

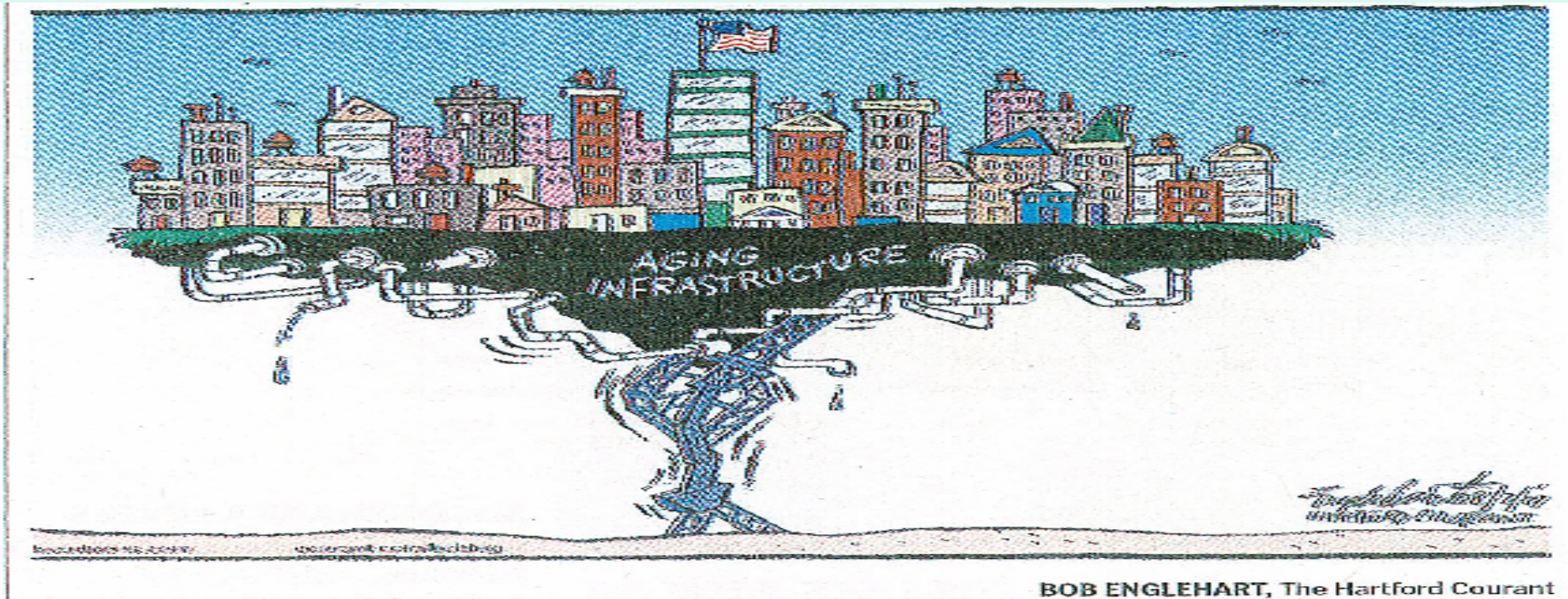


ARM's Three Legs We're Not in the 70's Anymore

Monumental MARC June 6, 2011
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The Utility Infrastructure Problem



Much of Pennsylvania's infrastructure is 70+
years old

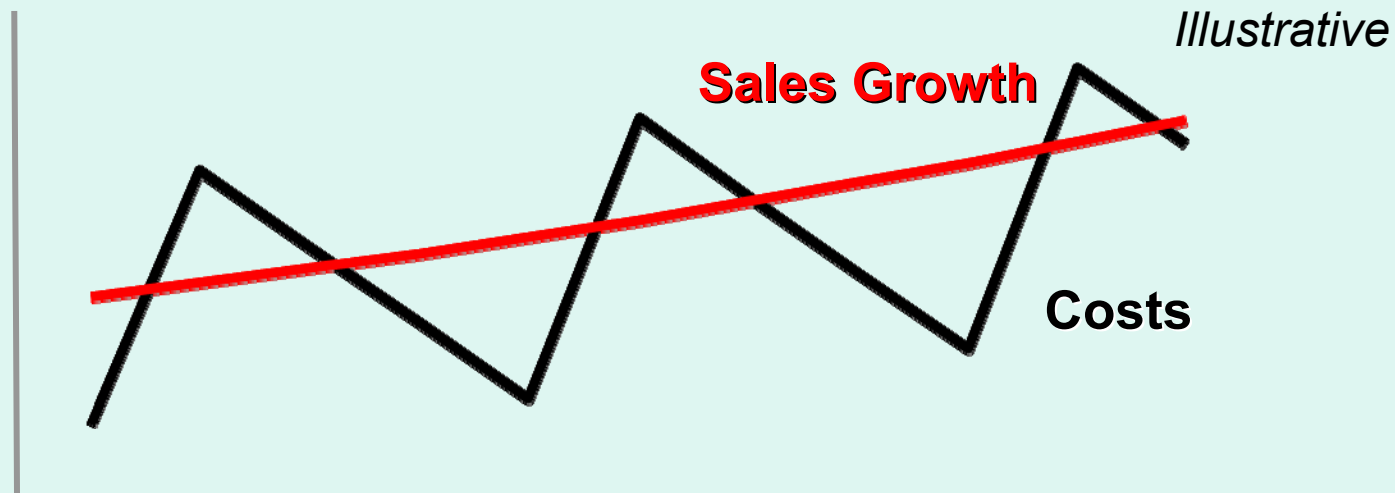
(gas pipelines, wastewater treatment systems, electric transmission
and distribution systems)

➤ Safety issue as well as an economic issue

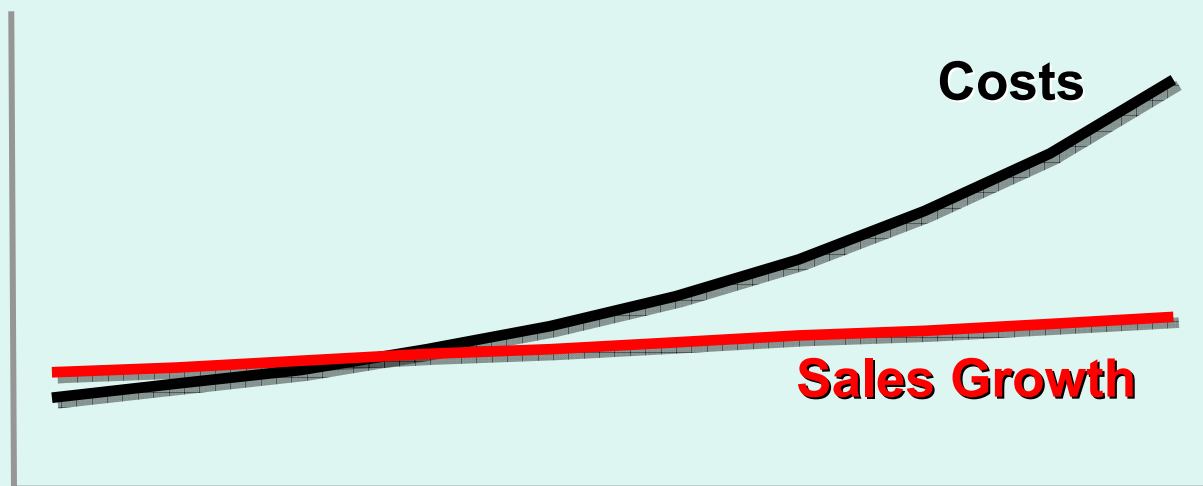


A Paradigm Shift

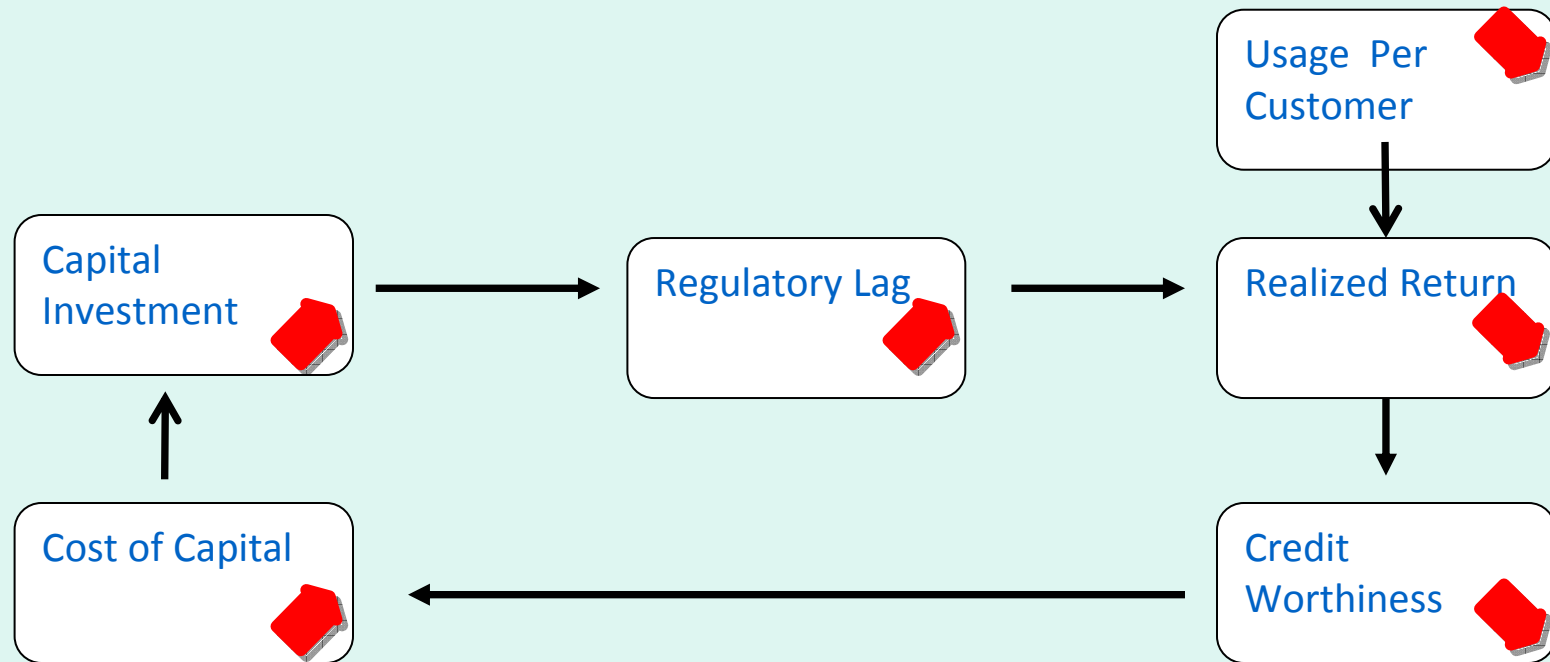
THEN... large periodic projects to support strong load growth required infrequent, but major, rate cases



NOW... Ongoing investment well above depreciation and slower sales growth requires ongoing rate increases



Overview of the Problem



Alternative Regulatory Mechanisms

ARM's Three Legs

- **Hard Tackle Regulatory Lag**
 - Future test year (1)
 - DSIC - other PA sectors/states (2)
- **Reduce WW Customers Pain**
 - Combine water and wastewater revenue requirements (3)



PA's Answer: Innovative Regulation

Distribution System Improvement Charge (DSIC)

- Surcharge that enables water companies to recover the return on and of investment in distribution infrastructure.
- PA was first in the nation to use DSIC.

➤ Benefits:

- Accelerates replacement of aging infrastructure
- Encourages proactive planning by utilities.
- Helps attract capital & reduce cost of capital.

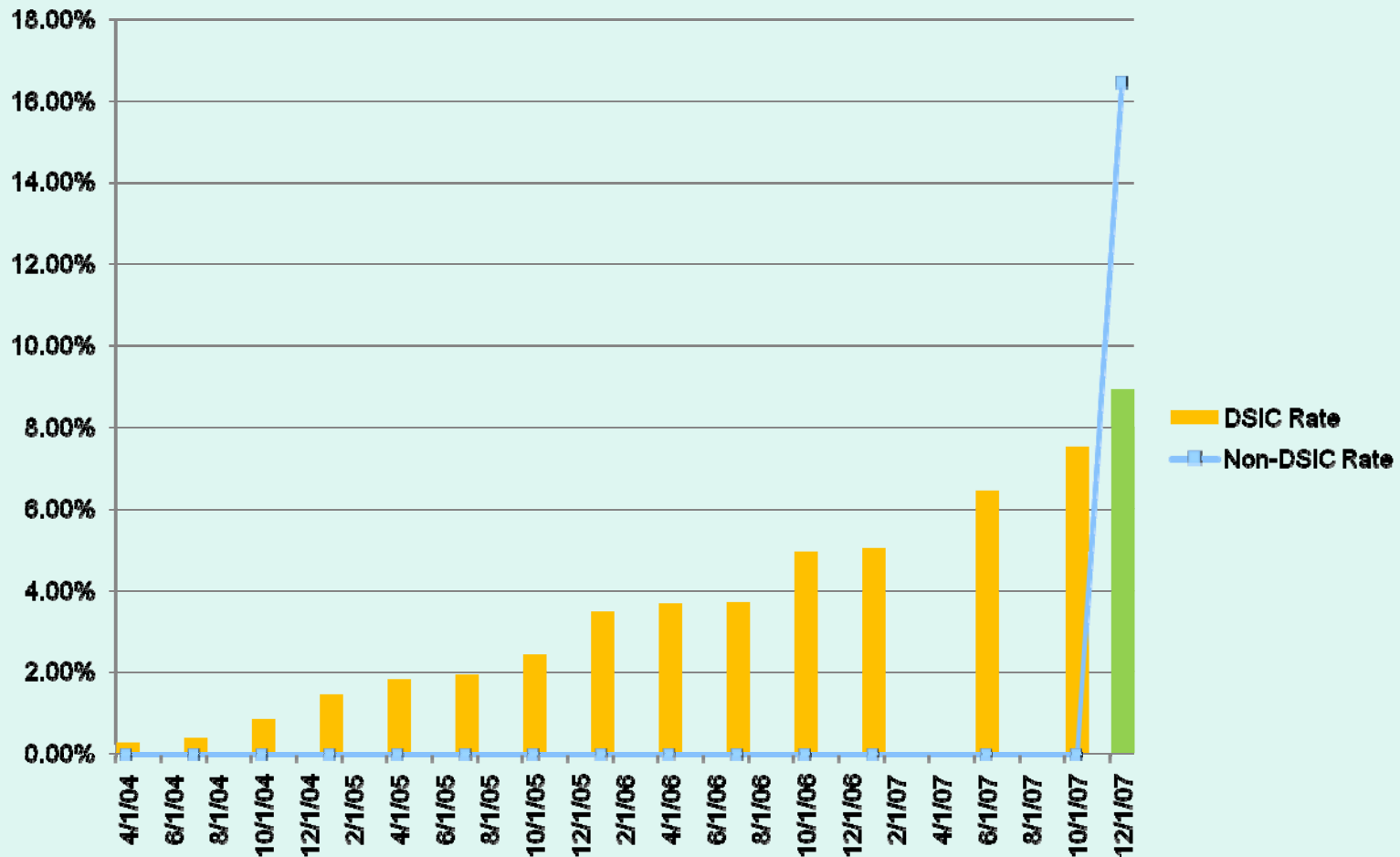
➤ Wastewater and Natural Gas DSIC

- Would apply nationally-recognized best practice in water industry to other sectors in clear need of accelerated infrastructure investment.

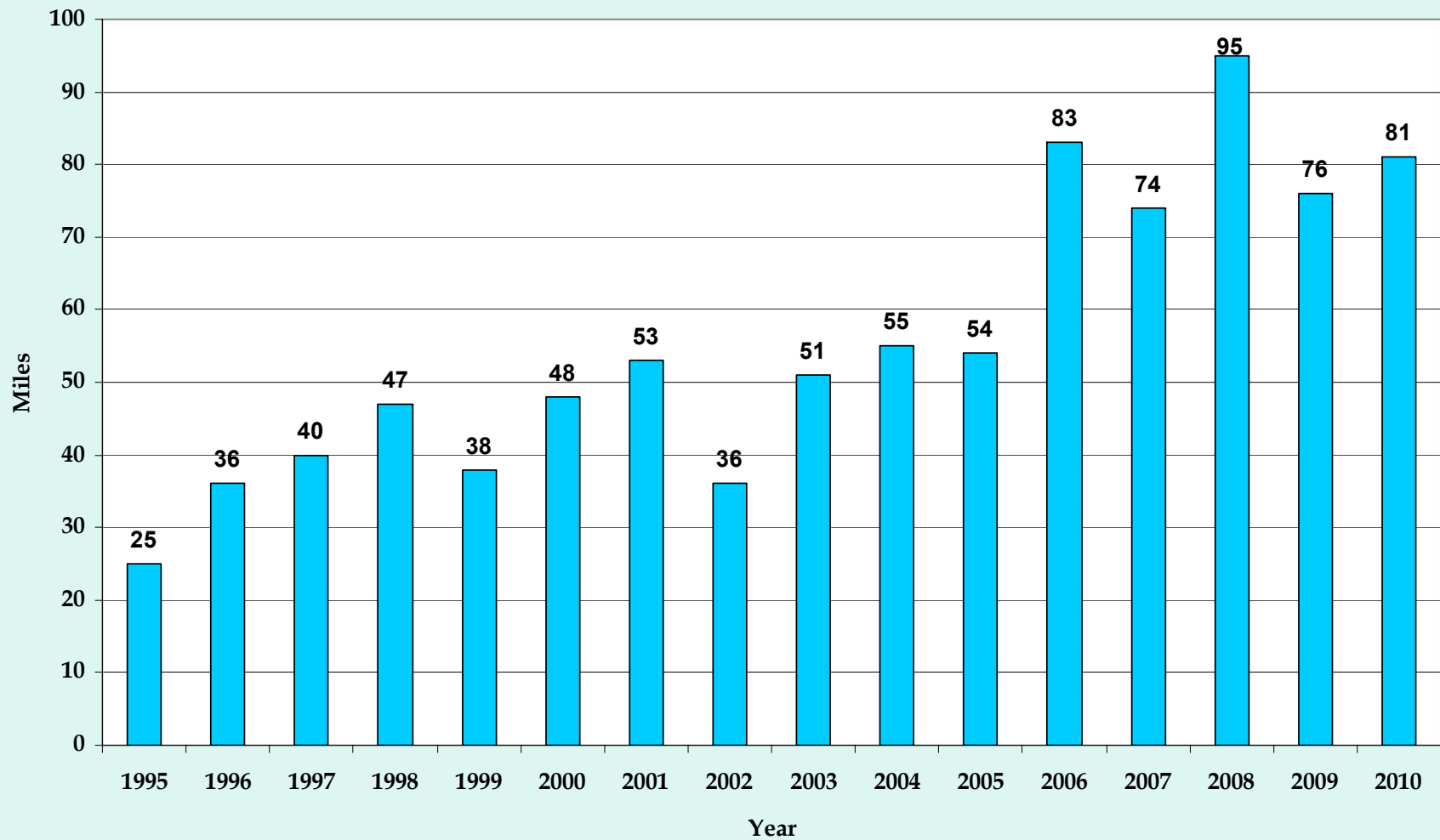


DSIC Rate Gradualism

Smaller rate increases over time



Pennsylvania American Water: Miles of Pipe Replaced



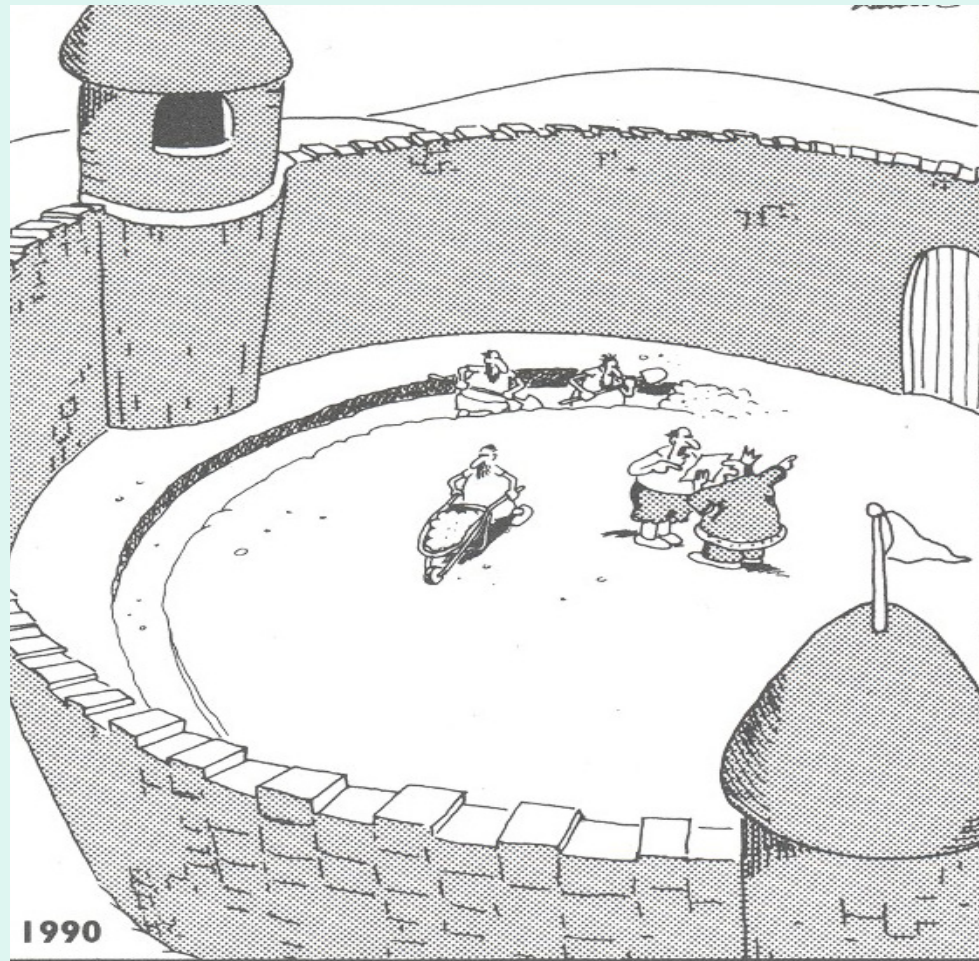
DSIC – More than a Surcharge Drives Action + Phase-In Tool

- Base Rates, over time, reduced for:

- ✓ Unaccounted for Water
- ✓ Rate Case Expense
- ✓ Capital Costs (Higher Credit Ratings)
- ✓ Capital Costs (Mitigates Future Backlog)
- ✓ Labor OT related to Main Breaks

- Other Benefits

- ✓ Promotes Economic Development
- ✓ Less Property Damage
- ✓ Less Traffic Disruption
- ✓ Facilitates Street Repaving Projects



Suddenly, a heated exchange took place between the king and the moat contractor.

Wastewater Sector

- **Not so good news**
 - More stringent environmental requirements
 - Treatment plant AND distribution system improvements needed
 - Fragmented
 - Small customer base
- **Economies of Scale Possible**
 - 2% of combined water and WW customers.
 - 50% WW increase = 1% for all

PA's Regulatory “Best Practices”

Examples of PA's Best Practices:

- DSIC
- Use of prospectively relevant test year
- Regionalization and consolidation of trouble systems
- Single tariff pricing

NARUC's*

July 27, 2005

Resolution:

Recognized these Best Practices and encouraged other regulators to adopt as many as possible

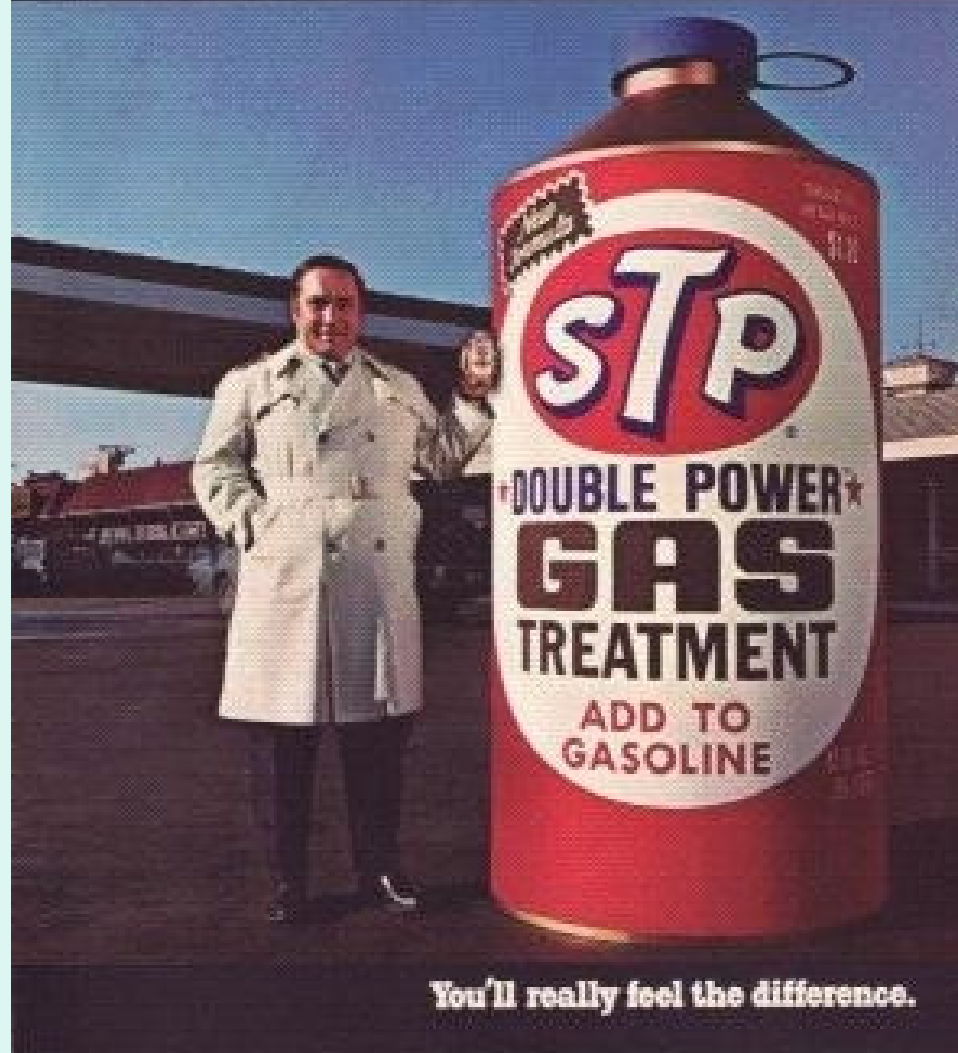
Janney Ranking of Water Utility Regulation

With its reputation for progressive regulation and status as a preferred capital destination, it's not surprising that Pennsylvania places #1 among the states included in our rankings.

Big Picture Conclusions

- Investment in utility infrastructure is critical for economic development and quality of life for customers.
- ARM's benefit companies AND customers
- Capital flows to jurisdictions that provide Regulatory Certainty.

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with power to burn.**



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