regulatory proceedings
- Policy directions and decisions in regulatory proceedings would be subject to two tests:
  - Does the action enhance/promote replacement of infrastructure and attraction of necessary capital at reasonable rates?
  - Does it protect ratepayers (protection from over earning, reconciliation, performance)?
  - Require all stakeholders (including PUC) to specifically address
- The question is not “either/or” – it must be how do BOTH get accomplished.
Illinois House Bill 14

“... The General Assembly finds that electric utilities are now entering a new construction cycle that is needed to refurbish, rebuild, modernize, and expand systems to continue to provide safe, reliable, and affordable service to the State’s current and future utility customers in this newly digitized age. In particular, the General Assembly finds that it is the policy of this State that significant investments must be made in the State’s electric grid over the next decade to modernize and upgrade transmission and distribution facilities in the State. These investments will ensure that the State’s electric utility infrastructure will promote future economic development in the State and that the State’s electric utilities will be able to continue to provide quality electric service to their customers, including innovative technological offerings that will enhance customer experience and choice such as smart grid. These investments, including programs to reinforce the safety and security of high voltage transmission lines, will also ensure that the State’s electric utility infrastructure continues to be safe and reliable. . .”

Why Does the General Assembly Need To Do This?
CAPITAL ATTRACTION:
Timely Recovery of Invested Capital – Regulatory Lag

HISTORIC TEST YEAR – 9 Mo. Rate Case, 2 yr Rate Case Cycle

Jan 1 '06                      Jan 1' 07                        Jan 1 '08                        Jan 1 '09                        Jan 1 '10                       Jan 1'11

Mar'07      Jun'07      New Rates           Sep’08                                          Mar’10                         New Rates
RateCase Investment Effective             Investment                                   New Rate                       Effective
Filed                         Case Filed

Results: • 3 ½ yr loss of return of or on June '07 investment and depreciation
• Skews efficient capital invested
• Forces more frequent, costly rate cases
• Disincents Capital Investment

Mitigation: Prospectively relevant test years
• Future test years (eg, IL, KY, TN, NY)
• Step Increase (eg, CA – 3-year rate cycle)
• DSIC (IL, PA, DE, MO, IN, NY, OH, CT)
• Adjustment mechanisms
Negative Impact of Regulatory Lag and Potential Impact on Cost of Capital for Capital Intensive Regulated Industries

“Primarily because of regulatory lag and increased financing expenses that cause balance sheet strain and execution risks, utilities suffer sub par returns during periods of heavy capital investment.”

(Source: Lehman Brothers; Power and Utilities: Regulated Utilities; Global Equity Research, North America, May 22, 2007)

Infrastructure Replacement Surcharge Programs Permit Utilities to Better Manage Cash Flows and Capitol Programs in Times of Extreme Financial /Market Volatility

“Firms can also reallocate capital to projects with more timely return periods and take advantage of regulatory mechanisms that recover investment more quickly. Pennsylvania’s distribution system infrastructure charge (DSIC), which allows a monthly customer surcharge for pipe repair costs, is an example of this.”

(Source: Janney Montgomery Scott, LLC; Water Industry Report; October 30, 2008)