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STEFANIE A. BRAND
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July 3, 2018

Via Hand Delivery and Regular Mail

Honorable Jacob S. Gertsman, ALJ
Office of Administrative Law
Quakerbridge Plaza, Bldg. 9
3444 Quakerbridge Road
Mercerville, New Jersey 08619

Re: In the Matter of the Petition of New Jersey-American Water Company Inc. for Approval of Increased Tariff Rates and Charges for Water and Wastewater Service, Changes in Depreciation Rates and Other Tariff Modifications
BPU Docket No.: WR17090985
OAL Docket No.: PUC 14251-17

Dear Judge Gertsman:

The Division of Rate Counsel ("Rate Counsel") is writing to alert Your Honor to a report issued by the New York Public Service Commission, Department of Public Service ("DPS") last Friday that may materially impact the New Jersey American Water Company's ("NJAWC" or "Company") rate case referenced above ("Rate Case"). We are enclosing a copy of the document, dated June 29, 2018, entitled "Staff Investigation into Causes of New York American Water's Property Tax Expense Error, and Reasons for Untimely Reporting to the Department of Public Service and the Commission" ("the Report").

In the attached report, the DPS found that the New York American Water Company Rates and Regulatory Team intentionally withheld material facts in its base rate case before the DPS. Three employees of the American Water Works Service Company Northeast Division were found to be most extensively involved in the misrepresentations and intentional "cover-up" of errors in the proceeding before the New York Commission. While the names of these individuals are redacted from the Report, based on the titles of these individuals, it appears that two of those employees were witnesses in the New Jersey proceeding presided over by your

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Honor on June 11, 13, 14, 18 and 25, 2018. Rate Counsel therefore seeks to bring this report to Your Honor's attention, and ask that the Company be required to verify and certify that the testimony provided by those individuals in this case is correct.

The witnesses are: Frank X. Simpson, Senior Director of Rates & Regulation ("RR") for the Eastern Division and, Dante M. DeStefano, Director RR, also for the Eastern Division. The third employee is the Director, Corporate Counsel for the Northeast Division (Report, pgs.1 and 22). In New York, these individuals failed to correct erroneous plant inventory data in the Company's filings with the Office of Real Property Tax Services in connection with an acquisition of the stock of Aqua America New York, Inc., (Report, p. 5). The erroneous data resulted in significantly over-assessed real property values, producing significantly inflated tax expenses which would have ordinarily been recovered from customers in the service territory (Report, p. 2).

The timeline of the investigation shows that the Rates and Regulatory team was made aware of the error by April 22, 2016. The RR team did not disclose the material error in data responses provided to DPS Staff in June, July and August. Rebuttal Testimony was filed with DPS on September 23, 2016, and the Rates and Regulatory team continued to withhold the material error. In March 2017, witness Dante DeStefano responded to a direct question by the ALJ in that case on the cause of the increased property taxes and again did not disclose the error.

Finally, in December 2017, NYAW senior staff became aware the error and came forward to Commission Staff. See, Report Timeline, p. 24.

The DPS found the Rates and Regulatory Team's actions to be egregious and intentionally deceptive. The Report concludes that "the erroneous tax filings were a known material fact and that fact was purposely withheld from the records in the DPS rate proceeding" (Report, p. 23). Also according to the Report, these RR witnesses were under investigation as of December 26, 2017, which is prior to the time hearings were held in this case. No one from the Company disclosed to the Parties to this proceeding that there was an ongoing active investigation into the veracity of certain NJAWC rate and regulatory personal or that an investigation was underway to determine why the New York American Water Company Rates and Regulatory Team failed to notify the DPS about errors and related impacts on customers when the errors were discovered (Report, p.3).

In light of this Report, Rate Counsel is concerned about the accuracy of the testimony filed in this case by these same witnesses. As the existence of this investigation was not known to the other parties until after the record in this case was closed, we were unable to explore any issues related to this investigation during cross-examination. It is our understanding that Mr. DeStefano, is no longer with NJAW. The direct and supplemental testimonies of Frank X. Simpson were adopted by Company witness, John S. Tomac. To ensure that the record in this case is correct, Rate Counsel respectfully requests that Your Honor direct NJAW to review the

testimonies of witnesses Simpson and DeStefano and provide a certification from a current NJAW officer that their testimonies are complete and free of errors or omissions.

Thank you for your attention to this matter.

Respectfully submitted,

STEFANIE A. BRAND
DIRECTOR, DIVISION OF RATE COUNSEL

By: _____
Susan E. McClure, Esq.
Assistant Deputy Rate Counsel

In the Matter of the Petition of New Jersey American Water Co. Inc. for Approval of Increased Tariff Rates and Charges for Water and Wastewater Service, Change in Deprecation Rates and Other Tariff Modifications
BPU Docket No. WR17090985
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NEW YORK STATE
DEPARTMENT OF PUBLIC SERVICE

Case 16-W-0259 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of New York American Water Company, Inc. for Water Service.

Case 17-W-0300 - Petition of New York American Water Company, Inc. for Approval to Offset the RAC/PTR Surcharge, P.S.C. No.5

STAFF INVESTIGATION INTO CAUSES OF NEW YORK AMERICAN WATER'S PROPERTY TAX EXPENSE ERROR, AND REASONS FOR UNTIMELY REPORTING TO THE DEPARTMENT OF PUBLIC SERVICE AND THE COMMISSION

June 29, 2018

NEW YORK STATE
DEPARTMENT OF PUBLIC SERVICE

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STAFF INVESTIGATION INTO CAUSES OF NEW YORK AMERICAN WATER'S PROPERTY TAX EXPENSE ERROR, AND REASONS FOR UNTIMELY REPORTING TO THE DEPARTMENT OF PUBLIC SERVICE AND THE COMMISSION

INTRODUCTION

On December 7, 2017, executives of New York American Water Company, Inc. (NYAW or the Company) traveled to Albany to personally inform Department of Public Service (DPS) Staff (Staff) that it filed incorrect plant inventory information with the Office of Real Property Tax Services (ORPTS) beginning in 2013, after NYAW's 2012 acquisition of Aqua New York, Inc.[1] The Company failed to correct the erroneous inventory data in its 2014 and 2015 filings with ORPTS.[2] The erroneous data resulted,

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[1] The President of NYAW, Senior Director of Rates and Regulatory, and the Director of Rates and Regulatory were the utility representatives in attendance at the meeting.

[2] The majority of NYAW's properties' assessed value is determined by ORPTS, and is based on the utility's self-

in the aggregate, in significantly over-assessed property values primarily in the Company's Sea Cliff Water District.[3] These over-assessments produced inflated tax expenses which the Company paid, and would ordinarily recover from customers in its Sea Cliff territory.

On December 26, 2017, Staff informed NYAW that a DPS investigation of the issue and related ratemaking would be conducted.[4] On December 28, 2017, NYAW filed a Petition[5] with the Commission seeking to hold its customers harmless by reconciling its past and future property taxes in the Sea Cliff District with the tax expenses the Company would have incurred if there had not been a reporting error. Also, on December 28, 2017, Carmen Tierno, President of NYAW, sent a letter to Chairman and Chief Executive Officer Rhodes, stating that: "NYAW

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reported plant information. Municipalities and school districts rely on ORPTS assessments to determine and bill annual property taxes. ORPTS market value assessments are based on the original costs and vintage year of additions as reported by New York utilities. The vintage year original cost data is adjusted to determine the cost to reproduce the plant in the current year. The "reproduction value less accumulated depreciation" represents the assessed market value of the assets for taxation purposes.

[3] There were also several less material errors related to some of the small upstate acquired systems that are detailed on page 37 of this report.

[4] December 26, 2017 letter from Chair and Chief Executive Officer John B. Rhodes to Carmen Tierno, President, New York American Water ("December 26, 2017 DPS Letter").

[5] Case 17-W-0300, New York American Water, Inc. - Surcharges, NYAW Petition to Reconcile Property Taxes (filed December 28, 2017) (Petition). The Petition was updated by NYAW on January 29, 2018.

is unconditionally committed to fully safeguard its customers from financial harm as a result of this issue."

In order to minimize any customer overcharges related to this error, NYAW immediately reduced two of its property tax recovery surcharges for its Sea Cliff customers, effective January 1, 2018.

On January 18, 2018, the New York State Public Service Commission (Commission) issued an Order directing Staff to continue to investigate and report on NYAW's disclosures.[6] In that Order, the Commission expressed its interest in "... understanding the reasons for the NYAW error and why that error was not reported and addressed by NYAW during the earlier phase of this proceeding."

On April 30, 2018 Staff issued an Interim Report[7] calculating the customer impact of these tax errors. This report addresses Staff's findings in the second phase of the investigation into how the initial error was made, why the errors persisted over the three-year period, and why the Company failed to notify Staff and the Commission about the errors and related impacts when the errors were discovered.

BACKGROUND

The Interim Report included an estimate of the incremental costs that the Company incurred for the period from

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[6] Case 16-W-0259, New York American Water, Inc. - Rates, Order Initiating Investigation (issued January 18, 2018), page 4 (2016 Rate Case).

[7] Cases 16-W-0259 and 17-W-0300, supra, Staff Interim Report on Its Investigation Into New York American Water's Property Tax Overcharges Hold Harmless Calculation (filed April 30, 2018) (Interim Report).

June 2014 (first impacted bills for 2014/2015 village taxes) through December 2018 (last impacted bills for 2018 town taxes) of approximately $2.3 million. Of this amount, only approximately $281,000 was recovered from customers and will be returned via a bill credit after Commission authorization. The Interim Report also found that the property tax allowance and related reconciliation targets in the current rate plan[8] were too high and recommended that the Commission lower the property tax targets and associated surcharges accordingly. Ultimately, the property tax targets built into the rate allowance are trued-up to the actual costs through the reconciliation mechanism set forth in the Rate Order[9].

This report focuses on why the tax reporting errors occurred, why they were perpetuated for three years, and why the matter was not reported to the Commission and/or DPS Staff in a timely manner. The report also addresses improvements to the Company's internal controls and processes to prevent similar errors from happening again.

Staff relied on historical records from the 2016 Rate Case and Property Tax Reconciliations (PTR), Company responses to Staff Information Requests (IRs), forensic data[10] obtained by Reed Smith, LLP (who was hired by the Company to do a forensic audit), and interviews with certain Company personnel.

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[8] Case 16-W-0259, New York American Water, Inc. - Rates, Order Establishing Rates for Water Service (issued May 18, 2017).

[9] Case 16-W-0259, New York American Water, Inc. - Rates, Order Establishing Rates for Water Service (issued May 18, 2017), pp. 40-47.

[10] Forensic data referenced here primarily represents e-mail correspondence originated and received by Company employees and representatives.

Staff's investigation focused on three departments at American Water:

1) **Utility Plant Accounting** - where the initial errors occurred in transferring plant data from the then newly acquired Aqua New York systems into the Company's fixed asset system, PowerPlant;

2) **Tax Department** - which made erroneous filings with ORPTS by filing incorrect plant inventory tax filings in 2013, and failing to correct those errors in its 2014 and 2015 filings, despite numerous warnings from ORPTS that there were issues with the data;

3) **Rates and Regulatory Department** - whose investigation into high property tax expenses discovered the on-going error, but then chose to withhold known material facts in rate proceedings before the Commission.

THE ORIGINAL ERROR – RECORDING INCORRECT IN-SERVICE DATES IN ITS POWERPLANT SYSTEM

In April 2012, the Commission approved[11] NYAW's parent American Water Works Company, Inc. acquisition of the stock of Aqua America New York, Inc. (Aqua), which resulted in the transfer of seven Aqua water service districts: Merrick, Sea Cliff, Cambridge, Dykeer, Kingsvale, Waccabuc, and Wild Oaks to NYAW. NYAW's Utility Plant Accounting Department was responsible for entering the acquired companies' historic plant-in-service data into the Company's fixed asset reporting system known as PowerPlant. Aqua's historic fixed asset data could not be loaded directly into NYAW's PowerPlant system, due to the use of different data field coding and labeling between the two systems. To prepare the data for import into PowerPlant, the Company manually created a large upload template using a

[11] Case 11-W-0472, Aqua Utilities, Inc. et al. - Acquisition, Order Approving Stock Acquisition (issued April 20, 2012).

Microsoft (MS) Excel spreadsheet (4,303 rows by 18 columns). Then Aqua's asset data were entered into the template by adding, changing and moving columns to match the Company's PowerPlant system's database format. During the manual data input process, an inadvertent partial or incomplete sort of the data fields resulted in vintage year in-service-date data being erroneously attributed to plant values. The shuffled vintage year error went undetected by the Company. Although the Company did check to make sure the sum of the assets values from Aqua's spreadsheet equaled the total assets values imported into its PowerPlant system, critically the Company never verified or tested any other data fields it entered into the PowerPlant system. NYAW did not realize that in the conversion process the "in_service _year" and "eng_in_service" columns were accidentally shuffled, using the Excel sort feature, from the related plant data in the other columns of the database. Since the in-service date is a critical component of the ORPTS's Reproduction Cost New Less Depreciation (RCNLD) valuation methodology, the shuffling of this data had an impact on NYAW's 2013 assessed values. As it turned out, the erroneous in-service dates had a material impact on the aggregate assessed value of the Company's taxable assets, thereby materially increasing the Company's annual property tax expense.

In late 2013, when notified by the Tax Department that there might be vintage year errors, the Utility Plant Accounting Department promptly looked into the matter. Utility Plant Accounting identified and fixed the problems in the PowerPlant system, and notified the Tax Department in January 2014 that the errors were corrected.

NYAW Proposals to Prevent Errors in Data Transfers

The table below summarizes data transfer process improvements that NYAW and Reed Smith propose going forward (details in Appendix A).

Actions and Proposals by NYAW and Reed Smith To Improve NYAW's Data Transfer Process (Details in Appendix A)	
New Data Verification Process	Document and place controls on Secondary review process
Review for potential automation of import process	Document standardized process for importing data
	Staff training for importing data

Prior to the data conversion error, NYAW maintained an acquisition checklist of steps the Tax Department should take both pre- and post-acquisition as well as a control document that describes the steps the Utility Plant Accounting Department should take to import acquired data into PowerPlant.[12] The procedures and controls in place at the time the error occurred did not prevent this error from happening. Staff finds the Company's data accuracy review process was particularly lacking, since it appears it only double checked to be sure the total plant balance matched, and did not spot-check to ensure other fields in the data base were transferred properly.

Commission regulations require utilities to maintain plant in-service data for the entire useful life of assets which may be as long as 70 years. This is critically important data to the Company and there is significant reliance on this information for tax filings and the rate setting process. It is imperative to take precautions when transitioning this data, to ensure it is accurate and complete. The only check the Company

[12] NYAW response to Staff IR JW-1.16, Attachments 5 and 6.

performed to ensure the accuracy of the data on the process was a check of the aggregate plant balances, which proved to be insufficient.

The Company plans to implement a new data verification process, to document and place controls on a second review process, and to create a standardized process for importing data. The Company also plans to conduct an employee training program for importing data. Staff believes implementing these steps will help ensure that the plant data entry process in the future is accurate, and if a mistake is made that it will likely be discovered and remedied in the review process.

ERRONEOUS INVENTORY REPORTS FILED WITH ORPTS IN 2013, 2014 and 2015

The assessed market value for the majority of NYAW's taxable property is determined by ORPTS, and is based on the utility's self-reported original cost value and vintage year of the assets, or the inventory filings. Since valuation of utility property is a highly specialized process, many municipalities and school districts rely on ORPTS' assessed values for local taxation of utility property. The RCNLD valuation method is the appraisal approach used by ORPTS to determine the assessed market value of utility assets for taxation purposes. ORPTS' market value assessments are based on the original costs and vintage year of investments (year plant is placed in service) as reported by New York utilities. The vintage year original cost data is adjusted by ORPTS to determine the cost to reproduce the asset in the current year. Depreciation is then accumulated from the in-service year and the RCNLD result is the assessed market value. The Tax Department is responsible for filing the plant in-service

inventory report with ORPTS. Three employees within the Tax Department handled the inventory report filings with OPRTS: a Senior Tax Accountant, who reported to the Supervisor in the Tax Department, who in turn reported to a Manager in the Tax Department. The Manager was responsible for reviewing and signing off on the annual "Utility Inventory Submission Verification" forms.

On May 30, 2013, the Company submitted its calendar year 2012 asset inventory reports to ORPTS (the 2013 filing). ORPTS assigned four employees to review the seven former-Aqua Company 2013 filings - Merrick, Sea Cliff, Cambridge, Dykeer, Kingsvale, Waccabuc, and Wild Oaks. Staff reviewed all the emails between NYAW and the ORPTS in May through December 2013 and found no evidence that the ORPTS reviewers questioned the 2013 filings for Kingsvale, Dykeer, Wild Oaks and Cambridge. However, ORPTS did raise questions about the install (or vintage) years for Cambridge in the 2014 asset inventory reports. For the Merrick, Sea Cliff and Waccabuc 2013 filings, ORPTS did raise issues regarding the install years not matching what was previously filed by Aqua.

Staff counted twenty e-mails where the ORPTS reviewer notified NYAW's Tax Department that something was wrong with the vintage year data, or other data in its filings. NYAW's Tax Department, however, told ORPTS again and again that the data reported in the previous Aqua filings must have been incorrect (While some e-mails included in this report are edited for length, the only redactions are people's names, in order to protect their privacy):

Sea Cliff's 2013 Filing E-Mails- NYAW's Tax Department and ORPTS

June 10, 2013 – ORPTS Reviewer to NYAW Tax Department - "Many install years on both the Mass and Structure inventories submitted do not even resemble what Sea Cliff has reported to us in the past. The install years, as they have been reported, previously are all listed on the Turn Around Documents we have included with this communication. You will have to make the determination if so many of the install years reported in the past were incorrect."

June 12, 2013 – NYAW Tax Dept. wrote back to ORPTS and stated, "[i]t seems to be that in the past Aqua reported some of those inventories using incorrect vintages [referring to install years]. We have automated the process and using the data received during the company acquisition. I have noticed that some of the assets acquired in the 1900s were reported as acquired in 2005 and 2009. I will put some of those assets in the retirement columns and put in the right ones. Swis codes location will be identified a [sic] corrected."

On June 17, 2013 – NYAW Tax Dept. sent back the Inventory Turnaround Document Report writing: "As you can see, Aqua reported most the vintages incorrect. Our reporting reflects the information received during our acquisition back in May 2012."

For Sea Cliff, ORPTS ultimately accepted NYAW's incorrect 2013 inventory filing.

Waccabuc's 2013 Filing E-Mails- NYAW's Tax Department and ORPTS

September 20, 2013 – ORPTS emailed NYAW's Tax Dept. stating that ORPTS needed the Company to submit the inventory for Waccabuc in Excel format. "In addition we should stay with the account numbers you used last year. If you could show your additions and/or retirements using last year's inventory we will be able to compare the changes from last year to this when we run our reports. I enclose all of the mass and structure data we have on our system. This will be useful to you as it gives install year. I enclose the balance file (5.1) from our system as well. You can see that the totals per each account on the mass and structure files equal the figures we have on last year's control balance report."

October 2, 2013 – ORPTS emailed NYAW's Tax Dept. after receiving Waccabuc's inventory in excel format stating: "I think we might be better off if you submit to us a transaction file….I

suggest this because what you have sent cannot be loaded successfully into our system…. Give us just the changes from the previous year. If anything was retired give us the additions….I think a full inventory now is only slowing us up. For a full inventory the information you give us has to match up with what we have when you do a retirement. What you summitted does not."

October 21, 2013 - ORPTS emailed NYAW's Tax Dept., stating, "I ran the full inventory you sent to me in development. That is where we can test things while we are off line. It looks like the changes you made will increase your values significantly. It looks like your highway side will see a 276% increase in RCNLD."

October 28, 2013 - ORPTS emailed NYAW's Tax Dept. attaching reports. "I hope these shed some light on the subject. It appears there has been a change in Install Years for Mass inventory and Structure…. You might want to look into this."

November 7, 2013 - NYAW's Tax Dept. emailed ORPTS stating, "[i]n addition current review indicates that there are multiple errors for 'Install Years' or 'Vintage years' when asset data was uploaded in our system when Waccubac [sic] was acquired by American Water. I am in the process of discussing this issue with our fixed asset group."

November 15, 2013 - NYAW's Tax Dept. emailed ORPTS: "I am meeting again with our fixed asset group concerning our errors for install years uploaded in our system after the acquisition. Please match the costs reported to you to the previous install years reported by Aqua-Waccabuc while we rectify the install years in our system."

ORPTS responded to the email, "I will do that change [sic] the install years where I can. In many instances I cannot with any certainty change the install years on the submitted inventory. The inventory is very dissimilar to what we had on our system prior. I will do this Monday."

Merrick's 2013 Filing E-Mails- NYAW's Tax Dept. and ORPTS

August 15, 2013 - NYAW's Tax Dept. emailed ORPTS stating that it was "…trying to utilize prior year Aqua's - NYWS annual Inventory report provided by [redacted] to determine Location/facility/sub facility for the costs reported. With the transition to American Water filling this return after the

acquisition of the former Aqua Co.. we are faced with various challenges reconciling what Aqua filed with what the asset detail that was provided to us at the close of the company. Install Years for various accounts do not tie with what we received after the acquisition."

ORPTS responded with the "structure file as of year 2011 and our location listing for NY Water Service."

August 23, 2013 - NYAW Tax Dept. emailed ORPTS stating that the "Structure reports provided [by ORPTS] has install years that are not on our report."

September 12, 2013 - ORPTS emailed NYAW Tax Dept. stating "I am sending you the inventory that we have in our database for New York Water Service. Our inventory does not agree with the inventory that you sent in for New York Water. Please review the enclosed inventory. We somehow need to reconcile the inventory that you have and what we have in our database."

ORPTS continued, "[t]he install years and asset additions that you have are not found in our database and it makes it hard for me to try and reconcile what we have to the inventory that you are sending in. That is why I am asking you to look at what we have and try to reconcile our inventory to what you are reporting."

Additionally, ORPTS stated, "[t]he problem with some of your install years is that they have never reported by Aqua."

NYAW Tax Dept. told ORPTS that "[e]verything reported is coming straight from our asset management software system Power Plant which also prepares our returns pulling all the info needed such as Install years and additions. Our return process is not manual and I believe Aqua's return preparation was manual."

ORPTS rejected NYAW's Tax Dept. suggestion stating, "I also process Long Island Water and have been processing the company the past 4 years. We have had trouble reconciling the inventory that you send with the inventory in our system because your Power Plant had some things wrong. We need to come to some sort of agreement about the inventory for NY Water because I cannot process the inventory that you sent in because it is so different than what we have in our database. It is the company's job to make sure that the inventory is correct. You have to look at the inventory that I sent from Aqua and reconcile it to the

inventory that you sent from NY Water to discover the differences."

NYAW Tax Dept. responded that it "…will need detailed asset listing from Aqua that they sent you not **structure/ mass** report to validate that we have the wrong vintage years in our system. We cannot go and change install years in our system just to accommodate Aqua filling not knowing what kind of internal reviews, procedures, practices and controls that ensured that they reported complete and accurate data to you. I am confident in our Asset management system, data and the controls in place for reporting. I recommend that you discontinue what you have in your data base from Aqua and build upon what we have reported to you."

September 13, 2013 - NYAW Tax Dept. reiterated its confidence that its data was correct stating, "I repeat.. we are very confident in the information that we are providing you, the process and controls that we have in place to ensure compliance. I have demonstrated this to you by providing a clear transparent record. I realize that this might be difficult for your work but I cannot validate the accuracy of the previous data that was provided to you by Aqua and recorded in your data base. I am not in a position to misrepresent our data and records to accommodate what was reported to you by Aqua. I request that you discontinue your historical data from Aqua and complete the necessary clean up to move forward providing as a fair assessment based on what we own as demonstrate[d]."

September 16, 2013 - ORPTS stated that "[a]lso, I had a hard time matching your location description and our description because the install years did not agree at all. This file is the best that I could do considering the costs and install years were totally different."

October 4, 2013 - ORPTS emailed NYAW Tax Dept. stating that "[a]fter discussing New York Waters' inventory with [redacted], we have decided to cancel the conference call on Monday, October 7th. We just need you to verify that the inventory you sent us for New York Water is the most detailed asset listing that you have. When we receive that verification, I can proceed with processing your company."
NYAW Tax Dept. confirmed that what the Company sent represented the most detailed listing.

October 11, 2013 - ORPTS emailed NYAW Tax Dept. stating, "[m]y main concern with the inventory is the disregard of the

inventory that New York Water has previously sent to us. I know that you feel that the inventory that you sent in this year is correct and everything that the New York Water sent us in previous years was incorrect. I do not believe that. The inventory that you sent in for 2012 did not agree with the PSC report that you sent in for 2012. When companies send in inventory and financial statements, our job is to reconcile the inventory to the financial statements. That is the only way we can verify that the inventory is correct. When it does not agree, it is the company's responsibility to find the discrepancies to make sure that the inventory and the financial statements reconcile."

November 14, 2013 - ORPTS emailed NYAW Tax Dept. stating, "I was able to reconcile the mass assets to their original install years. I was not able to do that for the structure inventory. You will have to reconcile the structure inventory to their original install years."

Cambridge's 2014 Filing E-Mails- NYAW's Tax Dept. and ORPTS

July 10, 2014 - ORPTS emailed NYAW's Tax Dept. stating that the inventory for Cambridge was "…out of alignment with last year's reporting." ORPTS asked for correct mass, structure, and balance files in Excel format.

August 28, 2014 - NYAW wrote ORPTS, "[l]ast year, there were a lot of acquisitions and the system was not streamlined, that caused some differences but this year we are trying to align every account as per the PSC and avoid differences in the future. Please adjust as per the excel sheet attached below given all the install years and various accounts and all belong to SWIS Code 532289 town Outside of Villages."

September 4, 2014 - ORPTS emailed NYAW's Tax Department stating, "[w]e have nothing comparable to what you have by install year. Refer to the above referenced pic and the 2012 Control Balance Report. I attach what we have on our system for this account…. Your inventory does not line up with ours either by install year or amounts…. You will have to use ORPTS records to show us how this is to be accomplished. Your records do not align with ours with regards to install year or amounts."

October 27, 2014 - NYAW's Tax Dept. emailed ORPTS Stating "[u]nfortunately we can't help you validate or confirm what you have in your records with what the previous owner (Aqua) filed.

I recommend that you adjust to our fillings for this and other inquiries that you may have to expedite your inquiries.

ORPTS responded, "[w]e will not change what we have in our records until you can prove to us that what we have is not correct. As is we will proceed with what we have on our system. In short, we do not need you to help us 'validate or confirm' our records. It is up to you to prove that our records are wrong. We have what Cambridge has given us over the years for inventory. The records we have were supplied by Cambridge employees whose job it was to supply the mass, structure, and balance files each year. You will have to file a complaint to contest this."

October 27, 2014 - ORPTS emailed NYAW's Tax Department stating, "[t]here were accounts out of balance at the end of last year partly because we had to move forward with processing. We will not adjust our records to conform to the records Aqua gave you. Our records are what was given to us year by year by Cambridge."

October 29, 2014 - ORPTS told NYAW's Tax Dept. "[i]f you plan on insisting we change our records you need to correspond with [redacted] and [redacted] [ORPTS supervisors]."

November 25, 2014 - ORPTS sent NYAW's Tax Dept. what ORPTS had on their system for Cambridge. "Let me know by end of business today if the movement of inventory looks correct. If I do not hear from you I will wrap up company processing tomorrow."

The e-mail interactions between ORPTS and NYAW's Tax Department demonstrate an atmosphere where NYAW's employees didn't seem to care about doing their job accurately, effectively or professionally. The employees in NYAW's Tax Department seemed indifferent to developing correct information for ORPTS, or how incorrect data would impact the Company and its customers. As this was the first time NYAW was making tax filings for the acquired former Aqua companies, extra care and review of the data should have been warranted. However, the Tax Department employees displayed arrogance and unwarranted certitude in the numbers they put forth even when it was pointed out several times, for several of the companies, that the

numbers appeared to be incorrect. ORPTS pointed out, repeatedly, that the vintage years appeared incorrect or were different than in previous Aqua filings. Nevertheless, the Tax Department employees, apparently without checking back to source documents, just kept asserting that their numbers were correct and that Aqua's previous filings must have been wrong. Even when the Tax Department employees became aware that "State Assessors have indicated that there will be large property tax impact due to these variances", they did nothing to make sure that all of the fillings were corrected. When the Merrick and Waccabuc filings were adjusted by ORPTS, the NYAW Tax Department inexplicably never amended any of the other Aqua-related filings or challenged the tentative assessments. The Merrick and Waccabuc matters with ORPTS provided a clear signal of the problem to the Tax Department and the Company, and again put them on notice of the issue.

ORPTS provided New York American Water's Tax Department tentative assessments in early 2014, based on the 2013 filing. Tentative assessments come with a hearing date 45 days later at which the assessment can be challenged by the utility or an assessing unit. If ORPTS receives a challenge, it holds a hearing. If ORPTS determines that the tentative assessment should be revised, it submits a recommendation to the State Board of Real Property Tax Services for a decision on the final assessment.[13] NYAW did not have procedures in place to review or challenge the tentative or final assessments. This is a simple and basic control, that NYAW's Tax Department should

[13] The State Board's final assessment can be challenged by filing a petition in the Supreme Court for the county where the special franchise property is located.

have had in place, which would have shown the steep increase in assessed values in time for something to be done about it.

There also was very little communication both within the NYAW Tax Department and between other Company departments. The two employees interacting with ORPTS were told time and time again that their vintage year numbers appeared to be off, but they never raised that concern with their immediate supervisor who is responsible for signing off on the filings. The employees were warned of the large property tax impacts, but apparently did not feel any need to inform their supervisor, the Rates and Regulatory Team or the President of the New York operating company. The supervisor, who has the responsibility of signing off on the filings, was apparently not engaged in the process to the level he/she should have been. If a supervisor is to sign off on a process, he/she has the responsibility to ensure it is correct, and that his/her subordinates have reported all relevant and material details.

In November 2013, near the end of the filing process with ORPTS, one of NYAW's Tax Department employees did ultimately communicate with the Utility Plant Accounting Department that the in-service years / engineering dates varied from Aqua's data. With that notification, the Utility Plant Accounting Department immediately fixed the data in the PowerPlant system. On January 23, 2014, after the PowerPlant data corrections were made, NYAW's Information Technology Services Department sent a report to the Director of American Water's Tax Department and the Manager of General Tax, who signed off on the faulty ORPTS filings, that stated, "This request is to update the Engineering In Service and In Service dates on specific NY assets that were part of the NY

acquisition. These assets were originally loaded with incorrect dates."

The Tax Department received this update in time to challenge the 2013 tentative assessment, dated February 6, 2013, with ORPTS within the 45-day deadline, but instead did nothing. What is even more inexplicable, is that for the next two years, 2014 and 2015, NYAW's Tax Department only filed plant "additions and retirements" for the preceding calendar years with ORPTS. There is no evidence that the Company attempted to correct the underlying error with ORPTS' base numbers in its 2014 and 2015 filings. Merrick and Cambridge, whose underlying data was corrected by ORPTS the year before were the exceptions. Despite the Tax Department reporting the problem to the Plant Accounting Department and receiving a report back in January 2014 that the problem was fixed, the tax filings were not revised and corrected by the Company. In the 2014 and 2015 filings with ORPTS, NYAW Tax Department only submitted "additions and retirements" reports, so the underlying problem with the full inventory report submitted in the 2013 filing was never corrected, and the error was perpetuated. Then, throughout the 2014 and 2015 filings, ORPTS continued to bring up issues with "install years", and those concerns continued to be ignored and were never raised to the Manager in the Tax Department.

NYAW Proposals to Prevent Future Tax Filing Errors

The table below summarizes tax filing process improvements that NYAW and Reed Smith propose going forward (details in Appendix B).

Actions and Proposals by NYAW and Reed Smith To Improve NYAW's Tax Filing Process (Details in Appendix B)	
Systems Integration	Review and Valuation of Property Tax Determinations
Evaluation and Improvement of Reporting Methodology	Calendaring and Appeals Process Map
Comparison and Analysis with Prior Year Filings	Defined Appeals Roles and Communication with Rates Group
Third-Party Consultant Review	Process for Communicating Adverse Appeal Determinations
Process Mapping	Hiring/Staffing
Policy and Training - Non-Routine Government Correspondence	

There were numerous things wrong with NYAW's Tax Department's management, processes, and actions or lack thereof. The employees with direct interaction with ORPTS lacked proper supervision, did not communicate critically important information to their supervisors, and it appears that they prioritized getting the tax filings completed, instead of getting them correct. They were also stubbornly insistent that they were correct, when time and time again ORPTS pointed out issues with their filings. The Tax Department also did not perform basic variance analysis that could have picked up these errors in time to be able to appeal the tentative assessments. The Tax Department also did not communicate and/or interact effectively with the Plant Accounting Department, NYAW's Operating President, or the Rates and Regulatory Team.

The Company did have an eleven-step written process in place on how to prepare the property tax filings. Also, prior to submitting an ORPTS filing, the NYAW Tax Department was required to complete a "review notes lead sheet" for filing and a package for management review. The review notes lead sheet

requires signatures by the return preparer, a reviewer, and the Tax Director. As part of this review, the reviewer must confirm whether there is a variance between the Company's accounting system (SAP) and its PowerPlant - Fixed Asset module (PPFA), and, if so, the amount of the variance. The review sheet also contains fields for listing the total estimated tax attributes (cost, reported amount, assessment amount, tax rate, and tax amount) for the current year and the total actual tax attributes for the prior year. It appears that the Company did not follow many of its formal written processes or procedures during the 2013-2015 time period.

The Company has since initiated changes to help ensure there are no errors in its tax filings with ORPTS. These changes include integrating its property tax systems, evaluating and improving its reporting methodology, comparing prior year filings, mapping its process that lists steps, decision points and constraints, and training for non-routine government correspondence.

The Company is also implementing changes to its property tax challenge procedures which will include, reviewing and evaluating assessments and tax determinations, mapping the appeals process and statute of limitations deadlines, defining appeals roles and communications with the rates group and developing a process for communicating adverse appeal determinations.

NYAW's and Reed Smith's proposed changes should improve the property tax filing process, reduce the possibility of errors, and the implementation of a review and appeals process, will likely catch and rectify errors before it's too late.

WITHHOLDING MATERIAL FACTS IN RATE PROCEEDINGS

Staff's investigation on the Company's withholding of material information in rate proceedings focuses primarily on the members of the Rates and Regulatory Team who knew of the material errors and failed to disclose that information in rate proceedings before the Commission. Staff's focus was on this group, because this segment of NYAW is responsible for making regulatory filings and responding to questions from the regulators and other interested parties. It should be noted that when it comes to withholding material facts in Commission proceedings, it is the responsibility of the Company, as a whole, not any one department to ensure filings and representations made are materially accurate. There were four rate proceedings that were impacted by NYAW's erroneous tax filings - the 2016 Rate Case, and three Property Tax Reconciliation (PTR) filings, in 2015, 2016, and 2017[14] (collectively, the Four Cases), which were made in compliance with the Company's then current rate plan. From the information Staff reviewed, it does not appear that the Rates and Regulatory Team was aware of the underlying errors in the 2015 PTR filing.

[14] Case 11-W-0200, Long Island Water Corporation d/b/a Long Island American Water - Rates, New York American Water Company, Inc., f/k/a Long Island Water Corporation, Compliance Filing (filed October 30, 2015 for rate year ended March 31, 2015), RPCRC Mechanism Reconciliation for the Rate Year ended March 31, 2016 Case No. 11-W-0200 (filed June 1, 2016 for rate year ended March 31, 2016), and New York American Water Company, Inc., f/k/a Long Island Water Corporation, RPCRC Mechanism Reconciliation and System Improvement Charge Reconciliation for the Rate Year ended March 31, 2017 Case Nos. 11-W-0200 and 14-W-0489 (filed May 31, 2017).

There were three NYAW employees who worked extensively on the Property Tax Expense issue in the Four Cases:

1) The Director of Rates and Regulatory for the Northeast Division (Director - RR) testified to the reasonableness of the property tax forecasts and reported to the Senior Director of Rates & Regulatory;
2) Senior Director of Rates & Regulatory of the Northeast Division (Senior Director - RR), who also testified in the 2016 Rate Case;
3) The Director, Corporate Counsel for the Northeast Division (NYAW Counsel).

Staff interviewed two of the members of the Rates and Regulatory Team as part of its investigation. The Rates and Regulatory Team's reasoning for not informing Staff or the Commission in the rate proceedings, was that they did not want to come forward with the problem, until they had a solution and could quantify the customer impact. When asked what they thought would happen when they finally came forward with this multi-million-dollar problem, he did not know. When asked how customers would be made whole once they came forward, they mentioned the reconciliation provision in the rate orders. These are sophisticated employees with considerable ratemaking experience; and they should know that the reconciliation mechanism trues up the rate forecast to actual property taxes paid, and in this instance the actual property taxes paid were erroneously too high. By itself the reconciliation mechanism would not have made customers whole. Although there were some e-mails indicating that at some point Company personnel intended to notify Staff, they chose not to disclose the information

during the rate proceedings. As evidence, a May 26, 2016 e-mail from a member of the team to the external tax lawyer stated, "and I would prefer to have as much information as possible on hand before broaching this topic with PSC Staff."

An August 23, 2016 e-mail from the Rates and Regulatory Team to ORPTS stating:

> Needless to say, there are several significant impacts at stake. First and foremost, the Company is currently in a major rate case for all its operating districts, and is nearing the stage where settlement discussions may occur. Having the best available information from which to project future expenses is vital in setting an appropriate level of revenues to recover such expenses from customers. Property taxes currently drive over 30% of the Company's revenues recovered from customers, 66% of which is derived from the ORPTS franchise assessments: resolution of this issue is clearly critical to the rate case.

In the end, it was NYAW's senior management and newly hired Counsel that came forward with this issue in December 2017, after the rate case had concluded. They stated in that meeting how sorry they were that this error occurred, and that it was not brought forward much sooner. They also stated that customers would be held harmless and agreed to investigate to find out what went wrong. Staff cannot know for certain, if the decision was left only to the Rates and Regulatory Team, whether they intended to ever come forward. Regardless of the Rates and Regulatory Team's ultimate intentions, the erroneous tax filings were a known material fact and that fact was purposely withheld from the records in the rate proceedings.

It is important to establish a timeline of when members of NYAW's Rates and Regulatory Team were aware that the NYAW Tax Department made erroneous tax filings and that the impact of those filings was material. The table below is a

timeline of relevant e-mails and regulatory filings and responses showing when the Rates and Regulatory Team became aware of the error, that they knew the error was material, and that the error impacted the rate case forecast and three years of PTR filings.

Timeline of the Rates and Regulatory Team	
Key: RR= NYAW Rates and Regulatory Team;	TD = NYAW Tax Department
June 1, 2015 – RR files PTR for recovery of $973K - not aware of the error at that time.	**July 1, 2016 –** RR responds to Staff IR-143 – no mention of material error
Oct. 2015 – RR becomes aware of rapidly increasing p-taxes & contacts consultant	**August 26, 2016** – RR responds to CAWS IR-1 – no mention of material error
Oct. 21, 2015 – Commission approves and defers a portion of the 2015 PTR filling which was based on affected bills for village tax	**Sept. 23, 2016** – RR files rebuttal testimony – no mention of known error
Jan. 8, 2016 - RR to TD – "They [ORPTS] are saying here that the value went from $10,604,598 to $15,636,467 (a **47% increase!)**...it's now showing the TFV is **121%** of the book value... There is something wrong here"	**Oct. 17, 2016** - Commission approves and defers a portion of the 2016 PTR filling which was based on affected bills.
Apr. 22, 2016 - email from TD notifying RR of the shuffled vintage years	**Oct 2016** – RR finds out corrections for 2016 were accepted by ORPTs
Apr. 29, 2016 – RR filed initial testimony in RC - no mention of material error	**Dec 2016** – RR responds to Staff email question after consulting with counsel
May 11, 2016 – RR contacts consultant to look into property tax error	**Jan. 9, 2017 –** RR submits JP in RC with Staff with no mention of the known error.
May 31, 2016 – RR and TD file corrected inventory reports with ORPTS	**Feb 2017** – RR receives tentative assessments from ORPTS
June 1, 2016 – RR files PTR for recovery of $1.6M and is aware that data was affected by error for village, school, and town taxes	**Mar. 8, 2017** – Hearing – RR responds to ALJ's question on the cause of increased property taxes in Sea Cliff district but does not mention known error
June 6, 2016 – RR responds to Staff IR-97 – no mention of material error	**May 18, 2017** – Commission issues Order establishing rates based on higher property tax bills.
June 13, 2016 –ORPTS, could address the issue going forward but that he did not think they could address any past special franchise values	**June 1, 2017** – RR files PTR for recovery of $2M and was aware data was affected by error for village, school, and town taxes.
June 28, 2016 – RR responds to Staff IRs-140 & 142 – no mention of material error	**October 23, 2017** – Commission approves and defers a portion of the 2017 PTR filling which was based on affected bills.
Late Spring/Summer – RR works directly with ORPTS to fix the error.	**Dec 2017** – NYAW senior management became aware of the error, came forward to Staff – promises to hold customers harmless.

In fact, the Rates and Regulatory Team was integral in hiring an outside consultant to help correct the tax errors and one of them worked directly with ORPTS throughout much of 2016 correcting the erroneous inventory filings.

On April 22, 2016, NYAW's Tax Department forwarded an e-mail dated November 14, 2013, to the NYAW witness testifying to the accuracy of the Company's property tax forecast. The e-mail stated, "in service years / engineering dates provided by Aqua varies with the dates we have [in PowerPlant]. State assessors have indicated that there will be a large property tax impact due to these variances."

This was a week before the NYAW Rates and Regulatory Team filed testimony in the 2016 Rate Case, on April 29, 2016. There was no mention of this very material fact in its initial testimony, nor was there any mention in the Company's rebuttal testimony filed on September 29, 2016.

Utility witnesses submitting testimony in a rate proceeding are expected, even before the testimony is sworn to, in the pre-filed statements, to fully disclose all information relevant and material to a proceeding. (16 NYCRR §5.1) In addition, during discovery, parties are required to respond to all written information requests (16 NYCRR §5.3), and supplement or correct responses which are materially incorrect (16 NYCRR §5.7).

During its review of NYAW's property tax expenses, Staff audited all of Sea Cliff's actual historic property tax bills supporting its rate case forecast, however the property tax bills themselves do not contain information as to how the

taxing authority determined the assessed values. Primarily the only information on the bills themselves includes:

1) Parcel address
2) assessed values
3) the tax rate
4) the equalization rate

These invoices, provided by the taxing authorities, are generally seen as reliable back-up to support the Company's stated expenses. Taxing authorities are generally assumed to be unbiased and accurate in their billings, and assessed values have been reviewed and deemed proper by either the taxing jurisdiction itself or ORPTS. If the taxing authorities do make an error to the Company's detriment, the Company could challenge the unjustified tax bills with resulting tax refund passed back to customers as appropriate. It is not possible from looking at the actual bills themselves to know if they are based on erroneous information. The variance analysis performed by Staff did show large increases in both the assessed values and the tax amounts during the impacted periods. This volatility raised concerns for Staff, who followed up with multiple questions to better understand this volatility. Staff reviewed IR responses, e-mails and testimony during the rate proceeding and conducted interviews during our investigation to determine that the Company willfully misled Staff, and was evasive and untruthful when asked in several different forums the reasons for the large increases in property taxes. Specifically:

May 25, 2016 - Staff sent IR DPS-97 (10) asking NYAW's Director - RR "In the last five years, has NYAW found any instances where property taxes changed for unusual reasons other than rate changes, changes to assessed values and changes resulting from plant additions. For example, has the company received a lot more individual property tax bills than it did in past years

(regardless of whether the total amount of property taxes increased from year to year)?"

In reference to IR DPS-97(10), the Director of RR wrote to the NYAW Tax Department: "I believe the answer is no, please confirm and provide details as needed." "Can you please review below and ensure we respond by noted due date."

NYAW Tax Department responded to the group with his proposed answers to DPS-97. "I agree and confirm per our call we have not found any instances where property taxes changed for unusual reasons other than rate changes, assessments."

On June 6, 2016, the Company submitted its response to DPS-97 (10), stating, "NYAW has not found unusual instances of property tax changes other than rate changes, assessed values and changes resulting from plant additions or retirements."

As Staff's investigation has shown, this was not a truthful, candid response. This response was, at best, a misleading statement. Both the Director of Rates and Regulatory and the Tax Department knew that NYAW had made its ORPTS filings based on erroneous inventory data, that would have materially impacted property tax expenses over, at least a portion of, the last five-year period. Erroneous tax filings, are an unusual reason for assessed value changes. There was no mention that NYAW made erroneous tax filings which had a significant impact on historical property tax expenses, and therefore impacted the expense forecast. These erroneous filings greatly inflated historical expenses, which were used as the starting point to forecast the rate year expense.

In responses to Staff's IRs DPS-140, 141, and 142, the Company provided actual tax bills covering the year ended June 30, 2016. The bills provided were affected by erroneous ORPTS certificate assessment valuations, but the Company failed to mention this critical fact.

On June 30, 2016, in response to a Staff follow-up question on IR DPS 140 the Director - RR wrote:

For Sea Cliff assessments, the recently received assessment jumped significantly. This is a resulting amount per the ORPTS assessment calculation (replacement cost less depreciation via Handy-Whitman index) based on the asset report we filed for that year. We have been having some preliminary conversations with ORPTS to see what specifically drove this increase (they tend to be tough to get a hold of, and personnel changes frequently). We will keep you posted as to the progress of these discussions.

At the time of this e-mail, the Director of RR was aware of the previous erroneous filings in 2013, 2014 and 2015, and he was actively working with ORPTS to make a proper 2016 filing. Yet in the IR response, he mentions that the amounts that jumped significantly were per ORPTS assessment calculations. He does mention that those calculations were based on the Company's filings, yet never mentions the most important fact - that he knows those filings were faulty.

On December 2, 2016 DPS Staff emailed the Director of RR:

In looking at the details of Sea Cliff Property taxes something big happened in 2014 for the Village of Sea Cliff and in 2016 at Oyster Bay and North Shore School District. For the Village of Sea Cliff - the assessed value went from $11M to $22M. For the North Shore School District, we see the drastic change in 2016 when the assessed values go from $13M to $18M. For Oyster Bay the assessed values also go from $13M to $18M in 2016.
One of the big culprits seems to be parcel [listed parcels].

It appears that this is the same piece of property.
For the Village it goes from $6.6M to $11.7M in 2014
For the school it goes from $6.6M to $11.7M in 2016.
For Oyster Bay it foes from $6.6M to $11.7M in 2016
Also in 2014 the Village added six new parcels in 2014 that added $800K to the assessed values. I don't see similar parcels being added on the school side or Oyster Bay. We need to understand this.

[redacted], do you know the reason for the large increase for this parcel? It is Special Franchise property, but it doesn't look like right-of-way property because logically you would expect increases for right-of-way to go up gradually over time as mains are replaced? not in one fell swoop? in 2014 or 2016. Was new plant added to this parcel?

The Director of RR sought assistance from his supervisor, in-house Counsel, and its outside tax consultant to answer this question. They knew at the time that the cause of the increases in assessed values was due to the erroneous tax filing, but failed to mention anything about it in the following response:

The Company has outstanding judicial challenges on Village of Sea Cliff property assessments other than the special franchise assessments which are created by ORPTS and not the Village. As previously noted, the Company is working with ORPTS to review their special franchise assessment calculations. You won't be able to directly correlate the Village assessments and bills to the School/Town taxes because the Village of Sea Cliff is a separate assessing unit from Nassau County with its own assessment roll and it only levies village taxes on its village assessments. The school and town taxes are levied using the Nassau County assessment roll which is totally different and separate from the Village assessment roll.

As I mentioned to [redacted], the School/Town S9F property is the ORPTS generated special franchise assessment on the Nassau County roll, and it coincides with the Village parcel 751D which is the ORPTS generated special franchise assessment that you cited on the Village assessment roll. The increase in this assessment is a primary reason we reached out to ORPTS to review their calculations that result in the special franchise assessments.

Also as I mentioned below, the Company reported its asset detail differently than Aqua had, which may be why the 5 new parcels showed up for the Village bills - they are not necessarily for new assets, but we provided more granular asset locations than was previously done, which caused a further breakdown in the tax bills. These new assessments match up to the values reflected in the ORPTS advisory appraisals that were provided to the Village. An assessing unit such as the Village of Sea Cliff can request that ORPTS provide an advisory appraisal on utility property and equipment that is subject to

assessment on the local roll. The Village does not have to use the ORPTS appraisals and can instead use their own assessments for this property.

I recall mentioning briefly to you during the case that we were working with ORPTS to review their calculations. I was hoping we would have some results available during the case, but it looks like we won't have answers from them in time. Of course, should the Company be able to achieve a favorable recalculation, the benefits would flow back to affected customers in the PTR and any applicable tax refund.

The Company was asked directly what was causing the increased assessed values and again it withheld critical information relevant to the pending rate application with a full understanding that Company errors were the principal driver of the higher assessments.

The e-mails below indicate that the Director RR indeed knew, as of October 8, 2016, that revised lower assessments were underway.

On October 17, 2016 -, NYAW Tax Dept. e-mailed Director of RR stating, "Please see attached. I will need to send files to [redacted] by Wednesday this week." Director of RR responded, "Is he accepting the 2012 reports as you filed? I'm ok with these files as long as they cover what you discussed with [redacted]."

On October 18, 2016 - NYAW Tax Dept. wrote to Director of RR: "He agreed to use the install years reported by aqua in his system prior to our reporting in 2012 and adjust for any new additions with a 2012 install years." Director of RR responded: "So he is updating to our correct Aqua 2012 vintage? He's using the 2011 vintages and updating for adds and retirements in 2012-2015?" NYAW Tax Dept. wrote back, "yes."

In January 2017, ORPTS sent the Company "tentative assessments" using the corrected data, which showed significantly lower assessed values, based on the corrected 2016 inventory filings. On February 6, 2017, NYAW Tax Department e-mailed the Director of Rates and Regulatory the Long Island, Sea

Cliff, and Cambridge tentative assessments from ORPTS. They were dated January 25, 2017, with a hearing date of March 9, 2017.

On March 8th 2017 at the Evidentiary Hearing in support of the Joint Proposal, the Administrative Law Judge (ALJ) asked:

"And could you provide me just a little bit of understanding about what's driving the property tax levels in Sea Cliff?"

The Direct of RR answered:

> There's a number of factors. Part of it is the -- the capital improvements we're doing which was baked into our projection. So the more capital improvements we do, the higher the value of the assets and the higher the assessments end up. There's also a very large energy supplier who is decommissioning their plant in Sea Cliff, which is a very large tax base for that area. And as they're a utility company and we're in that class of customers, those need to be allocated across that class. So we've seen large spikes as they've decommissioned their plant and lowered their value. And I guess then, on top of that, there's the regular changes in assessment and valuations of our property. It's a relatively high valued property area, parts of our system. A lot of properties along the shore and things like that, so it's a higher than normal assessments compared to some of the other parts of our system, as well.

The ALJ recognized the significance of the extraordinary spike in the Company's property tax expenses. At the hearing regarding rate recovery, the ALJ asked specifically what was driving the property tax burdens. The Company failed to disclose the principal driver of the tax burdens it was seeking to pass on to customers in its sworn testimonial response to the ALJ. The Company blamed the large increases on capital improvements, the decommissioning of a power generating plant, and higher than normal assessments compared to other parts of its system, but did not mention that the Company was

responsible for three years of erroneous tax filings. Certainly, after receiving Sea Cliff's tentative assessments from ORPTS on February 6, 2017, the Rates and Regulatory Team definitively knew there were significant decreases in assessed values based the corrected 2016 OPRPTS filings.

Based on the body of evidence that Staff reviewed, there is no doubt that the Company's Rates and Regulatory Team was intimately aware of the material impact of the errors, as well as the correction of the assessed values at the time of the hearing, yet they chose not to disclose the information, even when asked directly for the reason for the tax increases. The team knew of the error before filing testimony in the rate cases, and never updated the record as more information became known to the Company. In fact, the team was involved with the Company retaining a consultant and worked directly with ORPTS throughout much of 2016 to correct the filing errors. In interviews, the employees who withheld information from the DPS Staff claimed that they intended to notify the Commission, but did not want to come forward until the problem was fixed and the tax impacts could be accurately quantified. Whether these statements are true or not is irrelevant; it does nothing to correct the damage that was done by allowing the incomplete information to affect the Company's rates and tax reconciliation accounting.

Shortly after American Water's senior management, and the newly hired in-house counsel, became aware of the situation and the magnitude of the impact of the errors, the Company came forth in December 2017, admitting that it made several tax filing errors, which impacted rate proceedings, and promised that customers would be made whole for the impacts of its errors. The Company hired an outside law firm, Reed Smith, to

perform a forensic audit, and thoroughly investigate what went wrong and how they could avoid something like this from reoccurring in the future. The Company has been very cooperative with Staff during the investigation. Moreover, the Company was very open and briefed Staff at appropriate intervals during its internal investigation of the issues that led to these errors.

NYAW Proposals to Improve its Rate Case Process

The table below summarizes rate case process improvements that NYAW and Reed Smith propose going forward (details in Appendix C).

Actions and Proposals by NYAW and Reed Smith To Improve NYAW's Rate Filing Process (Details in Appendix C)	
Internal Compliance and Ethics Review	Creation of New York Senior Manager, Rates & Regulatory Position
Review of Rate Case Management Processes	NYAW Increased Management Oversight

While NYAW's Tax Department shares blame, it was the Rates and Regulatory Team's actions that Staff finds most egregious. Knowingly and purposefully withholding such material information from Commission proceedings, even when directly asked, is inexcusable. Withholding this information, materially hindered Staff and the Commission in fulfilling their statutory duties to establish just and reasonable rates for customers. In Staff's opinion, the failure to disclose was not a result of the Company's negligence, which is itself troubling, but rather, of the Company's intent to deceive. The integrity of the rate process relies heavily on utilities being forthcoming with relevant and material information. Utility witnesses submitting testimony in a rate proceeding are expected, even before the

introduction of sworn testimony, to be honest in pre-filed statements and to fully disclose all information relevant and material to a proceeding. (16 NYCRR §5.1). In addition, during discovery, parties are required to respond to all written information requests (16 NYCRR §5.3), and supplement or correct responses which are materially incorrect (16 NYCRR §5.7). The excuse that they did not have an adequate solution to the problem, or could not accurately calculate its precise impact, is irrelevant as to whether it should be disclosed. In the rate setting process, it is incumbent on the utilities to bring forth all relevant and material facts.

In addition to intentionally not revealing material facts in the rate proceedings, it appears that this material information was not shared beyond a few individuals on the rates team. One would expect that something this material and important would have been shared with supervisors, the rest of the rate team and certainly the President of NYAW.

In fact, in 2016, American Water conducted a review of its Compliance and Ethics Program, which recommended a dedicated position of Chief Compliance Officer and increased the number of dedicated staff to support the program. American Water has conducted annual ethics training based on its Code of Ethics since 2008. American Water's Code of Ethics requires that "[a]ll American Water dealings with government officials should be marked by honesty and professionalism." The Code of Conduct also states that "you should never, under any circumstances:… withhold information or make misleading or false statements to government investigators." In cases where an employee determines that a course of action may present an ethical issue, American Water's Code of Ethics instructs employee to contact their supervisor, department head, president, the chief ethics

and compliance officer, human resources, or the legal department. Yet the rate team apparently did not follow the Company's own ethics protocol.

As part of its review, Staff considered corporate policies that may unintentionally motivate employees not to disclose relevant material information to their supervisors and regulators. American Water has an "Annual Performance Plan" (the Plan, or APP), that reflects the Company's pay for performance philosophy. The Rates and Regulatory Team employees were eligible to receive an APP award of up to 20% of their annual earnings, based on their individual performance and the Company/Division meeting performance metrics described in the Plan. The financial performance part of the Plan was a goal of hitting the Company's/Division's Earnings Per Share (EPS) targets, which were weighted at 50% of the overall goal. It is plausible that the employees may have been influenced not to disclose information that would negatively impact the District's EPS, given that a reasonably large part of their compensation was directly tied to the District's EPS metric.

To address the issue of withholding material information in rate proceedings, the Company plans to review areas where it can reinforce adherence to its Code of Ethics, review and improve its rate case management process, establish a rate case steering committee to enhance management oversight of rate cases and other significant regulatory matters. The Company also plans to create a new senior Manager of Rates and Regulation dedicated to New York State.

As already explained, the Company had in place a Code of Ethics that addressed this specific type of issue and it also provided annual ethics training, yet this violation of specific ethical codes still occurred. The steps the Company put in

place will help address this issue in the future, but we would also like to see some additional steps to ensure employees working on cases in New York are specifically made aware of past violations of ethics. Specifically, American Water should:

- Shortly after the annual ethics training is taken by NYAW employees, and/or American Water employees who work on NYAW cases, the President of NYAW should make known that he/she expects all employees to be aware of the Ethics Code, that it is important, and if employees ever have any questions or dilemmas they are always welcome to discuss them with him/her, or another appropriate person, such as the Chief Compliance Officer.
- American Water's Code of Ethics gives specific examples of "Ethics in Action", where hypothetical real life ethical situations are discussed. The next time the Ethics Code is updated, a situation similar to what occurred here should be used as one of the "Ethics in Action" examples and it should be a regular part of the training.
- The Company should review its "Annual Performance Plan" and determine if EPS and/or other financial metrics are appropriate.

PTR ADJUSTMENT RELATED TO THE UPSTATE COMPANIES

The incorrect inventory filings with ORPTS also affected the acquired upstate companies (Cambridge, Dykeer, Kingsvale, Waccabuc, and Wild Oaks), resulting in property tax overpayments. However, these rate districts did not have a reconciliation mechanism set forth in the previous rate plan. Therefore, any property tax overpayments caused by the reporting errors for those rate districts prior to April 1, 2017, or the start of the current rate plan, were absorbed by the

shareholders, and were not passed along to customers. NYAW's current rate plan provides a property tax reconciliation mechanism for the Service Area 1 District, which includes these districts. The Company's inflated property tax bills as a result of the reporting errors would be relied on for the actual reconciliation process. For the upstate companies, we estimate the error related excess expense amounts to be $3,150 in Rate Year 1 (April 1, 2017 through March 31, 2018) and $324 in Rate Year 2 (April 1, 2018 through March 31, 2019). In order to ensure customers are held harmless for the impacts of the tax reporting errors, the customers should be credited these amounts when the Company makes its related Property Tax Reconciliation surcharge filing.

CONCLUSION

NYAW's senior management came forward with this issue once it became aware of the error. Since they came forward, the Company has demonstrated its commitment to holding customers harmless for its errors. The Company also undertook a rigorous examination of itself to identify what went wrong and committed to improve its policies and processes to ensure something like this does not happen in the future. It has also been very cooperative and transparent in working with Staff in its investigation. However, the investigations uncovered serious failings and communication breakdowns in three of the Company's Departments[15]:

1) Utility Plant Accounting,

2) The Tax Department,

[15] It should be noted that six of the employees most directly involved with these failings are no longer employed by the Company.

3) The Rates and Regulatory Team.

The original error by the Utility Plant Accounting Department could have potentially been avoided with better written procedures, and controls to verify that the data are transferred properly. The information related to these acquired assets is critically important to the utilities records and government filings, and should be afforded proper care. The Utility Plant Accounting Department did act promptly to correct the error once they were made aware of it. Further, NYAW is implementing a plan address the problems it found with the data transfer process.

The Tax Department had many significant problems. The employees with direct interaction with ORPTS lacked proper supervision, did not accept the analysis of ORPTS, did not communicate critically important information to their supervisors, and it appears that they prioritized getting the tax filings completed, instead of getting them correct. In a time of change, when new companies were coming on board for the first time, they were stubbornly insistent that they were correct, when time and time again ORPTS pointed out issues with their filings. They also did not properly review and analyze the tentative assessments to see how much the assessments changed year over year. If they became aware of these large increases when the assessments were received, they could have appealed the assessments within ORPTS's 45-day appeal process. They also did not communicate and/or interact effectively with the Plant Accounting Department, NYAW's Operating President, or the Rates and Regulatory Team. There were fundamental persistent failures. As shown in Appendix B, the Company is implementing a plan to address the short-comings of the Tax

Department to ensure that something like this does not happen again.

The most serious finding of Staff's investigation is that the Company's Rates and Regulatory Team intentionally withheld material facts in the rate proceedings. If such behavior is not properly and swiftly addressed, it may encourage other utilities to act in a similar fashion. Honesty, candor, and integrity are essential to the Commission's regulatory process. Therefore, while the rate effects of the error will be reversed and remedied, Staff recommends the Commission consider further enforcement actions, including requiring the Company to hire an independent monitor and reviewing whether certain costs associated with the Company's failures should be paid for by shareholders rather than ratepayers.

Appendix A

Actions and Proposals by NYAW and Reed Smith To Improve NYAW's Data Transfer Process

Category	Process, Procedure, and Control Improvements	Anticipated Implementation Date
Property Tax Data Importation	American Water plans to implement more robust data verification to reduce the risk of propagating data errors. American Water's data verification process requires employees to verify the integrity of imported data by comparing the revised data for import against the source data received from the acquired entity on an aggregate basis—such as comparing the total value of all acquired assets in each data set. American Water will revise its processes to compare additional data points so that imported data is verified against source data on a line-by-line basis. American Water also intends to create a procedure to obtain property tax records from tax administrators and/or tax return information from an acquired utility when it acquires assets that were previously subject to property tax. American Water will implement processes to compare imported data against tax filings and government records. The process will create a second level of data verification, allowing American Water to verify data integrity of import data against two independent data sources.	12/31/18
Property Tax Data Importation	American Water's process for preparing data for importation into PowerPlant after an acquisition is primarily a manual process performed by American Water employees. American Water plans to engage a third-party consultant to review its PowerPlant systems and provide recommendations for creating automated processes, including scripts and queries, to reduce the risk of human error. To the extent that automation is implemented, American Water will draft and implement additional controls for verifying that any automated processes are followed and maintained.	12/31/18
Property Tax Data Importation	American Water plans to implement two new controls to address secondary review during data importation. First, American Water will create a new process for supervisor/manager review of import data. This will include a checklist of verification steps that must be completed by a supervisor/manager before importing data into PowerPlant. Second, American Water will implement a new control that requires a second individual to review all data before it is imported into PowerPlant. Thus, if a supervisor or manager level employee prepares the data for importation, that supervisor/manager will not also be permitted to import the data into PowerPlant. Instead, a second employee will be required to follow the new reviewer data verification processes described above and then import the data into PowerPlant.	6/30/18
Property Tax Data Importation	American Water plans to implement a single, standardized process for importing data to reduce the risk of similar types of errors occurring in the future. Specifically, American Water will develop a process map that lists the steps, decision points, and constraints in importing fixed asset data before, during, and after an acquisition.	9/30/18
Property Tax Data Importation	American Water plans to conduct an internal training for all employees who are involved with importing data from acquisitions into PowerPlant (or who supervise employees with that role) to explain the new procedures, processes, and controls.	12/31/18

Actions and Proposals by NYAW and Reed Smith To Improve NYAW's Tax Filing Process

Category	Process, Procedure, and Control Improvements	Anticipated Implementation Date
Property Tax Compliance	American Water has engaged a consultant to assist in integrating its property tax systems. American Water is working with this consultant to create direct interfaces between SAP, PPFA, and PPPT. This integration will eliminate several labor- intensive steps in the return preparation process that are currently performed manually.	Already implemented
Property Tax Compliance	American Water is refining its ORPTS reporting process to address ORPTS's concerns regarding the level of detail and content of its filings, as well as consistency with prior filings. American Water is engaging ORPTS in pre-filing discussions to ensure that its final filings are acceptable to ORPTS.	Already implemented
Property Tax Compliance	American Water plans to revise its property tax reporting process to include new procedures. American Water will compare current year property tax data against prior year filings on an asset-by-asset basis. If a variance is discovered, American Water will prepare documentation explaining and reconciling the variance before submitting the current year filing. After an acquisition, this comparison will also include the acquired utility's prior year filings to the extent that the acquired utility previously filed returns.	Already implemented
Property Tax Compliance	American Water has engaged a consultant to review its property tax preparation process. The consultant will review whether queries or other software automations can be implemented to improve asset-by-asset comparison. American Water also intends to hire a consultant familiar with ORPTS practices and procedures to review and provide suggestions regarding filing procedures. Finally, American Water intends to engage a consultant to review and provide feedback regarding process maps.	Already implemented
Property Tax Compliance	American Water plans to create a process map that lists the steps, decision points, and constraints in preparing an ORPTS filing. This process map will address the process for corresponding with ORPTS after submitting a filing, including analyzing correspondence from ORPTS and preparing responsive turn around documents. American Water's new process maps will be informed by the recommendations of the outside consultant.	12/31/18
Property Tax Compliance	American Water is developing written protocols for responding to non-routine government correspondence. These protocols will establish guidance for responding to non-routine government correspondence as required, as well as appropriate internal communications and elevation of issues for review. Once finalized, American Water will disseminate and provide training to relevant personnel on these protocols.	9/30/18
Property Tax Compliance	American Water is recruiting for a candidate with property tax experience for a supervisor level position ("Supervisor – Property Tax") in its corporate tax function. American Water has already posted for the position. American Water intends to fill this position with an individual with the experience to supervise its property tax compliance function, including ORPTS compliance.	Already implemented

Actions and Proposals by NYAW and Reed Smith To Improve NYAW's Tax Filing Process

Category	Process, Procedure, and Control Improvements	Anticipated Implementation Date
Property Tax Challenges	American Water plans to modify its process for reviewing and valuing significant changes for New York property value assessments and tax determinations. This will include processes for identifying the cause of material changes compared to prior year filings, and for flagging these changes for review by tax management prior to expiration of appeal deadlines. Additionally, American Water will create a process to ensure that copies of incoming property value assessments and tax determinations are received by appropriate personnel.	9/30/18
Property Tax Challenges	American Water plans to create a process map for New York property tax appeals. This process map will include processes for calendaring statute of limitations deadlines and elevating issues to managers for review. This process map will also include a reference chart with a summary of the methods to challenge a property tax determination, including relevant statutes of limitations.	9/30/18
Property Tax Challenges	American Water plans to implement a process assigning responsibility for preparing and managing New York property tax appeals through the Tax Department. American Water has already implemented a new process for communicating status regarding tax matters between tax and the rates team by designating a Tax Department employee as a "point of contact" for each rate case and creating a process for setting rate case kick-off meetings and subsequent regular update meetings to address issues relevant to the rate case. American Water has also instituted a new process for tax point of contacts to attend American Water's in-house rate school.	9/30/18
Property Tax Challenges	American Water plans to create a process for the Tax Department to communicate adverse New York property tax appeals determinations to appropriate managers in the Tax Department, as well as to American Water stakeholders in other groups including rates.	9/30/18

Actions and Proposals by NYAW and Reed Smith To Improve NYAW's Rate Filing Process

Category	Process, Procedure, and Control Improvements	Anticipated Implementation Date
Rate Cases	As part of its Compliance and Ethics Program, American Water conducts annual ethics training based on its Code of Ethics. All employees are required to attend the training and completion of the training is required for eligible employees to receive annual performance compensation. In addition to this annual ethics training, American Water's Compliance and Ethics Program conducts additional ethics training, including roundtables on ethical decision making that are presented to all functions and subsidiaries within American Water.	Already implemented
Rate Cases	American Water provides in-house training regarding rate cases through its rate school. In-house rate school is a two-day seminar that provides an overview of public utility regulation and the ratemaking process. The rate school curriculum introduces the general regulatory framework for utilities and proceeds to track the life cycle of a rate case. In-house rate school is recommended for employees that are either directly or indirectly involved in rate cases.	Already implemented
Rate Cases	American Water adopted a RACI (Responsibility, Accountable, Consulted, and Informed) methodology that defines specific roles for rate case employees, and lines of communications between rate case employees. For each step in the rate case process, the RACI methodology requires the rates team to assign individuals responsible for completing defined tasks, individuals who are accountable for ensuring completion, and individuals who must be consulted for their expertise before an item is completed. RACI also requires the rate case team to identify individuals who must be kept informed of each item.	Already implemented
Rate Cases	American Water has developed revised rate case project management and process guidance documents for use across all company-owned utilities. These documents are memorialized in a template developed by American Water that is required for use in all rate cases. The template contains calendaring and organizational documents for use by rate case team members. The template includes checklists for compliance with company best practices, a responsibility assignment matrix for RACI project management as discussed above, Gantt charts, task and filing requirement lists, defined lists of rate team members with assigned responsibilities, rate case timeline, and links to the master task lists.	Already implemented

Actions and Proposals by NYAW and Reed Smith To Improve NYAW's Rate Filing Process

Category	Process, Procedure, and Control Improvements	Anticipated Implementation Date
Rate Cases	Under the new standardized rate case procedures, American Water assigns a tax liaison and an accounting liaison to each rate case. The tax and accounting liaisons serve as points of contact who are responsible for communicating information between the rate case team, tax, and accounting during a rate case.	Already implemented
Rate Cases	American Water holds a "kick-off meeting" prior to initiating a rate case that includes all stakeholder groups (including the tax liaison and the accounting liaison) to discuss the rate case, define roles, and identify issues that may impact the rate case process. Revised rate case best practices include regular update meetings that include relevant company stakeholders.	Already implemented
Rate Cases	American Water, through its Chief Compliance Officer, will continue to review areas where American Water can further reinforce adherence to its Code of Ethics and company values.	Already implemented
Rate Cases	NYAW will review its rate case processes for potential changes to improve the capture of material outstanding issues in a rate case and to increase visibility into those issues for company stakeholders.	Already implemented
Rate Cases	American Water will create a new position for a Senior Manager, Rates & Regulatory, New York American Water dedicated to New York State.	6/30/18
Rate Cases	NYAW will establish a Steering Committee to enhance management oversight of rate cases and other significant regulatory matters. The Steering Committee will include the appropriate leadership at the State and Divisional level (e.g., NYAW President, Divisional CFO, and Divisional General Counsel) and will meet regularly during the rate case process. The Rates Team will provide status updates and present key issues to the Steering Committee. The Steering Committee will review the status updates, consider the key issues presented, make inquiries and provide direction to the Rates Team.	9/30/18