PENNSYLVANIA-AMERICAN WATER COMPANY

STATEMENT OF SPECIFIC REASONS FOR PROPOSED INCREASE IN RATES

Pennsylvania-American Water Company ("PAWC" or the "Company") is filing herewith Original Tariff Water-Pa. P.U.C. No. 5 and Original Tariff Wastewater PA P.U.C. No. 16, which bear a proposed effective date of June 28, 2020, but may be suspended by operation of Section 1308(d) of the Pennsylvania Public Utility Code ("Code") until January 28, 2021. The rates proposed in those tariffs would increase the Company's total annual operating revenues by $138.6 million over the two-year period of the multi-year rate plan proposed in this case. Specifically, the Company proposes a revenue increase in 2021 of approximately $92.4 million, or 12.9%, and approximately $46.2 million, or 5.8%, in 2022. The reasons for the proposed increase are summarized below.

RATE INCREASE

One of the factors accounting for the need for rate relief is the Company's substantial investment in new utility plant. The Company is planning to invest approximately $1.16 billion in new utility plant during the period 2020 through 2022. Moreover, by the end of 2022, PAWC will have invested over $1.64 billion in utility plant since its last general rate increase filing.

Absent rate relief, the Company's overall rate of return on an original cost basis will be only 6.31% and 5.62% as of December 31, 2021 and 2022, respectively. More significantly, the indicated return on common equity is anticipated to be 7.85% and 6.70% as of December 31, 2021 and 2022, respectively, which is obviously less than is required, by any standard, to permit a reasonable return on such common equity and to provide a reasonable opportunity for the Company to attract the additional capital required to finance needed plant additions.

Ms. Ann E. Bulkley, Senior Vice President of Concentric Energy Advisors and an expert on the subject of rate of return, has recommended an equity return rate of 10.80% and resulting overall return rates of 8.02% for Rate Year 1 and 7.95% for Rate Year 2, for the Company's water operations and resulting overall return rates of 7.46% for Rate Year 1 and 7.46% for Rate Year 2, for the Company's wastewater water operations. Ms. Bulkley's rate of return recommendations are being filed with the Company's supporting data as PAWC Statement No. 13 and Exhibit No. 13-A and may be summarized as follows:

WATER OPERATIONS

	2021			2022		
TYPE OF CAPITAL	**RATIO**	**COST RATE**	**WEIGHTED COST RATE**	**RATIO**	**COST RATE**	**WEIGHTED COST RATE**
Long Term Debt	43.88%	4.47%	1.96%	44.02%	4.35%	1.91%
Preferred Stock	0.06%	8.80%	0.01%	0.01%	9.70%	0.00%
Common Equity	56.06%	10.80%	6.05%	55.97%	10.80%	6.04%
Overall Rate of Return			8.02%			7.95%

WASTEWATER (WW) OPERATIONS

	2021			2022		
TYPE OF CAPITAL	**RATIO**	**COST RATE**	**WEIGHTED COST RATE**	**RATIO**	**COST RATE**	**WEIGHTED COST RATE**
Long Term Debt	39.44%	4.47%	1.76%	39.90%	4.35%	1.74%
WW-Specific LTD	10.14%	2.55%	0.26%	9.36%	2.60%	0.24%
Preferred Stock	0.05%	8.80%	0.00%	0.01%	9.70%	0.00%
Common Equity	50.37%	10.80%	5.44%	50.73%	10.80%	5.48%
Overall Rate of Return			7.46%			7.46%

The Company is filing herewith all of the supporting data required by the Pennsylvania Public Utility Commission's ("Commission") regulations. The Company is basing its claim principally on data for Rate Years 1 and 2 of its proposed multi-year rate plan, which is explained below, and, therefore, the discussion that follows will primarily address such data.

Pursuant to Section 1330, which was added to the Code by Act 58 of 2018 ("Act 58"), the Company is employing in this case a multi-year rate plan encompassing the twelve months ending December 31, 2021 (Rate Year 1) and the twelve months ending December 31, 2022 (Rate Year 2). The Company is providing supporting data based on an historic test year ("HTY") ended December 31, 2019, a future test year ("FTY") ending December 31, 2020, Rate Year 1, and Rate Year 2. The revenue and expense data for Rate Year 1 and Rate Year 2 have been prepared in a manner substantially consistent with the Company's most recent (2017) general rate filing and in accordance with the accepted practices of the Commission.

To establish anticipated operating revenues under the proposed rates, operating revenues for the HTY were adjusted: (1) to annualize various rate changes and to annualize additional revenues obtained from acquisitions of water and wastewater systems; (2) to reflect the trend of declining per-customer consumption; and (3) to reflect changes in the number of customers and usage by specific customers during the HTY, FTY, Rate Year 1, and Rate Year 2.

After extensive and careful review of the Company's accounts, actual operating expenses for the HTY were adjusted to reflect currently effective and anticipated changes in expense levels, as summarized in Exhibit No. 3-A, through December 31, 2022. Such adjustments capture, among other things, increases in labor (salaries and wages), changes in production costs, insurance, and maintenance costs.

Operating revenue deductions other than expenses have also been adjusted to reflect changes in taxes other than income taxes, including the General Assessments for the Commission, the Damage Prevention Committee, the Office of Consumer Advocate and the Office of Small Business Advocate. Federal and state income taxes have been calculated on a pro forma basis to reflect the effect on the Company's taxable income at the proposed rates, the various expense adjustments made for ratemaking purposes and the use of currently effective state and federal income tax rates. The Company will fully reflect the effect of changes in the Internal Revenue Code made by the 2017 Tax Cuts and Jobs Act ("TCJA") and also proposes to flow back to customers excess accumulated deferred income taxes created by the reduction in the federal corporate income tax rate from 35% to 21% and the regulatory liability it recorded to reflect the effect of TCJA tax changes for the period January through June 30, 2018.

Annual depreciation charges included for ratemaking for major plant accounts have been calculated using the straight-line remaining life method. Provision has also been made for the deferred federal income taxes resulting from the use of the Accelerated Cost Recovery System for qualifying property additions, in accordance with the provisions of the Economic Recovery Tax Act of 1981, from the use of the Modified Accelerated Cost Recovery System for qualifying property additions, in accordance with the Tax Reform Act of 1986, from the TCJA, and from repair costs that can be deducted for income tax purposes but are capitalized for book accounting purposes.

After making the proper allowances for all necessary adjustments to determine the appropriate levels of revenue and expense for ratemaking purposes, the Company's anticipated operating income under the proposed Rate Year 1 and Rate Year 2 rates will be:

	Rate Year 1	Rate Year 2
Operating Revenues (000's)	$807,907	$848,727
Operating Revenue Deductions (000's)	$492,708	$511,253
Operating Income (000's)	$315,199	$337,474

The rate base elements that are submitted as part of this filing reflect the original cost of the Company's utility plant, as taken from its continuing property records, together with additions and retirements that occurred and are anticipated to occur each year from January 1, 2020 through December 31, 2022. The Company's claim for accrued depreciation applicable to original cost has been determined on the basis of the ratemaking book reserve, consistent with the procedures approved by the Commission in the past. As previously noted, the resulting claim for depreciated utility plant in service encompasses the Company's planned investment of approximately $1.16 million in new and acquired utility plant during the FTY, Rate Year 1, and Rate Year 2.

From the depreciated utility plant in service figures, the Company has deducted contributions-in-aid-of-construction, customer advances for construction and excluded property. Also deducted is the net cash working capital amount of long-term debt interest and preferred stock dividends accrued prior to payment, unamortized investment tax credits generated prior to 1971, extension deposits in suspense, contributions-in-aid-of-construction and customer advances for construction associated with the acquisition of the water assets of the former Citizens Utilities Water Company of Pennsylvania, the regulatory liability recorded for federal income tax savings associated with the TCJA for the period January 1, 2018 through June 30, 2018, other deductions, and the accumulated balance of deferred taxes attributable to accelerated depreciation and capitalized repair deductions. In addition, allowances for materials and supplies, cash working

capital, prepaid taxes net of accrued taxes, and the unamortized portion of the Company's investment in certain property obtained through acquisitions are reflected in the Company's rate base claim. As so developed, the estimated original cost measure of value at December 31, 2022 is $4,286,996,302.

Additionally, as part of its rate filing, the Company is seeking approval to implement a Regionalization and Consolidation Surcharge and a tracking mechanism for the expenses it incurs to provide pension and other post-employment benefits to its employees. The Regionalization and Consolidation Surcharge is a rate mechanism designed to adjust the Company's rates between base rate cases to reflect the additional costs it will incur to acquire water and wastewater systems under the statutory framework the General Assembly added to the Code by Act 12 of 2016. The tracking mechanism for pension and other post-employment benefit costs is designed to assure that the Company recovers neither more nor less than its actual costs to provide those benefits to its employees. The tracking mechanism will identify and record differences between actual costs the Company incurs and the amounts included in its base rates. The net difference recorded by the Company in the tracking account would be reflected in determining the Company's base rates in a subsequent base rate case.

It is evident from the information furnished above and from the voluminous supporting data filed by the Company with its proposed water and wastewater tariffs that the proposed rate increase is just and reasonable and represents the minimum rate increase necessary to enable the Company to earn a reasonable return on the fair value of its property used and useful in the public service and to maintain the integrity of its existing capital.

RATE STRUCTURE

As part of its supporting data, the Company has submitted, in Exhibits No. 12 A-H, Cost of Service Studies performed by the engineering firm of Gannett Fleming Valuation and Rate Consultants, Inc. The results of the Cost of Service Studies were one of the factors considered by the Company in developing its rate structure proposal. The principal elements of that proposal consist of the following:

- The consolidation of rate zones, where possible, such that the rates charged customers are the same regardless of geographic location;
- An increase in the low-income discount for water and wastewater customers;
- An increase of monthly service charges to be more in line with customer costs;
- The combining of a portion of the revenue requirement for wastewater operations with the revenue requirement for water operations pursuant to Section 1311(c), which was also added to the Code by Act 11 of 2012;
- A change in annual public fire hydrant rates to reflect 25% of the cost of public fire protection service, pursuant to Section 1328 of the Code; and
- The allocation of the requested rate increase in a manner designed to realign revenues by major customer classes to be more commensurate with the indicated cost of service.

CONCLUSION

In summary, the proposed increase in revenues is the minimum increase necessary to permit the Company to preserve public health and safety and to maintain the integrity of its existing capital, attract additional necessary capital at reasonable costs and have an opportunity to actually achieve a fair rate of return, particularly on its common equity capital. For these and the other reasons set forth above, the proposed rates should be permitted to become effective as filed.