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IN THE

Supreme Court of Virginia

RECORD NO. 171428

CITY OF ALEXANDRIA, *et al.*,

Appellants,

v.

STATE CORPORATION COMMISSION, *et al.*,

Appellees.

REPLY BRIEF OF APPELLANTS

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REPLY COUNTERSTATEMENT OF FACT

The Briefs of Appellees, Virginia State Corporation Commission ("Commission") and Virginia-American Water Company ("VAWC") contain material mischaracterizations of fact and law, which the City of Alexandria, Virginia and the City of Hopewell, Virginia (together, the "Cities") address in this reply counterstatement and the argument that follows.

It was not "undisputed" in the proceeding below "that there is a significant and growing need to accelerate the pace of investment in replacing mains and other infrastructure in the Company's Alexandria distribution system" as stated in the VAWC Brief. VAWC Brief at 1. Rather, it was undisputed simply that there is a need for infrastructure replacement. JA at 518. Further, VAWC is already accelerating infrastructure replacement efforts and such is demonstrated by VAWC's frequency of rate case filings since 2000, on average every 2.5 years. JA at 1039, 1678.

This Court has not specifically acknowledged or confirmed a special rate mechanism for a water utility's accelerated infrastructure replacement efforts, contrary to the VAWC's statement of the case and its citation to a case from 1955. VAWC Brief at 2. In fact, there is no *Commission* precedent for a water utility's accelerated infrastructure replacement charge, as the majority of the Commission has never ruled on that issue.

VAWC Brief at 5. In the proceeding below, the Hearing Examiner summarily stated that "there is substantial statutory support for the Commission's authority to implement a WWISC," but failed to cite anything specific beyond the general powers to set rates in a regular rate case. JA at 518. Subsequently, the Commission adopted the WWISC without specifically ruling on its authority to do so.

Although the Hearing Examiner in the 2014 Rulemaking suggested that the Commission could exercise its authority to implement a WWISC, the majority of the Commission made no determination about the "appropriateness of various rate design mechanisms that may be utilized in association with new infrastructure investment." VAWC Brief, at 5. Indeed, only one Commissioner agreed with the Hearing Examiner on the issue of the Commission's authority to approve a WWISC. Therefore, the Appellees are relying solely on the reports of two Hearing Examiners and one Commissioner's opinion to assert that the authority for the implementation of the WWISC is "long-standing". In fact, it has never been the official position of the Commission by order, and is unsupported by any statutory authority. This Court should make a formal ruling restricting the Commission and its Hearing Examiners to follow the law. Further, the Cities reassert their Statement of Facts in its Appellant's Brief.

ARGUMENT

I. Standard of Review

It is well settled that "[t]he commission is the creation of the Constitution and has no inherent power. All of its jurisdiction is conferred either by the Constitution or is derived from statutes which do not contravene the Constitution." *Commonwealth v. Old Dom. Power Co.*, 184 Va. 6, 12-12, 34 S.E.2d 364 (1945). Therefore, contrary to the standards advanced by VAWC and the Commission, this Court is not inextricably bound by the interpretation of a statute advanced by the Commission, despite it being a statute that the Commission is charged with enforcing. *BASF Corp. v. SCC*, 289 Va. 375, 403, 770 S.E.2d 458 (2015). In fact, as acknowledged by Aqua Virginia, Inc. ("Aqua") in its Brief *Amicus Curiae* in support of the Appellees, this Court "gives great weight to the practical construction given to a statute by public officials charged with its enforcement," ***but*** "it is not inexorably bound by that construction." Aqua Brief at 14. (Emphasis added). Curiously, both the VAWC and the Commission omitted the significant conjunctive limitation ("but") on the Commission's interpretation, appropriately recognized by the Cities and Aqua. *Id*. and Cities' Brief at 7. Of course, contrary to VAWC and the

Commission's suggestion, this Court has frequently stepped in to limit the Commission to its proper statutory role. Cities' Brief at 10-11.

Here, this Court has not yet reviewed *Virginia Code* § 56-235.2 with regard to the establishment of a separate charge for infrastructure replacement like the WWISC. This is a case of first impression and is not, as the Appellees allege, at all akin to a purchased gas adjustment clause reviewed and approved by this Court in 1955. *Norfolk v. Virginia Elec. & Power Co.*, 197 Va. 505, 90 S.E.2d 140 (1955) (easily distinguished below). Moreover, when the *Norfolk* case was decided, the statute in question in this case had not yet been enacted.

Any interpretative construction at the Commission with regard to a gas infrastructure surcharge is not as long-standing as the Appellees assert. Further, that interpretation is not one entitled to deference since it contradicts the statute itself. If not based on a correct application of the statute, it must be overturned. *BASF Corp. v. SCC,* 289 Va. 375, 391, 770 S.E.2d 458 (2015). It is well settled in Virginia law that "pure statutory interpretation is the prerogative of the judiciary." *Sims Wholesale Co. v. Brown-Forman Corp.*, 251 Va. 398, 404, 468 S.E.2d. 905, 908 (1996). Indeed, "[i]t is emphatically the province and duty of the judicial department to say what the law is." *Finnerty v. Thornton Hall, Inc.*, 42 Va. App. 628,

635, 593 S. E. 2d. 568, 571 (2004) (quoting *Marbury v. Madison*, 5 U.S. (1 Cranch) 137,177 (1803)). Thus, this Court must make a determination as to whether Section 56-235.2 authorizes the Commission's imposition of a WWISC on the Alexandria ratepayers.

II. The Commission Does Not Have the Authority to Impose the WWISC.

A. The Approved WWISC Does Not Comply With the Requirements of Virginia Code Section 56-235.2.

Despite VAWC's repetitive arguments with respect to the language in Virginia Code Section 56-235.2, the WWISC does not meet the requirements plainly laid out in the statute.

1. Virginia Code Section 56-235.2 Mandates Consideration of Criteria Not Considered in the WWISC.

The statute specifies the criteria pursuant to which a company's rates, tolls, charges and schedules for may be considered "just and reasonable" by the Commission. Specifically, the public utility must have ***demonstrated*** that aggregate revenues do not exceed aggregate actual costs, plus a fair return. By enacting this section, the General Assembly requires that accounting for necessary future improvements to infrastructure be included as a component considered by the Commission in approving a public utility's proposed rates. The WWISC, as approved by the Commission, considers only infrastructure costs at the time the rate is

set and does not consider returns on investment, revenues or profit to be derived from system improvements.

To defend this plain violation of statutory requirements, VAWC and the Commission point to the required "Earnings Test" as a counter to the Cities' argument that the WWISC does not consider all of the components mandated by the statute. VAWC Brief at 17; Commission Brief at 5. The VAWC will undergo an annual Earnings Test where the Commission will review Alexandria district revenues, and reconcile any overearnings through a refund at some point in the future to Alexandria customers. Commission Brief at 5. However, the Earnings Test confirms the rate applied to ratepayers on the front-end will be collected without any consideration of revenues or actual costs and prior to any refund. Therefore, the ratepayer may not be reimbursed for more than a year after the fact. The WWISC process cannot comply with the statute that clearly requires a company to "demonstrate" **in advance** that rates are reasonable taking into account aggregate revenues and costs. The plain language of the statute and the use of the past tense for the verb "demonstrate" does not envisage that at some point in the future the result to the ratepayers will be a just and reasonable rate. Rather, it requires the Commission to set and approve a just and reasonable rate from the outset.

Here, despite VAWC's assertions to the contrary, the replacement of infrastructure will no doubt result in higher revenues to VAWC, through the elimination of inflow and infiltration, greater capacity, and less loss through leakage. Therefore, such revenues must be considered and the statute requires such consideration in the context of a general rate case and prior to any rate being set.

VAWC and the Commission also describe a "true-up" adjustment that occurs after the WWISC revenue is collected for a full year. The true-up also does not bring the WWISC into compliance with the statute that requires all costs to be considered when the rates are set. Virginia Code § 53-234 directs public utilities to furnish adequate service at reasonable and just rates. This Court has stated that section must be read with Section 56-235.2, where the General Assembly defines reasonable. *Commonwealth Gas Pipeline v. Anheuser-Busch*, 233 Va. 396, 402-403, 355 S.E. 2d 605, 608 (1987). Section 56-235.2 provides that in a rate will be reasonable where the utility demonstrates that:

> such rates, tolls, charges or schedules in the aggregate provide revenues not in excess of the aggregate actual costs incurred by the public utility in serving customers within the jurisdiction of the Commission, including such normalization for nonrecurring costs and annualized adjustments for future costs as the Commission finds reasonably can be predicted to occur during the

> rate year, and a fair return on the public utility's rate base used to serve those jurisdictional customers.

The process advanced by VAWC provides that on one date the Commission will approve the WWISC Rider that implements a separate charge on each customer's water bill. At a later date the "true-up" adjustment will reconcile projected costs filed with the WWISC Rider the previous year and actual costs. If actual costs are higher, VAWC will recoup those costs with an additional charge to the customer. If actual costs are lower, then the Company will provide a reimbursement to customer. This process is not authorized by the statute or supported by caselaw.

2. Virginia Code Section 56-235.2A Confirms That Special Rates Are Only Allowed for "Individual Customers" or "Classes of Customers," Not All Customers like the WWISC.

Additionally, the latter half of Virginia Code Section 56-235.2A further confirms the lack of authority for a WWISC outside of a general rate proceeding in that it authorizes "special rates," but only to a class of customers, not to all customers across an entire Service District. This provision authorizes the Commission to specifically approve:

> either in the context of or **apart from a rate proceeding** after notice to all affected parties and hearing, **special rates**, contracts or incentives **to individual customers or**

> **classes of customers** where it finds such measures are in the public interest. (Emphasis provided).

Even if the WWISC were a "special rate", ignoring common sense and the plain meaning of the term "class," VAWC urges this court to conclude that the quoted language in the second half of Section 56-235.2A contemplates the Commission's establishment of a WWISC to be charged to every customer in the Alexandria district. VAWC Brief at 32. However, a "class of customers" cannot mean an entire service district, which by definition includes all customers of all classes. The plain meaning of a "class" of customers refers to a distinction **among customers** and never all customers. *Po River Water and Sewer v. Indian Acres Club*, 255 Va. 108, 113, 495 S.E.2d 478 (1998) ("the Commission is charged with establishing appropriate customer classes based on usage characteristics of individuals and entities utilizing the utility's services"); *Anheuser-Busch Co. v. Virginia Natural Gas*, 244 Va. 44, 47, 418 S.E.2d 857 (1992) (residential class of customers among "various classes of services"); *Roanoke Gas v. Att. General*, 219 Va. 1072, 1074, 254 S.E.2d 102 (1979) (residential, commercial, and industrial customer classes, who can also be grouped into two other categories of classes, "namely firm customers and interruptible customers"); *Estes Funeral Home v. Adkins*, 266 Va. 297, 300, 586 S.E.2d 162 (2003) (upholding various rates among various classes of customers

including households, certain enumerated businesses, fast food restaurants, other restaurants and "other businesses"). As a source in the record to show that VAWC considers a class of customers as less than all customers, see VAWC's Application, JA at 7, which refers to residential, commercial, and industrial classes of customers and also to potable versus non-potable classes of customers.

As common sense and plain meaning would dictate, none of these authorities refer to a "class" of customers as meaning all customers of all classes in a service district. In fact, the Cities have been unable to find any reference to a "class" of customers meaning all customers of all classes within a District (as in the current test case Alexandria District WWISC) or all customers of all classes within Company (which could potentially be approved if the Cities' appeal is not successful herein).

Thus, this portion of Section 56-235.2A confirms that while the General Assembly contemplates "special rates" "apart from a regular rate proceeding," it only authorized such special rates to "individual customers or classes of customers," not to all customers of all classes. Where, as here, a rate is to be charged to all customers, it cannot be "apart from a regular rate proceeding" which analyzes all statutory criteria.

B. *Norfolk* case does not support the WWISC.

VAWC and the Commission's reliance on a 1955 case regarding a purchased gas adjustment clause is misplaced. *Norfolk v. Virginia Elec. & Power Co.*, 197 Va. 505, 90 S.E.2d 140 (1955) involved a Commission order authorizing a power company's use of an escalator clause as part of its rates, charges, rules and regulations "[i]n order to avoid the disruptive effects of constant fluctuations in its wholesale cost of natural gas, which is fixed by federal authority and beyond its control." *Norfolk*, 197 Va. at 512, 90 S.E.2d at 145. The escalator clause is nothing like the WWISC and *Norfolk* is easily distinguished.

First, the escalator clause approved in *Norfolk* appears to have been approved by final order in a general rate proceeding, unlike the WWISC. The final Commission order considered in *Norfolk* ordered that the escalator clause was "just and reasonable and should be approved **as a part of** the schedule of rates, charges, rules and regulations" of the Company; and further ordered that the Company be "authorized to file and use the Purchased Gas Adjustment provision **as a part of** its rates, charges, rules and regulations now on file with the Commission." *Norfolk*, 197 Va. at 509, 90 S.E.2d at 143. This alone distinguishes the *Norfolk* case.

Moreover, the escalator clause in *Norfolk* allowed the power company to reconcile fluctuations in the price of purchased gas that amounted to about 50% of the Company's operating expenses. Id. at 512, 145. Also, the cost of gas purchased by the utility was determined by the Federal Power Commission for the interstate supplier of the Company and it had no control over these rates. Further, the Commission labeled such escalator clause as "highly remedial," conferring "no benefit on the stockholders of the Company except to help the avoidance of unjustified loss." Id. at 513, 146. Finally, in approving the clause, the Court indicated that it amounted to a mathematical formula that renders the resulting rates "as firmly fixed as if they were stated in terms of money." Id. at 516, 148.

Therefore, the escalator clause is fundamentally different from the WWISC. First, VAWC spends considerable time making the case for the necessity of the WWISC and describes the purported difficulty it has attracting capital, demonstrating that one of the primary purposes of the WWISC is intentionally for the benefit of VAWC investors. VAWC Brief at 15. Second, the WWISC is not for the purpose of purchasing a commodity from a third party setting the pricing thereof, such as the purchased gas surcharge approved in *Norfolk* or the purchased water surcharge cited to by VAWC. It depends on projects over which VAWC has control. Third,

neither the VAWC or the Commission staff described the WWISC as a mathematical formula that is as firmly fixed as if the rate was stated in terms of money. In fact, as ordered, it must be fixed by the Commission after filing a separate application. Fourth, with regard to revenue, a purchased gas or purchased water surcharge only collects the exact cost incurred by the utility to obtain those items and there is no threat of increased revenues because of such purchases. Conversely, the implementation of the WWISC will undoubtedly increase VAWC's revenues, or else the Earnings Test would not have been proposed by Commission staff during the proceeding below. The inclusion of the Earnings Test underscores that VAWC cannot demonstrate that the initial rate charged to customers is just and reasonable, as required by the statute.

C. The SAVE Act Clearly Exhibits the General Assembly's Intent to Not Allow Special Rates Like the WWISC for Water and Other Non-Gas Utilities.

The Cities maintain that the SAVE Act serves as an express grant of authority rather than an express limitation on the power of the Commission, as alleged by VAWC and the Commission. Its plain language authorizes the use of a surcharge by any gas company complying with the statutory

requirements. Further the definition of "SAVE rider" found in *Virginia Code* § 56-603 provides that it is:

> a recovery mechanism that will allow for recovery of the eligible infrastructure replacement costs, *through a separate mechanism from the customer rates established in a rate case using the cost of service methodology set forth in § 56-235.2*… (Emphasis added).

The use of the emphasized language demonstrates that the WWISC is not contemplated by Section 56-235.2 and the SAVE Act or something similar would be necessary for the Commission to authorize and implement a separate mechanism outside of a rate case. The General Assembly's adoption of the SAVE Act confirmed that the Commission could not otherwise authorize a separate rate mechanism for all customers outside of a general rate case. Further, the omission of all other utility companies from the SAVE Act demonstrates the General Assembly's intent to NOT give any other type of utility company, including water utilities, the right to seek recovery for infrastructure costs outside of a general rate case.

The Cities reserve and reassert all their prior points and authorities on the first assignment of error.

III. <u>Assignment of Error 2 ("AE2") is an Alternative Theory for Reversal.</u>

Contrary to the VAWC's assertion that the Cities abandoned the argument regarding the Commission's authority to establish a WWISC, AE2 is simply an alternative theory for reversal. AE2 states that if the Commission had the authority to establish a WWISC, the decision does not meet the statutory requirements based on the record. Indeed, the record below clearly shows that the Commission's decision to establish a WWISC did not meet the statutory standard of being just and reasonable, nor did it meet the criteria set by the Commission in the Rulemaking that such a rate mechanism be approved only if the evidence establishes that the rate is needed and will be in the public interest. Cities Brief at 22, 26, 29.

Therefore, even if this Court determines that the Commission had the authority to establish a WWISC, the evidence presented throughout the proceeding did not warrant such a decision. All parties below, except VAWC, argued that there was no need for the WWISC. The Cities reserve and reassert all its prior points and authorities on this AE2.

CONCLUSION

The Cities respectfully request that the Court reverse the Commission’s ruling authorizing a WWISC, enter final judgment prohibiting the WWISC, and award the Cities costs and attorney fees and any other such relief as the Court deems appropriate.

Respectfully Submitted,

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CERTIFICATE

I certify that there was compliance with Rule 5:26(e). As such, three copies of the foregoing Reply Brief of Appellants City of Alexandria, Virginia and the City of Hopewell, Virginia were hand-filed with the Clerk of the Supreme Court of Virginia on this 12th day of March, 2018. On this same day, the foregoing was served to on each of the following counsel of record by e-mail:

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