COMMONWEALTH OF PENNSYLVANIA

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September 26, 2013

Rosemary Chiavetta, Secretary
PA Public Utility Commission
Commonwealth Keystone Bldg.
400 North Street
Harrisburg, PA 17120

Re: Pa. Public Utility Commission
v.
The Columbia Water Company
Docket No. R-2013-2360798

Dear Secretary Chiavetta:

Attached for electronic filing is the Main Brief of the Office of Consumer Advocate in the above-referenced proceeding.

Copies have been served as indicated on the enclosed Certificate of Service.

Respectfully submitted,

Erin L. Gannon /cmH

Erin L. Gannon
Assistant Consumer Advocate

cc: Honorable Dennis J. Buckley
Certificate of Service

Attachment
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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2013-2360798
	:	
The Columbia Water Company	:	

<u>MAIN BRIEF OF THE</u>
<u>OFFICE OF CONSUMER ADVOCATE</u>

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DATED: September 26, 2013

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I. INTRODUCTION

The Office of Consumer Advocate (OCA) hereby submits this Main Brief regarding the rate increase proposed by The Columbia Water Company (Columbia, CWC or Company).

A. History of the Proceeding

On April 25, 2013, the Company filed Supplement No. 60 to Tariff Water - Pa. P.U.C. No. 7, to become effective June 24, 2013. In this filing, the Company sought Commission approval of rates designed to increase the Company's annual base rate revenues by $773,210 or 19.2%. For the typical residential customer using 3,000 gallons of water per month, the proposed rates would increase bills from $25.03 to $30.31 per month, or by 21.09%.

On May 15, 2013, the Office of Small Business Advocate filed a formal complaint and notice of appearance in the proceeding. On May 16, 2013, the OCA filed a Formal Complaint and Notice of Appearance in the proceeding. On May 20, 2013, the Bureau of Investigation and Enforcement (I&E) filed a Notice of Appearance. In addition, the Borough of Columbia and several customers have filed Rate Protests against the proposed increase. On June 13, 2013, the Commission suspended the filing and instituted an investigation into the justness and reasonableness of the proposed rates.

The OCA issued six sets of formal discovery and filed the direct and surrebuttal testimony of three witnesses setting forth its position in this proceeding. I&E also filed direct and surrebuttal testimony. On September 3, 2013, a public input hearing was held at the Columbia Fire Hall, located at 137 South Front St., Columbia, Pennsylvania at which time 12 customers testified. At evidentiary hearings on September 5, 2013, in Harrisburg, the OCA conducted cross-examination and introduced evidence in support of its positions in this case.

Included in Appendix B is a list of testimony, schedules and exhibits submitted by the OCA and admitted into the record.

B. Summary of the OCA's Revenue Recommendation

The OCA recommends a decrease in Columbia's revenues by $320,267, as opposed to the $773,210 increase the Company has requested. See OCA Table I.

As discussed herein, the OCA proposes adjustments pertaining to the Company's proposed capital structure, the cost of equity, rate base, and net operating income claims, including PennVest plant, materials and supplies, cash working capital, miscellaneous revenues, the amortization of an acquisition adjustment, engineering expense, bad debts, membership dues, registration fees, charitable contributions, allocations to the Marietta Division, general liability insurance, officers' salaries and directors' fees and regulatory assessments. If accepted, these adjustments would result in the OCA's recommended revenue decrease of $320,267. The OCA respectfully submits this Main Brief in support of the individual adjustments that underlie the recommended revenue decrease.

Based on the evidence Columbia has provided to support its revenue claim and the applicable law, it is clear that the Company's revenues should decrease by $320,267. The OCA has accepted Columbia's proposal to allocate the approved revenue decrease or increase across-the-board to all customer classes and between the customer charge and usage charge. OCA St. 1 at 62.

The Tables reflecting the OCA's adjustments and a complete set of schedules supporting the OCA's recommendation are attached to this Brief as Appendix A. Relevant portions of unpublished Commission Orders and Recommended Decisions cited in this brief are provided in Appendix C, where they have not been previously attached to OCA or Columbia testimony.

The OCA now submits this Main Brief in support of the positions set forth in the testimony of its witnesses in this case.

II. LEGAL STANDARD

Columbia bears the burden of proof to establish the justness and reasonableness of every element of its requested rate increase. As set forth in Section 315(a) of the Public Utility Code:

> Reasonableness of rates – In any proceeding upon the motion of the Commission, involving any proposed or existing rate of any public utility, or in any proceedings upon the complaint involving any proposed increase in rates, the burden of proof to show that the rate involved is just and reasonable shall be upon the public utility.

66 Pa. C.S. § 315(a). The Commonwealth Court interprets this principle as follows:

> Section 315(a) of the Public Utility Code, 66 Pa. C.S. § 315(a), places the burden of proving the justness and reasonableness of a proposed rate hike squarely on the utility. It is well-established that the evidence adduced by a utility to meet this burden must be substantial. [Citations omitted.]

<u>Lower Frederick Twp. v. Pa. P.U.C.</u>, 48 Pa. Commw. 222, 226-27, 409 A.2d 505, 507 (1980) (emphasis added). <u>See also</u>, <u>Brockway Glass v. Pa. P.U.C.</u>, 63 Pa. Commw. 238, 437 A.2d 1067 (1981).

The Pennsylvania Supreme Court has stated that the party with the burden of proof has a formidable task to show that the Commission may lawfully adopt its position. Even where a party has established a prima facie case, the party with the burden must establish that "the elements of that cause of action are proven with substantial evidence which enables the party asserting the cause of action to prevail, precluding all reasonable inferences to the contrary." <u>Burleson v. Pa. P.U.C.</u>, 461 A.2d 1234, 1236 (Pa. 1983) (<u>Burleson</u>). Thus, a utility has an affirmative burden to establish the justness and reasonableness of every component of its rate request.

The OCA points out that Pennsylvania law is clear that there is no similar burden for a party proposing an adjustment to a utility base rate filing. See, e.g., Berner v. Pa. P.U.C., 382 Pa. 622, 116 A.2d 738 (1955) (Berner). In Berner, the Pennsylvania Supreme Court stated:

> [T]he appellants did not have the burden of proving that the plant additions were improper, unnecessary or too costly; on the contrary, that burden is, by statute, on the utility to demonstrate the reasonable necessity and cost of the installations and that is the burden which the utility patently failed to carry.

Berner, 382 Pa. at 631, 116 A.2d at 744. The Commission recognizes this standard in its rate determinations. Pa. P.U.C. v. Equitable Gas Co., 57 PaPUC 423, 471 (1983). See also University of Pennsylvania v. Pa. P.U.C., 86 Pa. Commw. 410, 485 A.2d 1217 (1984). Thus, it is unnecessary for the OCA (or any challenger) to prove that Columbia's proposed rates are unjust, unreasonable, or not in the public interest. To prevail in its challenge, Pennsylvania law requires only that the OCA show how Columbia failed to meet its burden of proof. While subtle, this critical distinction shows that parties opposing a utility in a rate proceeding need only to shift the burden of going forward to prevail.

In conclusion, Columbia must affirmatively demonstrate the reasonableness of every element of their claims and demonstrate that their proposed rates are just, reasonable, and in the public interest. The OCA will show that Columbia has failed to satisfy its statutory burden in the manner set forth below.

III. RESOLVED ISSUES

During the course of the proceeding, Columbia and the OCA reached an agreement on several adjustments. In the OCA's final tables in Appendix A, these adjustments are marked with an asterisk to show that they are not in dispute.

A. General Liability Insurance

The Company claimed a HTY general liability insurance expense of $87,712 and a FTY expense of $88,000. GDS Exh. 1 at 1-15. In response to OCA-III-50, the Company indicated that the $88,000 claim was an estimate and they since received the actual quote, which was reduced by $1,920. OCA St. 1 at 45. As a result, the OCA recommended an adjustment of $2,207 to reflect the actual claim of $85,793 (87,712-1,920). OCA St. 1 at 45. The Company, thereafter, accepted the OCA's adjustment of $2,207 to the general liability insurance expense. Tr. at 166.

In addition, the OCA initially recommended that twelve percent (or $10,295) of the general liability expense should be allocated to the Marietta Division. OCA St. 1 at 45. In his rebuttal testimony, Company Witness Lewis clarified that the claimed general and flood insurance expense "only includes the premiums associated with the Columbia Division." CWC St. 2R at 15-16. He further explained that a portion of the general liability insurance expense has already been allocated to the Marietta Division: "Our general liability and flood insurance premium in 2012 was $89,406. Of that amount, $87,712 was allocated to the Columbia Division and $1,694.00 to the Marietta Division. This allocation is based upon the actual cost of the insurance for the properties in the associated division." CWC St. 2R at 16. With this clarification, the OCA has withdrawn its recommended adjustment to allocate twelve percent of general liability insurance expense to the Marietta Division. OCA St. 1S at 29.

B. NAWC Dues Related to Lobbying

The Company claimed a pro forma expense for membership dues in the amount of $10,000. GDS Exh. 1 at 1-15. Of the claimed membership dues, invoices indicated that $4,762 was spent on National Association of Water Companies (NAWC) dues. OCA St. 1 at 25. Eleven percent of the NAWC dues, according to the invoice, relate to lobbying activity. OCA St. 1 at 25. Because lobbying activity is not a suitable expense for ratemaking purposes, the OCA recommended an adjustment of $524 to remove lobbying expenses for ratemaking purposes.[1] OCA St. 1 at 25. The Company subsequently accepted the OCA's recommended adjustment to the claimed expense for membership dues. Tr. 166. I&E made a larger adjustment which comports with the additional information contained in the two other invoices provided by the Company. See I&E St. 2-SR; I&E Exh. 2. The OCA submits that I&E's adjustment is reasonable and should be adopted as well.

C. Registration Fees

The Company claimed a 2012 expense of $40 with a pro forma increase of $516 for registration fees for conventions and meetings of industry. GDS Exh. 1 at 1-15. In response to OCA-I-47, the Company stated that the $516 increase was an error and they did not expect an increase in registration fees for conventions and meetings of industry in 2013. OCA St. 1 at 25. Consequently, the OCA recommended an adjustment of $516 to the registration fees expense, and the Company accepted that adjustment. OCA St. 1 at 25; Tr. at 166.

[1] $4,762 x 11% = $524

D. Charitable Contributions

The Company included an expense of $2,734 for charitable contributions. GDS Exh. 1 at 1-15. As OCA Witness Everette[2] testified, "[c]haritable contributions are not related to the provision of water service and should not be charged to ratepayers." OCA St. 1 at 25-26. Thus, the OCA recommended that charitable contribution expenses be removed for ratemaking purposes. OCA St. 1 at 26. Company witness Shambaugh subsequently testified that the Company accepted the OCA's removal of $2,734 in charitable contributions for ratemaking purposes. Tr. 167.

E. Purchased Power

The Company claimed a purchased power expense in the amount of $182,000. GDS Exh. 1 at 1-15. In response to I&E-RE-15, the Company provided a breakdown of purchased power sites, which indicated that the purchased power for the meter pit at the emergency interconnection with the Marietta Gravity system was charged to the Columbia Division. OCA St. 1 at 26. The OCA Witness Everette initially recommended that this expense be allocated to the Marietta Division because the purpose of the interconnection is to solely benefit the Marietta Division. OCA St. 1 at 26. In its response to OCA-IV-5, provided after Ms. Everette's direct testimony, the Company indicated that the Marietta Division is charged full tariff rates for the water provided through the interconnection. OCA St. 1S at 12. The OCA agrees with Company Witness Lewis that "[t]he Marietta Division should not have to pay full price for the water it receives if it will also then need to pay for the expenses related to treating and delivering the

[2] Ashley E. Everette is employed by the OCA as a Regulatory Analyst. She has an M.B.A. and a B.A. in Economics. She is responsible for analyzing the financial, economic, rate of return, and policy issues of various public utility filings. Her full background and qualifications are attached as Appendix A to OCA Statement 1.

same water." CWC St. 1R at 4. Accordingly, the OCA has accepted that the purchased power expense should be paid by the Columbia Division. OCA St. 1S at 12.

F. Qualified Domestic Production Activities Deduction

The Company's claimed federal income taxes did not reflect a deduction for "Qualified Domestic Production Activities." OCA St. 1 at 61. As OCA Witness Everette explained, "[b]eginning with 2007 tax year, certain taxpayers are allowed a federal income tax deduction for Qualified Domestic Production Activities (QDRA)." Id. The Company's response to I&E-RE-17 indicated that the Company anticipates that it will qualify for the QDRA deduction for the tax year ending December 31, 2013 and has calculated the amount of the deduction to be $50,476. Id. The QDRA is derived from meter sales and forfeited discounts, customer accounting, administrative, interest and depreciation expenses. OCA St. 1 at 61. OCA Witness Everette testified that the QDRA deduction should be passed to ratepayers because the deduction is directly related to ratemaking revenues and expenses. Id. The Company subsequently accepted the OCA's recommended adjustment. See GDS Rebuttal Exh. 3 (Revised) at 2; OCA St. 1S at 45.

G. Cost of Debt

The Company initially proposed a long-term debt cost rate of 5.24% but later conceded to a 5.0% debt cost rate presented by I&E. CWC St. 3 at 2; CWC 3R at 3; I&E St. 1 at 17. The OCA accepts I&E's proposal of 5.0% as the ceiling for the long-term debt cost rate. OCA St. 2S at 4-5. As discussed below, however, the OCA recommends adding "unrecognized debt financing" at a cost rate of 4.50% to calculate a long-term debt cost rate of 4.85%. OCA St. 2S at 5.

IV. RATE BASE

A. Cash Working Capital

The parties agree on the methodology to be used to calculate cash working capital for Columbia Water. Specifically, the Company has used the formula method, or one-eighth (12.5%) of operating and maintenance (O&M) expenses. GDS Exh. No. 1 at 1-17. Using this method, Columbia calculated a claim for cash working capital of $248,967. Id. Ms. Everette made an adjustment to cash working capital of $10,808, representing 12.5% of the total adjustments she recommended to O&M expenses. OCA Table II, line 16; OCA Exh. AEE-1S, Sch. 1S, line 4; OCA St. 1 at 7. This is in line with Commission practice. The Commission should ultimately modify the adjustment to cash working capital to reflect the total operations and maintenance adjustments adopted in this proceeding. OCA St. 1 at 7.

B. Deductions from/Additions to Rate Base

1. PennVest Plant

Columbia collected its PennVest debt through a reconcilable surcharge between 1997 and 2011, when the loan was retired. GDS Exh. 1 at 1-17; OCA St. 1 at 5; OCA St. 1S at 39-40, 44. In this case, Columbia has included the *undepreciated* value of the same plant in rate base.[3] OCA St. 1 at 6; OCA St. 1S at 39, 42-43; I&E St. 3SR at 4. The OCA and I&E position is that utilities may choose to finance plant additions through inclusion in rate base *or* a principle and interest surcharge. OCA St. 1S at 38; I&E St. 3SR at 4. As the OCA will discuss below, Columbia's claim is not consistent with basic ratemaking, Commission precedent or the Commission's policy statement on PennVest recovery. In fact, the same argument by the same

[3] The average remaining life of the PennVest-funded plant is 26.5 years. CWC St. 2R at 12, 13.

witness on behalf of a different utility was rejected twenty years ago. Pa. P.U.C. v. National Util., Inc., Recommended Decision at 24-28 (July 1, 1994) (NUI RD). For all of these reasons, the Company's PennVest-funded plant should not be reflected in rate base, nor should any associated depreciation expense be allowed. OCA St. 1S at 43; I&E St. 3 at 1-2. The OCA's adjustments to rate base and expense are shown on lines 14 and 17 of OCA Table II.

a. Two Methods: Rate Base or Principle and Interest Surcharge

Historically, the Commission has recognized two methods of recovery of the costs of plant funded by PennVest loans. The utility may choose to put the plant in rate base and recover the associated costs through depreciation expense and the opportunity to earn a return on the undepreciated plant over the useful life of the plant. Alternatively, the utility may choose to recover the principle and interest through a surcharge during the term of the loan. OCA St. 1 at 1S at 38. The Commission's "either or" position was established in several cases in the late 80's to mid 90's and, ultimately memorialized in its 1994 Policy Statement regarding the treatment of PennVest obligations at 52 Pa. Code § 69.363. Pa. P.U.C. v. National Util., Inc., 1994 Pa. PUC LEXIS 55 at *17 (noting that the Commission permitted plant financed by WFLB loans to be included in the rate base of York Water Company in Docket No. R-850268, Order entered Nov. 25, 1986); Pa. P.U.C. v. Shickshinny Water Co., 67 PaPUC 3, 6, 12-13 (1988) (denying utilities' requests for rate base treatment and approving a principle/interest surcharge) (Shickshinny); Pa. P.U.C. v. Lemont Water Co., R-000912114, Order (June 19, 1992) (allowing the Company to include the PennVest-financed plant in rate base instead of recovering a principle and interest surcharge) (Lemont). Consistent with those cases, Section 69.363 provides that only principle/interest may be recovered through a surcharge mechanism:

> Water and wastewater companies with outstanding PennVest obligations that have not been reflected in rates or future PennVest obligations, may establish . . . an automatic adjustment by means of a sliding scale of rates or other method limited solely to recovery of the company's PennVest principal and interest obligations.

52 Pa. Code § 69.363 (emphasis added).

Under rate base/rate of return treatment, in keeping with the basic principles of depreciation accounting and ratemaking, the utility has an opportunity to earn a return on the investment, but the amounts recovered are never reconciled to either actual loan payments or a specified depreciation expense and rate of return allowed from the prior base rate case. OCA St. 1S at 38. The debt service costs are recouped through the rate of return over the entire useful life of the plant and may be more or less than the amount necessary to repay principle and interest, depending *inter alia* on capital structure, depreciation rate and the frequency of rate increase requests. OCA St. 1S at 42; Shickshinny at 6; NUI Order at *23, 29-30. With a principle/interest surcharge, the Company recovers a higher amount in rates over the shorter term of the PennVest loan and nothing after the repayment period ends because the plant is not reflected in rate base. OCA St. 1S at 38, 40, 43; I&E St. 3-SR at 5-6 (citing NUI Order at *25-26); see also, Lemont at 31-34, 42-43, Shickshinny at 6-7 (discussing whether the utility's size and cash flow was sufficient for it to repay its PennVest debt through rate base treatment rather than a principle/interest surcharge).

In each of these cases, there was a factual determination whether the utility would be able to repay its PennVest loan under traditional rate base/rate of return ratemaking or whether principle/interest surcharge recovery over the term of the loan was required to ensure timely payments to PennVest.[4] For example, in Shickshinny, due to its small size and limited cash

[4] As summarized by the Presiding Officer in Lemont:

flow, and because the separate surcharge facilitates tracking the utility's loan repayment, the Commission determined that a principle/interest surcharge was appropriate.

> Rate base inclusion, with regard to these companies, could result in over or under recovery of these loans depending on the hypothetical capital structure, the cost of money employed, the depreciation rate recognized and the frequency of the rate increase requests. We therefore believe that the public interest would be better served by separate rate recognition of the principal and interest, rather than rate base inclusion.

Shickshinny at 6. In contrast, in Lemont, where the Commission allowed rate base recovery, the utility served more than 2,000 customers, had substantial non-PennVest rate base, adequate cash flow and a solid record in repaying its PennVest debt. Pa. P.U.C. v. Lemont Water Co., R-912114, R.D. at 32-34, 42-43 (May 15, 1992).

Further, the determination of rate base/rate of return treatment versus principal and interest surcharge is made during the case in which the plant first becomes used and useful. Other than one unique instance described below, once that determination is made by the Commission, there is no opportunity to change the methodology.

b. 1993 Settlement

In 1993, Columbia filed a request for approval of a principle and interest surcharge to recover the costs associated with a PennVest loan. Tr. 156; Pa. P.U.C. v. Columbia Water Co., R-00932594, Corrected Order (Apr. 30, 1993) (1993 Order). The OCA opposed this method of recovery on the basis that the facts did not support principle/interest methodology for this utility.

> [g]iven the size (nearly 6,000 customers) and financial condition of the Company, the Company should not be permitted to impose a debt-service based surcharge.

> The crux of the surcharge vs. rate-base repayment methodology was, in our opinion . . . that the operative factual conditions extant in this case should determine which theory should be applied.

Pa. P.U.C. v. Lemont Water Co., R-912114, R.D. at 33 (May 15, 1992).

GDS Rebuttal Exh. 1, App. B at 1 (Joint Petition for Settlement) and App. C at 2 (OCA Statement in Support). Consistent with the OCA's position and Lemont, the Commission approved a Settlement between the Company and OCA that provided for rate base recovery of the PennVest costs. 1993 Order at 3. The Commission stated:

> The primary feature of the proposed settlement was Columbia's agreement to Rate Base treatment for plant additions of $4,547,617, constituting amounts attributable to PennVest funding, rather than to apply a surcharge equal to the debt service on the PennVest Loan.

1993 Order at 1-2. Specifically, paragraph 7 of the Settlement provided:

> Regarding the ratemaking treatment of Plant in Service, the Company agrees to Rate Base treatment for plant additions of $4,547,617, constituting amounts attributable to PennVest funding, rather than apply a surcharge equal to the debt service on the PennVest Loan. The following items are also reflected in the total revenue increase proposed in this stipulation: (a) the inclusion of these plant additions in the rate base, along with a return on the increased plant at an overall rate of return of 7.27%; (b) depreciation expense computed at the Company's current composite depreciation rate; (c) reflection of increased deferred income taxes.

GDS Rebuttal Exh. 1 (1993 Settlement); OCA St. 1S at 39. The settlement language is clear: the parties agreed to rate base treatment "rather than apply a surcharge equal to the debt service on the PennVest loan." Id. (emphasis added); Tr. 153.

c. Columbia's Treatment of PennVest Costs Since 1993

The settlement rates took effect on May 1, 1993. 1993 Order at 4. In its subsequent filings (after 1997), the evidence shows that Columbia changed its method of recovery from rate base/rate of return treatment with depreciation to a reconcilable surcharge. OCA St. 1S at 39. Specifically, in its 1997 general rate increase, Columbia's first filing after 1993, the Company excluded the PennVest-funded plant from rate base, excluded the surcharge revenues and excluded the PennVest loan from capital structure in calculating its base rate revenue requirement. Pa. P.U.C. v. Columbia Water Co., R-00974007, RD at 10 (Nov. 20, 1997), Joint Petition at 4 (Oct. 27, 1997) (1997 RD); OCA St. 1S at 40.

In this case, Columbia advances the theory that it excluded the PennVest plant from the rate base in which it reflected all other utility plant but maintained a separate, additional PennVest rate base, to which it applied the rates of return and depreciation established in the 1993 Settlement.[5] Tr. 139, 145, 157-58. This treatment was neither required nor authorized by the Commission's Order in 1997 and is inconsistent with how other utilities reflect PennVest plant in rate base.[6] OCA St. 1S at 41. As a part of rate base, the PennVest plant would have earned the Company's overall rate of return and reflected changes in depreciation methods, adjustments to accumulated deferred income taxes and annual increases to the depreciation

[5] The parties agreed on a PennVest-specific rate in the 1993 case because the revenue increase related solely to the Company's proposed principle/interest surcharge. 1993 Order at 3. The initial rates of return and depreciation were intended to become irrelevant because the Company would have reflected the PennVest-funded plant in rate base thereafter and it would have been addressed just like any other plant in service in subsequent general rate cases. See OCA St. 1S at 38, 41-42.

[6] As described by OCA Witness Everette:

> When PAWC or Aqua fund capital additions using PennVest loans, the plant is recorded as depreciable plant and is depreciated accordingly. In the companies' next base rate case, the companies include that plant in rate base so that they may depreciate the PennVest-funded plant as any other plant and have the opportunity to earn a return on the investment, just as they would any other plant investment. When calculating the companies' rate of return in the rate case, the PennVest debt is included in the capital structure. This same procedure is followed in every rate case throughout the life of the PennVest-funded plant. That is, the PennVest-funded plant is included in rate base along with all other plant. The accumulated depreciation on the PennVest-funded plant is subtracted from rate base along with the accumulated depreciation on all other plant. The depreciation expense is calculated on the PennVest-funded plant in the same manner as all other plant. Finally, the outstanding balance of the PennVest loan and the interest rate on the loan is fully reflected in the capital structure.

OCA St. 1S at 41. Although PAWC and Aqua were used as specific examples, this process is the same for any water or wastewater utility that has used or will use rate base/rate of return recovery for its PennVest-funded plant. See, e.g., Pa. P.U.C. v. Emporium Water Co., 208 PUR4th 502, 509 (2001); Lemont at 1.

reserve on the PennVest plant. Id. at 42-43. In contrast, Columbia's PennVest-only rate base has a fixed "income target" for the remaining useful life of the plant. Tr. 139.

In 1997, Columbia also began reconciling the separate PennVest rate "to ensure it hit its rate base/rate of return income target." Id. The Company argues that this reconciliation is still based on rate of return rather than principle/interest. Tr. 139. The 1997 Settlement of that case tied the surcharge increase to PennVest payments, however, stating that the Company was "significantly under-recovering adequate revenues to repay the PennVest loan." 1997 RD, Joint Petition at 5. The 1997 settlement also provided that the Company would annually revisit the PennVest surcharge, "in order to 'true-up' recovery under such surcharge." Id. As discussed by OCA Witness Everette, rate base treatment does not provide for true-up or reconciliation:

> Under rate base/rate of return regulation, these companies have the opportunity to earn a return on the investment, but amounts recovered are never reconciled to either actual loan payments or a specified depreciation expense and rate of return allowed from the prior base rate case. The debt service costs are recouped through the rate of return.

OCA St. 1S at 42.

Columbia reconciled the amount of the surcharge at least four more times during the loan period, in 2001, 2003, 2005 and 2007. OCA St. 1S at 40, 44 and App. A. The subsequent cases are explicit that surcharge recovery was being reconciled to the annual repayment amount and, therefore, not to a rate base/rate of return income target. The Settlement of the Company's next base rate case in 2001 states specifically that the surcharge was calculated to recover the Company's PennVest loan payments through a surcharge reconciled to the annual repayment amount.

> Revenue for repayment of the Company's PennVest loan is recovered in rates charged to customers through a surcharge of \$0.79 per 1,000 gallons that is imposed on all usage on a volume basis. For rate purposes, the revenue from the PennVest surcharge is excluded from base revenue, and associated capital costs are excluded from the rate base. Because the annual revenues required to repay

> the PennVest loan remain static and the Company's volumes of water sold have increased, the surcharge amount is being lowered to $0.72 per thousand gallons on all usage on a volume basis.

Pa. P.U.C. v. Columbia Water Co., R-00016423, Columbia Statement in Support of Settlement at 3, ¶5 (Oct. 17, 2001). The Commission's Orders in 2003 and 2005 also show the Commission understood Columbia's surcharge to be recovering principle and interest. The Orders stated:

> This decrease in the surcharge is necessary to bring the Respondent's surcharge collections into alignment with its PennVest obligation. The surcharge rates, most recently applied, have caused a surplus to accumulate and while the proposed rate of $0.66/1,000 gallons will generate fewer funds than necessary to meet the PennVest payments, it will allow the surplus to be drawn-down within approximately 3 years.

Pa. P.U.C. v. Columbia Water Co., R-00038428, Order at 1-2 (July 17, 2003).

> This increase in the surcharge is necessary to bring the Respondent's surcharge collections into alignment with its PennVest obligation. The current surcharge rates have resulted in an under collection of Columbia's PennVest liability and the proposed rate of $0.68 per 1,000 gallons will generate sufficient funds to meet the PennVest payments.

Pa. P.U.C. v. Columbia Water Co., R-00050611, Order at 1 (July 14, 2005).

Significantly, Columbia's counsel filed a tariff supplement ending the surcharge when it ended its principle and interest payments to PennVest. The surcharge had been in effect for fourteen years, since the Company changed its recovery method to a reconcilable surcharge in 1997. The April 25, 2011 letter states:

> The occasion for the reduction of the stated surcharge is the retirement of the Company's indebtedness to PennVest. Accordingly no further surcharge recovery is required at this time.

OCA St. 1S at 39, App. A (letter from CWC counsel). The Commission approved the filing by Secretarial Letter dated June 2, 2011. I&E Exh. No. 3, Sched. 3.

In summary, Columbia's actions since the 1993 settlement are not consistent with rate base treatment. The Company never included the PennVest plant in rate base after its 1993

PennVest-only rate case, so the amount recovered was never adjusted to account for changes in depreciation methods, adjustments to accumulated deferred income taxes, the annual increases to the depreciation reserve on the PennVest-funded plant, or changes in the allowed rate of return. OCA St. 1S at 42-43. Over multiple cases and years, when the Company under-recovered and over-recovered, it reconciled. The Company committed to "true-up" its revenues and costs annually. 1997 RD, Joint Petition at 5. Most telling, when the Company stopped paying PennVest, it ended the surcharge, even though the PennVest-funded plant remains used and useful. As such, Columbia's PennVest-funded plant should not now be reflected in rate base, nor should any associated depreciation expense be included in expenses, in any amount in this case. OCA St. 1S at 42-43; see also I&E St 3-SR at 8.

d. The NUI Case Limits Post-Surcharge Recovery to PennVest Loan Balance.

The OCA and I&E recommendation is consistent with the Commission's Order in NUI Order, *supra*. There, as here, the utility asked for approval to take PennVest-financed plant that the Company had been recovering from ratepayers through a reconcilable surcharge and place it into rate base at its depreciated original cost amount.[7] NUI Order at *3. The Commission allowed the plant to be included in rate base but only at the amount of the PennVest account loan balances. The Commission stated:

> In considering this matter, we find, as the ALJ did, that the value of the Pennvest financed plant should be based upon the principal balance of the Pennvest/WFLB loans. We, therefore, conclude that the sum representing the difference between the loan balances and the original cost of the plant has in fact been provided by the customers. Therefore, NUI's proposal to include Pennvest financed plant in its

[7] The circumstances in the NUI case were unique. Specifically, NUI was consolidating rates for 19 previously stand-alone companies, most of which had PennVest loans that were being recovered through principle/interest surcharges. NUI Order at *3.

rate base at original cost less book depreciation would result in double recovery from the ratepayers.

NUI Order at *29-30. In NUI's case the utility was still assessing a surcharge and repaying PennVest. Columbia has no remaining "loan balance," however, so there is no value to include in rate base. OCA St. 1S at 39.

Comparison of Columbia's surcharge revenues to its PennVest payments shows that the Company recovered $7.28 million from customers and paid $7.47 million to PennVest. Tr. 158-60. If Columbia believed that it had not fully recovered principle and interest on the loan, it had the opportunity to reconcile the surcharge rather than ending it in 2011.[8] The Company cannot, however, recalculate its rate base as though surcharge recovery never occurred.

Columbia witness Shambaugh argues, however, because the rate is no longer in Columbia's tariff and the remaining undepreciated plant and facilities are used and useful, the Company must be given the opportunity to earn a return on its debt-financed investment. CWC St. 2R at 2-3. Mr. Shambaugh took the same position on behalf of the utility in the NUI case. NUI RD at 24-28. His arguments fail here, for the same reasons they were rejected by the Presiding Officer and Commission in that proceeding. First, the Public Utility Code sets forth certain standards which the Commission must follow, but does not prescribe rate base/rate of return regulation as the only permissible means of cost recovery for PennVest loans. The Code sets as an overriding standard that "[e]very rate . . . shall be just and reasonable." 66 Pa. C.S. §1301. The Company tries to argue that not allowing rate base/rate of return recovery would be confiscatory. There is no "confiscation" as it is the end result and not the method employed that is controlling. Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944). Where a

[8] If Columbia made such a claim now, it would violate the Commission's prohibition against retroactive ratemaking because it would compensate it for an alleged past loss that the Company chose not to correct.

Company recovers its PennVest obligation by surcharge, the utility recovers the return of investments (depreciation) at a faster rate during the period of the loan that if the plant had been included in rate base and depreciated over its useful life.[9] I&E St. 3-SR at 5-6 (quoting NUI Order at *26).

> The dollar-for-dollar recovery of PennVEST debt service through the surcharge allowed the NUI companies to collect for and pay off their Penn VEST loans on a direct basis. This treatment provided a return of capital in the form of the repayment of the principal amount of the loan.

Id. In this way, surcharge recovery is more beneficial to the utility during the early years of the loan than rate base treatment would be. Contrary to Mr. Shambaugh's claim, there is no way to construe this result as being "confiscatory" or otherwise unconstitutional. CWC St. 3R at 11, 14; NUI RD at 55; NUI Order at *28-29.

Second, it cannot be overlooked that the Company *did* have the opportunity to earn a return on and of its debt-financed investment – rate base/rate of return recovery was approved by the Commission in 1993. Despite Commission approval of rate base/rate of return recovery, Columbia changed its recovery method and chose to fund the plant through a reconcilable surcharge over the period of the PennVest loan instead. OCA St. 1S at 43.

Company witness Shambaugh raises several other related arguments against the OCA's recommended removal of the PennVest plant from rate base, *inter alia* that the OCA treats the surcharge as a form of contribution in aid of construction (CWC St. 2R at 3-5) and does not recognize that the Company is at risk for the loan and plant (Id. at 5-6). The Presiding Officer in the NUI case considered and was not persuaded by the same arguments.

[9] In 1993, the average remaining life of the PennVest plant was 46.5 years. CWC St. 2R at 12, 13. The term of the PennVest loan was 18 years. DTL Rebuttal Exh. 1 (Promissory Note, ¶3) ("Principal and interest shall be payable in 221 consecutive monthly installments commencing on the first day of each calendar month beginning with January 1, 1993 and continuing the first day of each calendar month thereafter to and including May 1, 2011.")

> We accept the OCA and OTS position that the loan payments were provided by the ratepayers and that NUI did earn a return of investment and a return of capital. NUI or its shareholders did not provide the funds, it was the ratepayers and it is inconceivable that the ratepayers should have to pay twice for the same plant.

NUI RD at 24-26, 52-55; OCA St. 1S at 40-41, 43 ("when a PennVest loan is recovered through a surcharge, it is treated differently than a traditional loan or bond for ratemaking purposes."). The bottom line is that when the Company chose to recover the plant through a reconcilable surcharge, they made a choice to recover principle and interest over the life of the loan rather than depreciation and return over the life of the plant. OCA St. 1S at 43.

In support of its argument that it has always recovered its PennVest investment through rate base/rate of return, Columbia argues that the Company earned more and less than its target rate of return. As such, its rate of return was not "guaranteed," as suggested by OCA Witness Everette. Tr. 145. The Company points out that in some years there were shortfalls. Id. The record also shows that the Company earned more than its PennVest payments over some 12-month periods. Tr. 159-161. This does not indicate, however, that the Company was applying rate base/rate of return treatment. Rather, it indicates that the Company could have done a better job of reconciling during the term of the loan. Recall that in the 1997 Settlement the Company committed to annual review of its Section 1307 surcharge in order to true-up recovery. 1997 RD, Joint Petition at 5.

e. Summary

For the all of the reasons discussed above, Columbia's position must be rejected. The OCA recommends that the Company's rate base claim be reduced by $3,048,292, to remove the net plant in service as of 12/31/13 that was funded by PennVest loans. OCA Table II, line 14. Columbia also claimed an associated annual depreciation expense of $115,913, which should be removed. OCA Table II, line 17. As discussed, I&E has also recommended adjustments to the Company's rate base and related depreciation expense to remove the PennVest-funded plant. I&E St. 3SR at 1-2.

2. Materials & Supplies

Columbia claimed Materials & Supplies in rate base of $62,314. GDS Exh. 1 at 1-17. This claim is based on a three year average of the Company's Materials & Supplies inventory. OCA Witness Everette explained that it is Commission policy to use a thirteen-month average of materials and supplies in order to recognize the volatile nature of the balance of this account from month to month within a test year. OCA St. 1 at 7. The Company's thirteen-month average of M&S inventory from January 2012 to January 2013 was $57,722. OCA St. 1 at 7 (citing Company response to OCA-I-7). Accordingly, the OCA recommends adjusting the Company's rate base claim by $4,592 ($62,314 – $57,722) to the Company's claim for rate base. OCA Table II, line 15; OCA Exh. AEE-1S, Sch. 1S, line 3.

In rebuttal, Company witness Shambaugh argued that if the expense is volatile an average of a longer period should be used. CWC St. 2R at 14-15. OCA witness explained that the volatility of M&S is better reflected in a monthly average.

> The reason for this is that M&S in rate base are purchases that the Company makes in a given month but may not use for several months. For example, suppose that the Company makes a large purchase in April and then uses these items throughout the summer. The Company might have a large balance in April, but a very low balance by October. Averaging three years of M&S would not smooth out this volatility; rather, it would highlight it.
>
> If the Company's year ended in May, the balance would be much larger than it might have been the rest of the year; if the Company's year ended in December, the balance would be much smaller than it might have been the rest of the year. By the same token, if the Company made large purchases in December, a year-ending balance from December would be greater than the average of the amount

> that Company had actually kept on-hand throughout the year, and would overstate the Company's investment in M&S throughout the year.
>
> A 13-month average helps to smooth out the volatility of this month-to-month variability, and is preferable to an average of several years of year-end balances.

OCA St. 1S at 8-9.

Mr. Shambaugh also contended that the Company would have to close its books on a monthly basis in order to accurately reflect a 13-month average. CWC St. 2R at 14. This is not correct. The Company records this information monthly, as evidenced by its ability to provide monthly M&S balances in response to OCA discovery. OCA St. 1 at 7 (citing Company response to OCA-I-7).

In rejoinder, the Company argued that a three-year average was accepted by the Commission in other proceedings. Tr. 136, 164. In fact, the Company's witness was not able to identify any cases where the Commission specifically approved use of a three-year average. Tr. 164. The Commission did not address the calculation of Columbia's Materials & Supplies claim in its 2008 Order. <u>2008 Order</u>; <u>2008 RD</u>.

The Company also argued that if a 13-month average is used, the most recent 13 month balances would be a more representative cycle. Tr. 136; CWC Rejoinder Exh. 3. The thirteen-month average for July 2012 to July 2013 is $64,888. Id.; Tr. 136. The OCA maintains that the calendar year is more appropriate because it allows these expenditures to be matched with the test year claims, creating a better match between the test year level of inventory and the test year expenses incurred. Id. at 9.

Accordingly, the OCA's recommendation to reduce Columbia's rate base claim by $4,592 should be adopted. OCA Table II, line 15; OCA Exh. AEE-1S, Sch. 1S, line 3.

C. Summary

For the all of the reasons discussed above, Columbia's position must be rejected. The OCA recommends that the Company's rate base claim be reduced by $3,048,292, to remove the net plant in service as of 12/31/13 that was funded by PennVest loans. OCA Table II, line 14. Columbia also claimed an associated annual depreciation expense of $115,913, which should be removed. OCA Table II, line 17. As discussed, I&E has also recommended adjustments to the Company's rate base and related depreciation expense to remove the PennVest-funded plant. I&E St. 3SR at 1-2.

V. REVENUES

A. Merchandising Sales and Jobbing Work

The Company claimed $15,762 of revenue received for Merchandising Sales and Jobbing Work as non-operating income. GDS Exh. No. 1 at 1-22; OCA St. 1 at 8. The revenue for Merchandising Sales and Jobbing Work in the amount of $15,762 should be included in Columbia's above-the-line operating revenue. OCA St. 1 at 8-10; OCA St. 1S at 2-3. In response to I&E-RE-21 at 4, the Company provided the sources of the income, which include the following: the sale of billing data to Lancaster Area Sewer Authority; assisting the Borough of Columbia with turn-ons and turn-offs; bulk water sales; revenues for a meter, damage to a fence, and repairs to an air compressor. OCA St. 1 at 8; OCA St. 1S at 2 n.2. The Company later admitted that the $9,932[10] of revenue from sewer billing data "should have been categorized as operating revenue and included in the filing." CWC St. 2 at 17; OCA St. 1 at 8-9.

[10] The Company accepted the I&E adjustment for these revenues. The I&E adjustment was based on a three year average. I&E St. No. 3 at 14-15. The OCA's adjustment for these revenues used the test year amount, or $9,924. OCA St. 1 at 8-9.

The remaining \$5,838 of the revenue that the Company included in the Merchandising Sales and Jobbing account as non-operating income should be included as above-the-line operating revenue because the expenses associated with these revenues are paid for and borne by the Columbia ratepayers. In the Company's last rate case in 2008, the Commission approved the inclusion of nearly identical revenues as above-the-line operating expenses. Pa. P.U.C. v. Columbia Water Co., 2009 Pa. PUC LEXIS 1423 (May 28, 2009) (2008 Order). Specifically, in 2008, the Company initially claimed that \$12,662 of revenue received from the sale of water meter readings, bulk water sales, dual check valves, and damage or frozen meters was non-operating revenue. Id. at *27. The then Office of Trial Staff argued "that Columbia claimed costs expended to generate these sums as operating expenses, and thus "all revenues generated from these expenditures should be included above the line as miscellaneous operating revenue." Id. at *28. Columbia subsequently agreed to the adjustment and the ALJ recommended that the Commission add \$12,662 to Columbia's operating revenue. Notably, the Commission adopted the ALJ's recommendation, finding the "recommendation to be reasonable, appropriate and otherwise in accord with the record evidence." Id. at *28.

Similarly, in this case, the Company's claim that the \$5,838 of revenue for Merchandising Sales and Jobbing Work should be categorized as non-operating revenue because it includes revenues related to fixed capital plant is without merit. Specifically, the Company claims that the revenues received include revenue from salvage and insurance, and according to the Uniform System of Accounts, must be recorded to the accumulated depreciation reserve. CWC St. 2R at 17-18. This statement is misleading. First, only \$640 of the total Merchandising Sales and Jobbing Work of \$15,762, was related to salvage value and insurance payments. OCA St. 1S at 2. Second, as noted by Ms. Everette, "Even if these repairs to capital items were considered fixed capital plant under the Uniform System of Accounts . . . this is not how the Company treated them." Id. If these revenues had been correctly accounted for under the Uniform System of Accounts, the Company would have credited the revenues to the depreciation reserve. The Company did not do that. Rather, the Company charged the repairs to Materials and Supplies expense and reflected the revenues as a credit to the expense. OCA St. 1S at 3; Company response to I&E RE-21 (attached to OCA St. 1). Thus, contrary to Mr. Shambaugh's statement, the Company charged the expenses related to these revenues to expense accounts that are claimed in this case and the revenues received by the Company to offset these expenses should be considered as above the line and reflected in this case.

The Company did not address the remaining revenues in rebuttal. Of the remaining $5,198[11] revenues, the revenues were received for assisting the Borough with turn offs and turn ons, and bulk water sales. As discussed above, because the Company claimed costs expended to generate the revenues as operating expenses, the revenues themselves should be included above-the-line. OCA St. 1S at 2. In rejoinder, Company witness Shambaugh opines that the revenues related to these tasks are not under the direct control of the Company. Tr. 133-34. This testimony is not relevant to the determination of whether the revenue should be above the line. The point is that there is revenue that was received for these tasks and since the expenses are claimed as expenses in this case, the revenues should be reflected in rates as well.

In summary, the OCA recommends that $15,762 categorized as non-operating revenue for Merchandising Sales and Jobbing Work should be moved above-the-line. The Company has already admitted that the $9,932 associated with sewer billing data should be categorized as operating revenue. The remaining $5,838 includes the revenues for bulk water sales and

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[11] $5,838-$640=$5,198.

assisting Columbia Borough with turn-offs and turn-ons and are nearly identical to those in the Company's 2008 rate case in which the Commission adopted the adjustment to operating revenue. In addition, the Company has charged the expenses associated with these revenues to the customers of Columbia Water Company. OCA Table II ; OCA Exh. AEE-1S, Sch. 1S.

VI. EXPENSES

A. Remove Depreciation Expense related to PennVest

As discussed above, Columbia's PennVest-funded plant should not be reflected in rate base. *Supra*, Section IV.B.1. For the same reasons, no depreciation expense related to that plant should be allowed in expenses. The OCA's adjustment of $115,913 is shown on line 17 of OCA Table II. OCA Exh. AEE-1S, Sch. 1S, line 13.

B. Acquisition Adjustment

Columbia is requesting that an acquisition adjustment of $225,581 (the amount of the purchase price less the net original cost) be reflected in expenses in this case by amortizing it over 15 years, for an annual amount of $15,039. OCA St. 1 at 10. The amortization is related to the acquisition of Marietta Gravity Water Company (MGWC). Id. The Company's claimed expense related to the acquisition of MGWC should be rejected because the Company is not eligible for an acquisition adjustment under Section 1327. OCA St. 1 at 10-17; OCA St. 1S at 3-6. In October 2012, the Company purchased the assets of the MGWC; the total cost of the acquisition was $570,827. OCA St. 1 at 10, 16-17. The Company has not included the cost of MGWC assets in rate base, but the Company has claimed an expense of $15,039, which represents a fifteen year amortization of $225,581, the amount of expense the Company incurred in the process of acquiring the MGWC assets. OCA St.1 at 10; CWC St. 2R at 19. This claimed expense is an acquisition adjustment for which the Company is not entitled.

Section 1327(a) establishes nine criteria that must be met before a utility can claim an acquisition adjustment in rate base and an amortization of the acquisition adjustment in expenses. 66 Pa. C.S. § 1327. Relevant to the instant proceeding, the Company fails to satisfy subsections (a)(3), (a)(7), and (a)(9). Section 1327(a)(3) requires that the acquired utility "was not, at the time of acquisition, furnishing and maintaining adequate, efficient, safe and reasonable service and facilities . . . ." 66 Pa. C.S. 1327(a)(3). In regards to MGWC's technical fitness, OCA Witness Fought[12] testified that MGWC was a viable water system at the time it was acquired by Columbia. OCA St. 3 at 6. Specifically, OCA Witness Fought testified to the following: the security and maintenance repairs made by Columbia after the acquisition of MGWC are normal expenses for proper operation of and maintenance of a water system; "there was nothing in the [Company's] application [to acquire MGWC] that indicated that the PUC, DEP, or any regulatory agency found MGWC to be not viable or in violation of any regulation;" the application [to acquire MGWC] "does not state that MGWC could not implement the over $300,000 in maintenance and upgrades that the Company agreed to make to MGWC'S system; there was no evidence that "MGWC was in violation of any [DEP] regulation that required the maintenance and upgrades listed in the application;" and "the quarterly reports provided by MGWC show no violation of the Secondary Maximum Contaminant Levels (MCLs) for iron or manganese, and MGWC indicated that it received no customer complaints prior to being acquired by CWC. OCA St. 3 at 3-6. In addition, OCA Witness Everette testified that MGWC had adequate supply because of an existing interconnection between CWC and MGWC, which provided "spare capacity to respond to future growth in its service territory without significant capital additions for storage and sources of supply." OCA St. 1 at 14 (citing <u>2008 Order</u> at *127).

With respect to MGWC's financial fitness, OCA Witness Everette testified as follows:

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[12] Terry L. Fought is a professional engineer who is licensed in Pennsylvania, New Jersey and Virginia, with particular experience as a sanitary engineer. He has been involved in the design, construction and operation of water and wastewater facilities for over 40 years. He has also served as a consultant to the OCA for numerous water and sewer matters since 1984. Mr. Fought's background and qualifications are attached as Appendix A to OCA Statement 3.

> [T]he Commission has made no findings of financial, managerial or technical inabilities on the part of MGWC. In fact, with regard to MGWC's financial standing, the Annual Reports to the Commission filed by MGWC show net income of $206,454, $197,977, $160,768, $354,287 and $117,579, for the years 2008, 2009, 2010, 2011 and 2012 through October 4 (the time of acquisition), respectively. These amounts range from 18% to 44% of total operating revenue for these years. With regard to MGWC's managerial fitness, David Lewis, the Vice President and General Manager of CWC, was also employed by MGWC as Superintendent for several years prior to the acquisition. With regard to MGWC's technical abilities, as mentioned, David Lewis was MGWC's Superintendent prior to the acquisition. Mr. Lewis' technical capabilities as a Professional Engineer were as much available to MGWC as to CWC prior to the acquisition. [Further], MGWC has sought and received base rate increases when necessary (i.e., R-00050814, R-00005305, R-00963828).

OCA St. 1 at 13-14. Consequently, the Company has not established that MGWC was not furnishing and maintaining adequate, efficient, safe and reasonable service and facilities as required by Section 1327(a)(3).

In addition, the Company fails to satisfy Section 1327(a)(7) and Section 1327(a)(9). Section 1327(a)(7) requires that "neither the acquiring nor the selling public utility, municipal corporation or person is an affiliated interest of the other." 66 Pa. C.S. § 1327(a)(7). As OCA Witness Everette testified, Columbia and MGWC were affiliated interests pursuant to 66 Pa. C.S. § 2101(a)(3):

> Donald Nikolaus was the President of and served on the Board of Directors of both CWC and MGWC. As shown in the Annual Reports to the Commission, at the time of acquisition, CWC and MGWC had several common shareholders who held in excess of one percent of the voting securities of each company. At the end of 2011, Mr. Nikolaus held 17.95% and 18.71% of CWC and MGWC, respectively. This qualifies the two companies as affiliated interests under 66 Pa.C.S. § 2101 (a), criteria 3. Additionally, as noted above, David Lewis was employed as the highest level manager of both companies prior to the acquisition.

OCA St. 1 at 15.

Section 1327(a)(9) states that the "excess of the acquisition cost over the depreciated original cost will be added to the rate base to be amortized as an addition to expense over a reasonable period of time with corresponding reductions in the rate base." 66 Pa. C.S. § 1327(a)(9). Although the Company has not included any amount of the acquisition adjustment in rate base, it has included a fifteen year amortization of the adjustment in expenses. OCA St. 1 at 15. Based on the foregoing, the Company has failed to satisfy all nine criteria of Section 1327 that must be met for a utility to be eligible for an acquisition adjustment.

The Company argues that the claimed expense is not a purchase price adjustment because the "Company is simply requesting a 15 year amortization of expenses incurred, <u>not</u> price of assets, to acquire the Marietta Gravity Water Company." CWC St. 2R at 19 (emphasis in original). Despite the Company's attempt to bifurcate the cost of MGWC assets and the expenses incurred to acquire the assets, the expenses incurred to purchase MGWC are part of the purchase price acquisition adjustment. OCA St. 1S at 4. As OCA Witness Everette testified, "the total purchase price includes closing costs, expenses incurred, etc. The total net value (original cost minus accumulated reserve) minus the cost paid (including expenses incurred) is the purchase price acquisition adjustment." OCA St. 1S at 4. The Company has recognized that the acquisition cost includes all incurred costs by calling the claimed expense the "Utility Plant Acquisition Adjustment." GDS Exhibit 1 at 1-14; GDS Rebuttal Exhibit at 1.

In the event that the costs are not considered an acquisition adjustment, the Company is not eligible for recovery through a fifteen year amortization. OCA St. 1S at 5. First, the Company has allocated 100% of the costs to acquire MGWC to Columbia customers. OCA St. 1S at 5. "The 2012 Annual Report to the Commission for the Marietta Division indicates that the Company has recorded on the books of the Marietta Division the full difference between purchase price and net book value, other than the legal and consulting fees." OCA St. 1S at 5. Thus, "the Columbia Division is being charged for all of the acquisition costs related to this purchase." OCA St. 1S at 5. Such an allocation is inappropriate. While the Company is proposing that the Columbia Division be charged for 100% of the costs, the Columbia Division is only acquiring "a very small amount of benefit from the acquisition of MGWC (i.e., in the direct case, they allocated a small portion of salaries but none of the associated benefits, insurances, utilities, etc.)." OCA St. 1S at 5.

Second, if the costs are not an acquisition adjustment pursuant to Section 1327, as non-recurring costs that occurred in the past, the Company should have requested permission for a deferral from the Commission to be allowed to recover the cost through an amortization. OCA St. 1S at 5. OCA Witness Everette testified that 10% of the costs incurred in the acquisition of MGWC were incurred in 2011 and the remainder in 2012. OCA St. 1S at 5. Without filing a petition for permission to defer the costs associated with acquiring MGWC, the Company cannot now claim the expense.

In rejoinder, Company witness Shambaugh stated, for the first time, that, at a minimum, $120,902 of costs should be capitalized. Tr. 138. In addition to being untimely because it was raised for the first time in rejoinder, this position should be rejected because it is not what the Company actually did. There is no evidence that Columbia Water capitalized the expenses related to legal fees, and the regulatory expenses. Thus, Company witness Shambaugh's rejoinder testimony should be disregarded.

For the foregoing reasons, the Company's claimed expense of $15, 039, representing a fifteen year amortization of $225,581 expenses incurred while acquiring the Marietta Gravity Water Company should be rejected. OCA Table II; AEE-1S, Sch. 1S.

C. Engineering

Columbia claimed a pro forma 2013 expense of $13,500 for Engineering Contractual Services. GDS Exh. 1 at 1-15. Two of the invoices provided in support of this claim were for Ronald F. Weigel Consulting, both dated August 5, 2012, in the amounts of $2,325 and $3,180. OCA St. 1 at 22-23 (citing OCA Set I-32). The Company described the services as follows:

> Mr. Weigel monitored public meetings, orders issued by the Commission, and rulemakings of potential interest to, or affecting, the Company. Assisted management in evaluating potential regulatory filings and reviewed filings prepared by the Company's lawyers or consultants.

Id. (quoting CWC response to OCA Set III-31). Consistent with this description, Ms. Everette determined that the expense related to the preparation of the current rate case and recommended that it be removed from engineering expense. OCA St. 1 at 23. In rebuttal, the Company clarified that Mr. Weigel's services were, instead, related to the acquisition of the Marietta system and for ongoing monitoring of the Commission. CWC St. 1R at 3. As discussed with regard to the acquisition adjustment, *supra*, consulting fees related to the acquisition should not be charged to the Columbia Division customers because *inter alia* the Company has not met the criteria for the utility to include an amortization of the acquisition adjustment expenses and it is not appropriate for the Columbia Division to pay all of the acquisition expenses related to the purchase of Marietta. OCA St. 1 at 10-17; OCA St. 1S at 4-5, 8.

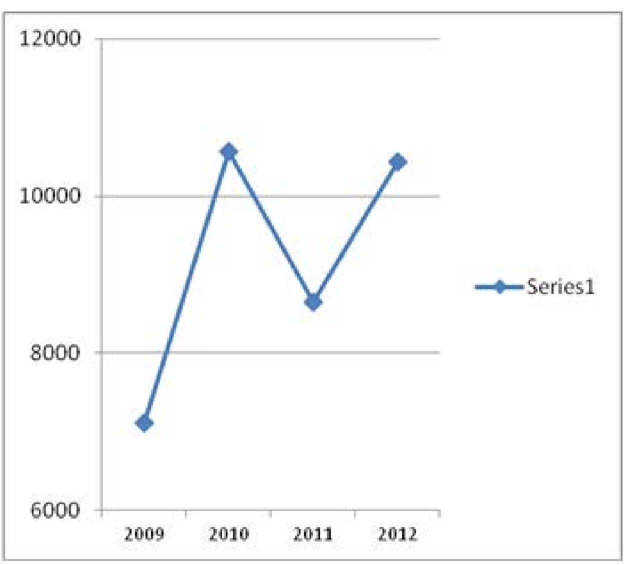
In rejoinder, the Company provided examples of some regulatory matters that are not related to the Marietta acquisition for which it *may* or *could* use a consultant like Mr. Weigel. Tr. 110-111; CWC Rejoinder Exhs. 1, 2. Columbia never identified what portion – if any – of the expenses invoiced on August 5, 2012 for monitoring the Commission were unrelated to the acquisition. OCA St. 1S at 8. As such, OCA witness Everette based her adjustment on what is known – that services invoiced on August 5, 2012 were related to the acquisition. CWC St. 1R at 3.

Accordingly, the OCA recommends that the $5,505 ($2,325 + $3,180) expense be removed because it relates to the Marietta Gravity acquisition. OCA Table II; OCA Exh. AEE-1S, Sch. 1S; OCA St. 1S at 8.

D. Bad Debt Expense

The Company claimed pro forma bad debt expense of $11,000. OCA St. 1 at 24; GDS Exh. No. 1 at 1-15. The claim should be adjusted to reflect a four year historical average of $9,192. OCA St. 1 at 24-25; OCA St. 1S at 9-12. A four year historical average of actual bad debt expense accounts for variations from year to year and is a more accurate method to estimate future bad debt expense. OCA St.1S at 10.

The actual bad debt expenses for years 2009 through 2012 were as follows: $7,115 for 2009; $10,567 for 2010; $8,650 for 2011; and $10,436 for 2012. OCA St. 1 at 24. As illustrated by the following graph, the actual bad debt expense is not a linear progression but fluctuates from year to year.



OCA St. 1S at 10. Further, the fluctuations within the actual bad debt expense provided by the Company are significant; there is a 48.5% difference between the year with the highest bad debt expense (2010) and the year with the lowest bad debt expense (2009). OCA St. 1 at 24. The Company's increase of $564 from the test year 2012 expense of $10,436 to $11,000 does not accurately reflect the variation of bad debt expense. The OCA's adjustment is consistent with the Commission's traditional approach to this issue. Specifically, the Commission has held, "We note that bad debt expense has been traditionally computed based upon historical experience. Further, we note, in order to normalize bad debt expense to the extent possible, we consider projections over multi-year periods." Pa. PUC v. LP Water & Sewer, 1993 Pa. PUC LEXIS 149, *63 (July 14, 1993).

The Company posits that an increase in the bad debt expense of $564 over the test year 2012 expense is appropriate because "the real world of utility management recognizes that with customer rate increases, bad debt expense will likely increase because additional customers become delinquent on their water bills." CWC St. 2R at 15. Yet, the argument that an increase in rates will necessarily cause an increase bad debt expense is not the truism that the Company suggests. For example, the Company's actual bad debt expense for 2008 was $7,971. 2008 Order. In 2009, after the rate increase of the 2008 rate case, the Company's bad debt expense was $7,115, a decrease of $856. OCA St. 1 at 24. Further, more customers paid their bills in 2010 than 2009, and more customers paid their bills in 2012 than 2011. OCA St.1S at 10. Thus, the Company's argument that the bad debt expense must increase from the test year 2012 bad debt expense because the increase in rates will necessarily cause an increase bad debt expense is unfounded.

Similarly, citing the testimony of the Borough Manager that the Borough is an economically challenged community with a disproportionately high percentage of low-income households, senior citizens and rental housing, Columbia witness Shambaugh argued that, in his experience, bad debt will increase going-forward. Tr. 134-35. None of the public input testimony suggested that these conditions did not exist four years ago. Stated otherwise, during the past four years, under the same conditions, bad debt expense fluctuated significantly and as much as 48.5%.

Next, the Company argues that the claimed bad debt expense of $11,000 is reasonable because it only amounts to 0.23% of the Company's proposed billed revenues. CWC St. 2R at 16.[13] The OCA's proposed bad debt expense amounts to 0.25% of the OCA's proposed billed revenues ($3,725,556) at December 31, 2013. Id. OCA Witness Everette testified that "[j]ust as with the total amount of bad debt expense, the reasonableness of the percentage can only be assessed in terms of what that percentage has been historically. For this reason, the OCA has recommended an average of bad debt expense over the previous four years." OCA St. 1S at 11.

Finally, Company Witness Shambaugh asserts that OCA Witness Everette, by using a thirteen month average to adjust Materials and Supplies and a four year average to adjust bad debt expense, has engaged in selective ratemaking. CWC St. 2R at 16. This assertion is incorrect. As explained by OCA Witness Everette, using a thirteen month average for Materials and Supplies and a four year average for bad debt is appropriate:

> [T]he amount of M&S on which the Company is eligible to earn a return fluctuates from month-to-month, so it is appropriate to reflect that month-to-month volatility when establishing rates. Bad debt expense is considered annually, so looking at the trend over several years is appropriate. For further explanation, I

[13] In direct and rebuttal testimony, the Company reflected an incorrect percentage of bad debt expense, stating that it was 0.023%. OCA St. 1S at 11. Company witness Shambaugh corrected it to 0.23%. Tr. 131.

> note that Mr. Shambaugh has accepted I&E's recommended three-year average of revenues from the sale of billing data. In other words, he apparently believes that it is appropriate to use an average for this ratemaking item. However, I doubt Mr. Shambaugh would be amenable to using a 3-year average of employee salaries: rather, the Company and OCA have annualized 2013 salaries and used only the present expense. This is appropriate because one item might fluctuate from year-to year, while the other (salaries) is known and measurable for the test year. This demonstrates why it appropriate to treat each ratemaking item on its own merit.

OCA St. 1S at 12(emphasis added).

For the foregoing reasons, the Company's claimed bad debt expense of $11,000 should be adjusted to reflect a four year historical average of $9,192 in order to more accurately reflect the wide fluctuations of actual bad debt expense from year to year. OCA Table II; AEE-1S, Sch. 1S.

E. Employee Salaries & Wages and Related Adjustment to Payroll Taxes

The Company claimed a 2012 salaries and wages expense for employees of $820,483 with a Going-Level Adjustment of ($25,597), for a total 2013 claim of $794,886. The decrease was the result of an allocation to the Marietta Division. GDS Exh. 1 at 1-15, 1-16; OCA St. 1 at 27. Columbia based its allocation for hourly employees on their time sheets since the acquisition in October 2012. OCA St. 1 at 27 (citing Company response to IE-RE-6). For its salaried employees Columbia allocated 15% to the Marietta Division on the basis that "[o]n average, the salaried employees are spending about 6 hours per week on Marietta Division tasks."[14] Id. This resulted in an overall allocation to Marietta of 8.13% of *total* salaries ($81,874 out of the total salaries of $1,006,760) excluding those employees who work only for the Marietta Division. OCA St. 1 at 28.

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[14] The OCA notes that Columbia allocated individual employee salaries at more and less than 15% (8% of total salaries and wages), but allocated the salaries of employees who work for both divisions, as a whole, at 15% (or 8% of total salaries and wages). CWC St. 1R at 2; OCA St. 1S at 13-14.

The OCA disagrees with how Columbia allocated the hours of its hourly employees who perform work for Marietta. OCA St. 1 at 28-30. Ms. Everette explained that the data from a few months of time sheets is not a reasonable basis to allocate wages over the course of a year:

> The hourly employees tracked their time on their time sheets since the purchase of Marietta Gravity on October 5, 2012. In other words, the Company does not even have one full year of data to show what portion of time the employees have spent on the two divisions. In fact, the Company states because the acquisition was so recent, there is "insufficient data to complete a meaningful study" (OCA-III-17, attached). Having a complete year-round picture is necessary in order to observe the fluctuations in the work load that may occur throughout the year.

OCA St. 1 at 28; OCA St. 1S at 14. A more informed basis for allocating wages between the divisions is to use the 15% allocation that was determined by the Company based on the experience of David Lewis as Superintendent of Marietta Gravity. OCA St. 1 at 28. In other words, the OCA recommends applying the Company's 15% allocation factor to the Salaries and Wages of all applicable salaried and hourly employees. Id. at 28-29. As Ms. Everette noted, not all employees do work for the Marietta Division and the OCA did not recommend allocating any of their salaries and wages to that division, *i.e.* Operators, Laborers, and Construction Manager.[15] OCA St. 1 at 29. Ms. Everette allocated all remaining (or "applicable") employees to the Marietta Division at 15%, for a total of $125,485. OCA Exh. AEE-1S, Sch. 2S. The resulting adjustment to the Company's claim for Salaries & Wages is $4,117. OCA Exh. AEE-1S, Sch. 1S.

The Company argues that the 15% factor used by the OCA is substantially higher than Columbia's recommended 8% allocation and because it ignores that Columbia employees must still do Columbia Division work. CWC St. 1R at 2, 4-5. First, with regard to the number

[15] OCA witness Everette noted that the allocation for the Construction Manager may need to be adjusted in future cases after the treatment plant upgrade project ends. Currently, he is spending 100% of his time on that project and no time on the Marietta Division. OCA St. 1 at 29 (citing Company response to OCA Set III-13).

confusion, Ms. Everette explained that the difference between the Company and OCA positions is actually only 0.41%, or the difference between 8.13%[16] and 8.54%. OCA St. 1S at 13-14. This is because the Company's figure is based on its allocation of all Columbia salaries to the Marietta Division. Ms. Everette's allocation of 15% of a portion of all salaries, which results in an allocation of 8.54%[17] of all Columbia salaries. Id. at 13-14. Thus, the OCA's recommended percentage allocation is not significantly higher than the Company's percentage.

Second, the OCA does not suggest that Columbia Division work was reduced or eliminated after the acquisition. OCA St. 1S at 14. The OCA's recommendation does not address the quantity of work being performed. Rather, Ms. Everette's proposed allocation reflects the need to fairly allocate the costs of that work. Id.

The Company also raised some specific objections to Ms. Everette's recommended allocations for certain employees. CWC St. 1R at 5-8. Several of these objections are resolved by updates and corrections contained in Ms. Everette's surrebuttal testimony, made in response to information provided in Columbia's rebuttal testimony. OCA St. 1S at 15-17. Specifically, she accepted the Company's 4.3% allocation for salaries of Customer Service personnel based on the fact that this position fluctuates with the number of bills sent for each division.[18] OCA St. 1S at 16; CWC St. 1R at 5-6. Similarly, OCA witness Everette accepted the Company's recommended 4.3% allocation for the Meter Reader based on the relative frequency of meter

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[16] The Company's allocation was actually 8.13% of total salaries. When discussing this figure in rebuttal testimony, Mr. Lewis rounded it to 8%. OCA St. 1S at 13, n.5.

[17] The 8.54% reflects Ms. Everette's revised position provided in surrebuttal. Specifically, her revised position allocates $85,991 of the total $1,046,254 of CWC salaries to the Marietta Division. ($85,991/$1,006,760 = 8.54%). OCA St. 1S at 14, n.7.

[18] According to the Company, the Columbia Division has 105,600 bills per year and the Marietta Division has approximately 4,690 or 4.3% of the total bills. OCA St. 1S at 16.

reads for each division.[19] OCA St. 1S at 17; CWC St. 1R at 6-7. Ms. Everette also eliminated any allocation for the Fire Hydrant Painter because he does not work in the Marietta Division. OCA St. 1S at 17; CWC St. 1R at 7. Finally, Ms. Everette corrected her unintentional allocation to the Operator's salary. OCA St. 1S at 17-18.

The Company's remaining objections relate to the Foreman and Service Person. CWC St. 1R at 5-6.

It should be noted that the Company has claimed Salaries & Wages expense for two Service Person employees. OCA St. 1S at 16. The Company allocated one person at 2.31% and the other at 28.4%. Id. at 16, n.8; OCA Exh. AEE-1S, Sch. 2S. The OCA allocated both at 15%, which decreased the revenue requirement for one and increased the revenue requirement for the other, for a net effect of increasing the revenue requirement by $735. Thus, if Ms. Everette's adjustment to the Service Person expense on line 10 of Schedule 2S is not accepted, her adjustment on line 17 of Schedule 2S must also be adjusted so that her recommended revenue requirement decreases by $735. Id.

In summary, line 26 of Schedule 2S shows that the effect of these updates results in a recommended decrease of $4,117 to the Company's claim for Employee Salaries & Wages. The OCA recommends approval of its revised position. OCA Table II; OCA Exh. AEE-1S, Sch. 1S, line 21.

Ms. Everette also adjusted the Company's claim for Payroll Taxes to correspond with each of her Salaries & Wages adjustments. OCA St. 1 at 30; OCA St. 1S at 18. Her figures

[19] Ms. Everette noted that in her original analysis, she allocated 15% of only one of the two meter readers' salaries. Therefore, in order to change the 15% allocation to 4.3%, it is necessary to increase the second meter reader from 0% to 4.3%. This will reflect that 4.3% of the Meter Readers' time as a whole is spent on the Marietta Division. The net effect of these two adjustments is a decrease of $1,341 rather than a decrease of $3,905 as initially recommended. OCA Exh. 1S, Sch. 2S, lines 5 and 12. Columbia agrees with this position. Tr. 112.

include the payroll taxes for the salaried officers. See Section VI.L, *infra*. Ms. Everette's payroll tax calculations are detailed on Schedule 3S, and the increase of $72 is shown on line 22 of Schedule 1S. OCA Table II; OCA Exh. AEE-1S, line 22.

F. Pensions & Benefits

Columbia claimed a Future Test Year Pensions & Benefits expense of $147,054. GDS Exh. 1 at 1-15. This claim includes expenses for Pensions, Disability/Life Insurance, Health Insurance and Employee Recognition. OCA St. 1 at 18-19 (citing OCA-I-29). As will be discussed below, these claims represent a portion of employee costs, and should be allocated to the Marietta Division. In addition, the OCA recommends adjustments to the amount of the claim for Health Insurance, Pension Expense, Disability/Life Insurance, and Employee Recognition.

1. Health Insurance

The Company claimed a total health insurance expense of $105,963 but provided support for an annual amount of $102,881. OCA St. 1 at 31 (citing CWC response to OCA-I-29). Additionally, $102,881 was the annual health insurance cost approved at the Board of Director's meeting on July 24, 2012.[20] Id. (citing CWC response to I&E-RE-19). Accordingly, Ms. Everette recommended an adjustment of $3,082, which allows only the supported $102,881.

In rebuttal, Company witness Lewis stated that the Company received quotes to renew the health insurance and the premiums will increase to $148,484. CWC St. 1R at 10. The Company did not provide any support for this claimed increase. OCA St. 1S at 21. Mr. Lewis also did not specify any time period for the alleged increase; it may not be within Columbia's

[20] Ms. Everette suggested that the $105,963 may have been an estimate based on a 10% increase from the 2012 cost of $96,330. OCA St. 1S at 31.

chosen future test year, ending 12/31/13. OCA St. 1S at 21. The evidence supports a total health insurance claim of $102,881.

Although the Company allocated portions of salaries to the Marietta Division, it allocated no Pensions and Benefits to the Marietta Division in 2012. OCA St. 1 at 31 (citing CWC response to OCA-III-24). Columbia indicated that, in 2013, it would allocate a portion of the Pensions and Benefits to Marietta based upon actual hours worked in that division. Id. The OCA recommends that the Company's proposal to wait until it has more data to allocate the Pension and Benefits claim, including Health Insurance be rejected. Columbia admits that its employees do work for the Marietta Division and the Company has allocated a portion of its employees' salaries to the Marietta Division. OCA St. 1S at 32. Pensions and Benefits are part of the total cost of employees and must be allocated to Marietta for ratemaking purposes. Id.

Originally, Ms. Everette recommended moving 15% of the health insurance costs of employees who are allocated to the Marietta Division. OCA St. 1S at 19. In surrebuttal, Ms. Everette took into account the time spent by each employee on the Marietta Division by reflecting the portion of that employee's salary that the OCA recommended be allocated to Marietta.[21] OCA St. 1S at 20-21; OCA Exh. AEE-1S, Sch. 4S. Her updated calculation results in an allocation to the Marietta Division of $8,648. OCA St. 1S at 20-21; OCA Exh. AEE-1, Sch. 6S, line 2, Sch. 1S, line 23(total Pension and Benefit adjustment of $16,141 as developed on Sch. 6S).

As with Salaries & Wages, the Company objected to the OCA's use of the 15% allocation factor. CWC St. 1R at 10. Mr. Lewis also notes that health insurance costs are not the same for every employee and argued that the Company's allocations take varying health

[21] Ms. Everette's health insurance calculation reflects her updates to the salary allocation. OCA St. 1S at 20.

insurance costs into account. Id., Tr. 114. Despite his position that this information is important, Company witness Lewis did not provide the information. Ms. Everette, as indicated above, made her adjustment with a reasonable proxy.

As discussed above, Ms. Everette's method applies the allocation percentage provided by Mr. Lewis for salaried employees. OCA St. 1 at 19-20. This is more reasonable than Columbia's proposal to extrapolate an allocation from data for hourly employees that the Company has deemed insufficient or to allocate zero costs to Marietta until sufficient data is available. OCA St. 1S at 14-15, OCA St. 1 at 31. In addition, Ms. Everette noted that her original recommendation was to move 15% of the costs of employees who are allocated to the Marietta Division, which means that she allocated only 9% of the Company's total health insurance costs to the Marietta Division. Id. at 19.

Further, Ms. Everette responded to the Company's concerns by modifying her calculation to base it on time spent rather than using 15% for each employee. OCA St. 1S at 20; OCA Exh. AEE-1S, Sch. 4. This allocation better reflects the portion of each position which has been allocated to the Marietta Division. OCA St. 1S at 21. Accordingly, the OCA recommends that $8,648 related to Health Insurance expenses be moved to the Marietta Division. OCA Table II; OCA Sch. 1S.

2. Pension

Columbia claimed a total pension expense of $59,682. OCA St. 1S (citing CWC Response to OCA-1-29). The Company was asked to provide evidence of the most current pension deposit and, in response, provided a copy of a check showing a payment of $57,944. Id. The OCA recommends an adjustment of $1,738 to reflect the amount that is not supported by the record.

The OCA also recommends that a portion of pension costs be allocated to the Marietta Division. OCA St. 1 at 33. Columbia makes the same arguments regarding the OCA's use of a 15% allocation factor here, as it did for Health Insurance and Salaries & Wages. CWC St. 1R at 10-11. Mr. Lewis asserts that if a percentage allocation is used, it must based upon the actual time spent on Marietta Division tasks and using the actual cost of their pension benefits. Id. He calculates that if the allocation is calculated that way, it results in 8.75% of the total pension costs. Id.

The fact remains that the Company's proposed allocation is based on insufficient data. OCA St. 1 at 28; OCA St. 1S at 14 (citing CWC Response to OCA-III-17). The OCA's recommended allocation recognizes that the cost of pensions is related to salaries or wages. OCA St. 1 at 33. Moreover, OCA witness Everette updated her calculation to base it on time spent rather than using 15% for each employee. OCA St. 1S at 20; OCA Exh. AEE-1S, Sch. 4. Ms. Everette stated that this allocation better reflects the portion of each position which has been allocated to the Marietta Division. OCA St. 1S at 21. The OCA recommends that $4,846 related to Pension expenses be moved to the Marietta Division. OCA Table II; OCA Exh. AEE-1S, Sch. 1S.

3. Disability and Life Insurance

The Company claimed that its Disability/Life Insurance expense was $10,176, which would be an increase of 10% over the 2012 claim. The invoice provided in response to discovery, however, supports a claim of only $9,147. OCA St. 1 at 34 (citing CWC response to OCA-III-26. OCA witness Everette recommended that the Company's claim related to Disability/Life Insurance should be reduced by $1,029 ($10,176 - $9,147).

In rebuttal, Company witness Lewis testified that the Company received the renewal notice for the disability/life insurance premium and it has increased by $1,659. CWC St. 1R at 11. The Company did not provide any support for this claimed increase or provide a time period for which the expense is allegedly increasing. Id. Accordingly, OCA witness Everette reflected only the $9,147 amount supported by invoices. OCA Exh. AEE-1S, Sch. 6S, line 4.

The OCA also recommended that Disability/Life Insurance be allocated using the same (updated) calculations recommended for other Pension and Benefits expenses, for each full-time employee who is partially allocated to the Marietta Division. OCA St. 1 at 34; OCA St. 1S at 22. For all of the reasons discussed in the context of health insurance and pensions, the OCA submits that $765 should be allocated to the Marietta Division. Table II; OCA Exh. AEE-1S, Sch. 6S, line 4.

4. Employee Recognition

The Company's Pensions and Benefits claim includes $6,051 for Employee Recognition. OCA St. 1 at 35 (citing CWC response to OCA-1-29). This claim includes a "Hershey Park Outing" and the Employee/Officers Year End Banquet. Id. OCA witness Everette recommended that these items be removed from expenses for ratemaking purposes because they are not part of the employees' compensation. OCA St. 1 at 35-36; OCA St. 1S at 22. I&E witness Wilson also recommended that the entire claim be denied. I&E St. 2 at 10.

Mr. Lewis argues that these expenses are "necessary" for the Company to attract and retain skilled employees. CWC St. 1R at 12. However, the Company did not put forward any evidence to support its claim that outings are required to retain employees. These employee entertainment expenses are not necessary to the provision of public utility service to customers. See I&E St. 2 at 10. The Commission has consistently disallowed these types of entertainment expenses based on its reasonable determination that they are not necessary in the provision of public utility service. See Pa. P.U.C. v. Pennsylvania-American Water Co., 1993 PaPUC LEXIS 79, *121-23 (PAWC 1993) (expenses for entertainment and gifts inappropriately included in utility's rates because they did not directly relate to the provision of quality water service); see also Pa. P.U.C. v. Citizens Utilities Water Co. of Pa., 169 PUR4th 552, 584-85 (1996) (disallowing expenses for gifts, flowers, in-house luncheons and horticultural service despite the Company's claim that these items improved employee morale). Only expenses directly related to "employee recognition" dinners are permitted. See PAWC 1993 at *123; Pa. P.U.C. v. Pennsylvania-American Water Co., 1995 PaPUC LEXIS 170, *38-39 (PAWC 1995). In Columbia's last rate case, the Company made similar arguments with regard to a Hershey Park outing and a Christmas party. 2008 RD at 23-25. Consistent with these prior Commission Orders, the ALJ removed the expense from the Company's claim. Id.

Here, Mr. Lewis admits that the Hershey Park trip is not for employee recognition. Tr. 112. Specifically, he stated:

> It's not a trip to Hersheypark. It's not a picnic at the park. We provide our employees tickets. The employee uses the tickets when they want and they use them throughout the year. The employee must use them on a weekend or they take a vacation day to use them.

Id. The Company does not provide any specific information about the year-end banquet to demonstrate that it qualifies as an "employee recognition" dinner or is otherwise necessary to the provision of service. CWC St. 1R at 11-12.

The OCA notes that customers already pay the full cost of the Company's employee salaries and benefits and should not be required to compensate the Company for these entertainment expenses. Moreover, the fact that "Columbia has been providing its employees these benefits for years" only serves to show that there is no nexus between the entertainment expenses and the provision of utility service, *i.e.*, the expenses are not related to recognizing employee performance, for which the Commission has allowed rate recovery in some cases. Pa. P.U.C. v. Pennsylvania-American Water Co., 79 PaPUC 25, 62-63 (1993); PAWC 1995 at *38-39. The OCA's position does not preclude the Company from continuing these expenditures if they are funded by its shareholders, which is what Columbia Water has done since its last case, when these costs were not permitted for ratemaking purposes.

If any part of the claim is allowed, however, Ms. Everette recommends that a portion of the cost should be allocated to the Marietta Division to reflect the portion of time that is allocated to the Marietta Division. OCA St. 1S at 23. Ms. Everette explained:

> Considering the adjustments to salaries that I made in Schedule 2, I have allocated 8.54% of CWC salaries to the Marietta Division. Therefore, if the Commission decided that this expense should be included for ratemaking purposes, 8.54%, or $517 should be allocated to the Marietta Division.

OCA St. 1S at 23.

For the reasons set forth above, OCA witness Everette made a negative adjustment of $6,051 to the Company's claim of employee benefits that relate to dinners and outings. Table II; OCA St. 1 at 35-36; OCA St. 1S at 22-23.

G. Vehicle Insurance

The Company claimed $6,900 in the future test year for vehicle insurance. OCA St. 1 at 37-38; OCA St. 1S at 23-25. As recommended by Ms. Everette, the Company's vehicle insurance expense should be adjusted by allocating $589 to the Marietta Division. OCA St. 1S at 24. In response to OCA-III-48, the Company indicated that "other vehicles on the policy were used by workers when doing work for the Marietta Division." OCA St. 1 at 37. The Company further indicated that "[a] portion of the shared vehicle's commercial auto premium will be expensed to the Marietta Division using hours worked by staff in that division as the basis for sharing." OCA St. 1 at 37. Thus, the Company planned to allocate the cost of vehicle insurance to the Marietta Division in the future based on employee work hours. OCA St. 1 at 37. The delayed allocation of vehicle insurance costs to the Marietta Division is not appropriate for ratemaking purposes. OCA St. 1 at 37.

Ms. Everette used the same allocation percentage for vehicle insurance as she used for employee salaries and wages. See VI. E, *supra*; OCA St. 1S at 24. It is reasonable to estimate that employees are using Company vehicles for Marietta tasks 8.54% of the time. OCA St. 1 at 37. Thus, 8.54% of the Company's claimed vehicle insurance expense of $6,900 (or $589) should be allocated to the Marietta Division. OCA St. 1S at 24.

After initially stating that a portion of the shared vehicle's insurance premiums would be allocated to Marietta at some time in the future, based on employee work hours, (OCA St. 1 at 37) in his rebuttal testimony, Company Witness Lewis argues that none of the insurance cost should be allocated to the Marietta Division. CWC St. 1R at 12. Witness Lewis states that "[m]ost of the time allocated to the Marietta Division is related to managers and office staff who do not use company vehicles." CWC St. 1R at 12; Tr. at 114. This position, however, is contradictory to Mr. Lewis's statement that "other vehicles on the policy are used by workers when doing work for the Marietta Division." OCA St. 1S at 24. As OCA Witness Everette testified, "[i]f CWC vehicles are being used for work in the Marietta Division, it is appropriate that these costs be allocated to the Marietta Division." OCA St. 1S at 24.

Mr. Lewis also claims that the Company's insurance premiums are increasing. CWC St. 1R at 13. OCA Witness Everette testified that the increase should not be included for ratemaking purposes because "it is not a known and measurable Test Year expense." OCA St.

1S at 25. OCA Witness Everette explained as follows: "[t]he invoice included in his exhibit lists this expense as a 2013-2014 projected expense. Given that there are only four months left of 2013, and this rate has not gone into effect yet, it appears that this incremental, projected expense does not fall within the Future Test Year of 2013." OCA St. 1S at 25. If the Commission, however, does include the increase, 8.54% of the increase should be allocated to the Marietta Division. OCA St. 1S at 25.

For the foregoing reasons, the Company's claimed vehicle insurance expense should be adjusted to allocate 8.54% of the expense (or $589) to the Marietta Division. OCA Table II, AEE-1S, Sch. 1S.

H. Worker's Compensation Insurance

The Company's claimed expense of $24,500 for worker's compensation insurance should be adjusted to reflect an allocation of $2,938 to the Marietta Division. OCA St. 1 at 38-41; OCA St. 1S at 25-26. Similar to the vehicle insurance expense discussed above, although Columbia employees perform tasks for the Marietta Division, "[n]one of the Workman's Compensation Insurance was expensed to the Marietta Division." OCA St. 1 at 38. Further, the Marietta Division does not carry its own workman's compensation insurance for Marietta employees.[22] See OCA St. 1 at 38; CWC response to OCA III-55(App. B to OCA St. 1).

With regard to the three employees who work solely for the Marietta Division, the Company is required to provide worker's compensation insurance. OCA St. 1 at 39. If the Company has complied with this requirement, the expense for worker's compensation insurance that the Company has "proposed to charge to the Columbia Division's ratepayers includes the

[22] The Marietta Gravity Water Company carried worker's compensation insurance before it was acquired by the Company. OCA St. 1 at 38. The 2011 and 2012 Annual Report to the Commission showed Worker's Compensation expenses of $3,351 and $3,879, respectively. OCA St. 1 at 38.

costs of worker's compensation insurance for employees who work only for the Marietta Division." Id. It is inappropriate for the Columbia Division to pay for costs related to the Marietta Division employees. OCA St. 1 at 39.

"Regarding the cost of worker's compensation insurance for those employees who are allocated in part to the Marietta Division, the Marietta Division should be paying an appropriate portion of those employees' worker's compensation insurance." OCA St. 1 at 39. While the Company agrees that a portion of the Worker's Compensation insurance should be expensed to the Marietta Division, it proposes to allocate the cost at some future date. OCA St. 1 at 39. Just as with the vehicle insurance expense, such an approach is not appropriate for ratemaking purposes. OCA St. 1 at 39. As OCA Witness Everette testified,

> The Marietta Division's share of worker's compensation insurance must be estimated in order to establish an appropriate level of expense for ratemaking purposes. This is especially important because it appears that CWC has included the employees who only work for the Marietta Division in this policy that they are proposing to charge exclusively to the Columbia Division's ratepayers.

OCA St. 1 at 39-40.

As a result, the OCA recommends that 11.99% of the worker's compensation insurance expense should be allocated to the Marietta Division. OCA Witness Everette explained the 11.99% allocation as follows:

> The Marietta Division's three employees are included in CWC's claim for workers' compensation insurance. This means that I must use total salaries in developing the allocation. The total salaries allocated to the Marietta Division, including the three employees who are allocated 100%, represent 11.99% of total salaries (shown on line 29 of Schedule 2S). Therefore, 11.99% of workers' compensation insurance should be allocated to the Marietta Division. This is based on my acceptance of Mr. Lewis' statement that "The amount to be allocated should be based upon the actual amount of time allocated to the Marietta Division" (CWC Statement No. 1R, Page 13, Lines 16-17).

OCA St. 1S at 25. Consequently, $2,938 (11.99% of $24,500) should be allocated to the Marietta Division. OCA St. 1S at 26; OCA Table II; AEE-1S, Sch. 1S. Similar to the Company's claim that vehicle insurance expense is increasing, Company witness Lewis's claim that worker's compensation insurance expense is increasing should not be included for ratemaking purposes because it is not a known and measurable Test Year expense. OCA St. 1S at 26. If the Commission does allow the increase, however, 11.99% of the increase should be allocated to the Marietta Division. OCA St. 1S at 26.

I. Accounting

The Company claimed $28,300 for Accounting Contractual Services. GDS Exh. 1 at 1-15. In response to OCA-I-33, the Company provided invoices to support this claim. OCA St. 1 at 41-42. One of these invoices was for the Company's tax preparation and audit, in the amount of $19,700. The Company stated that it will file one tax return and have one audit that includes both divisions. OCA St. 1 at 42 (citing CWC response to OCA-III-32, 33). This indicates that the $19,700 expense for the joint filings will be borne exclusively by Columbia ratepayers but Marietta Division customers will benefit from the expense. OCA St. 1S at 27; OCA St. 1 at 42. Accordingly, Ms. Everette recommended that a portion of this cost should be allocated to the Marietta Division. OCA St. 1 at 42. Specifically, she used 12%, which represents the number of customers in the Marietta Division relative to the whole company. This 12% factor was provided by David Lewis in OCA-III-17. The resulting adjustment is $2,364. Id.; OCA Exh. AEE-1, Sch. 1, line 26.

In support of her allocation, Ms. Everette noted that the cost of necessary services, like Accounting are built in to the Marietta Division's rates. Allowing Columbia to recover the full cost of preparing/filing the tax return and audit would allow the Company to double-collect this expense. OCA St. 1 at 42-43. The allocation of this cost moves $2,364 to the Marietta Division. Id.

Company witness Lewis objected to any allocation of the expense on the basis that the Company expects overall accounting costs to go up as a result of the acquisition. CWC St. 1R at 14. He stated that the two divisions will keep separate books, budgets and depreciation calculations that will be used for the consolidated tax filings and audits. Tr. 115. As a result, Mr. Lewis contended:

> The Columbia Division's accounting costs will not go down or somehow get "shared" with the Marietta Division, but instead the accounting costs will increase and the additional costs will get allocated to the Marietta Division.

CWC St. 1R at 14. As Ms. Everette indicated, the Company's position seems inconsistent with its position during the proceeding to acquire Marietta. OCA St. 1S at 28. There, Columbia asserted that the transaction would:

> benefit the customers of both water systems through financial, managerial and operational efficiencies which may be realized over time... Additionally, the Joint Applicants submit that the transaction will likely result in a consolidation of reporting and operations that may impact future rate increase requests to the benefit of ratepayers.

OCA St. 1S at 27 (quoting Joint Application of Columbia Water Co. and Marietta Gravity Water Co., A-2012-2282219, Order (Aug. 30, 2012). In fact, the Company provided an email from the Company's accountant with an estimated fee increase of 10% to 15%. CWC St. 1R at 14; DTL Rebuttal Exh. 2.

Ms. Everette responded with three reasons why the claimed increase does not change the need to allocate a portion of the $19,700 invoice expenses to Marietta:

> First, this is not a known and measurable expense for the Columbia Division. An estimation of future expenses does not meet the Company's burden of proof.

> Second, the Columbia Division supported accounting and auditing costs of $28,300, and as discussed previously, $19,700 of this expense was for tax preparation and auditing. Based on Mr. Lewis' statements in response to OCA-III-32 and OCA-III-33 (quoted above), the Company's tax return and audit will include both Columbia and Marietta. Therefore, these costs should be allocated in part to the Marietta Division

OCA St. 1S at 28. Third, the claimed increase is not relevant because Ms. Everette did not allocate the Company's total accounting costs; she only allocated the $19,700 related to tax preparation and the audit. For all of these reasons, the OCA recommends approval of its proposed allocation of 12% of those costs to the Marietta Division. OCA Exh. AEE-1S, Sch. 1S, line 26.

J. Management Fees

The OCA no longer recommends an adjustment to the Company's claimed expense of $26,063 for management fees. OCA St. 1S at 29. A portion of the management fees are expenses for services provided by Wells Fargo Bank for check and credit card processing. OCA St. 1 at 43. Because the bank account in question is used by both the Columbia and Marietta Division, the OCA initially proposed to adjust the claimed management fees to reflect a twelve percent allocation to the Marietta Division.[23] OCA St. 1 at 44. In his rebuttal testimony, however, Company Witness Lewis indicated that the only management fees claimed by the Company were those associated with the Columbia Division. CWC St. 1R at 15. Although Mr. Lewis's rebuttal testimony is not completely accurate,[24] the OCA no longer recommends an adjustment to the Company's management fees. OCA St. 1S at 29.

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[23] Twelve percent represents the portion of customers that are served by the Marietta Division.

[24] The management fees do include expenses associated with the Marietta Division since October 2012. Tr. 125.

K. Office Expenses and Utilities

The Company claimed a future test year expense for Office Expenses and Utilities of $18,000. OCA St. 1 at 46; OCA St. 1S at 29-30. This claim should be adjusted by $774 to reflect a 4.3% allocation to the Marietta Division. OCA St. 1S at 30. The office and utility expenses are for software support, financial software, and office computers. OCA St. 1 at 46. These costs "related directly to the number of bills [the Company] print and send and to the payments [the Company] receives." CWC St. 1R at 16. The Columbia Division produces 105,600 bills per year and the Marietta Division produces 4,690 bills per year. CWC St. 1R at 16. As a result, both the Company and the OCA agree that 4.3% is an accurate reflection of the office and utility expenses that should be allocated to the Marietta Division. OCA St. 1S at 30; CWC St. 1R at 16. Thus, 4.3% of the Company's claimed office expenses and utilities (or $774) should be allocated to the Marietta Division. OCA St. 1S at 30. OCA Table II;,AEE-1S, Sch. 1S.

L. Officers and Directors

Columbia claimed $68,900 of Salaries for Officers, Directors and Majority Shareholders and $62,500 for Directors' Fees & Expenses in this proceeding. GDS Exh. 1 at 1-15. The OCA recommends an adjustment based on the reasonableness of these costs and also an adjustment to allocate a portion of these expenses to the Marietta Division. OCA St. 1 at 47, 56-57, 59-61; OCA St. 1S at 30-34, 37. The OCA's third recommendation is that the Commission deny Columbia's request to end the Commission's directive in the 2008 case and continue to require the Company to account for actual hours spent by its officers and directors on Columbia business in relation to all other business interests. OCA St. 1 at 59-61; OCA St. 1S at 35-36. The basis for each of the OCA's recommendations is discussed below.

1. Adjustment to Remove Excessive Salaries and Fees

The evidence in this proceeding shows that the compensation of the officers and directors is excessive in relation to the time spent on Columbia business. The amount of Officers' Salaries and Directors' Fees that is charged to ratepayers should reflect the contribution provided to Columbia by its officers/directors.[25] The OCA recommends that the combined expenses should be reduced by $33,451, from the Company's claim of $130,835.[26] OCA St. 1 at 55-57.

OCA witness Everette explained that Columbia may choose to set salaries and fees at any level; its Board of Directors is accountable to the shareholders. OCA St. 1 at 54-55. Only the amount of those salaries and fees that the Commission determines are just and reasonable, however, may be reflected in rates. Id. at 54-56. The OCA submits that reasonableness should be measured based on each officer and director's contribution to the provision of safe and adequate service. Id. OCA Everette explained:

> [O]fficers and directors do not get paid simply for having experience that can be brought to the table if necessary. Officers and directors are only necessary, and therefore, reasonable for ratemaking purposes, if they actively contribute to the well-being of the utility Company.

OCA St. 1 at 52. The time the officers/directors spend on Company business is an indication of their active contribution to the utility. OCA St. 1 at 52, 55-56. The compensation they receive relative to that time is a gauge of the reasonableness of their salaries and fees. Id. at 51, 53, 55.

> The reasonableness check here is that if an officer or director is paid well beyond what one could expect these individuals to make in a competitive business, then

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[25] Four of Columbia's five officers are also directors. CWC St. 1 at 2, 15, 17. Dave Lewis is the only full-time officer and he is not a director. Id.

[26] Total salaries, fees and expenses of $131,400 ($62,500 + $68,900) less expenses of $565 equals the total salary and fee claim of $130,835. OCA St. 1 at 46-47.

> perhaps the expense is not reasonable for an individual in a monopoly business that is regulated to protect consumers.

OCA St. 1 at 53; OCA St. 1S at 33. OCA witness Everette provided the chart below, which shows the average hourly rate for each officer and director from 2010 to 2012 (calculated by dividing the amount they are paid by the hours that they worked for Columbia).

	2010		2011		2012	
Name	Officer	Director	Officer	Director	Officer	Director
Nikolaus	$208	$191	$217	$165	$193	$177
Glatfelter	$211	$301	$208	$192	$164	$340
Hinkle	$472	$306	$528	$256	$521	$256
Lutz	$234	$1,108	$409	$467	$349	$256
Kraft	n/a	***	n/a	***	n/a	***

OCA St. 1 at 53. Even with the understanding that the officers/directors are not hourly employees, it is clear that some of these salaries and fees are out of line with what these individuals could expect to make in a competitive business. Id. at 53-54; OCA St. 1S at 33. Ms. Everette stated:

> Hundreds of dollars per hour, including an hourly rate for one individual in excess of $1000 per hour (Lutz, 2010), is not a reasonable cost to pass to ratepayers.

Id. at 53-54.

Based on this information, the OCA recommends that the total expense claim of $130,835 for Officers' Salaries and Directors' Fees be reduced by $33,451. OCA St. 1 at 57. As shown, the average rate of compensation for the officers and directors ranges from $165 per hour to $1,108 per hour during the three years ending 2012. Within this range, OCA witness Everette determined that the rate paid to the Company President was most realistic. OCA St. 1 at 53, 56. Mr. Nikolaus averaged $178 per hour as a director and $206 per hour as an officer from 2010 to 2012. Id. Ms. Everette applied Mr. Nikolaus' average rate of pay to the average total annual hours worked by the officers and directors from 2010 to 2012, which was 274 hours and 230 hours, respectively.[27] Id. at 56-57. This results in a reduction of $12,456 to the claim for officers and $20,995 to the claim for directors, or a total reduction of $33,451. OCA Table II, line 31; OCA Sch. 1S, line 31. Ms. Everette's recommendation allows $97,384 for Officers' Salaries and Directors' Fees expenses.

In response to the OCA's adjustment, Company witness Lewis notes that Columbia's directors' fees are substantially less than the per-meeting cost that the OCA recommended for Newtown Artesian Water Company in its 2011 rate case. CWC St. 1R at 19. Ms. Everette explained that, in that proceeding, NAWC did not provide an actual accounting of its hours in order for the OCA to make a utility-specific adjustment. OCA St. 1S at 33-34. The OCA recommended that the Commission require the Company to provide that support for its officers' and directors' expenses in future cases. Ms. Everette explained:

> This recommendation, similar to the OCA's recommendation in the 2008 CWC case, was intended to allow the OCA, Commission and other parties to evaluate the reasonableness of the claims in the next case. For CWC, this is the "next case" and the OCA is attempting to use this information to evaluate the Company's claims, in order to ensure they are reasonable for ratemaking purposes.

OCA St. 1S at 34.

The Company contends that the officers and directors are being compensated for the quality of their work more than just the quantity. CWC St. 1 at 19-20; CWC St. 1R at 18, 21-22. The OCA recognizes that these employees are salaried and do not work specific hours to earn their compensation. OCA St. 1 at 51, 53, 55; OCA St. 1S at 30. It is unreasonable to suggest, however, that the amount of compensation that is properly recovered in customer rates should

[27] The Company did not provide any hours worked by Mr. Kraft. OCA St. 1 at 57. As discussed in her testimony, Ms. Everette assumed the same number of hours for Mr. Kraft that Mr. Lutz spent in his role as director. Id.

have no relationship to the amount of time an individual spends on Company business. Id. In this case, the record shows that over the last three years, Mr. Lutz received an average of $432 per hour more as a director than Mr. Nikolaus.[28] Yet, the Company indicates that the typical duties are the same for all directors. CWC St. 1 at 16. Moreover, Mr. Nikolaus is the Chairman of the Board. Id. The $432 disparity is likewise not explained by any evidence showing that Mr. Lutz brings significantly more "quality and extent of experience . . . to the table" than Mr. Nikolaus in terms of his business background, management judgment or leadership skills. CWC St. 1 at 17-19.

With regard to their roles as officers, Mr. Lutz received an average of $125 more per hour as Secretary of the Executive Committee than Mr. Nikolaus received as President of the Company.[29] CWC St. 1 at 15. As noted, there is no evidence that Mr. Lutz brings more qualifications and experience to the table than Mr. Nikolaus. See, e.g., CWC St. 1 at 18. Nor do Mr. Lutz's activities on behalf of the Company support 60% more compensation on an hourly basis. According to the Company, Mr. Lutz's duties as Secretary are the following:

> communicates information for various special meetings of the Executive Committee and records all minutes of the Executive Committee meetings. He also serves as a signatory for the Corporate Checking Accounts.

CWC St. 1 at 15. In comparison, it describes Mr. Nikolaus' activity as President as substantially more involved:

- Visits construction sites to review progress and workmanship;
- Reviews all reports and studies;
- Reviews and approves project plans;

[28] As Directors: Lutz = $1,108 + $467 + $256 = $1831; $1831 ÷ 3 = $610. Nikolaus = $191 + $165 + $177 = $533; $533 ÷ 3 = $178. $610 - $178 = $432.

[29] As Officers: Lutz = $234 + $409 + $349 = $992; $992 ÷ 3 = $331. Nikolaus = $208 + $217 + $193 = $618; $618 ÷ 3 = $206. $331 - $206 = $125. $125 ÷ $206 = 60.7%.

- Reviews and approves permit applications;
- Reviews and approves major equipment selections;
- Reviews and approves PENNVEST payment requests;
- Reviews and approves vouchers;
- Signs checks;
- Reviews and executes agreements;
- Reviews treatment plant performance and water quality test results;
- Reviews and approves annual reports to regulatory agencies;
- Reviews and approves communications with the customers (i.e. Consumer Confidence Reports, program announcements, water conservation brochures, etc.).
- Meets with outside contractors to review progress and workmanship;
- Participates in employee interviews and hiring;
- Participates in employee performance evaluations;
- Provides input to General Manager relating to contract renewals;
- Attends public meetings when required when Company business will be discussed;
- Meets with the Company's banker periodically; and
- Visits Company facilities to review operations and maintenance.

Id. at 12-13. The evidence does not show that the quality of work or responsibilities of their roles supports the substantial difference between Mr. Lutz’s and Mr. Nikolaus’ compensation compared on an average hourly basis.

The Company argues that the OCA is “engaging in micromanaging and invading the Company’s managerial discretion.” CWC St. 1R at 19. OCA witness Everette made clear that the OCA is not asking the Commission to dictate what the Company pays its officers and directors. OCA St. 1 at 55-56; OCA St. 1S at 31-32. The Commission must determine, however, what amount can reasonably be recovered from ratepayers pursuant to the Public Utility Code. The OCA is making a recommendation based on the record evidence regarding the relative amount of each individual’s contribution to the Company, taking into consideration their time spent on Company business and the compensation that a competitive business might pay. OCA St. 1 at 51-52, 55; OCA St. 1S at 32-33, 35.

For these reasons, the Company’s expense claim for Officers and Directors exceeds the amount that is just and reasonable for ratemaking purposes. The OCA’s recommendation reduces the Officers' Salaries expense by $12,465 and reduces Directors' Fees by $20,995, or a total reduction of $33,451. See OCA Table II, line 31; OCA Sch. 1S, line 31.

2. The Commission's Ongoing Requirement for Time Records Should Continue.

In 2008, the Commission directed the Company, in its future rate cases, to provide an account of actual hours for officers to show time spent on Columbia business in relation to all other business interests. 2008 Order at *55-56, 138. The Company argues that the Commission's requirement is unreasonable and does not want to provide time records in the future. CWC St. 1 at 19. The OCA recommends that this requirement be continued. OCA St. 1 at 59-61; OCA St. 1S at 35-36.

In its last base rate case, Columbia provided only estimates of time devoted by its officers/directors to CWC business in support of its salaries and wages claims. 2008 RD at 31-32. The OCA did not challenge the level of the officers or directors fees on the basis that they were too high in that proceeding, but recommended that in future rate cases, the Company be required to provide an actual accounting of hours devoted to CWC business by its officers and directors, in relation to all other business interests. OCA M.B. at 24.

The OCA based its request on the statutory requirement that the Company support every element of its claim with specific evidence to show it is reasonable for ratemaking purposes. 66 Pa. C.S. § 315(a); see also 66 Pa. C.S. § 1301, et seq. Pennsylvania law is clear that there is no similar burden for a party proposing an adjustment to a utility base rate filing. To prevail in its challenge, Pennsylvania law requires only that the OCA show how Columbia failed to meet its burden of proof. *Supra*, Section II; Berner. The Commission agreed with the OCA that, in light of the officers/directors' multiple other business interests, the officers/directors should provide an actual accounting for their hours, relative to those interests, in future cases. 2008 Order at 41.

In the present case, Columbia argues that its officers/directors should no longer be required to keep hourly time sheets for the time they spend on company business because their compensation is not based upon hourly rates. CWC St. 1 at 19-20. The OCA notes that their compensation was not based on hourly rates in the last case either but the Commission still ordered the Company to account for the officers' and directors' time. 2008 Order at 33. Now, as then, all of the Company's officers/directors are part-time and have outside business interests.[30] CWC St. 1 at 18. As discussed above with regard to reasonableness of the compensation, there is an important distinction between the Company's discretion to pay its officers and directors whatever the shareholders support and the amount that is just and reasonable for ratemaking purposes. OCA St. 1 at 55. For the latter, the utility is accountable to the Commission, and time sheets provide information for the Commission to use in evaluating the reasonableness of the Company's expense claims.

Case in point, in the 2008 case, the OCA questioned whether the salaries paid to officers were reasonable but recommended no adjustment for ratemaking purposes based on the limited estimated time information available. OCA St. 1 at 60-61. In the present case, the information provided by the time sheets allowed the OCA to evaluate the reasonableness of the Company's claims and recommend an adjustment. See *supra*, Section VI.L.1.

[30] For example, Columbia specified that Mr. Hinkle is a pharmacist and Mr. Nikolaus is an attorney at law with offices in Columbia and Lancaster and also a director, president and CEO of Donegal Mutual Insurance Company and its affiliates. CWC St. 1 at 18. Mr. Lutz has retired from full-time employment, but his insurance company brokered the Company's 2013-2014 workers compensation and auto insurance policies through Mr. Nikolaus' insurance company. DTL Rebuttal Exh. 1. The Company did not specify Mr. Glatfelter's other business interests.

Contrary to the Company's contention, keeping time records in not limited to hourly positions. Many salaried employees keep time records in order to properly charge time to the correct entity. OCA St. 1 at 60. In fact, the Company has indicated that it will use time records to make allocations to the Marietta Division. OCA St. 1 at 60.

> An amount [of officers' salaries] will be allocated based upon the amount of time the officers spend on Marietta Division items.

Id. (citing Company response to OCA III-14). This provides another example of how time records provide valuable information that can be used to evaluate the reasonableness of the salaries claimed for ratemaking purposes. Because Columbia has maintained Marietta as a separate division, keeping adequate time records will improve the accuracy of the Company's allocation of the officers and directors' time between its two divisions in the next rate case and provide the Commission and interested parties with another tool for evaluation of the Company's claims. Id.; OCA St. 1S at 35.

Mr. Lewis argues that the time sheets are burdensome. CWC St. 1R at 22. Ms. Everette demonstrated that the time sheets provided by the Company do not indicate they took undue time or effort. OCA St. 1S at 36. She described the time records provided by Columbia:

> each Officer recorded approximately six lines of writing per month to explain the hours they recorded. (In some cases, the written explanations were only 2-3 words.) This statement is not to criticize the time records kept by the officers, but rather, to point out that this "unnecessary burden" should take the officers a very small amount of time to record. Given the benefits of allowing the Commission and other parties to evaluate the Company's claim in exchange for a few lines of time records each month, this timekeeping should not be considered an unnecessary burden by the Commission.

Id.

Mr. Lewis also argues that no other utilities or corporations are required to provide timesheets. CWC St. 1R at 18. OCA witness Everette explained that the facts of this case drive the need for timesheets. OCA St. 1S at 31. She stated:

> As CWC's officers and directors are part-time, they have other business interests which naturally take up portions of their time. The request for timesheets is not punitive; it is simply a necessary tool by which the OCA, Commission, and other parties can evaluate the reasonableness of the Company's claim for ratemaking purposes.

Id. Ms. Everette notes that Columbia is not the only company from whom the OCA has requested director timesheets. In 2011, the OCA recommended that Newtown Artesian Water Company "be required, in future cases, to support its officers' and directors' expenses in terms of actual time devoted and services provided." OCA St. 1S at 31.

Finally, Company witness Lewis argues that the officers' and directors' roles are important and the Company does not want to risk them leaving their positions because they are required to keep time sheets. CWC St. 1R at 21-22. As discussed above, the time records provided by the Company consisted of a few notations for each month. OCA St. 1S at 36. The officers and directors must recognize that their duties include helping the Company to provide water that complies with all state and federal requirements and providing this service at rates that are just and reasonable. OCA St. 1 at 55; OCA St. 1S at 35-36; 66 Pa. C.S. §§ 315(a), 1301, *et seq.*, 1501. The Commission has imposed an ongoing obligation for the officers and directors to account for hours to support an expense the Company wants to recover from ratepayers. It seems reasonable that the officers and directors would recognize that their duties include compliance with regulatory directives, particularly where the directive requires small effort.

3. Allocation

The Company did not allocate any of the Officers' Salaries or Directors' Fees to the Marietta Division. OCA St. 1 at 47 (citing the Company's response to OCA Set III-14). As a result of the acquisition of the Marietta Gravity Water Company, the officers and directors of the Columbia Division are also the officers and directors of the Marietta Division. It is therefore unreasonable to charge the Columbia Division customers for the entire cost of the officers and directors. OCA St. 1R at 36-37. Moreover, the Marietta Division has Officers' Salaries and Directors' Fees built into its existing base rates. OCA St. 1 at 57-58. To allow the Columbia Division to include the full amount of these costs in Columbia Division rates would allow the Company to double collect on these expenditures.

Specifically, OCA witness Everette recommended that 15% of the total Officers' Salaries and Directors' Fees allowed by the Commission be allocated to the Marietta Division. OCA St. 1 at 58. This is based on the logic that the time spent by Columbia's officers and directors will be the same as or similar to the ratio of time spent by Columbia employees on the Marietta Division. Id. The Company's Vice President stated that the Company expensed 15 percent of the salaries and benefits of Columbia's salaried employees to the Marietta Division. OCA St. 1 at 58 (citing Company response to I&E-RE-6). This allocation is based on his "prior experience as Superintendent for the Marietta Gravity Water Company." Mr. Lewis also pointed out that his 15% allocation is supported by the fact that the Marietta Division accounts for about 12 percent of the overall customer base. Id. (citing Company response to OCA-III-17).

The OCA's allocation is further supported because it will also benefit the Marietta Division. That division paid $17,850 in Officers' Salaries and $16,800 in Directors' Fees in 2011 (the last pre-acquisition year). Ms. Everette's 15% allocation would allocate substantially less to the customers in that division. OCA St. 1 at 59 ($8,467 for Officers' Salaries and $6,141 for Directors' Fees.

As noted, the Company did not allocate any amount of the Officers' Salaries and Directors' Fees in its initial filing. OCA St. 1 at 47. Columbia said that "[i]nsufficient time had passed since the acquisition to determine the appropriate amount of time that should be allocated to the Marietta Division. An amount will be allocated based upon the amount of time the officers spend on Marietta Division items." Id. The Company contests the OCA's 15% allocation, however, on the basis that it compares the allocation of supervisors to (part-time) officers and directors. The Company offers no valid alternative, however. As Ms. Everette explained:

> Mr. Lewis' counter-proposal of 4% is unsupported and unreasonably low. Mr. Lewis provided no justification for his recommended 4% allocation, and it is not supported by number of customers, number of employees, time spent by employees between divisions, or annual revenues.

OCA St. 1S at 37. Moreover, the Company has not supported any correlation between the Officers and Directors' responsibilities and customer bills. Tr. 117.

For these reasons, the OCA's recommended 15% allocation of the total Officers' Salaries and Directors' Fees allowed by the Commission to the Marietta Division should be adopted. Ms. Everette recommended a total expense of $97,384 for Officers' Salaries and Directors' Fees ($56,444 for Officers' Salaries and $40,940 for Directors' Fees); 15% of this results in an allocation of $14,608 to the Marietta Division.[31] OCA Table II; OCA Sch. 1S, line 32.

[31] If the Commission does not accept the OCA's adjustment to the amount of Officers' Salaries and Directors' Fees expenses, *i.e.* allows the entire claim of $130,095 ($68,900 Officers' Salaries + $61,195 Directors' Fees), 15%, or $19,514 should be allocated to the Marietta Division. OCA St. 1S at 59, n.22.

Based on the record in this proceeding, it appears that affiliated interest agreements may need to be filed with the Commission regarding CWC's purchase of services from Donegal Mutual Insurance Company and Lutz. See 66 Pa.C.S. §§ 2101 and 2102. 2101(a)(5)

M. Reduce Regulatory Assessments for OCA Revenue Recommendation

Consistent with the OCA's recommended reduction to revenues, the OCA recommends approval of its reduction to regulatory assessment. OCA Exh. AEE-1S, Sch. 1S.

N. Summary

The OCA recommends a total adjustment of $236,742 to the Company's expense claim, as shown on line 34 of Schedule 1S. OCA Table II.

VII. TAXES

OCA witness Everette calculated the Gross Revenue Conversion Factor of 1.4228 shown on Schedule 1S, line 8 using the information outlined on GDS Exhibit No. 1, Supporting Schedule No. 10, adjusted for interest synchronization and the OCA's revenue requirement adjustments. This Factor also reflects the deduction for Qualified Domestic Production Activities, which was accepted by the Company as shown on GDS Rebuttal Exhibit No. 3 (Revised). OCA St. 1S at 45; OCA Exh. AEE-1S, Schs. 1S, 8S.

VIII. COST OF CAPITAL AND RATE OF RETURN

A. Introduction

In this proceeding, Columbia has claimed a 9.18% overall cost of capital including an equity cost rate of 11.35%. The Company proposes to utilize its actual capital structure consisting of 35.6% long-term debt and 64.4% common equity. CWC St. 3, Appendix B, Sch. DWD-1 at 1. As discussed below and based on the testimony of OCA witness Aaron Rothschild,[32] the OCA submits that the Company's proposed rate of return is excessive due to an equity-rich capital structure and an overstated equity cost rate. The OCA recommends use of the actual capital structure of 44.15% long-term debt and 55.85% common equity. The OCA submits that Columbia's overall cost of capital is 6.75%, including an equity cost rate of 8.25%. OCA Surrebuttal Sch. ALR-2.

[32] Mr. Rothschild is a financial consultant specializing in cost of capital issues in utility regulation. He has seventeen years of experience providing utility financial analysis. Mr. Rothschild has applied his expertise and testified in numerous proceedings before the Pennsylvania Public Utility Commission, over twenty other state public service commissions, and the Federal Energy Regulatory Commission. His full background and qualifications are attached as Appendix A to OCA Statement 2.

1. The Legal Framework for Determining What Rate of Return Is Fair to Columbia Consumers and the Company.

As a general matter, cost of capital is the basis for determining a fair rate of return. Pa. P.U.C. v. Philadelphia Suburban Water Co., 71 PaPUC 593, 623 (1989) (PSWC 1989). The Commission has defined an appropriate rate of return as:

> the amount of money a utility earns, over and above operating expenses, depreciation expense and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base. Included in the 'return' are interest on long-term debt, dividends on preferred stock, and earnings on common stock equity. In other words, the return is the money earned from operations which is available for distribution among the capital. In the case of common stockholders, part of their share may be retained as surplus.

Pa. P.U.C. v. Emporium Water Co., 95 PaPUC 191, 196, 208 PUR4th 502, 507 (2001) (quoting Paul J. Garfield & Wallace F. Lovejoy, Public Utility Economics 116 (1964)). Further, "[t]he return authorized must not be confiscatory, and must be based upon the evidence presented." Pa. P.U.C. v. Phila. Suburban Water Co., 71 Pa. PUC 593, 623 (Dec. 28, 1989) (citing Pittsburgh v. Pa. P.U.C., 165 Pa. Super. 519, 69 A.2d 844 (1949)).

A public utility with facilities and assets used and useful in the public service is entitled to no more than a reasonable opportunity to earn a fair rate of return on its investment. Pa. P.U.C. v. Consumer Pa. Water Co. – Roaring Creek Div., 87 Pa. PUC 826, 844 (Nov. 21, 1997). The United States Supreme Court established the standard with which to evaluate whether a rate of return is fair in Bluefield Waterworks & Improvement Co. v. Public Service Comm'n of West Va., 262 U.S. 679 (1923) (Bluefield), stating:

> The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management . . . to raise the money necessary for the proper discharge of public duties.

Bluefield, 262 U.S. at 693. The Court also said that allowed rates of return should reflect the following:

> [A] return on the value of the [utility's] property which it employs for the convenience of the public equal to that. . .being made at the same time… on investments in other business undertakings which are attended by corresponding risks and uncertainties.

Bluefield, 262 U.S. at 692. Twenty-one years later, the Court reviewed the issue of fair rate of return in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944) (Hope). In Hope, the Court held that a fair rate of return "should be commensurate with returns on investments in other enterprises having corresponding risks" while being sufficient "to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital." Hope, 320 U.S. at 603. The Court noted that "[t]he rate-making process under the Act, *i.e.*, the fixing of 'just and reasonable' rates, involves a balancing of the investor and consumer interests . . . and does not insure that the business shall produce revenues." Id. More recently, the Court stated that consumers are obliged to rely upon regulatory commissions to protect them from excessive rates and charges. See Permian Basin Area Rate Cases, 390 U.S. 747, 794-95 (1968) (citing Atlantic Refining Co. v. Public Service Comm'n, 360 U.S. 378, 388 (1959)).

Finally, in Duquesne Light Co. v. Barasch, the Court stated "whether a particular rate is 'unjust' or 'unreasonable' will depend to some extent on what is a fair rate of return given the risks under a particular ratesetting, and on the amount of capital upon which the investors are entitled to earn on that return." Duquesne Light Co. v. Barasch, 488 U.S. 299, 310 (1989), aff'g Barasch v. Pa. P.U.C., 532 A.2d 325 (Pa. 1987). The Commission has stated:

> A fair rate of return for a public utility, however, is not a matter which is to be determined by the application of a mathematical formula. It requires the exercise of informed judgment based upon an evaluation of the particular facts presented in each proceeding. There is no one precise answer to the question as to what constitutes the proper rate of return. The interests of the Company and its

> investors are to be considered along with those of the customers, all to the end of assuring adequate service to the public at the least cost, while at the same time maintaining the financial integrity of the utility.

Pa. P.U.C v. Pennsylvania Power Co., 55 PaPUC 552, 579 (1982) (emphasis added). See Pa. P.U.C. v. National Fuel Gas Dist. Corp., 73 PaPUC 552, 603-05 (1990).

2. Summary

For purposes of this proceeding, the OCA recommends use of the Company's actual capital structure of 44.15% debt to 55.85% equity, which is corrected from the actual capital structure proposed by the Company. The parties have agreed on a long-term debt calculation method based on a weighted average cost rate of the Company's outstanding debt of 5.00%; the OCA adjusts this number to reflect unrecognized debt financing at a cost rate of 4.50% to calculate its recommended long-term debt cost rate of 4.85%. This capital structure is in line with the capitalizations of water utility companies in the market that the OCA uses to develop its equity cost rate. The 8.25% cost of equity is the result of the analysis and informed judgment of OCA expert Aaron L. Rothschild. The OCA's recommended 8.25% cost of equity capital and 6.75% overall rate of return when applied to the Company's adjusted rate base will properly provide Columbia an opportunity to earn a fair rate of return while benefiting consumers with public service at reasonable rates, consistent with Pennsylvania law and public policy as set forth in the Public Utility Code. See 66 Pa. C.S. § 101, *et seq.*

B. Capital Structure

The Commission has used the actual capital structure for ratemaking purposes in many cases. Notably, in Columbia's 2008 base rate case, the Commission adopted the Company's actual capital structure of 64.2% equity and 35.8% debt. The OCA and I&E argued in that proceeding that the Company's actual capital structure ratios did not reflect the capitalization of similar water utility companies. 2008 Order at 65, 67. The average common equity for the proxy groups was 50%. Id. at 65. In this case, the Company claimed an actual capital structure ratio of 64.40% common equity and 35.60% long-term debt. CWC St. 2 at 2.

OCA witness Rothschild presented evidence showing that the Company's capital structure was not the correct actual capital structure. OCA St. 2 at 5-6. Mr. Rothschild used the Total Measure Value of $13,527,774 used by the Company to set rates as the total capitalization and the $7,555,405 common equity reported by the Company to determine the amount of long-term debt of $5,972,369 ($13,527,774 - $7,555,405). Id. at 6. The Company's development of capital structure ratios for rate making purposes includes only $11,738,152, which is $1,789,622 less than the $13,527,774 Total Measure of Value used to set rates. Id.; CWC St. 2, Supporting Sch. 9. Considering that the Company received a $2.2 million Wells Loan on October 4, 2012 at a 4.50% interest rate it is appropriate to allocate this cost rate to this unexplained gap between the Company's claimed capitalization and the Total Measure of Value to set rates. OCA St. 2 at 6 (citing CWC response to I&E-RE-3). The correct actual capital structure is 55.85% common equity and 44.15% long-term debt. OCA St. 2 at 5-7, Sch. ALR 1 at 1, Sch. ALR 6.

Mr. Rothschild also offered an alternative hypothetical capital structure recommendation based on the capital structure ratios of the comparative water group of 48.24% common equity and 51.76% long-term debt. OCA St. 2 at 5, 7, Sch. ALR 1 at 2. I&E also recommended a hypothetical capital structure of 50% common equity and 50% long-term debt, based on the five year average capital structure for Ms. Maurer's barometer group. I&E St. 1 at 15.

In rebuttal, the Company's witness D'Ascendis argues that, because the Company's actual capital structure and the average common equity ratio of his proxy group in the current case are so similar to those in the 2008 rate case, that Mr. Rothschild's recommended capital structure is not reasonable. CWC St. 1R at 3. The Company fails to address the $1.8 million gap between the Company's claimed capitalization and the Total Measure of Value to set rates. OCA St. 1S at 4. The projected Measure of Value and the projected capital structure should be related in order to create a credible projected capital structure; thus Mr. Rothschild's correction is reasonable.

The OCA's recommends that its corrected, actual capital structure be approved. It is appropriate to relate the projected Measure of Value and the projected capital structure in order to create a credible projected capital structure. OCA St. 1S at 4. Moreover, the OCA's primary recommendation represents an appropriate balance between the interests of the utility and ratepayers.

C. Cost of Debt

The Company calculated its weighted cost of debt, as of the end of the future test year, to be 5.24% based on the amount of debt outstanding and the interest expense estimated for the year ending December 31, 2013. CWC St. 2, at 2, Sch. DWD-1. OCA witness Rothschild removed the cost rate of loans that have zero balances and allocated $1,789,622 of debt at the cost rate of the recently received loan discussed above with regard to capital structure. These adjustments produced his recommended embedded cost of debt of 4.32%. OCA St. 2 at 6.

Similarly, I&E witness Maurer opposed Mr. D'Ascendis' method for calculating the cost of debt because "it includes debt issuances that are expected to be paid off by the end of the test year and calculates the cost rate based on the amount of interest expense paid during the test year." I&E St. 1 at 15. She corrected for this by assigning the cost rate for each series of debt a weight according to what percent the amount outstanding at December 2013 will be as a part of the total outstanding, which produced her recommended cost of debt rate of 5.00%. Id. at 17; I&E Exh. 1, Sch. 3.

In rebuttal, Company witness D'Ascendis conceded to the debt cost rate calculated by Ms. Maurer. CWC St. 3R at 3. Mr. Rothschild also accepted Ms. Maurer's cost of long-term debt calculation method. He also recommended adding the "unrecognized debt financing" of $1,789,622 to Ms. Maurer's calculations at a cost rate of 4.50% to calculate a long-term debt cost rate of 4.85%. OCA St. 2S at 5; OCA Surrebuttal Sch. ALR-2. As discussed above, this adjustment is necessary to relate the projected Measure of Value and the projected capital structure. OCA St. 2 at 6; OCA St. 2S at 4.

D. Cost of Equity

1. Introduction

The current capital markets indicate that an appropriate return on equity for Columbia Water is 8.56% or 8.25% with Columbia Water's actual capital structure. See OCA St. 2 at 8-44. As discussed by Mr. Rothschild, the Fear Index is below levels in the year prior to the financial crisis, government bond yields are at historic lows, bond yields have returned to pre-recession levels, stock indices are near all-time highs, and companies have access to capital. To develop the appropriate return on equity, Mr. Rothschild used a nearly identical comparison group, and used the constant growth form of the Discounted Cash Flow (DCF) method. In contrast, Company witness D'Ascendis recommended 11.35% overstates the cost of equity for Columbia Water. See OCA St. 2 at 44-51. The Company's witness uses incorrect inputs, multiple methods with flaws, and does not correctly apply the DCF method. In addition, he adds unnecessary adjustments for business and financial risk.

As discussed in more detail below, the Commission should accept the OCA's recommended cost of equity of 8.25%, used in conjunction with the actual capital structure as discussed above.

2. The Commission Should Adopt the OCA's 8.25% DCF-Derived Equity Cost Rate Because the Commission Favors DCF Results to Set Common Equity Cost Rates.

The Pennsylvania Public Utility Commission favors the use of the DCF analysis. The Commission has relied on the DCF approach for setting returns on equity for many years. See, e.g., Pa. P.U.C. v. York Water Co., 75 PaPUC 134, 159-69 (1991) (York) PSWC 1989; Pa. P.U.C. v. Pennsylvania-American Water Co., 71 PaPUC 210, 279-82 (1989); Pa. P.U.C. v. The Peoples Natural Gas Co., 69 Pa. PUC 1, 167-68 (1989); Pa. P.U.C. v. Pennsylvania Power Co., 67 PaPUC 91, 164, 93 PUR4th 189, 266 (1988)(Penn Power); Pa. P.U.C. v. National Fuel Gas Dist. Corp., 67 PaPUC 264, 332 (1988).

> After a thorough examination of the record in this proceeding, we continue to find that the DCF method is the preferred method of analysis to determine a market based common equity cost rate.

PSWC 2002 at *113.

Moreover, the Commission has preferred the DCF approach to several other methods. Pa. P.U.C. v. Roaring Creek Water Co., 84 PaPUC 438, 462 (1995) (Roaring Creek 1994). Concerning the DCF method, the Commission has stated:

> In considering the issues and arguments raised regarding the appropriate return on common equity for RCW, we note the following. We have, in recent years, relied primarily on the DCF methodology in arriving at our authorized return on common equity. As correctly observed by the ALJ, we rejected the use of the risk premium and the CAPM methods in the company's last rate case at Roaring Creek 1994, *supra*, as well as in Pennsylvania Power Company, *supra*. There is no evidence of record in the proceeding before us, which convinces us that such

> methodologies should be used in this proceeding. Accordingly, we will continue to rely primarily on the DCF methodology and informed judgment.

Roaring Creek 1994 at 462; see also PSWC 1989 at 623-32; Pa. PUC v. Western Water Co., 67 PaPUC 529, 559-70 (1988); York at 153-67; Pa. P.U.C. v. Equitable Gas Co., 73 PaPUC 345-46 (1990); Pa. P.U.C. v. Pennsylvania American Water Co., 2002 PaPUC LEXIS 1 at *90. While the OCA acknowledges that the Commission has used other methodologies as a check on recommended DCF results, the Commission relies primarily on the DCF model to set common equity cost rates. Mr. Rothschild's common equity cost evaluation is consistent with the Commission's approach and using this approach he determined an 8.25% common equity cost rate is appropriate for Columbia Water. OCA St. 2 at 3.

In rebuttal, Company witness D'Ascendis criticizes Mr. Rothschild for relying exclusively on the DCF. CWC St. 3R at 19. As noted by Mr. Rothschild, "It is critical to have one accurate model. Adding more models, particularly if they are flawed, does not increase accuracy." OCA St. 2S at 2. Moreover, Mr. Rothschild used the non-constant DCF method as a check on his results. As discussed below, it is clear that Company witness D'Ascendis' method of using many different models that have significant flaws does not ensure greater accuracy. Rather, it clutters the record with results that are clearly not reasonable.

3. The OCA Recommended DCF Result Is Consistent With Investor Expectations and Current Market Conditions.

Columbia Water is not a publicly traded company, therefore it is necessary to use a comparison group to approximate the dividend yield and growth rate. Mr. Rothschild used seven of the nine companies used by Company witness D'Ascendis. The only difference is that Mr. Rothschild did not include York Water Company and Artesian Resources Corporation. OCA St. 2 at 24. Mr. Rothschild did not include those two companies because, as of April 19, 2013, they were not included in Value Line's standard report publications and as a result, the same level of financial data was not available for those two companies compared to the seven others in the comparison group. Id.

As noted by Mr. Rothschild, the DCF method is an approach to calculating the cost of common equity that "recognizes that investors purchase common stock to receive future cash payment." Id. Investors receive these future payments from current and future dividends and proceeds from selling stock. Id. "A rational investor will buy stock to receive dividends and to ultimately sell the stock to another investor at a gain. The price the new owner is willing to pay for stock is related to the future flow of dividends and the future expected selling price." OCA St. 2 at 25. Mr. Rothschild explained that the value of the stock is equal to the discounted value of future dividends until the stock is sold plus the value of the sale proceeds. Id. He provided the following example:

> [I]f the cost of equity is 9% and the dividend is $1 per share, then the $1 dividend paid out next year is today worth $1/[$1+.09] which equals $0.92 reflecting the discounted present value.

OCA St. 2 at 25.

Mr. Rothschild provided historical information about the use of the DCF method, noting that the DCF approach first appeared in 1937. OCA St. 2 at 25-26. Before the DCF method, investors used methods such as P/E ratios or dividend yields. As he noted, although these methods are still used today, they are incomplete and can provide only rough guidelines to investment value. Id.

In determining the appropriate common equity cost rate for Columbia Water, Mr. Rothschild used the constant growth DCF method. That method determines growth based on the sustainable retention growth procedure. OCA St. 2 at 24. He used a non-constant DCF method as a check. The constant growth form of the DCF model can be used when investors can reasonably expect that the growth of retained earnings and dividends will be constant. OCA St. 2 at 27. Retained earnings are the fund that a company keeps to either grow the business or pay off debt. Id. Investors look at retained earnings as an indicator of whether the company is growing, which informs them about the future value of a company's stock. Id.

Mr. Rothschild explained how the constant growth model works:

> The constant growth model is described by this equation k= D/P + g, where:
>
> k= cost of equity;
> D=Dividend rate; and
> P=Market price of stock.
>
> In the above equation:
>
> g=the growth rate, where g= br + sv;
> b=the earnings retention rate;
> r=rate of return on common equity investment;
> v=the fraction of funds raised by the sale of stock that increases the book value of the existing shareholders' common equity; and
> s=the rate of continuous new stock financing.
>
> The constant growth model is therefore correctly recognized to be:
>
> k=D/P + (br +sv)

OCA St. 2 at 27-28. As discussed below, Mr. Rothschild applied the constant growth DCF method to the comparison group.

Mr. Rothschild noted that sufficient care must be taken to ensure that the growth rate, "g" is representative of the constant sustainable growth. He noted that using earnings per share growth rate will result in an overstatement of the cost of equity if there also is an expectation of a lower dividend growth rate because the dividend yield portion of the constant growth form of the equation will be overstated. OCA St. 2 at 29. He noted that using the "br" approach (b=earnings retention rate x the rate of return on common equity investment), rather than an analysts earnings per share growth rate is reasonable because the "br" approach eliminates the mathematical error caused when there is an inconsistency between earnings per share growth and dividends per share growth expectations. Id.

In rebuttal, Company witness D'Ascendis criticizes Mr. Rothschild's sustainable growth methodology as a short term forecast. See OCA St. 2S at 2. However, this criticism is unfounded. Mr. Rothschild's DCF is different from Company witness D'Ascendis' method because Mr. Rothschild's DCF respect the interrelationship between earnings, dividends, book value and stock price. Id. Mr. Rothschild's DCF application is consistent with the result of the McKinsey study (OCA St. 2 at 23) and the mathematical relationship between earnings, dividends, and retention rate.

In rebuttal, Company witness D'Ascendis criticizes the sustainable growth methodology as circular. Mr. Rothschild noted that criticisms of the "br" approach are unfounded:

> 1. The constant growth form of the equation using br is:
>
> $$k= D/P + (br + sv).$$
>
> In this equation, k is the variable for the cost of equity, and r is the future expected return on equity. The cost of equity, "k," is not the same variable as the future expected earned return on equity, "r." In fact, there often is a large difference between the two.
>
> 2. The correct value to use for "r" is the return on book equity expected by investors as of the time the stock price and dividend data is used to quantify the D/P term in the equation. Therefore, even if future events occur that may change what investors expect

for "r", the computation of the cost of equity "k" remains correct as of the time the computation was made.

3. The ability of a commission decision to influence future cash flow expectations is not unique to the retention growth approach to the DCF method. The five-year analysts' earnings per share growth rate is a computation that is directly influenced by what earnings per share will be in five years. A change in what analysts expect will be the allowed return on equity for earnings generated five years from now will change not only the expected earnings per share five years from now, but will also change the five year earnings per share growth rate.

OCA St. 2 at 31-32 (emphasis added). Mr. Rothschild applied the constant growth form of the DCF method by "staying true to the mathematically derived "k=D/P + (br+ sv)" form of the DCF model." OCA St. 2 at 33. He also fully allocated all future expected earning to either future cash flow(in the form of dividends, or "D") or to retained earnings (the retention rate, "b"). Id.

The DCF method requires the dividend expected over the next year (D), which Mr. Rothschild estimated by increasing the quarterly dividend rate by ½ of the current actual quarterly dividend rate. OCA St. 2 at 33. Mr. Rothschild obtained the stock price (P) from the closing prices of the stocks on June 30, 2013. Id. at 34. He also looked at an average stock price by averaging the high and low stock prices during the 12 months ending June 30, 2013.

Mr. Rothschild used the Value Line expected average return on book equity to find the value of "r". Id. at 34. He also looked at the earned return on equity based on analyst earning growth rate expectations and the actual earned returns on equity. He noted that for a stable industry like the water companies, investors will look at actual earned returns as one indicator of future earned returns on book equity.[33] Id.

Mr. Rothschild also quantified the growth experienced by utility companies by selling new common stock. OCA St. 2 at 35. Specifically, he calculated the growth caused by the sale of new common stock above book value by multiplying the amount that the actual market to book ration exceeds 1.0 by the compound annual growth rate of stock forecasted by Value Line. See Sch. ALR-4, p. 1.

Recognizing that some want to focus on current price and others are concerned about using a spot price, Mr. Rothschild presented both so as to provide the Commission with the option it determines is most appropriate. Applying the constant growth DCF method based on year end and average prices to his comparison group results in a range between 7.94% and 8.70% for the year ending June 30, 2013, and as of June 30, the results are 8.35% and 9.17%. Thus, the range for Mr. Rothschild's constant growth DCF is 7.94% and 9.17%. Sch. ALR-2.

It should be noted that his results are not as influenced by overoptimistic analysts' forecasts because he did not rely on the five year earnings growth rate forecasts, relying instead on computing sustainable growth rates. OCA St. 2 at 37. In rebuttal, Company witness D'Ascendis claims that earnings per share growth rates are the superior option in selecting projected growth in a DCF model. See OCA St. 2S at 3. As explained by Mr.

[33] Mr. Rothschild cautioned that the "return on book equity expectation used in the DCF method to compute growth must *not* be confused with the cost of equity. Since the stock prices for the comparative companies are considerably higher than their book value, the return investors expect to receive on their market price investment is considerably less than whatever is the anticipated return on book value. If the market price is low, the cost of equity will be higher than the future expected return on book equity, and if the market price is high, then the return on book equity will be less than the cost of equity." OCA St. 2 at 33-34

Rothschild, a recent study shows that earning per share growth rates are not the best indicator of investor required returns. Id. Specifically, a 2010 study conducted by McKinsey & Company found that analysts have been persistently over optimistic, by almost 100%, for the past 25 years. OCA St. 2 at 23; OCA St. 2S at 3. Thus, Company witness D'Ascendis' criticism is unfounded and his analysis is overstated.

Mr. Rothschild used the non-constant growth form of the DCF as a check on his constant growth DCF calculations. OCA St. 2 at 37-44. Although not as common as the constant growth model, using it as a check confirms that his range is reasonable. The results of the non-constant growth DCF for the comparison group are 7.27%. OCA St. 2 at 44. The non-constant growth DCF accounts for growth rates that change over time. It is based on an estimate of each separate annual cash flow the investor expects to receive. Mr. Rothschild used Value Line's annual forecasts to arrive at the specific non-constant growth rates. See OCA St. 2 at 37-38; Sch. ALR-4, p. 2. Mr. Rothschild used the annual model rather than a quarterly non-constant growth DCF method because it is easier to input the data and for observers to more easily understand what is happening. OCA St. 2 at 39. Using the annual model causes a small overstatement of the cost of equity. Id. Finally, it is not necessary for earnings and dividends to grow at a constant rate for the model to be accurate. OCA St. 2 at 42.

Mr. Rothschild also noted that the DCF method is still valid when market-to-book ratios are different than one. OCA St. 2 at 42. Older methods such as the P/E ratio lose accuracy as the market to book ration varies from 1.0 but the DCF method is a model that produces reliable results regardless of the market to book ratio. Id.

4. The OCA Recommended Cost Rate Is Appropriate in Today's Financial Market.

Mr. Rothschild also reviewed his common equity cost rate recommendation of 8.25% with Columbia Water's actual capital structure in relation to the financial market. OCA St. 2 at 8-23. According to Mr. Rothschild, the current financial market demonstrates that his common equity cost rate is reasonable. Market data in four key areas show that "fear is down, the market expects low interest rates to continue, corporations can raise debt capital and investors are buying equities." In rebuttal, Company witness D'Ascendis appears to be confused that this overview of the current financial market is somehow the basis of Mr. Rothschild's cost of equity recommendation. See OCA St. 2S at 5. However, it is clear that Mr. Rothschild's cost of equity recommendation is based on his DCF analysis and the purpose of the overview of the financial market is simply that, to provide an overview. Id. The financial data presented by Mr. Rothschild, as discussed below, is informative to place the discussion regarding the appropriate cost of equity for Columbia Water in context.

a. The Fear Index is Down

A market index, called the Market Volatility Index (VIX), or sometimes known as the fear index, and initiated in 1993 by the Chicago Board Options Exchange, shows investors' assessment of the riskiness of financial markets. OCA St. 2 at 10. The index is based on options on the S&P 500 Index and looks out over the next 30 days on an annual basis. That index shows that investors' perception of future volatility has decreased significantly. OCA St. 2 at 9. As of June 28, 2013, the VIX Index was trading at 16.86 which means that investors expect an annualized change of 16.86% over the next 30 days. OCA St. 2 at 10. As shown on the chart at page 10 of OCA St. 2, this level is significantly below the 80 that the VIX Index was trading at in 2008.

Mr. Rothschild also explained that there is a volatility index, VXV, which is based on the same methodology but measures the markets' expectation of three month volatility. It too is significantly below its 2008 levels (18.39 compared to more than 60) and near historic lows. OCA St. 2 at 11.

b. Government Bond Yields Are At Historic Lows.

Mr. Rothschild explained that bond prices have stabilized and that yields are being kept low by the U.S. Government. OCA St. 2 at 11. He explained that impacts cost of equity because the stated goal of the federal government is to get investors to purchase higher risk securities to spur the economy and reduce the cost of equity. Id. at 12. This policy appears to be working, according to Mr. Rothschild, because stock indices are reaching all-time highs and corporations are able to finance at low interest rates.

c. Bond Yield Spreads Have Returned to Pre-Recession Levels.

Another indicator that OCA's equity cost rate is appropriate in the current financial climate is that the premium that investors require to purchase bonds has been trending down in 2013 and are lower than levels seen during the recession as can be seen on the chart in Mr. Rothschild's testimony OCA St. 2 at 12-13.

d. Stock Indices Are Reaching All-Time Highs

Mr. Rothschild included a chart that shows that the S&P 500 index has grown over 100% since the recession. OCA St. 2 at 13-14. He noted that the increase in stock prices indicates that investors are buying equities and that the cost of equity is decreasing. Id. at 15.

e. Companies Have Access to Capital

Mr. Rothschild noted that the corporate bond market has been expanding since 2011 which has reduced the average yield by 10 basis points each quarter since 2011. OCA St. 2 at

15-16. He explained that the yield on 30-year Treasury bonds was lower than at any other time since 1977, as can be seen on the chart included in his testimony. Although the decrease in bond yields has been significant, there has not been a direct proportional reduction in authorized returns. OCA St. 2 at 17.

5. The Commission Should Reject the Company's 11.35% Equity Cost Rate Which Is Based on Multiple Costing Methods with Biased Inputs.

a. Introduction

Although the Commission continues to favor the DCF model for estimating an appropriate cost of equity for public utilities in Pennsylvania, Columbia witness D'Ascendis applied three cost rate models, a DCF model, a risk premium, and the CAPM. OCA St. 2 at 45. From the results of all of these models, Company witness D'Ascendis identified an indicated equity cost rate of 10.6%. CWC St. 3 at 4. He then added 25 basis points for managerial performance and 25 basis points for acquisition incentives, 40 basis points for a size adjustment and a (0.16) basis points adjustment for financial risk. OCA St. 2 at 45-46. After these adjustments, the Company's resulting recommended equity return is 11.35%.

As explained below, the Company's risk adjusted return of 11.35% overstates the appropriate cost of equity for Columbia through the blending of results of flawed valuation analyses plus unwarranted adjustments for size and performance. OCA St. 2 at 44-51.

b. Company Witness D'Ascendis' DCF Model Results Are Overstated and Should Be Rejected.

Company witness D'Ascendis used a single stage constant growth DCF model, incorporating a projected five year growth in earnings per share to an adjusted dividend yield for each of the nine companies in his comparison group. This resulted in an average result of 8.98%, and a median result of 7.98%. OCA St. 2 at 46.

The use of non-constant 5 year earnings per share growth rate can lead to unreliable results. His growth component is a 5 year point to point estimate that in not a long term sustainable growth rate. OCA St. 2 at 47.

The overstatement of Mr. D'Ascendis' DCF model results is exacerbated by his further adjustment for size. Mr. D'Ascendis makes a 40 basis point adjustment because he believes that the Company has a greater relative risk than the average company in his barometer group due to its smaller size compared with the group. CWC St. 3 at 34. The fallacy of this size adjustment is addressed by I&E witness Maurer. I&E St. 1 at 40-41. The OCA agrees that no size adjustment is warranted. Mr. Rothschild did not consider a size premium in determining his recommended cost of equity.

c. <u>Company Witness D'Ascendis' Risk Premium and CAPM Analyses Are Flawed and Not Appropriate to Determine the Cost of Equity for Columbia.</u>

Company witness D'Ascendis calculated a cost of equity of 12.08% based on his Risk Premium and 10.49% based on his CAPM. OCA St. 2 at 48. All of these analyses are flawed.

Company witness D'Ascendis used two risk premium models. As explained by Mr. Rothschild:

> His PRPM™ is based on research showing that the level of volatility in equity returns can be used to predict future levels of risk premiums. The model inputs include historical returns of the common equity of the companies in his proxy group minus the historical monthly yield on long-term U.S. Treasury securities through May 2013. Statistical software was used to determine the projected equity risk premium for each of the water companies in Mr. D'Ascendis's proxy group, which range between 5.83% for Connecticut Water Services to 15.1% for American Water Works as shown on Schedule DWD-6, Page 2 of 10 of his Direct Testimony. The risk-free rate component of 4.51% is based on an average of forecasted 30-year U.S. Treasury Bond of 3.73% and

> the average historical return of long-term government bonds of 5.28%.
>
> Mr. D'Ascendis's total market approach RPM adds a prospective public utility bond yield to an equity risk premium. The equity risk premium is based on a beta-adjusted total market equity risk premium and an equity risk premium based upon S&P Utilities Index. He determines the prospective bond yield based on the consensus forecasts of about 50 economists of Aaa rated corporate bonds (4.47%) and then increases this result by 0.30% to be equivalent to a Moody's A2 rated public utility bond (4.77%). He adds an additional 0.16% to make the prospective bond yield applicable to the average Moody's bond rating of A3 of the proxy group of nine water companies (4.93%). The equity risk premium portion is based on his consideration of Value Line's forecasted total annual market return in excess of prospective bond yields and two different equity risk premium studies for public utility equity returns over Moody's A rated bonds.

OCA St. 2 at 48-49. Mr. Rothschild concluded that the cost of equity results that approach 20% for water companies, among the lowest risk industries, as indicated by their betas, are unrealistically high. Clearly, these results cannot be relied upon and must be rejected.

Company witness D'Ascendis also used a CAPM method. OCA St. 2 at 49-51. Many of the inputs he used are inaccurate and result in overstating the cost of equity he derives from this model. Specifically, he uses arithmetic average return that overstates the historical risk premium by about 200 basis points. The arithmetic mean is not appropriate for calculating the cost of equity. See OCA St. 2 at 51. In addition, his risk free rate is based on unreliable forecasts and historical data instead of current market rates. Id.

6. The Record Does Not Contain Evidence to Support Columbia's Proposed Adjustments for Performance.

Mr. D'Ascendis' recommended return on equity for Columbia includes the Company's request for an additional 50 basis point premium to reflect Columbia's management efficiency, a 1998 acquisition of a neighboring water system, and a 2012 acquisition of an affiliate water system. CWC St. 3 at 4, 36-37. The fifty basis point reward would add approximately $68,988 to the Company's annual revenue requirement.[34]

Section 523 of the Public Utility Code makes clear that a utility cannot be rewarded with a rate of return premium without specific evidence to support the adjustment. 66 Pa. C.S. § 523(a). The statute provides that the Commission will consider evidence regarding the utility's efficiency, effectiveness and adequacy of service. Section 69.721(g) of the Commission's regulations specifies that the Commission will consider evidence regarding acquisitions in finding whether any Section 523 adjustment is warranted, if the requesting utility provides specific evidence in support. 52 Pa. Code § 69.721(g). The OCA offers this clarification because the Company's rate of return witness states, incorrectly, that there is a distinction between "the performance factor and the acquisition premium." CWC St. 3RJ at 8.

In the following discussion, the OCA will demonstrate that the evidence put forth by Columbia does not warrant any upward adjustment to the DCF-indicated return on equity to reflect the Company's management efficiency or acquisitions.

a. Management Efficiency

Columbia has requested an 11.35% return on equity in this proceeding, which includes a 25 basis point adder to recognize the Company's "outstanding service and commitment to the community." CWC St. 1 at 10. Specific reasons cited by Columbia as justification for awarding a rate of return premium include: (1) compliance with water quality and pressure requirements, (2) efforts to minimize expenses and use existing staff efficiently, (3) extending lines to an area

[34] Using the Company's proposed equity ratio of 64.4%, a 0.25% equity bump results in a 0.16% bump to ROR (64.45% x 0.25% = 0.16%). Sch. DWD-1 at 1. Using the rate base claimed in Columbia's revised rebuttal testimony of $13,796,707, each 0.25% adder results in an additional $34,492 of revenue requirement ($13,796,707 x 0.25% = $34,492). GDS Rebuttal Exh. 3 at 3.

of Manor and West Hempfield Townships, and (4) acquiring Marietta Gravity Water Company. Id. at 7-9.

All regulated utilities in Pennsylvania are required to provide safe, adequate, reasonable and efficient service as a matter of law. 66 Pa. C.S. § 1501. An appropriate rate of return on common equity assumes efficient and reasonable management of a utility. This is established by the fact that the Commission will allow a utility less than the indicated rate of return where service does not meet the requirements of Section 1501. See, e.g., Pa. P.U.C. v. Pennsylvania Gas & Water Co., 61 PaPUC 409, 415-16, 425, 427, 74 PUR4th 238, 244-45, 254, 256 (1986); Pa. P.U.C. v. Pennsylvania Gas & Water Co., 68 PaPUC 191, 195-96 (1988). It follows that a utility must be doing more than providing efficient and reasonable service in order to receive more than the indicated rate of return pursuant to 66 Pa. C.S. § 523.

It was for this reason, in the Company's most recent base rate case that the Presiding Officer and the Commission rejected Columbia's request for a 25 basis point rate of return premium to recognize management efficiency. Pa. P.U.C. v. Columbia Water Co., R-2008-2045157, Order at 91-92 (June 10, 2009) (2008 Order), Recommended Decision at 67 (Mar. 20, 2009) (2008 RD). The ALJ determined, and the Commission agreed, that the evidence provided by the Company showed compliance with Commission requirements and policies, *i.e.* reasonable and adequate service, which did not support a rate adjustment. Id. In the 2008 proceeding, the Company offered much of the same evidence it offers here. 2008 RD at 63-65. For the same reasons stated in that case, the rate of return premium should be denied here.

In 2008 and the instant proceeding, Columbia provided testimony regarding its compliance with state and federal drinking water standards, including lead and copper requirements, pressure requirements and unaccounted for water parameters, and customer complaints.[35] R.D. at 63-64; CWC St. 1 at 5. In 2008, the ALJ found that:

> With regard to Columbia's adequacy of service and water quality, the evidence indicates that it is providing adequate, reasonable service. It is in compliance with all existing State and Federal primary and secondary drinking water standards, including lead and copper requirements. The system's pressure and unaccounted for water meet all Commission regulations. There were no complaints filed with BCS against Columbia in either the historic or future test years. These all point to adequate, reasonable service. This is not sufficient to warrant a rate of return premium of 0.25%.

2008 RD at 67. In the pending case, the Company also points to its response to "someone who broke into a locked finished water storage tank" to show that it handled the situation well. CWC St. 1 at 5-6. Review of the email from DEP[36] indicates, at best, that the Company responded properly. "I know this will be expensive for the company, but I am glad to know you are not willing to put your customer's safety at risk to save a few dollars." CWC St. 1, App. 2. The closing paragraph states:

> I believe there were many positives that can be taken from this incident. You have shown that your Emergency Response Plan works as it should. It has revealed the parts of the plan that need tweaked, and the vulnerability of the existing measures used to secure your storage tanks. I was introduced to some real-world emergency water testing. I think we (DEP) have shown you that we can be counted on as a partner in getting your water system back to normal. A learning experience for us all.

CWC St. 1, App. 2. The evidence regarding Columbia's adequacy of service and water quality is not sufficient to warrant a rate of return premium of 0.25%.

Columbia also notes actions taken to minimize expenses and use existing staff efficiently, like finding ways to reduce chemical and electric costs and consumption, extending and repairing

[35] In the 2008 case, there were no complaints filed with BCS in the historic or future test years. In the present case, Columbia discusses one complaint and states that its UCare statistics are good. R.D. at 64; CWC St. 1 at 6.

[36] The email does not state on its face that it is from DEP. CWC St. 1, App. 2.

mains in-house rather than contracting those services, and establishing an electronic billing and payment program. CWC St. 1 at 7-8; OCA St. 1 at 19-20. In the 2008 case, Columbia noted that it had minimized staffing, taken steps to keep its operating expenses at the lowest responsible level, invested heavily in water system improvements and capital additions to insure the continued provision of quality water service and negotiated with cellular phone service providers for the rental of Company space for cellular towers, resulting in annual income of $44,000. 2008 RD at 65. Here, as there, the evidence does not show that Columbia has done more than provide efficient and reasonable service and no adjustment to the indicated rate of return is warranted.

Next, Columbia asserts that extensions of service to Manor and West Hempfield Townships support a rate of return premium. CWC St. 1 at 7-8. The same evidence regarding extensions to Manor Township was presented in the 2008 rate case. 2008 Order at 88; 2008 RD at 64. The Commission agreed with the ALJ's conclusion that Columbia did not provided sufficient evidence to warrant a positive management performance factor adjustment. 2008 Order at 93; 2008 RD at 67. Specifically, the ALJ stated:

> With regard to the extensions of its franchise territory the evidence indicates that Columbia is providing adequate, reasonable service. These franchise expansions evidence Columbia's efforts toward promoting regionalization of water service. This only complies with stated Commission policies set forth at 52 Pa. Code § 69.711(a). This is not sufficient to warrant a rate of return premium of 0.25%. Accordingly, the Commission should deny the requested 25 basis point adjustment related to management efficiency.

2008 RD at 67.

The OCA notes that Columbia raises its acquisition of the Marietta system as support of its management efficiency and its "track record" of acquisitions. The OCA will discuss the reasons why the Marietta acquisition does not support an acquisition adjustment in response to the Company's Section 69.721 argument, in the following section.

Finally, Columbia argues that it should receive a 25 basis point adjustment to its return on equity because Aqua Pennsylvania received a 22 basis point adjustment in its 2008 base rate case. CWC St. 3 at 36-37. Company witness D'Ascendis states that "CWC's managerial performance is at least at par with Aqua in this case. Therefore, CWC should be awarded a similar performance factor premium." Id. at 36. In the 2008 rate case proceeding involving Aqua Pennsylvania, the Commission permitted a 22 basis point performance factor adjustment, "in recognition of [Aqua's] exemplary managerial performance."[37] Pa. P.U.C. v. Aqua Pennsylvania, Inc., R-00072711, Order at 50 (July 31, 2008). Based on the record in this proceeding, however, Columbia has not adduced sufficient evidence to warrant any kind of a positive management performance factor adjustment. As OCA Witness Everette noted, the examples provided by the Company are acts routinely performed by utilities in order to provide the reasonable and adequate service required by law and do not demonstrate "extraordinary" service. OCA St. 1 at 19-20; OCA St. 1S at 6.

b. Acquisition of Mountville and Marietta Gravity

Columbia claims that an additional 25 basis point adjustment to rate of return is warranted because Columbia has a "history of acquiring less viable water systems," citing the Commission's policy statement at Section 69.721(g). CWC St. 1 at 10-11; CWC St. 3 at 37. The evidence shows, however, that no adjustment to return is warranted. Specifically, Section 69.721(g) provides that a rate of return premium may be requested where an acquisition (1) falls outside of the parameters of 66 Pa. C.S. § 1327 and (2) the utility has a "demonstrated track record of acquiring and improving the service provided to the customers of smaller and less

[37] The same argument was advanced by Columbia in the 2008 case. There, for the same reasons as here, the OCA established that Columbia had not produced sufficient evidence to warrant a positive management performance factor adjustment. The ALJ and Commission agreed. 2008 RD at 66-67; 2008 Order at 93.

viable water systems." As discussed in Section VI.B, *supra*, Columbia's acquisition of Marietta does not satisfy the requirements of Section 1327. Columbia has not established, however, that Marietta was a less viable system or that it has improved service to those customers as envisioned by Section 69.721.

Subsection (a) of the Policy Statement provides:

> The Commission believes that further consolidation of water and wastewater systems within this Commonwealth may, with appropriate management, result in greater environmental and economic benefits to customers. The regionalization of water and wastewater systems through mergers and acquisitions will allow the water industry to institute better management practices and achieve greater economies of scale. To further this goal, the Commission sets forth the following guidance regarding the acquisition of water and wastewater systems.

52 Pa. Code § 69.721(a).

The testimony of OCA witnesses Everette and Fought show that Marietta was not less viable than Columbia. Ms. Everette summarized the evidence regarding Marietta's viability as follows:

> CWC and MGWC were already affiliated at the time of acquisition. These companies had common ownership, executive management and operational management. MGWC had access to the same managerial and technical resources as CWC prior to the acquisition. An interconnection between the two systems has existed since 2008. Furthermore, the Company has not provided evidence of any financial difficulties being experienced by MGWC. In fact, as shown above, MGWC experienced regular positive earnings in the years prior to the acquisition.

OCA St. 1 at 19-20.

Further, Columbia has not provided sufficient evidence to show that service to MGWC customers has improved as a result of the acquisition. As discussed by OCA witness Fought, the Company did not identify any improvements that the Marietta system needed at the time of acquisition that, if not completed, would jeopardize the adequacy of service. OCA St. 3 at 4. He stated:

> The security and maintenance repairs and replacements mentioned are normal for the proper operation and maintenance of a water system.
>
> . . .
>
> Although MGWC serves fewer customers than CWC, I have found nothing to indicate that MGWC was less viable than CWC with regard to its operations. My understanding is that MGWC and CWC were being operated by the same person, David Lewis.

Id. at 4, 6. Nor did the Company provide evidence to show that MGWC was not able to implement them. OCA St. 3 at 5.

The record does show that, in many ways, Marietta continues to be operated as a separate system and that costs for customers of both systems remain the same or greater. For example, with regard to employee-related costs, Mr. Lewis testified that:

> The Marietta Division employees and their contract operators were retained and continue to do the bulk of the work within that division.

CWC St. 1R at 2. With regard to accounting costs, he stated that:

> We expect the overall accounting costs to go up because of the acquisition of the Marietta Division. Our accountants will be doing more work due to this acquisition. With the separate division we will be preparing separate budgets, keeping separate books, preparing separate depreciation calculations and accruals, and auditing separate books.

CWC St. 1R at 14.

> The Marietta Division has different rates and we need to use these separate accounting tools to properly track and account for the costs associated with this division.
> Q. And when you say separate rates, you're not talking about depreciation. You mean base rates for utility service?
> A. That's correct.

CWC St. 1R at 14; tr. at 115. During hearings, he continued:

> And [Columbia and Marietta] are both run – from an operational standpoint, they're run separately or individually?
> A. Correct.

Tr. 129. Concerning Officers & Directors fees, he added that:

> The Marietta Division work is additional work and in no way becomes shared work with the Columbia Division.

Tr. 118.

Columbia's acquisition of Mountville stands in sharp contrast. There, Columbia asserted that the Columbia and Mountville customers benefited from the integration of the two systems' operations, costs, customer base and rates. 2008 RD at 59. The Company also averred that evidence showed that Mountville was not able to resolve serious, continuing deficiencies in its physical plant and its operations. Id. Any rate of return adjustment related to this acquisition, however, was determined to be untimely in Columbia's 2008 bate rate case. Id. at 62.

OCA Witness Everette summarized the reasons why no rate of return adjustment is warranted:

> the acquisitions of Mountville and MGWC are the only two acquisitions that the Company has referenced in its entire history. A fifteen-year-old acquisition along with an acquisition of an already-affiliated company that has not been shown to be "less viable" simply do not constitute a "history" or "track record" of acquiring smaller, less viable systems. Thus, the Company has not justified its request for a 0.25% rate of return premium related to acquisitions.

OCA St. 1 at 22. The requested 25 basis point adjustment related to the Company's 1998 and 2012 acquisitions should be denied because Columbia has not provided the specific evidence required by Section 523 to support its request.

c. Conclusion

As discussed above, Section 523 requires "specific findings upon evidence of record" to support a performance factor adjustment. 66 Pa. C.S. § 523(a). Columbia has not established a record in this proceeding to support a 50 basis point increase to equity, particularly, given that *without* these performance factor adjustments, the Company has asked the Commission to approve an equity claim of 10.85%, which is *already 75 basis points higher* than the return on equity approved by the Commission for water utility Distribution System Improvement Charges in its most recent Quarterly Earnings Report. CWC St. 3 at 32; Sch. DWD-1; Bureau of Technical Utility Services Report on the Quarterly Earnings of Jurisdictional Utility Services for the Period Ended Mar. 31, 2012, M-2013-2371435, Att. E (Public Meeting July 16, 2013) http://www.puc.state.pa.us/pcdocs/1238441.docx.

E. The OCA's Cost of Capital Recommendations Conform With Applicable Legal Standards and Should Be Adopted for Setting Prospective Base Rates for Columbia.

The Commission should adopt the corrected, actual capital structure ratio of 55.85% common equity and 44.15% long-term debt as recommended by the OCA for the future test year and overall rate of return of 6.75%, based on the OCA's recommended long-term debt cost of 4.85% and Mr. Rothschild's recommended 8.25% cost of equity, to determine new prospective base rates for Columbia. The OCA's cost of capital recommendation will properly provide Columbia an opportunity to earn a fair rate of return while benefiting consumers with public service at reasonable rates, consistent with Pennsylvania law and public policy as set forth in the Public Utility Code. See 66 Pa. C.S. § 101, *et seq*.

IX. RATE DESIGN

The OCA did not take issue with the Company's proposed revenue allocation. Specifically, OCA Witness Everette agreed to allocate any approved revenue decrease or increase across-the-board to all customer classes and between the customer and consumption charges. OCA St. 1 at 62-63. This is also consistent with the scale back recommended by I&E witness Cline. I&E St. 3 at 16.

X. CONCLUSION

As the OCA demonstrated above, Columbia has not shown that it is entitled to the claimed increases and awarding the level of revenue proposed by the Company would produce unjust and unreasonable rates. For all the above reasons the Office of Consumer Advocate respectfully requests that the Commission approve a rate decrease of $320,267. The OCA submits that a rate decrease is just, reasonable, and in the public interest.

Respectfully submitted,

____

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Date: September 26, 2013

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BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Pennsylvania Public Utility Commission	:	
	:	
v.	:	Docket No. R-2013-2360798
	:	
The Columbia Water Company	:	

APPENDICES TO THE MAIN BRIEF OF THE
OFFICE OF CONSUMER ADVOCATE

DATED: September 26, 2013

Appendix A

OCA Tables I and II

Columbia Water Company
Docket No. R-2013-2360798

Table I

Income Summary

	Pro Forma Present Rates	OCA Recommended Adjustments	Adjusted Present Rates	Revenue Adjustment	Total Recommended Revenue
Operating Revenues	$4,032,272	$15,762	$4,048,034	(320,267)	$3,727,767
Deductions:					
O&M/Amort. Expenses	2,045,437	(103,243)	1,942,194		1,942,194
Depreciation	739,260	(115,913)	623,347		623,347
Assessments	24,159		24,159	(1,824)	22,335
Other Taxes	134,931		134,931		134,931
Income Taxes	246,394	69,818	316,212	(17,578)	298,634
Total Deductions	3,190,181	(149,338)	3,040,843	(19,402)	3,021,441
Net Income Available for Return	$842,091	$165,100	$1,007,191	(300,865)	$706,326
Rate Base	$13,527,774	(3,063,692)	$10,464,082		$10,464,082
Rate of Return	6.22%		9.63%		6.75%

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Columbia Water Company
Docket No. R-2013-2360798

Table II

Summary of Adjustments

Recommended Adjustment	Exhibit Reference		Rate Base Effect	Revenue Effect	Expense Effect	Effect Upon Other Taxes	Depreciation Expense Effect	Income Tax Effect Eff. Rate 29.72%	Net Operating Income Effect
Adjust Rate Base for PennVest Plant	OCA Statement 1		(3,048,292)						
Adjust Materials & Supplies for 13-month average	OCA Statement 1		(4,592)						
Adjust Cash Working Capital for O&M Adj.	OCA Statement 1		(10,808)						
Remove Depreciation Expense related to PennVest	OCA Statement 1						(115,913)	34,449	81,464
Add Revenue from Merchandising and Jobbing	OCA Statement 1			15,762				4,684	11,078
Remove Acquisition Adjustment	OCA Statement 1				(15,039)			4,470	10,569
Engineering: move to rate case expense	OCA Statement 1				(5,505)			1,636	3,869
Adjust bad debt expense to 4 year average	OCA Statement 1				(1,808)			537	1,271
Remove NAWC Dues Related to Lobbying	OCA Statement 1S	*			(524)			156	368
Correct registration fees	OCA Statement 1S	*			(516)			153	363
Remove Charitable Contributions	OCA Statement 1S	*			(2,734)			813	1,921
Purchased Power	OCA Statement 1S	*			-			-	-
Employee Salaries & Wages	OCA Statement 1				(4,117)			1,224	2,893
Payroll Taxes	OCA Statement 1				72			(21)	(51)
Adjust Pensions & Benefits	OCA Statement 1				(16,141)			4,797	11,344
Vehicle Insurance	OCA Statement 1				(589)			175	414
Workman's Compensation Insurance	OCA Statement 1				(2,938)			873	2,065
Allocate accounting audit & tax prep to MG	OCA Statement 1				(2,364)			703	1,661
Allocate Management Fees	OCA Statement 1S	*			-			-	-
General Liability Insurance: Adjust to actual	OCA Statement 1S	*			(2,207)			656	1,551
General Liability Insurance: Allocate to Marietta	OCA Statement 1S	*			-			-	-
Allocate Office Expenses & Utilities	OCA Statement 1				(774)			230	544
Adjust Officers' Salaries & Directors' Fees	OCA Statement 1				(33,451)			9,942	23,509
Alloc. Officers & Directors to Marietta	OCA Statement 1				(14,608)			4,341	10,267
Reduce Reg. Assessments for OCA Rev. Rec.	OCA Statement 1S					(1,824)		542	(542)
Total Adjustments			$ (3,063,692)	$ 15,762	$ (103,243)	$ (1,824)	$ (115,913)	$ 69,818	$ 165,100

[*] These adjustments are not in dispute.

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Appendix B

List of OCA Testimony, Schedules and Exhibits

OCA-Sponsored Testimony, Schedules and Exhibits

The following OCA testimony and exhibits were admitted into the record at the Evidentiary Hearing on September 5, 2013.

Direct Testimony of Ashley E. Everette, OCA Statement 1
Appendix A – Background and Qualifications of Ashley E. Everette
Appendix B – Proprietary Interrogatory Responses by Columbia Water Company
Appendix C – Non-Proprietary Interrogatory Responses by Columbia Water Company
OCA Exhibit AEE-1, Schedules 1 through 7 (Proprietary and Non-Proprietary)

Direct Testimony of Aaron L. Rothshild, OCA Statement 2
Appendix A – Background and Qualifications of Aaron L. Rothschild
OCA Schedules ALR-1 through 8

Direct Testimony of Terry L. Fought, OCA Statement 3
Appendix A – Background and Qualifications of Terry L. Fought

Surrebuttal Testimony of Ashley E. Everette, OCA Statement 1S
Appendix A – Interrogatory Responses by Columbia Water Company; Prior Columbia Water Company Rate Case Filings, Data, and Orders
OCA Exhibit AEE-1S, Schedules 1S through 8S (Proprietary and Non-Proprietary)

Surrebuttal Testimony of Aaron L. Rothschild, OCA Statement 2S
OCA Surrebuttal Schedules ALR-1 and ALR-2

Appendix C

Unpublished Commission Orders and Recommended Decisions

Pa. P.U.C. v. National Util., Inc., Recommended Decision at 24-28 (July 1, 1994)
Pa. P.U.C. v. Lemont Water Co., R-000912114, Order (June 19, 1992)
Pa. P.U.C. v. Columbia Water Co., R-00974007, Recommended Decision (Nov. 20, 1997)
Pa. P.U.C. v. Columbia Water Co., R-2008-2045157, Recommended Decision (Mar. 20, 2009)

CERTIFICATE OF SERVICE

Re: Pennsylvania Public Utility Commission, et al.
v.
Columbia Water Company
Docket Nos. R-2013-2360798

I hereby certify that I have this day served a true copy of the foregoing Main Brief of the Office of Consumer Advocate upon parties of record in this proceeding in accordance with the requirements of 52 Pa. Code §1.54 (relating to service by a participant) and as modified by the Presiding Officer, in the manner and upon the persons listed below:

Dated this 26th day of September 2013.

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